PUBLIC UTILITIES CORPORATION
(A COMPONENT UNIT OF THE REPUBLIC OF PALAU)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Public Utilities Corporation:

We have audited the accompanying statements of net assets of the Public Utilities Corporation (PUC), a component unit of the Republic of Palau, as of September 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of PUC's management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of PUC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of PUC as of September 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 12, 2013 on our consideration of the PUC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 12 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.

Deloitte & Touche LLP

July 12, 2013

This Management's Discussion and Analysis (MD&A) presents the Public Utilities Corporation's (PUC) financial performance during the fiscal year ended September 30, 2012. Please read it in conjunction with the audited financial statements as of and for the year ended September 30, 2012, which follow this section.

In preparing this MD&A, forward-looking remarks about operational and/or financial matters may be used. Such remarks are usually identified by words such as "expected", "could", etc. Matters discussed in these remarks are subject to risks and changes. The reader should not assume such remarks are guarantees.

MISSION AND OPERATIONS

As the electrification arm of the Palau national government, PUC is mandated by law to plan, develop and execute an electrification plan for the entire Republic of Palau (ROP). To date, PUC has succeeded in meeting its mandate with the exception of the three southern-most islands of Tobi, Sonsorol and Pulo Anna. Due to distance and isolation, electrification of these islands has been slow in developing.

PUC operates five (5) power systems throughout Palau. The two largest systems are located in Koror and Babeldaop (KB), feeding the KB grid that services roughly 95% of Palau's population. The remaining three smaller power systems are located in Peleliu, Angaur and Kayangel servicing less than five hundred people combined. PUC's power generation is fossil fuel driven which makes it vulnerable to spikes in the fuel market. After the 2008 crisis, we continue to see occasional surges of oil prices which make electricity a significant cost in Palau residential economics.

In step with the National Energy Policy (NEP), PUC has established a Renewable Energy Division (created in 2010), tasked with research, exploration and development of PUC's renewable energy sector. The division has already undertaken responsibility for the maintenance of the Ngerulmud Capitol Solar System as well as management and maintenance of PUC's solar system installed at the Palau International Airport. In partnership with the Palau Energy Office, the division continues to pursue opportunities for expanding PUC's renewable energy platforms, and has to date achieved 2% of its goal of achieving 20% renewable energy by the year 2020.

In addition to renewable energy alternatives, PUC continues its efforts toward fuel efficiency and reduction of energy losses with upgrades to its aging infrastructure and equipment. To date, PUC has achieved the following:

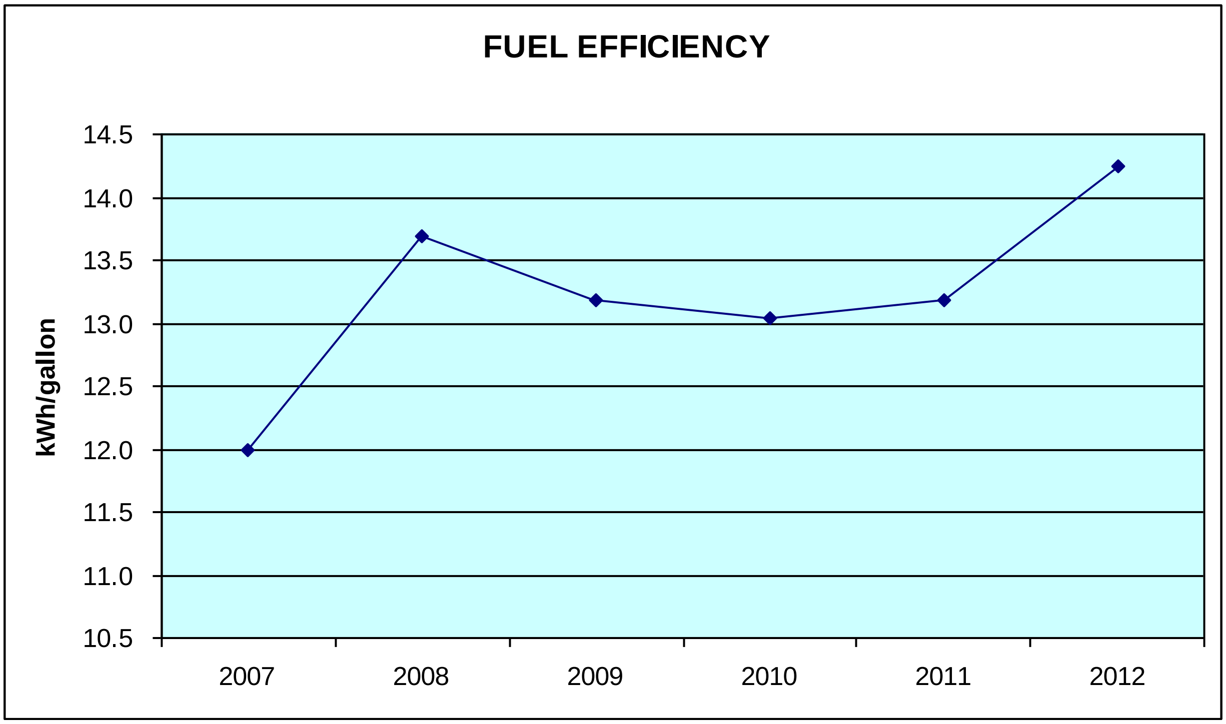
- Installed and commissioned two 5 megawatt (MW) generators at the Malakal Power Plant on August 11, 2011. With the new larger units in operation, PUC has realized fuel savings evidenced by the fuel economy graph below.

- Acquired four small 0.5MW generators for back-up power through a Japan Government grant aid of $2.1M. Units were still under construction at fiscal year-end.

- Installed and commissioned downsized generators at all three outlying states by May 2013. It is anticipated that the downsized units will reduce losses at these stations due to oversized units that were in operation. Average losses from these stations averaged around $700K per year.

- Commenced development works for a new power plant facility equipped with two 5MW baseload generators in Aimeliik. This project is funded by a June 27, 2012 grant agreement between ROP and the Japan Government, under which PUC is a beneficiary. Construction commenced late in the fiscal year and turnover and commissioning of the new plant and generators is anticipated in May 2014.

The chart below reflects PUC's overall generation performance for the last five years. As seen in the graph, PUC had made significant improvements to its generation plants in 2007-2008 but age and poor maintenance had degenerated efficiency until 2012, when the newly acquired Niigata engines commenced full operation.



In addition to upgrades and expansion efforts, PUC management is cognizant of the high cost of maintenance which impacts its customers and, therefore, is undertaking proactive efforts to control and minimize such costs. In 2013, PUC management successfully negotiated purchase of maintenance parts for the new baseload generators directly from the manufacturer resulting in material savings of about a half million dollars. Streamlining purchases, thus, eliminating unnecessary middlemen and cost, will be pursued on future orders. Further, PUC terminated an Operations & Maintenance Contract with a contractor for their failure to provide sound technical advice and an inferior maintenance program. PUC management will strive to ensure full return on monies spent.

On November 5, 2011, PUC suffered an unfortunate fire to its Aimeliik Power Plant, resulting in the decommissioning of all four Pielstick generators with a combined generation capacity of 8MW. This forced power rationing and brown-outs for two months. In collaboration with ROP, PUC was able to purchase and install a brand new 2MW Caterpillar (CAT) generator at the Aimeliik Power Plant to augment power supply until repair work is completed on the main baseload units installed at the Malakal Power Plant. Losses suffered from the fire exceeded $1.2M.

FINANCIAL HIGHLIGHTS

Various factors contributed to current year's net loss of $370K including increased maintenance cost on generators, bad debt and the unexpected fire in Aimeliik Power Plant. These detractors were buffered by an improved and stabilized fuel market and foreign grants of $2.1M from the Japan Government for additional smaller units to augment generation capacity.

In 2012, the PUC Board of Directors adopted a new tariff schedule which took effect October 1, 2012. The new tariff schedule reflects current cost values and is better-designed to achieve operational viability, although not at full-cost recovery due to certain constraints created by law. The adoption of a new tariff schedule is a positive move and is expected to alleviate PUC's financial challenges and improve corporate preparedness for the ongoing power generation and fuel market challenges.

The following summarizes PUC's financial position and revenues, expenses, and changes in net assets during the year.

Table 1

(Dollars in Thousands)

	As of September 30,			Increase (Decrease)	Increase (Decrease)
	2012	**2011**	**2010**	**2012 to 2011**	**2011 to 2010**
Statements of Net Assets					
Current assets	$ 16,682	$ 20,479	$ 17,480	$ (3,797)	$ 2,999
Other Assets	228	203	3,804	25	(3,601)
Net Utility Plant	26,620	26,262	23,277	358	2,985
Total Assets	43,530	46,944	44,561	(3,414)	2,383
Current Liabilities	7,502	10,018	7,057	(2,516)	2,961
Other Liabilities	8,079	8,607	9,117	(528)	(510)
Total Liabilities	15,581	18,625	16,174	(3,044)	2,451
Invested in Capital Assets	20,996	17,346	19,235	3,650	(1,889)
Unrestricted	6,953	10,973	9,152	(4,020)	1,821
Total Net Assets	$ 27,949	$ 28,319	$ 28,387	$ (370)	$ (68)

	Years Ended September 30, 2012	2011	2010	Increase (Decrease) 2012 to 2011	Increase (Decrease) 2011 to 2010
Revenues, Expenses, and Changes in Net Assets					
Operating Revenues:					
Electric	$ 25,238	$ 25,172	$ 22,811	$ 66	$ 2,361
Others	609	1,019	677	(410)	342
(Provision for) recovery of bad debts	(208)	1,193	(1,146)	(1,401)	2,339
Non-operating Revenues/Expenses	(718)	(336)	283	(382)	(619)
Total Revenues	24,921	27,048	22,625	(2,127)	4,423
Operating Expenses:					
Generation fuel	18,974	20,130	15,804	(1,156)	4,326
Generation - other costs	3,083	2,686	2,614	397	72
Depreciation	1,758	1,833	2,614	(75)	(781)
Administration	1,154	1,104	1,139	50	(35)
Distribution and transmission	923	855	790	68	65
Engineering	200	410	324	(210)	86
Renewable energy	100	98	90	2	8
Total Operating Expenses	26,192	27,116	23,375	(924)	3,741
Extraordinary Item	(1,208)	-	-	(1,208)	-
Contributions from:					
Japan Government	2,109	-	-	2,109	
ROP	-	-	200	-	(200)
Change in Net Assets	(370)	(68)	(550)	(302)	482
Beginning Net Assets	28,319	28,387	28,937	(68)	(550)
Ending Net Assets	$ 27,949	$ 28,319	$ 28,387	$ (370)	$ (68)

The following is a discussion of significant changes during the year:

1. Current assets decreased by $3.8M as a result of the following financial events:

    - Receivables decreased by $4.2M as a result of a negotiated settlement of accumulated ROP receivables. An outflow of this settlement was a realized recovery of bad debt of $1.2M in 2011 and a cash injection of $3.2M.

    - Inventory decreased by $1.1M and prepayments for maintenance parts reduced by $231K as PUC beefed up maintenance efforts during the year.

2. Other assets, comprised of non-current receivables on contracts and receivable from a local bank, increased by $25K.

3. Net change to plant assets resulted from acquisition of one 2MW generator for approximately $1M and four small 0.5MW standby units that are still in process and valued at over $2M less the loss of certain assets damaged by a fire in November 2011 valued at $1.2M, write off of a donated asset valued at over $200K (accounts for the increase in non-operating expense), and normal depreciation expense.

4. Electric sales increase is attributed to rate changes during the year. On the expense side, fuel continues to dominate operating costs comprising 72% of total operating expenses in 2012 (74% in 2011). Fuel cost is dependent on the fuel market dynamics and outside PUC's control. Other generation cost increased materially in 2012 as PUC pumped more resources into its maintenance program to improve operational efficiency. All other operating costs hovered at expected levels with the exception of Engineering Services which decreased as a result of reduced metering costs and an internal reorganization, which placed various engineers under the Engineering Services Department to vacant positions in other departments.

5. The extraordinary item of $1.2M represents the value of the damages from the fire in November 2011.

6. As noted above, PUC was a beneficiary of a Japan Government grant aid worth over $2.1M in standby units as of fiscal year-end.

CAPITAL ASSETS and LONG-TERM DEBT

Capital Assets

Investment in capital assets has been minimal in the past due to tight cash flow. At the end of FY 2012, PUC had invested in a broad range of utility capital assets, including its power generation plants, electric transmission and distribution infrastructure, and general support and administrative equipment. PUC's investment in capital assets increased by $1M to $57M at the end of 2012. Net of depreciation, capital assets valued at $27M. Refer below for details of this year's activities and to note 7 for additional information.

The following table summarizes PUC's capital assets by category and accumulated depreciation, and the changes therein for the years ended September 30, 2012, 2011, and 2010, respectively.

CAPITAL ASSETS AND ACCUMULATED DEPRECIATION
(Dollars in Thousands)

	Years Ended September 30,			Inc (Dec)	Inc (Dec)
	2012	2011	2010	2012 to 2011	2011 to 2010
CAPITAL ASSETS:					
Electric Plants:					
Electric Plants, Koror/Aimeliik	$ 28,340	$ 29,280	$ 24,874	$ (940)	$ 4,406
Electric Plants, Outlying States	2,378	2,378	2,378	-	-
Total Electric Plants	30,718	31,658	27,252	(940)	4,406
Accumulated Depreciation	(17,951)	(17,866)	(16,808)	(85)	(1,058)
Net Electric Plant	12,767	13,792	10,444	(1,025)	3,348
Transmission & Distribution System (T&D)					
T&D System, Koror/Aimeliik	17,263	17,263	17,203	-	60
T&D System, Outlying States	2,090	2,090	2,090	-	-
Total T&D System	19,353	19,353	19,293	-	60
Accumulated Depreciation	(9,325)	(8,775)	(8,226)	(550)	(549)
Net T&D System	10,028	10,578	11,067	(550)	(489)
Administrative Equipment					
Buildings	1,424	1,399	917	25	482
Heavy Equipment & Vehicles	1,546	1,542	1,545	4	(3)
Tools & Maintenance Equipment	882	868	936	14	(68)
Computers & Office Equipment	644	647	831	(3)	(184)
Total Administrative Equipment	4,496	4,456	4,229	40	227
Accumulated Depreciation	(2,868)	(2,782)	(2,809)	(86)	27
Net Administrative Equipment	1,628	1,674	1,420	(46)	254
Capital Improvement Projects:					
500KW Mitsubishi Generators (4)	2,109	-	-	2,109	-
APP New Power Plant Groundworks	88	-	-	88	-
APP Plant Renovation	-	-	134	-	(134)
2MW CAT Generator	-	218	211	(218)	7
Total Capital Projects in Progress	2,197	218	345	1,979	(127)
TOTAL CAPITAL ASSETS	$ 26,620	$ 26,262	$ 23,276	$ 358	$ 2,986

The following major Capital Improvement Projects were completed during the year:

- One new 2MW CAT generator at Aimeliik $ 218K
- Malakal Auxiliary Building $ 178K
- Malakal Control Room $ 100K
- Aimeliik Renovation $ 172K

Ongoing Capital Improvement Projects are:

- Four 500 kilowatt (KW) Mitsubishi generators at Malakal $ 2,109K
- APP New Power Plant $ 88K

PUC's capital improvement plans are based on the master plan developed for PUC in FY2009. The master plan identifies forward-looking strategies based on externally developed assumptions about PUC's demographics and customer demands up to year 2025. The plan includes construction of a new power plant at Aimeliik with installation of six 5MW generators staggered every two years. The plan has been modified internally to include only the first two 5MW units, deferring the remaining units until an updated study can be made of energy demand and renewable energy plans.

PUC is continuing its efforts to augment generation with alternative renewable energy. A new 225KW photovoltaic (PV) system was installed and commenced operation in October 2011 at the Palau International Airport parking lot. Transfer of ownership is pending execution of a Memorandum of Understanding with an affiliate being the official grant recipient. With this acquisition, plus existing third party renewable energy systems connected to the PUC grid, total renewable energy generation capacity add up to 377KW. Further, studies and plans are underway for possible additional solar, wind and hydro systems for the main power grid; and hybrid systems for the Outlying States.

Long-Term Debt

At September 30, 2012, PUC's loan portfolio comprised of the following:

	Original	At September 30, 2012
International Loan	$ 7,000,000	$ 5,800,000
Local Loan	$ 3,000,000	$ 2,806,048
TOTAL	$ 10,000,000	$ 8,606,048

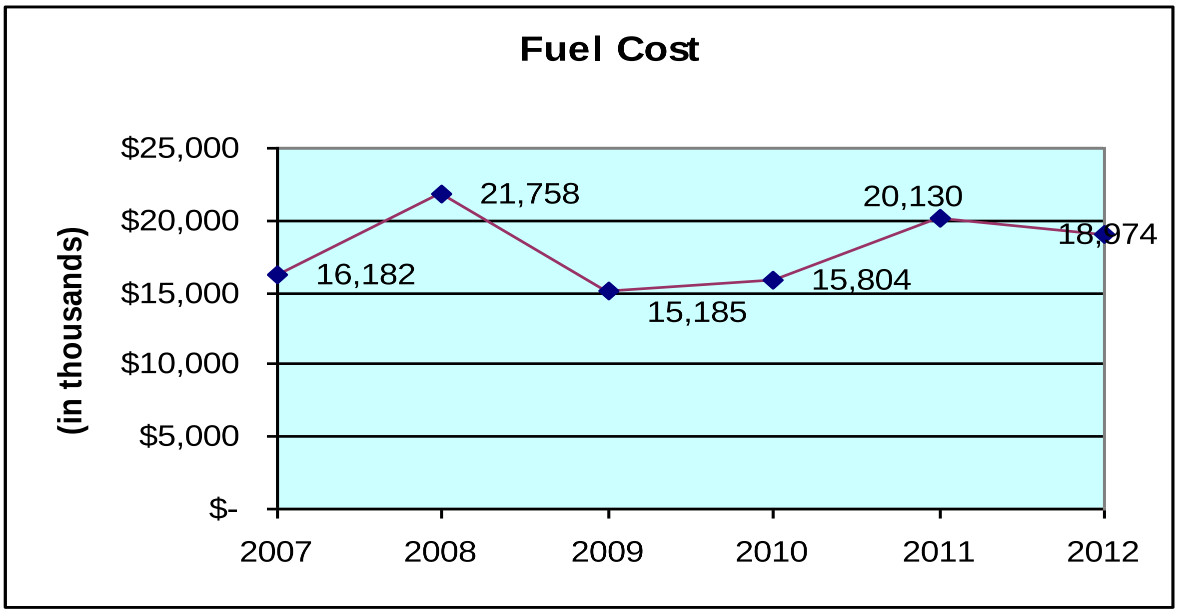
The above debt were acquired to purchase additional generation capacity and to finance major repairs and generation auxiliary equipment. Please see note 8 to the financial statements for additional information regarding PUC's long-term debt.

ECONOMIC FACTORS AND OUTLOOK

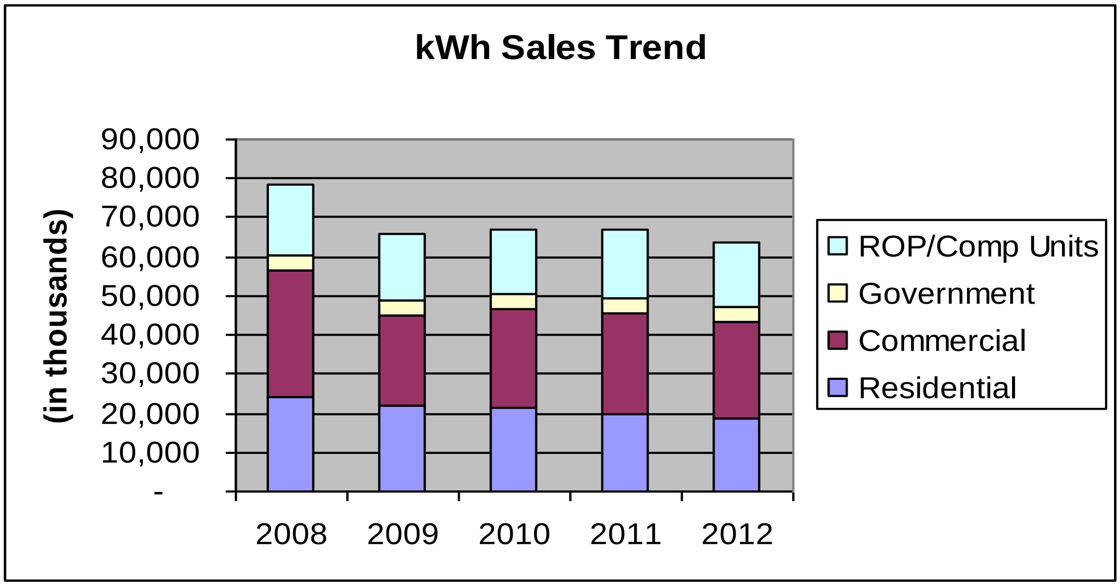
<u>Fuel Market</u>

Fuel cost makes up over 70% of PUC's operating costs. Due to size and location, PUC's dependence on fossil fuel is likely to continue for several years and price volatility will continue to be a germane factor in PUC's power supply scenario. PUC's vulnerability is clear and efforts will continue to try and contain this risk.

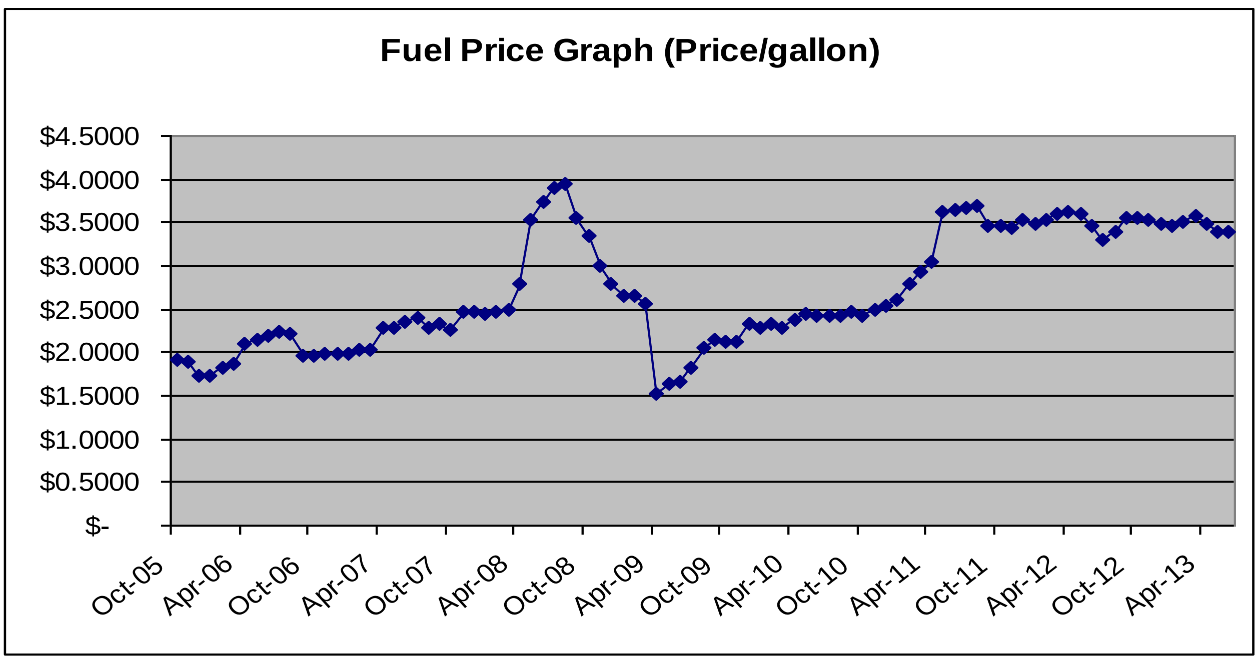
The cost trend of fuel for the past three years almost mirrors the previous three years (see chart below). This movement highlights the volatility of the market and PUC's exposure.



Fuel impact is evident in our sales performance. The steep price spikes in the fuel market in 2008 provoked unforeseen energy conservation efforts which carried throughout 2009 resulting in a drop in sales by 16%. Steady sales through 2011 were disrupted by a 4% drop in consumption, apparently a reaction to resurgence of price escalation in 2011, which impelled further conservation measures. The chart below illustrates this impact on sales performance.



Various factors drive gasoil prices. Tensions in the Middle East and economic outlook of the demand regions are contributing factors. These factors are unpredictable and erratic as seen in the graph below.



Unpredictability and volatility of the fuel market gives impetus to the drive for stable and controlled electric cost. Combined with global temperament towards environmental issues, these factors are making renewable energy a relevant, if not a significant, energy source in the future. PUC is continuing its efforts, aided by development partners, to diversify its energy source and reduce dependence on fossil fuel.

Another dynamic on the energy scene in Palau is PUC customers making entry into renewable energy platforms in an effort to protect themselves from risks in the fossil market. To date, total PV systems installed at various establishments add up to approximately 1% of PUC's total generation capacity at KW percentage. Furthermore, various hotels have made significant investment in solar water heaters, reducing power consumption. This scenario reveals the energy market in Palau is becoming increasingly competitive.

<u>Merger</u>

On June 6, 2013, a bill was signed into law that consolidated the two independent public corporations, the Palau Water & Sewer Corporation and the Public Utilities Corporation, under one corporate identity, the Palau Public Utilities Corporation (PPUC). The intent of the Consolidation Act was to streamline administrative processes and reduce operating costs. It is anticipated that little will change on the operations side, but the administration and back office processes will be materially affected. Full impact will be known once both operations are fully integrated.

FUTURE OUTLOOK

PUC will continue to exert efforts towards the NEP targets of 30/20/20 (30% reduction of overall energy consumption and 20% renewable energy platforms by the year 2020). Renewable energy continues to attract development partners sympathetic to global warming issues. PUC's efforts should focus on energy diversification and generation upgrades to assure energy supply stability and to benefit from cutting-edge technological advances.

Palau's economic outlook appears fair. Our tourism market appears to be stable based on visitor arrival statistics provided by the Palau Visitors Authority, as follows:

- 2013, January through May – (5%) contraction over the same period in the previous year;
- 2012 - 9% growth over 2011; and
- 2011 - 27% jump over 2010.

The recent contraction in tourist arrivals may be a temporary decline and continued publicity and promotion of Palau may assure our economy of its fair share of the tourism market. Overall, management is optimistic of a healthy economy which translates to a healthy demand market for PUC.

Relative to our largest customer, the national government, the newly elected administration is on the verge of closing negotiations on a new Compact of Free Association (COFA). Renewed COFA terms will assure the national government, and the local economy, of steady capital inflow to sustain current and spur new economic initiatives. This is a positive indicator as the national government is the single largest employer on island as well as a major player in Palau's economy.

CONTACTING PUC'S FINANCIAL MANAGEMENT

This financial report is designed to provide PUC's rate payers and creditors with a general overview of PUC's finances and to demonstrate PUC's accountability for the money it receives. Management's Discussion and Analysis for the year ended September 30, 2011 is set forth in PUC's report on the audit of financial statements which is dated August 11, 2012. If you have questions about this report, or need additional information, contact the PUC Accounting Department at the Palau Public Utilities Corporation, P.O. Box 1372, Koror, Republic of Palau 96940, or e-mail jalexander@PUC.com or call 488-5320.

PUBLIC UTILITIES CORPORATION

Statements of Net Assets
September 30, 2012 and 2011

ASSETS	2012	2011
Utility plant:		
Depreciable utility plant:		
Electric plant	$ 30,718,056	$ 31,658,415
General support equipment	23,302,289	23,279,285
Administrative equipment	547,319	529,495
Utility plant in service	54,567,664	55,467,195
Accumulated depreciation	(30,144,337)	(29,422,429)
Net utility plant in service	24,423,327	26,044,766
Non-depreciable utility plant:		
Construction in progress	2,196,741	218,055
Net utility plant	26,620,068	26,262,821
Current assets:		
Cash and cash equivalents	3,702,550	1,909,076
Restricted cash and cash equivalents	124,844	207,907
Receivables:		
Trade	2,836,726	3,464,861
Affiliate	1,311,610	5,659,741
Contracts	102,780	239,115
Other	31,686	42,482
	4,282,802	9,406,199
Less allowance for doubtful accounts	(410,000)	(1,368,168)
Total receivables, net	3,872,802	8,038,031
Prepaid expenses	290,098	521,071
Inventory, net	8,691,303	9,792,074
Due from grantor agency	-	10,500
Total current assets	16,681,597	20,478,659
Other non-current assets:		
Contracts receivable, net of current portion	228,260	169,732
Receivable from a local bank, net	-	32,997
Total other non-current assets	228,260	202,729
	$ 43,529,925	$ 46,944,209
LIABILITIES AND NET ASSETS		
Net assets:		
Invested in capital assets, net of related debt	$ 20,996,199	$ 17,345,678
Unrestricted	6,953,195	10,973,066
Total net assets	27,949,394	28,318,744
Commitments and contingencies		
Current liabilities:		
Current portion of long-term debt	527,601	517,743
Accounts payable	6,168,973	8,715,741
Accrued expenses	348,845	355,048
Customer deposits	456,665	429,625
Total current liabilities	7,502,084	10,018,157
Long-term debt, net of current portion	8,078,447	8,607,308
Total liabilities	15,580,531	18,625,465
	$ 43,529,925	$ 46,944,209

See accompanying notes to financial statements.

PUBLIC UTILITIES CORPORATION

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2012 and 2011

	2012	2011
Operating revenues:		
Power	$ 25,237,736	$ 25,172,146
Other	609,155	1,018,950
Total operating revenues	25,846,891	26,191,096
Recovery of (provision for) uncollectible receivables	(208,071)	1,193,000
Net operating revenues	25,638,820	27,384,096
Operating expenses:		
Generation - fuel	18,973,663	20,129,991
Generation - other cost	3,083,178	2,685,605
Depreciation	1,757,965	1,833,162
Administration	1,153,797	1,104,118
Distribution and transmission	922,759	855,299
Engineering services	200,365	409,726
Renewable energy	99,934	98,410
Total operating expenses	26,191,661	27,116,311
Operating (loss) income	(552,841)	267,785
Nonoperating revenues (expenses):		
Interest income	2,358	1,238
Grants from the United States Government	-	51,789
Loss on disposal of assets	(218,055)	(1,146)
Interest expense	(480,755)	(205,234)
Writedown of receivable from a local bank	-	(167,003)
Other	(20,972)	(16,014)
Total nonoperating revenues (expenses), net	(717,424)	(336,370)
Loss before extraordinary item	(1,270,265)	(68,585)
Extraordinary item:		
Loss on disposal of assets related to a catastrophic fire	(1,208,189)	-
Loss before capital contributions	(2,478,454)	(68,585)
Capital contributions:		
Grants from the Japan Government	2,109,104	-
Change in net assets	(369,350)	(68,585)
Net assets at beginning of year	28,318,744	28,387,329
Net assets at end of year	$ 27,949,394	$ 28,318,744

See accompanying notes to financial statements.

Statements of Cash Flows
Years Ended September 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from customers	$ 28,776,561	$ 24,966,520
Cash payments to suppliers for goods and services	(23,445,933)	(22,381,750)
Cash payments to employees for services	(2,209,644)	(2,291,895)
Net cash provided by operating activities	3,120,984	292,875
Cash flows from investing activities:		
Net change in restricted cash	83,063	1,746,261
Interest and dividends on investments and restricted cash	2,358	1,238
Other non-operating	12,025	(16,014)
Net cash provided by investing activities	97,446	1,731,485
Cash flows from non-capital financing activities:		
Cash received from grantor agencies	10,500	69,045
Net cash provided by non-capital financing activities	10,500	69,045
Cash flows from capital and related financing activities:		
Principal payment on long-term debt	(519,003)	(474,949)
Interest paid on long-term debt	(480,101)	(369,639)
Acquisition of utility plant	(436,352)	(1,216,586)
Net cash used for capital and related financing activities	(1,435,456)	(2,061,174)
Net change in cash and cash equivalents	1,793,474	32,231
Cash and cash equivalents at beginning of year	1,909,076	1,876,845
Cash and cash equivalents at end of year	$ 3,702,550	$ 1,909,076
Reconciliation of operating (loss) income to net cash provided by operating activities:		
Operating (loss) income	$ (552,841)	$ 267,785
Adjustments to reconcile operating (loss) income to net cash provided by operating activities:		
Depreciation	1,757,965	1,833,162
Provision for (recovery of) uncollectible receivables	208,071	(1,193,000)
(Increase) decrease in assets:		
Receivables:		
Trade	(538,104)	(508,462)
Affiliate	3,352,131	(318,205)
Contracts	77,807	(408,847)
Other	10,796	25,753
Prepaid expenses	230,973	(326,123)
Inventory	1,100,771	(2,170,444)
Increase (decrease) in liabilities:		
Accounts payable	(2,546,768)	3,079,148
Accrued expenses	(6,857)	26,923
Customer deposits	27,040	(14,815)
Net cash provided by operating activities	$ 3,120,984	$ 292,875

Non-cash transactions:

In 2012, PUC received a $2,109,104 grant from the Japan Government consisting of various utility plant equipment and related costs of installation.

In 2012, the Republic of Palau (ROP) purchased a generator on behalf of PUC at a cost of $996,000 which was offset against ROP's outstanding receivables.

In 2011, deposits of $3,604,156 were applied to utility plant purchases.

See accompanying notes to financial statements.

(1) Organization

The Public Utilities Corporation (PUC), a component unit of the Republic of Palau (ROP), was created on July 6, 1994, under the provisions of Republic of Palau Public Law (RPPL) 4-13. The law created a wholly-owned government corporation governed by a Board of Directors appointed by the President of the ROP, with the advice and consent of the Senate of the Olbiil Era Kelulau (ROP National Congress). The primary purpose of PUC is to establish and operate electrical utility services within ROP.

PUC's financial statements are incorporated into the financial statements of ROP as a component unit.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The accounting policies of PUC conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. PUC 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. GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, except those that conflict with a GASB pronouncement. PUC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

Net Assets

Net assets represent the residual interest in PUC's assets after liabilities are deducted and consist of four sections: invested in capital assets, net of related debt; restricted expendable and nonexpendable, and unrestricted. Net assets invested in capital assets, net of debt, include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. All other net assets are unrestricted.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits and time certificates of deposit with original maturities of three months or less.

(2) Summary of Significant Accounting Policies, Continued

Receivables

PUC grants credit, on an unsecured basis, to individuals, businesses and governmental entities situated in the Republic of Palau. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluation of the collectability of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables charged to expense.

Inventory

Inventories of fuel and supplies are stated at the lower of cost (first-in, first-out) or market (net realizable value).

Utility Plant

Utility plant is stated at cost. Donated utility plant is recorded at fair market value at the date of donation or at the donating entity's basis in the asset if donated by ROP or an ROP agency. PUC capitalizes utility plant with a cost of $500 or more. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets.

Capitalization of Interest

PUC capitalizes interest in order to recognize all costs associated with construction based on PUC's weighted average borrowing rate. During the year ended September 30, 2011, $187,263 of eligible interest was capitalized. No interest was capitalized during the year ended September 30, 2012.

New Accounting Standards

During fiscal year 2012, PUC implemented the following pronouncements:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*, which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements,* which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus,* which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity,* and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management has not yet determined the effect of implementation of this statement on the financial statements of PUC.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities,* which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of PUC.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of PUC.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans,* which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions,* which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of PUC.

(2) Summary of Significant Accounting Policies, Continued

Sales of Electricity

Sales of electricity are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the most recent cycle billing. Unbilled revenues at September 30, 2012 and 2011 were $1,490,559 and $1,688,731, respectively.

Retirement Plan

PUC contributes to the Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost-sharing, multiple employer pension plan established and administered by the Republic of Palau.

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents, of the Republic of Palau, 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 25 years of vesting service, are entitled to retirement benefits. RPPL 2-26 is the authority under which benefit provisions are established. Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and matched dollar for dollar by the employer. PUC contributed $102,092, $103,690 and $97,503 to the Fund during the fiscal years 2012, 2011 and 2010, respectively, which was equal to the required contributions for the respective years then ended.

Under the provisions of RPPL 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation Plan 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. PUC's total payroll, except expatriate workers, for fiscal years 2012 and 2011 is covered by the Fund's plan. The Fund utilizes the actuarial cost method termed "aggregate cost method" with actuarial assumptions used to compute the pension benefit obligation as follows: (a) a rate of return of 8.5% per year on the investment of present and future assets, (b) a 3% increase in employee salaries until retirement, and (c) members are assumed to retire at their normal retirement date.

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.

The Fund's October 1, 2011 actuarial valuation determined the unfunded pension benefit obligation as follows:

Participants in pay status	$ 62,987,516
Active participants	74,716,975
Participants with vested deferred benefits	2,323,366
Total pension benefit obligation	140,027,857
Net assets available for benefits, at market value	(36,128,666)
Unfunded benefit obligation	$ 103,899,191

(2) Summary of Significant Accounting Policies, Continued

Retirement 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 assets available for benefits by sponsor.

The Fund issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained by writing to the Republic of Palau Civil Service Pension Plan, P.O. Box 1767, Koror, Palau 96940.

Taxes

Based on enactment of RPPL 4-13, PUC is exempt from all national and state non-payroll taxes or fees.

Compensated Absences

Accumulated unpaid annual leave is accrued when earned and is included in the statements of net assets as an accrued expense. Accumulated unused sick pay benefit is accrued at 25% of the sick leave hours recorded times the employee regular base rate, and is included in the statements of net assets as an accrued expense.

Operating and Non-Operating Revenues and Expenses

Operating revenues and expenses include all direct and administrative revenues and expenses associated with the generation and distribution of electricity to customers in the Republic of Palau.

Non-operating revenues and expenses result from investing and financing activities, including operating and capital grants from other governmental entities.

(3) Cash and Cash Equivalents and Restricted Cash Equivalent

Cash and Cash Equivalents

Custodial credit risk is the risk that in the event of a bank failure, PUC’s deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government’s name. PUC does not have a deposit policy for custodial credit risk.

As of September 30, 2012 and 2011, cash and cash equivalents and restricted cash equivalents were \$3,827,394 and \$2,116,983, respectively, and the corresponding bank balances were \$3,901,920 and \$2,698,460, respectively. Of these amounts, \$3,366,651 and \$1,461,276, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance; while \$458,804 and \$653,768 as of September 30, 2012 and 2011, respectively, are held and administered by investment managers subject to Securities Investor Protection Corporation Insurance. As of September 30, 2012 and 2011, bank deposits of \$1,894,129 and \$1,985,211, respectively, were FDIC insured. PUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage and deposits in financial institutions not subject to FDIC coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

(3) Cash and Cash Equivalents and Restricted Cash, Continued

Restricted Cash and Cash Equivalents

PUC's restricted cash and cash equivalents of $124,844 and $207,907 as of September 30, 2012 and 2011, respectively, represent the unspent portion of proceeds from PUC's loan with a foreign bank (see note 8).

(4) Grants

U.S. Federal Government:

PUC is a subrecipient of federal grants received by ROP from a U.S. federal agency. Excess grant disbursements over receipts are recognized as due from grantor agencies until funds are received in accordance with grant terms and conditions.

Changes in the due from grantor agency accounts for the years ended September 30, 2012 and 2011 are as follows:

	2012	2011
Balance at beginning of year	$ 10,500	$ 27,756
Additions - program outlays	-	51,789
Deductions - cash receipts from grantor agencies	(10,500)	(69,045)
Balance at end of year	$ -	$ 10,500

Japan Government:

On March 2, 2012, the Japan Government awarded an emergency grant aid of up to 300,000,000 yen, or approximately $3,000,000 at the date of award, for the purpose of contributing to the implementation of an emergency measure against a power crisis in November 2011. On March 5, 2012, PUC entered into an agent agreement (the Agreement) with Japan International Cooperation System, a Japan non-for-profit organization in charge of procurement services in Grant Aid and Technical Cooperation, to be its procurement agent as a requirement of the grant.

Of the aforementioned grant award, PUC recorded $2,109,104 as of September 30, 2012 which is presented as grants from Japan Government in the accompanying statements of revenues, expenses and changes in net assets. Proceeds from the grant were used to fund utility plant related projects (see note 7).

(5) Receivable from a Local Bank

At September 30, 2012 and 2011, PUC has uninsured deposits of $2,025,381 and $2,058,378, respectively, with a bank that went into receivership on November 7, 2006. These deposits are reflected net of an allowance of $2,025,381 at September 30, 2012 and 2011 and are recorded as a receivable from a local bank in the accompanying statements of net assets.

(6) Inventory

Inventory at September 30, 2012 and 2011, consists of the following:

	2012	2011
Generation parts and supplies	$ 5,091,522	$ 4,565,951
Fuel	3,804,152	5,378,684
Lubricants	27,295	21,907
	8,922,969	9,966,542
Provision for slow moving inventory	(231,666)	(174,468)
	$ 8,691,303	$ 9,792,074

Generation parts and supplies inventory of approximately $900,000 are maintained in the Aimeliik power plant that caught fire in November 2011. Management is in the process of evaluating the utilization of the Aimeliik inventory and believes that these are usable at other sites. Accordingly, no provision for obsolescence of the Aimeliik inventory has been recognized at September 30, 2012 in the accompanying financial statements.

(7) Utility Plant and Construction in Progress

Utility plant and construction in progress consist of the following detailed balances at September 30, 2012 and 2011:

	Estimated Useful Lives	Balance at October 1, 2011	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2012
Depreciable utility plant:					
Electric plant	3 - 25 years	$ 31,658,415	$ 1,068,714	$ (2,009,073)	$ 30,718,056
General support equipment	2 - 30 years	23,279,285	164,575	(141,571)	23,302,289
Administrative equipment	2 - 10 years	529,495	111,425	(93,601)	547,319
		55,467,195	1,344,714	(2,244,245)	54,567,664
Less accumulated depreciation		(29,422,429)	(1,757,965)	1,036,057	(30,144,337)
		26,044,766	(413,251)	(1,208,188)	24,423,327
Non-depreciable assets:					
Construction in progress		218,055	2,196,741	(218,055)	2,196,741
		$ 26,262,821	$ 1,783,490	$ (1,426,243)	$ 26,620,068

	Estimated Useful Lives	Balance at October 1, 2010	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2011
Depreciable utility plant:					
Electric plant	3 - 25 years	$ 27,251,933	$ 4,406,482	$ -	$ 31,658,415
General support equipment	2 - 30 years	22,746,036	541,595	(8,346)	23,279,285
Administrative equipment	2 - 10 years	776,907	-	(247,412)	529,495
		50,774,876	4,948,077	(255,758)	55,467,195
Less accumulated depreciation		(27,843,879)	(1,833,162)	254,612	(29,422,429)
		22,930,997	3,114,915	(1,146)	26,044,766
Non-depreciable utility plant:					
Construction in progress		345,390	4,761,085	(4,888,420)	218,055
		$ 23,276,387	$ 7,876,000	$ (4,889,566)	$ 26,262,821

(7) Utility Plant and Construction in Progress, Continued

In November 2011, the Aimeliik power plant caught fire resulting in damage to several generators and to the plant building. In March 2012, PUC decided that the damaged generators will not be rehabilitated and will be sold. The generators were written down to $227,660 and are included in the electric plant assets. Further, as a result of PUC's evaluation of the damages sustained from the fire, the cost of the plant building was written down and other damaged equipment were disposed of. The loss resulting from the aforementioned disposals and write downs totaled $1,208,189 and is presented as loss on disposal of assets related to a catastrophic fire in the accompanying statements of revenues, expenses and changes in net assets.

At September 30, 2012, construction in progress included $2,109,104 of Japan Government funded projects (see note 4).

(8) Long-Term Debt

On September 4, 2006, PUC entered into a loan with a foreign bank not to exceed $7,000,000 with interest at 3.5% per annum to finance the purchase of portable generators, a crankshaft assembly and other necessary equipment to facilitate the overhaul of aging generators. The loan is guaranteed by the Republic of Palau and is to be repaid in thirty-five consecutive semi-annual principal installments of $200,000 plus interest; the first installment being repaid on the last day of the thirty-sixth month from the date of the initial advance and thereafter semi-annually on the last day of each successive six-month period, until fully paid.

On April 21, 2010, PUC entered into a loan with a development bank, an affiliated organization, for $3,000,000 to finance the purchase of two generator sets. The loan is collateralized by the generator sets inclusive of auxiliary equipment. The loan bears interest of 7.5% per annum and is to be repaid monthly beginning January 30, 2011 in principal payments of $27,810 plus accrued interest. Payment of interest during the eight month grace period will be spread over twelve months with an equal payment of $12,500 per month starting January 30, 2011.

Principal payments for subsequent years ending September 30 and applicable interest due, are as follows:

Year Ending September 30,	Principal	Interest	Total
2013	$ 527,601	$ 404,087	$ 931,688
2014	537,507	379,987	917,494
2015	548,182	355,118	903,300
2016	559,183	330,350	889,533
2017	572,043	302,867	874,910
2018 - 2022	3,082,141	1,079,767	4,161,908
2023 - 2027	2,779,391	270,816	3,050,207
	$ 8,606,048	$ 3,122,992	$ 11,729,040

(8) Long-Term Debt, Continued

Movements in long-term liabilities for the years ended September 30, 2012 and 2011, are as follows:

	Balance at October 1, 2011	Additions	Repayments	Balance at September 30, 2012	Balance Due in One Year
Long-term debt	$ 9,125,051	$ -	$ (519,003)	$ 8,606,048	$ 527,601

	Balance at October 1, 2010	Additions	Repayments	Balance at September 30, 2011	Balance Due in One Year
Long-term debt	$ 9,600,000	$ -	$ (474,949)	$ 9,125,051	$ 517,743

(9) Related Party Transactions

Utility services of $6,898,072 and $7,097,470 were rendered to ROP for the years ended September 30, 2012 and 2011, respectively. PUC provides electrical utility services to ROP at the same rates charged to third parties.

Receivables of $1,311,610 and $5,659,741 (gross of allowance for doubtful accounts of $34,000 and $1,056,000) are due from ROP as of September 30, 2012 and 2011, respectively. Of these receivables, $20,509 and $3,358,547 as of September 30, 2012 and 2011, respectively, have been outstanding for more than ninety days.

In December 2011, PUC entered into an agreement with ROP for the settlement of certain ROP long outstanding receivables. The settlement included payment of $3,200,000 from ROP, plus the offset of receivables against the cost of two generators and assistance provided by ROP to PUC during the Aimeliik fire. PUC recorded a recovery of uncollectible receivables of $1,193,000 at September 30, 2011 as a result of the settlement.

In October 2007, PUC entered into a Maintenance Agreement with the National Government of Palau for a period of ten years in line with ROP's utilization of alternative energy technology to reduce dependence on petroleum based fuel products through the installation of solar photovoltaic systems (PV systems). Under the agreement, the National Government shall provide necessary equipment, execute all documents required for receipt of the project resources, and coordinate with the contractor. ROP shall also pay PUC the energy charge produced by the PV systems and PUC shall in turn use the payment in the maintenance, repair and replacement of components of the PV systems. However, any excess cost incurred in the maintenance, repair and replacement of the PV system shall be borne by ROP. For the years ended September 30, 2012 and 2011, the energy charge incurred by ROP was $42,798 and $8,520, respectively.

(10) Commitments

PUC entered into an agreement on October 14, 1999 with the Republic of Palau, State of Koror and Koror State Public Land Authority, in which PUC is granted the use and exclusive possession of real property located in Malakal (on which the Malakal Power Plant is located) for a term of thirty years. PUC is not required to pay rent or fees for its use of the property.

(10) Commitments, Continued

In 2008, PUC entered into commercial supply agreements with two contractors each ending in 2011 in which PUC will purchase production and vehicle fuel and lubricants. Purchase prices are based on movements of the base price for fuel and lubricants. One of the contracts was renewed and is effective until December 31, 2016 with the same basic contract terms while the other contract was extended until September 2011 and on a purchase order basis thereafter until a contract is executed.

(11) Contingencies

As of September 30, 2012, PUC is in noncompliance with the insurance coverage covenant related to its loan with a development bank. The ultimate outcome of such noncompliance is not determinable at September 30, 2012 and, accordingly, no provision or adjustment for the impact of the contingency has been recognized in the accompanying financial statements.

PUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, PUC will be self insured for the entire amount (see note 12).

Under the provisions of RPPL 4-51, PUC shall credit from future electric utility charges the actual cost, including freight and insurance, incurred by any non-governmental electric utility customer, or incurred by any state government customer prior to the transfer of the Aimeliik Power Plant to PUC, to purchase transformers, cables, and meter bases necessary to connect such customer to the electric power distribution system; provided, however, that the customer is not entitled to such credit unless it has obtained written confirmation from PUC that the types of transformers, cables and meter bases are suitable to connect the customer to the electric power distribution system and that the proposed cost is reasonable. The expected credit from future electric utility charges cannot be presently determined and, accordingly, no provision for any credit has been recognized in the accompanying financial statements.

(12) Risk Management

PUC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. PUC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed, except for inventory and utility plant. Settled claims from insured risks have not exceeded commercial insurance coverage in the past three years.

(13) Subsequent Event

On June 6, 2013, Republic of Palau Public Law (RPPL) 9-4 was signed into law to merge the Palau Water and Sewer Corporation into the Palau Public Utilities Corporation (PPUC), and amend RPPL 4-13 to require the PPUC to be responsible for the water and waste water operations of the Republic of Palau. Further, water and waste water operations shall be treated as a separate business segment from the electricity operations of PPUC. PPUC shall adopt an organizational structure delineating a chain of management for water and waste water operations that is separate from electricity operations. Shared administrative costs and expertise shall be allocated to the two separate business segments based on the United States standard of cost accounting applicable to utilities. The two separate business segments shall not be utilized to subsidize the other.