

# Audited Project Financial Statements

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Project Number: 46382-001  
Loan/Grant Number: 3346/3347  
Period covered: 1 Oct 2016 to 30 Sep 2017

## PALAU: North Pacific Regional Connectivity Investment Project

Prepared by Belau Submarine Cable Corporation

For the Asian Development Bank  
Date accepted by ADB: 18 July 2018

The audited project financial statements are documents owned by the borrower. The views expressed herein do not necessarily represent those of ADB's Board of Directors, Management, or staff. These documents are made publicly available in accordance with ADB's Access to Information Policy and as agreed between ADB and the Republic of Palau Ministry of Finance

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

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**FINANCIAL STATEMENTS**  
**AND**  
**INDEPENDENT AUDITORS' REPORT**

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**Years Ended September 30, 2017 and 2016**



**BURGER · COMER · MAGLIARI**  
**CERTIFIED PUBLIC ACCOUNTANTS**

**INDEPENDENT AUDITORS' REPORT**

Board of Directors  
Belau Submarine Cable Corporation:

**Report on the Financial Statements**

We have audited the accompanying financial statements of net position of Belau Submarine Cable Corporation (BSCC), a component unit of the Republic of Palau (ROP), as of September 30, 2017 and 2016, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise BSCC's basic financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BSCC as of September 30, 2017 and 2016, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis (MD&A) on pages 3 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 2, 2018 on my consideration of the BSCC's internal control over financial reporting and our tests of its compliance with certain provision of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing on internal controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering BSCC's internal control over financial reporting and compliance.



Koror, Republic of Palau  
April 2, 2018

**BELAU SUBMARINE CABLE CORPORATION**  
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis  
September 30, 2017 and 2016

**Management's Discussion and Analysis**

This section of Belau Submarine Cable Corporation's (BSCC) annual financial report presents the analysis of its financial performance during the fiscal year ended September 30, 2017. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes which follows this section. Responsibility for the completeness and fairness of this information rests with the Corporation.

As management of the Belau Submarine Cable Corporation, a component unit of the Republic of Palau (ROP), we offer readers of the Corporation's financial statements this narrative overview and analysis of the financial activities of the Corporation for the fiscal year ended September 30, 2017 and 2016. We encourage readers to consider the information presented in conjunction with the Corporation's financial statements, and accompanying notes to the financial statements on pages 9 through 25.

**Using This Annual Report**

The Belau Submarine Cable Corporation's financial statements are designed to emulate corporate presentation models whereby all Corporation activities are consolidated into one total. The focus of the Statements of Net Position is designed to be similar to bottom line results for the Corporation. This Statement combines and consolidates current financial resources (short-term spendable resources) with capital assets. The Statements of Revenues, Expenses, and Changes in Net Position focus on BSCC's initial activities, which are supported mainly by Loans from the Republic of Palau. This approach is intended to summarize and simplify the user's analysis of cost of various BSCC services to the public.

**Overview of Financial Statements**

The Financial Section of this report presents the Corporation's financial statements as two components: basic financial statements and notes to the financial statements.

*Basic Financial Statements*

The *Statement of Net Position* reflects the financial position of the Corporation as of September 30, 2017. It shows the assets owned or controlled, deferred outflows of resources, related liabilities and other obligations, deferred inflows of resources, and the categories of net position. Net position is an accounting concept defined as total assets and deferred outflows less total liabilities and deferred inflows. Since the Corporation is in its first year of operations, there are no deferred outflows and inflow of resources reported in the accompanying financial statements. As such, it represents the residual of all other elements presented in the Statements of Net Position of the Corporation.

**BELAU SUBMARINE CABLE CORPORATION**  
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis  
September 30, 2017 and 2016

The *Statements of Revenues, Expenses, and Changes in Net Position* reflects the results of operations and other changes for the year ended September 30, 2017 and 2016. It shows revenues and expenses, both operating and non-operating, and reconciles the beginning net position amount to the ending net position amount, which is shown on the Statements of Net Position described above.

The *Statements of Cash Flows* reflects the inflows and outflows of cash for the year ended September 30, 2017 and 2016. It shows the cash activities by type and reconciles the beginning cash amount to the ending cash amount, which is shown on the *Statements of Net Position*, described above. In addition, this Statement reconciles cash flows from operating activities to operating loss on the *Statements of Revenues, Expenses, and Changes in Net Position* described above.

*Notes to the Financial Statements*

Various notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements and are found immediately following the financial statements to which they refer.

The Belau Submarine Cable Corporation (BSCC) was in start-up mode during the fiscal year ended September 30, 2016. BSCC was established by RPPL 9-47 (BSCC Act) on September 21, 2015 as a state-owned corporation to procure, own and manage a submarine fiber optic cable for the Republic of Palau.

**Current Status of Project**

The current scope of the project will be completed well within the \$25M funding envelope. It includes:

- An Indefeasible Right of Use (IRU) with Globe Telecom International (GTI) of Philippines for five 100 Gigabit per second wavelengths on the SEA-US cable that was Ready For Service (RFS) in July 2017. That is, at the time of writing this analysis, SEA-US is completed and in operation. The IRU is a capacity ownership contract for the span from the Palau Branching Unit (BU) 3a to the Guam Telecom (GTA) Cable Landing Station in Guam.
- Construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths.
- Construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, approximately 220 km, including all CLS Submarine Line Terminating Equipment

## BELAU SUBMARINE CABLE CORPORATION

(A Component Unit of the Republic of Palau)

### Management's Discussion and Analysis

September 30, 2017 and 2016

(SLTE), Power Feed Equipment (PFE), Network Protection Equipment (NPE) and network management systems and equipment, plus industry standard spares.

In FY 2018, the scope of the project will be expanded so BSCC can fulfil its charter to provide equal access to its customers, since the CLS site, while the best available in Republic of Palau for a submarine cable landing, is somewhat remote from the main population centers. A proposal to extend the network with fiber along the roadside to an additional Customer Access Point (CAP) in Airai has been approved by the Asian Development Bank (ADB). This extension can be accommodated within the funding envelope. A design contract for the outside plant route has been completed by Globe Telecom of the Philippines.

At the time of writing, the original scope of the project has been completed within budget and ahead of schedule. The network was placed in operation on December 7, 2017.

BSCC's business model is shaped by the provisions of the BSCC Act. It is a wholesale carrier, selling only to service providers, at full economic cost (including financing cost). In such a capital-intensive commodity business, the key to maximizing the overall end user goals of improved services at significantly lower unit prices is to ensure that the construction cost is managed effectively, with an uncompromising focus on quality. Expected cost to complete as of September 30, 2017 (including the network extension to Airai) was \$6.5 million against a total expected project cost of \$22 million.

The network has been running at 100% availability (i.e., zero service interruptions) since the start of the confidence trial on September 11, 2017.

Sales have exceeded expectation and are currently at 2.25 Gbits/sec. A standby credit facility with the National Development Bank of Palau was not required and has been cancelled.

Further clarity on the cost to complete will be available once tender processes for the construction contracts for the extension to Airai have been completed.

BSCC has entered operational contracts as follows:

Supplier	Activity	Annual	
		Recurring Cost	One-Time Cost
Globe Telecom	Network Operations Center	\$ 25,000	\$ 30,000
Docomo Pacific Inc.	Customer Service Center	\$ 114,000	\$ -
TE Subcom	Marine Maintenance	\$ 41,470	\$ -
GTA	Transport GTA to Tata Piti	\$ 40,200	\$ -
ABS	VAST for DCN	\$ 17,280	\$ 70,500

**BELAU SUBMARINE CABLE CORPORATION**  
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis  
September 30, 2017 and 2016

**Financial Statements for the Year Ended September 30, 2017 and 2016**

Statements of Net Position  
September 30, 2017 and 2016

<u>ASSETS</u>	<u>2017</u>	<u>2016</u>
Current assets:		
Cash	\$ 124,731	\$ 276,098
Capital Assets:		
Non-depreciable capital asset	402,201	275
Capital asset under construction	9,406,768	2,674,227
Indefeasible right of use	<u>4,007,600</u>	<u>3,122,200</u>
	<u>\$ 13,941,300</u>	<u>\$ 6,072,800</u>
<u>LIABILITIES AND NET POSITION</u>		
Non-current Liabilities:		
Long-term debt	\$ 13,816,173	\$ 5,767,827
Commitments		
Net Position:		
Net investments in capital assets	396	28,875
Unrestricted	<u>124,731</u>	<u>276,098</u>
	<u>125,127</u>	<u>304,973</u>
	<u>\$ 13,941,300</u>	<u>\$ 6,072,800</u>



**BELAU SUBMARINE CABLE CORPORATION**  
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis  
September 30, 2017 and 2016

Statements of Revenues and Expenses and Changes in Net Position  
Years Ended September 30, 2017 and 2016

	2017	2016
Operating expenses:		
Salaries and wages	\$ 85,723	\$ -
Travel	29,397	-
Professional fees	26,000	-
Rent	9,770	-
Utilities	3,661	-
Communications	3,278	30
Miscellaneous	22,043	-
Total operating expenses	179,872	30
Nonoperating revenues:		
Republic of Palau appropriations	-	305,000
Interest income	26	3
Total nonoperating revenues	26	305,003
Change in net position	(179,846)	304,973
Net position, beginning of year	304,973	-
Net position, end of year	\$ 125,127	\$ 304,973

**BELAU SUBMARINE CABLE CORPORATION**  
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis  
September 30, 2017 and 2016

Statements of Cash Flows  
Years Ended September 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash paid to suppliers for goods and services	\$ (179,872)	\$ (30)
Cash flows from capital and related financing activities:		
Additions to capital assets and infeasible rights of use	(8,019,867)	(5,796,702)
Proceeds from long-term debt	8,048,346	5,767,827
Operating subsidy from the Republic of Palau	-	305,000
Net cash provided by capital and related financing activities	28,479	276,125
Cash flows from investing activities:		
Interest received on cash in bank	26	3
Net change in cash	(151,367)	276,098
Cash, beginning of year	276,098	-
Cash, end of year	\$ 124,731	\$ 276,098

BSCC was funded by an injection of \$276,400 in cash and \$28,600 in kind by Republic of Palau on August 25, 2016. Additional financing was through back to back loans from Asian Development Bank (ADB) via Republic of Palau totaling US\$25,000,000 as part of the North Pacific Regional Connectivity Investment Project:

3346-PAL 7 <sup>th</sup> March 2016	Ordinary Loan	\$16,470,000
3347-PAL 7 <sup>th</sup> March 2016	Subsidiary Loan	\$8,530,000

While in start-up in FY 2016, the BSCC Board of Directors contracted with Globe Telecom International (GTI) to secure capacity on the SEA-US cable to Guam; with NEC for the turnkey fixed price construction of the network; and with McCann Consulting International (MCI) to operate the Project Management Unit. All contracting was in accordance with ADB procurement guidelines.

**BELAU SUBMARINE CABLE CORPORATION**  
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis  
September 30, 2017 and 2016

Initial Payments were made under those contracts, as follows:

GTI	\$ 3,122,200
NEC	2,623,738
MCI	<u>37,499</u>
	<u>\$ 5,783,437</u>

Payments were also made to Republic of Palau for interest expense, to the Post Office for a post office box and to Ngeremlengui State for land acquisition. As BSCC had not commenced operations, there was no income for FY 2017 except bank interest.

BSCC has hired a CEO and construction of the original scope of the network is completed. To date the project is on schedule and under budget.

**Economic Factors that will affect the Future**

In most markets world-wide, capacity demand growth has proved remarkably impervious to fluctuations in overall economic activity. However, given the significant tourist numbers in Palau relative to the resident population, a sustained downturn in tourist arrivals would have a negative impact on BSCC revenue growth.

**Requests for Information**

This report is intended to provide a summary of the financial condition of Belau Submarine Cable Corporation. Questions or requests for additional information should be addressed to:

Robin Russell  
Chief Executive Officer  
P.O. Box 10253  
Koror, Palau 96940

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Statements of Net Position  
September 30, 2017 and 2016

<u>ASSETS</u>	<u>2017</u>	<u>2016</u>
Current assets:		
Cash	\$ 124,731	\$ 276,098
Capital Assets:		
Non-depreciable capital asset	402,201	275
Capital asset under construction	9,406,768	2,674,227
Indefeasible right of use	<u>4,007,600</u>	<u>3,122,200</u>
	<u>\$ 13,941,300</u>	<u>\$ 6,072,800</u>
<u>LIABILITIES AND NET POSITION</u>		
Non-current Liabilities:		
Long-term debt	\$ 13,816,173	\$ 5,767,827
Commitments		
Net Position:		
Net investments in capital assets	396	28,875
Unrestricted	<u>124,731</u>	<u>276,098</u>
	<u>125,127</u>	<u>304,973</u>
	<u>\$ 13,941,300</u>	<u>\$ 6,072,800</u>

See accompanying notes to financial statements.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Statements of Revenues and Expenses and Changes in Net Position  
Years Ended September 30, 2017 and 2016

	2017	2016
Operating expenses:		
Salaries and wages	\$ 85,723	\$ -
Travel	29,397	-
Professional fees	26,000	-
Bank service charges	10,246	-
Rent	9,770	-
Meals and entertainment	5,295	-
Office	4,730	-
Utilities	3,661	-
Communications	3,278	30
Miscellaneous	1,772	-
Total operating expenses	179,872	30
Nonoperating revenues:		
Republic of Palau appropriations	-	305,000
Interest income	26	3
Total nonoperating revenues	26	305,003
Change in net position	(179,846)	304,973
Net position, beginning of year	304,973	-
Net position, end of year	\$ 125,127	\$ 304,973

See accompanying notes to financial statements.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Statements of Cash Flows  
Years Ended September 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash paid to suppliers for goods and services	\$ (179,872)	\$ (30)
Cash flows from capital and related financing activities:		
Additions to capital assets	(7,134,467)	(2,674,502)
Acquisition of indefeasible right of use	(885,400)	(3,122,200)
Proceeds from long-term debt	8,048,346	5,767,827
Operating subsidy from the Republic of Palau	-	305,000
Net cash provided by capital and related financing activities	28,479	276,125
Cash flows from investing activities:		
Interest received on cash in bank	26	3
Net change in cash	(151,367)	276,098
Cash, beginning of year	276,098	-
Cash, end of year	\$ 124,731	\$ 276,098

See accompanying notes to financial statements.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies

Organization

Belau Submarine Cable Corporation (BSCC), a component unit of the Republic of Palau (ROP), was created on September 15, 2015, under the provisions of Republic of Palau Public Law (RPPL) 9-47 and approved and signed in by the President of the Republic of Palau on September 21, 2015. (as amended, the “Incorporation Act”). In accordance with the Incorporation Act, the initial shareholders of BSCC is the Government of the Republic of Palau. The law created a wholly-owned government corporation governed by a Board of Directors comprising five (5) members appointed by the President of the ROP, with the advice and consent of the Senate of the Olbiil Era Kelulau (ROP National Congress). The Board members serve terms of four (4) years and may be reappointed by the President with the advice and consent of the ROP National Congress.

The primary purpose of BSCC is to procure, own and manage a fiber optic cable on behalf of the ROP government.

Basis of Accounting and Presentation

The accounting policies of BSCC conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. BSSC utilizes the flow of economic resources measurement focus. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial statements of BSCC have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental entities. BSCC implemented Government Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement identifies and consolidates accounting and financial reporting provisions that apply to state and local governments.

BSCC implemented GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Government as amended by GASB Statement No. 37, Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* in a statement of financial position.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies, Continued

BSCC follows the business-type activities requirements of GASB Statement No. 34. This approach requires the following components of BSCC's financial statements:

- Management's discussion and analysis;
- Basic financial statements, including a statement of net position, statement of revenues, expenses and changes in net position and a statement of cash flows using the direct method; and
- Notes to financial statements

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, requires BSCC to establish net position categories as follows:

*Net investment in capital assets:*

Capital assets net of accumulated depreciation, reduced by the outstanding principal balances of debt attributable to the acquisition, construction or improvements of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt should be included in this component of net position. At September 30, 2017 and 2016, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of net position.

*Restricted:*

Restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. At September 30, 2017 and 2016, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of restricted net position.

*Unrestricted:*

Net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position. Unrestricted net position may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties. At September 30, 2017 and 2016, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of net position.



**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies, Continued

Cash

For the purposes of the Statement of Net Assets and Statement of Cash Flows, BSCC considers cash to be cash on hand plus cash in checking and savings accounts. All of BSCC's cash deposits are with a federally insured bank, \$250,000 of which is subject to coverage by federal insurance and is within insurable limits as of September 30, 2017 and 2016.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. BSSC capitalizes buildings, land improvements and equipment that have a cost of \$200 or more and an estimated useful life of at least five years. The cost of maintenance and repairs is charged to expense. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets.

Capital Asset Under Construction

The capital asset under construction represents the cost incurred for the submarine fiber optic spur to-date totaling \$9,406,768 and \$2,674,227 as of September 30, 2017 and 2016, respectively. This also includes related capitalized interest totaling \$157,973 and \$12,990 for years ended September 30, 2017 and 2016, respectively. This includes the construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths. It also includes the construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, including all CLS Submarine Line Terminating Equipment, Power Feed Equipment, Network Protection Equipment and network management systems and equipment, plus industry standard spares.

A summary of changes in property, plant, equipment and capital asset under construction is as follows:

	Balance 9/30/2016	Additions	Transfers Disposals	Balance 09/30/2017
Non-depreciable capital asset	\$ 275	\$ -	\$ (275)	\$ -
Depreciable capital assets	-	401,926	275	402,201
Capital asset under construction	<u>2,674,227</u>	<u>6,732,541</u>	<u>-</u>	<u>9,406,768</u>
	2,674,502	7,134,467	-	9,808,969
Accumulated depreciation	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net capital assets	<u>\$ 2,674,502</u>	<u>\$ 7,134,467</u>	<u>\$ -</u>	<u>\$ 9,808,969</u>

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Summary of Significant Accounting Policies, Continued

Indefeasible Right of Use

BSCC has capitalized the cost of acquisition of the exclusive right to use a specified amount of fiber capacity for a period of time, which is amortized over 25 years, the length of the term of the capacity agreement on the straight-line method.

Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. During the fiscal years ending September 30, 2017 and 2016, BSCC was a newly incorporated governmental entity with no employees and had not participated or contributed to the Republic of Palau Civil Service Pension Trust Fund. Therefore, it did not report any deferred outflows of resources for the years ended September 30, 2017 and 2016.

Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. During the fiscal years ending September 30, 2017 and 2016, BSCC was a newly incorporated governmental entity with no employees and had not participated or contributed to the Republic of Palau Civil Service Pension Trust Fund. Therefore, it did not report any deferred outflows of resources for the years ended September 30, 2017 and 2016.

Net Position

Net position represents the residual interest in BSCC's assets after liabilities are deducted. Net investments in capital assets include capital assets reduced by outstanding debt. Unrestricted net position is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Summary of Significant Accounting Policies, Continued

Pensions

Pensions are required to be recognized and disclosed using the accrual basis of accounting. In FY 2016, BSCC was a newly formed governmental entity with no employees and had not made any contributions and has not participated or contributed to the Republic of Palau Civil Service Pension Trust Fund. Therefore, BSCC did not recognize a net pension liability and pension expense in the accompanying financial statements for the year ended September 30, 2017 and 2016.

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Non-operating Revenues and Expenses

Non-operating revenues and expenses result from investing and financial activities, including operating and capital grants from governmental entities. Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as interest income, and other revenue sources that are defined as non-operating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*.

Income Taxes

ROP does not impose corporate income taxes. In lieu of income taxes, all businesses are required to pay a business Gross Revenue Tax (GRT) on essentially all revenue received. The tax rate is 4% and is paid on a quarterly basis. BSCC is exempt from GRT.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68 and Amendments to Certain Provisions of GASB Statement 67 and 68*, which aligns the reporting requirements for pensions and pension plan not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental non-employer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statements will have on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefits Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 31, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units- an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in- substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. The provisions of GASB Statement No. 86 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. GASB Statement No. 87 will be effective for the Corporation for fiscal year ending September 30, 2021. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(2) Deposits and investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. This statement also requires disclosure of formal policies related to deposit and investment risks.

*Deposits*

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- |            |  |
|------------|--|
| Category 1 | Deposits that are federally insured or collateralized with securities held by BSCC or its agent in the BSCC's name;  |
| Category 2 | Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the BSCC's name; or             |
| Category 3 | Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in BSCC's name and noncollateralized deposits. |

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(2) Deposits and investments, Continued

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, BSCC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. BSCC does not have an investment and deposit policy for custodial credit risk.

For credit risk in the case of deposits, there is the risk that in the event of a bank failure, BSCC's deposits may not be returned to it. As of September 30, 2017 and 2016, the carrying amount of BSCC's total cash in checking and savings was \$124,731 and \$276,098 with a corresponding bank balance of 124,731 and \$276,128, respectively. From these deposits, \$250,000 at September 30, 2017 and 2016 was subject to coverage by FDIC. BSCC does not require collateralization of bank accounts, and therefore, amounts in excess of insurable limits are uncollateralized and are subject to custodial credit risk.

*Investments*

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- |            |  |
|------------|--|
| Category 1 | Investments that are insured or registered, or securities held by BSCC or its agent in BSCC's name;  |
| Category 2 | Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the BSCC's name; or |
| Category 3 | Investments that are uninsured and unregistered, with securities held by the counterparty's trust department or agent but not in BSCC's name.            |

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial risk in GASB Statement No. 3.

As of September 30, 2017 and 2016, BSCC did not have investments subject to GASB Statement No. 40.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(3) Indefeasible Right of Use (IRU) Agreement

In February 2016, BSCC and a third party IRU provider entered into an agreement for the acquisition of the executive right to use the optical wavelength channels in the IRU provider’s fiber between the Guam Cable Landing Station and the West Subsystem near the coast of Palau (the “Branching Unit”), as required for BSCC’s use of capacity in such optical wavelength channels to transmit telecommunication traffic (the “Purchased Waves”); as well as the exclusive right to connect the submarine fiber optic cable spur to the Branching Unit and to connect to the optical add-drop multiplexer inside the Branching Unit.

The agreement is effective for 25 years starting on the date BSSC issues its notice of acceptance to the IRU provider of the first activated Purchase Wave’s conformity to all applicable requirements (the “IRU RFS date”).

Total purchase price of \$6.7 million is due and payable in installments through the IRU RFS date, of which is \$2,658,934 is due on or before the IRU RFS date. As of September 30, 2017 and 2016, \$4,007,600 and \$3,122,200, respectively, of the purchase price has been paid. Since the IRU RFS date has not yet commenced, no amortization of the IRU has been recognized for the year ended September 30, 2017 and 2016.

(4) Long-Term Liabilities

Summary

Long-term liabilities of BSCC consist solely of notes payable. The changes in in long-term liabilities for the years ended September 30, 2017 and 2016 are as follows:

	Outstanding October 1, 2016	Increases	Decreases	Outstanding September 30, 2017	Current	Noncurrent
Notes Payable	\$ 5,767,827	\$ 8,048,346	-	\$ 13,816,173	-	\$ 13,816,173
	<u>\$ 5,767,827</u>	<u>\$ 8,048,346</u>	<u>\$ -</u>	<u>\$ 13,816,173</u>	<u>\$ -</u>	<u>\$ 13,816,173</u>



**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(4) Long-Term Liabilities, Continued

Long-Term Debt

In March 2016, BSCC and Asian Development Bank (ADB) entered into an agreement for the North Pacific Regional Connectivity Investment Project (Project Agreement), which provides for the establishment of a submarine cable connection from Palau to the submarine cable system owned by the SEA-US Consortium that connects to the international cable hub in Guam (the “Project”).

Under the Project Agreement, ADB has agreed to:

- a) Lend ROP \$16,470,000 on the condition that the proceeds of the loan be made available to BSCC, which agrees to undertake certain obligations towards ADB under the agreement (“Ordinary Operations Loan Agreement”).
- b) Lend ROP, in various currencies, equivalent to Special Drawing Rights (SDR 6,032,000) or \$8,530,000 on the condition that the proceeds of the loan be made available to BSCC, which agrees to undertake certain obligations towards ADB under the agreement (“Special Operations Loan Agreement”).

Also in March 2016, ROP executed a subsidiary loan agreement with BSCC to re-lend the amounts disbursed by ADB to ROP under the same terms and conditions provided in the Ordinary and Special Operations Loan Agreements.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(4) Long-Term Liabilities, Continued

Long-term debt at September 30, 2017 and 2016 is as follows:

	2017	2016
Loan payable under the Ordinary Operations Loan Agreement, with a 20-year term after the grace period ends June 1, 2021 when the first principal repayment becomes due, interest at LIBOR plus 0.05% per annum and payable every June 1st and December 1st. Principal is to repaid at 2.5% of the total principal amount outstanding on each payment date.	\$ 9,108,626	\$ 3,800,769
Loan payable under the Special Operations Loan Agreement, with a 20-year term after the grace period ends June 1, 2021 when the first principal repayment of \$213,250 becomes due, interest at 2.0% per annum and payable every June 1st and December 1st.	<u>4,707,547</u>	<u>1,967,058</u>
	<u>\$ 13,816,173</u>	<u>\$ 5,767,827</u>

As of September 30, 2017 and 2016, amounts available under the Ordinary and Special Operations Loan Agreements that may be drawn in subsequent years approximate \$12.7 million and \$6.6 million, respectively. Given the difference after predicting when additional drawdowns will occur, presentation of future principal and interest amortization is not possible at this time.

(5) Construction and Other Commitments

BSCC has entered into a supply contract with a third party for the Project's construction and installation that is expected to be completed by December 31, 2017. Approximately \$683,000 and \$9.7 million, respectively, was outstanding under the contract as of September 30, 2017 and 2016.

Additionally, BSCC entered into a project management/consultancy agreement with another third party to undertake activities necessary to ensure timely, cost-effective and secure installation and implementation of the Project in compliance with the terms and conditions of the Project Agreement, including loan agreements, with ADB. The agreement covers the period from September 2016 to July 2018. As of September 30, 2017 and 2016, total commitments related to this agreement approximated \$168,000 and \$599,000, respectively.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(5) Construction and Other Commitments, Continued

During September 2017, BSCC engaged a third-party to design a fiber optic cable extension linking the Project's Ngaremlengui Cable Landing Station Customer Access Point (CAP-IN) and a customer access point at or near Aiarai (CAP-A) at a cost approximating \$48,000. The extension, which will provide a medium to long-term solution for customer access, aims for greater network capacity to support anticipated future demand.

(6) Pension Plan

The Belau Submarine Cable Corporation did not participate or contribute to the Palau Civil Service Pension Trust Fund (the Fund), during the year ended September 30, 2017 and 2016. The Fund is a defined benefit, cost-sharing, multi-employer pension plan established and administered by the Republic of Palau. The Fund issues a stand-alone financial report which is available at its office site.

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents, of the Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are the credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members, who retire at or after age 60, or with 30 years of vesting service, are entitled to retirement benefits. Republic of Palau Public Law 2-26 is the authority under which benefit provisions and contributions rates are established. Member contribution rates are established by Republic of Palau Public Law 2-26 at six percent (6%) of total payroll and are deducted from the member's dollar for dollar by the employer.

Under the provisions of the Republic of Palau Public Law 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation which has the force and effect of law, and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code.

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(6) Pension Plan, continued

The Fund utilizes the actuarial cost method termed “level aggregate cost method” with actuarial assumptions used to compute the pension benefit obligation. The following is the statement of actuarial assumptions as of October 1, 2015 applicable to the plan year ending September 30, 2015 of the ROP Civil Service Pension Plan:

Actuarial Cost Method	: Normal costs are calculated under the entry age normal method
Investment Income	: 7.5% per year
Expenses	: \$300,000 each year
Salary Increase	: 3% per year
Mortality	: RP 2000 Combined Healthy Mortality Table, set forward four years
Disabled Mortality	: PBGC Mortality Table for Disabled Persons Receiving Social Security
Retirement Age	: Age 60 and contributed for at least 5 years

The pension benefit obligation, which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits, estimated to be payable in the future as a result of employment service to date. The measure is intended to assist users to evaluate the Fund’s funding status on a going-concern basis, and evaluate progress made in accumulating adequate assets to pay benefits when due.

Based on the actuarial valuation of the Fund as of October 1, 2015, the actuarial valuation determined the unfunded pension benefit obligation as follows:

Accrued liability as of October 1, 2015 for:

Present value of Future Benefits	\$ 187,644,517
Present value of Future Normal Costs	<u>(26,735,675)</u>
Actuarial Accrued Liability	160,908,842
Market value of assets	<u>(28,115,140)</u>
Unfunded Actuarial Accrued Liability	\$ <u>132,793,702</u>
Funded ratio (ratio of assets to liabilities)	17.5%

**BELAU SUBMARINE CABLE CORPORATION**  
**(A Component Unit of the Republic of Palau)**

Notes to Financial Statements  
September 30, 2017 and 2016

(6) Pension Plan, continued

The actuarial valuation did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net position available for benefits by sponsor.

(7) Republic of Palau

During the year ended September 30, 2017 and 2016, the Republic of Palau (ROP) appropriated and contributed \$0 and \$305,000, respectively, through RPPL 9-47 as the initial funding to secure the ROP's interest in the fiber optic submarine cable.

(8) Fair Value of Financial Instruments

BSCC's financial instruments are cash and long-term debt. The recorded value for cash approximate its fair value based on its short-term nature. The recorded value the note payable approximates its fair value, as interest approximates market rates. The fair values of BSCC's long-term debt is determined using quoted market prices for those securities or similar financial instruments.

(9) Risk Management

BSCC is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; errors and omissions; employee injuries and illnesses; natural disasters, employee health, dental and accident benefits. BSCC has elected to purchase commercial insurance coverage for claims arising from such matters.

BSCC is self-insured for underwater cables.

Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, would include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported during the year ended September 30, 2017 and 2016.

(10) Subsequent Events

Subsequent to September 30, 2017, BSCC officially commenced operations effective December 7, 2017.