

PALAU INTERNATIONAL CORAL REEF CENTER

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2001 AND
PERIOD FROM INCEPTION (NOVEMBER 20, 1998)
THROUGH SEPTEMBER 30, 2000

INDEPENDENT AUDITORS' REPORT

Board of Directors
Palau International Coral Reef Center:

We have audited the accompanying balance sheets of the Palau International Coral Reef Center (the Center), a component unit of the Republic of Palau, as of September 30, 2001 and 2000, and the related statements of revenues, expenses and changes in fund equity and cash flows for the year ended September 30, 2001 and for the period from inception (November 20, 1998) through September 30, 2000. These financial statements are the responsibility of the Center'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 the Center as of September 30, 2001 and 2000, and the results of its operations and its cash flows for the year ended September 30, 2001 and for the period from inception (November 20, 1998) through September 30, 2000, 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 February 11, 2002, on our consideration of the Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche

February 11, 2002

PALAU INTERNATIONAL CORAL REEF CENTER

Balance Sheets
September 30, 2001 and 2000

<u>ASSETS</u>	<u>2001</u>	2000 (As Restated <u>Note 8)</u>
Current assets:		
Cash and cash equivalents	\$ 123,893	\$ 353,328
Receivables:		
Grantor agencies (note 3)	41,655	41,640
Republic of Palau	11,551	-
Interest	-	501
Other	-	1,000
Inventories (note 4)	<u>51,992</u>	<u>56,364</u>
Total current assets	229,091	452,833
Property, plant and equipment, net (note 5)	<u>6,069,889</u>	<u>6,445,117</u>
	<u>\$ 6,298,980</u>	<u>\$ 6,897,950</u>
 <u>LIABILITIES AND FUND EQUITY</u> 		
Current liabilities:		
Accounts payable	\$ -	\$ 2,809
Accrued expenses	<u>13,459</u>	<u>10,575</u>
Total current liabilities	<u>13,459</u>	<u>13,384</u>
Fund equity:		
Contributed capital	5,919,804	6,692,225
Retained earnings	<u>365,717</u>	<u>192,341</u>
Total fund equity	<u>6,285,521</u>	<u>6,884,566</u>
	<u>\$ 6,298,980</u>	<u>\$ 6,897,950</u>

See accompanying notes to financial statements.

PALAU INTERNATIONAL CORAL REEF CENTER

Statements of Revenues, Expenses and Changes in Fund Equity
Year Ended September 30, 2001 and Period From
Inception (November 20, 1998) Through September 30, 2000

	2001	2000 (As Restated Note 8)
Operating revenues:		
Facility user and admission fees	\$ 63,625	\$ -
Merchandise sales	29,998	-
Research facilities	3,172	-
Accommodation	1,820	-
Total operating revenues	<u>98,615</u>	<u>-</u>
Operating expenses:		
General and administrative expenses:		
Depreciation	757,927	74,256
Salaries, wages and fringe benefits	307,530	158,063
Supplies and printing	60,187	21,763
Utilities	58,044	4,832
Sales and marketing	43,562	9,955
Travel	30,134	49,473
Communications	15,897	8,879
Professional services	14,821	9,315
Repairs and maintenance	8,908	6,416
Entertainment	7,406	1,960
Training	6,399	15,398
Honorariums and meetings	3,501	9,218
Insurance	3,113	1,228
Dues and subscriptions	1,175	1,549
Rental	860	13,000
Other	10,985	8,163
Total general and administrative expenses	<u>1,330,449</u>	<u>393,468</u>
Operating loss	<u>(1,231,834)</u>	<u>(393,468)</u>
Nonoperating revenues (expenses):		
Appropriations (note 6)	500,000	420,000
Grants (note 3)	152,813	83,250
Interest income	14,218	5,965
Donations	11,978	15,563
Other income	1,973	-
Loss on disposal of assets	-	(878)
Total nonoperating revenues (expenses), net	<u>680,982</u>	<u>523,900</u>
Net income	(550,852)	130,432
Add depreciation on equipment acquired by grants for capital acquisitions that reduces contributed capital	<u>724,228</u>	<u>61,909</u>
Increase in retained earnings	173,376	192,341
Retained earnings at beginning of period	192,341	-
Retained earnings at end of period	<u>365,717</u>	<u>192,341</u>
Contributed capital at beginning of period	6,692,225	-
Additions to contributed capital (notes 4, 5 and 6)	-	6,754,134
Amortization of contributed capital	(772,421)	(61,909)
Contributed capital at end of period	<u>5,919,804</u>	<u>6,692,225</u>
Total fund equity	<u>\$ 6,285,521</u>	<u>\$ 6,884,566</u>

See accompanying notes to financial statements.

PALAU INTERNATIONAL CORAL REEF CENTER

Statements of Cash Flows
 Year Ended September 30, 2001 and Period From
 Inception (November 20, 1998) Through September 30, 2000

	2001	2000 (As Restated Note 8)
Cash flows from operating activities:		
Operating loss	\$ (1,231,834)	\$ (393,468)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	757,927	74,256
(Increase) decrease in assets:		
Receivables:		
Republic of Palau	(11,551)	-
Other	1,000	(1,000)
Inventories	(43,821)	-
Increase (decrease) in liabilities:		
Accounts payable	(2,809)	2,809
Accrued expenses	2,884	10,575
Net cash used for operating activities	<u>(528,204)</u>	<u>(306,828)</u>
Cash flows from noncapital financing activities:		
Appropriations (note 6)	500,000	420,000
Interest received	14,719	5,464
Other income	1,973	-
Net cash provided by noncapital financing activities	<u>516,692</u>	<u>425,464</u>
Cash flows from capital and relating financing activities:		
Property, plant and equipment acquisitions	(382,699)	(129,481)
Contributed capital (note 6)	-	307,000
Cash received from grantor agencies (note 3)	152,798	41,610
Donations	11,978	15,563
Net cash (used for) provided by capital and related financing activities	<u>(217,923)</u>	<u>234,692</u>
Net (decrease) increase in cash and cash equivalents	(229,435)	353,328
Cash and cash equivalents at beginning of period	353,328	-
Cash and cash equivalents at end of period	<u>\$ 123,893</u>	<u>\$ 353,328</u>
Supplementary schedule of noncash capital and related financing activities (notes 4 and 5):		
Noncash increase of property, plant and equipment	\$ -	\$ 6,390,770
Noncash increase (decrease) of inventory	(48,193)	56,364
Noncash decrease (increase) of contributed capital	48,193	(6,447,134)
Net effect	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

PALAU INTERNATIONAL CORAL REEF CENTER

Notes to Financial Statements
September 30, 2001 and 2000

(1) Organization

The Palau International Coral Reef Center (the Center), a component unit of the Republic of Palau (ROP), was created on November 20, 1998, under the provisions of Republic of Palau Public Law (RPPL) 5-17. The Law created a wholly owned government non-profit corporation managed by a Board of Directors appointed by the President of the Republic of Palau with the advice and consent of the Senate of the Olbiil Era Kelulau (ROP National Congress). The primary purpose of the Center is to carry out marine research and educate the public about the ecological, economic and cultural importance of coral reefs and their associated marine habitats.

The Center's financial statements are incorporated into the general purpose financial statements of ROP as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of the Center conform to accounting principles generally accepted in the United States of America, as applied to government entities, specifically proprietary funds. Governmental Accounting Standards Board (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. The Center has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the balance sheet. Fund equity (i.e., net assets) is segregated into contributed capital and retained earnings components. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred.

Cash and Cash Equivalents

For purposes of the balance sheets and the statements of cash flows, cash and cash equivalents are defined as cash on hand, cash held in demand accounts, as well as short-term investments with a maturity date within three months of the date acquired. As of September 30, 2001 and 2000, cash and cash equivalents were \$123,893 and \$353,328, respectively, and the corresponding bank balances were \$120,260 and \$361,750, respectively, which are maintained in financial institutions located in Palau subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2001 and 2000, bank deposits in the amount of \$101,500 and \$100,000, respectively, were FDIC insured. The Center does not require collateralization of its cash deposits, therefore, deposit levels in excess of FDIC coverage are uncollateralized.

PALAU INTERNATIONAL CORAL REEF CENTER

Notes to Financial Statements
September 30, 2001 and 2000

(2) Summary of Significant Accounting Policies, Continued

Inventories

Inventories of spare parts, merchandise and supplies are stated at the lower of cost (first-in, first out) or market.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Contributed fixed assets are stated at their estimated fair value at the date of transfer. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets.

Retirement Plan

The Center contributes to the Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost-sharing, multi-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.

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. The Center's payroll for the year ended September 30, 2001 and the period from inception (November 20, 1998) through September 30, 2000 was covered by the Fund's pension 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 10% 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.

PALAU INTERNATIONAL CORAL REEF CENTER

Notes to Financial Statements
September 30, 2001 and 2000

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan, Continued

The Fund's October 1, 1999 actuarial valuation determined the unfunded pension benefit obligation as follows:

Participants in pay status	\$ 28,241,213
Active participants	25,917,335
Participants with vested deferred benefits	<u>998,820</u>
Total pension benefit obligation	55,157,368
Net assets available for benefits, at market value	<u>31,093,274</u>
Unfunded benefit obligation	\$ <u>24,064,094</u>

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.

Compensated Absences

Vested or accumulated unpaid annual leave is accrued when earned and is included in the balance sheet as an accrued expense. Annual leave accumulates at the rate of 6 hours biweekly, if less than 6 years of service, 7 hours biweekly, if between 7 and 14 years of service, and 8 hours biweekly if 15 years or more of service

Taxes

RPPL 5-17 exempted the Center from all national and state non-payroll taxes or fees.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

(3) Due From Grantor Agencies

The Center is a direct recipient of a contract award received from the U.S. Department of Commerce, National Oceanic and Atmospheric Administration/National Ocean Services and a grant from the David and Lucile Packard Foundation. The Center is also a subrecipient of a grant received by the South Pacific Regional Environment Program. Excess grant disbursements over receipts are recognized as due from grantor agencies until such funds are received in accordance with grant terms and conditions.

PALAU INTERNATIONAL CORAL REEF CENTER

Notes to Financial Statements
September 30, 2001 and 2000

(3) Due From Grantor Agencies, Continued

Changes in the due from grantor agency account for the year ended September 30, 2001 and the period from inception (November 20, 1998) through September 30, 2000 are as follows:

	<u>2001</u>	<u>2000</u>
Balance at beginning of period	\$ 41,640	\$ -
Deductions - cash receipts from grantor agency	(152,798)	(41,610)
Additions - program outlays	<u>152,813</u>	<u>83,250</u>
Balance at end of period	<u>\$ 41,655</u>	<u>\$ 41,640</u>

(4) Inventories

Inventories as of September 30, 2001 and 2000, consist of the following:

	<u>2001</u>	<u>2000</u> (As Restated Note 8)
Merchandise	\$ 42,145	\$ -
Spare parts	9,847	8,171
Research supplies	<u>-</u>	<u>\$ 48,193</u>
	<u>\$ 51,992</u>	<u>\$ 56,364</u>

The inventory for spare parts and research supplies as of September 30, 2000 was received as contributions from the Government of Japan on August 30, 2000. Research supplies inventory amounting to \$48,193 was used for operations during the year ended September 30, 2001, which is recorded as amortization of contributed capital in the accompanying financial statements.

(5) Property, Plant and Equipment

Property, plant and equipment as of September 30, 2001 and 2000, consist of the following:

	<u>Estimated Useful Lives</u>	<u>2001</u>	<u>2000</u>
Buildings	10 - 30 years	\$ 3,587,952	\$ 3,236,363
Mechanical, electrical, research, office, exhibit and marine equipment	2 - 15 years	1,656,728	1,645,461
Aquarium	7 years	1,486,239	1,481,548
Furniture and fixtures	5 years	145,283	138,131
Vehicles	3 years	<u>25,652</u>	<u>17,652</u>
		6,901,854	6,519,155
Less accumulated depreciation		<u>(831,965)</u>	<u>(74,038)</u>
		<u>\$ 6,069,889</u>	<u>\$ 6,445,117</u>

PALAU INTERNATIONAL CORAL REEF CENTER

Notes to Financial Statements
September 30, 2001 and 2000

(5) Property, Plant and Equipment, Continued

The Center received \$-0- and \$6,390,770 as contributions of buildings and equipment from the Government of Japan during the year ended September 30, 2001 and the period from inception (November 20, 1998) through September 30, 2000, respectively.

(6) Republic of Palau

During the year ended September 30, 2001 and the period from inception (November 20, 1998) through September 30, 2000, the Center was appropriated \$500,000 and \$420,000, respectively, through RPPLs 6-1, 5-47, 5-38 and 5-18 for operations. Additionally, during the year ended September 30, 2001 and the period from inception (November 20, 1998) through September 30, 2000, the Center was appropriated \$-0- and \$307,000, respectively, through RPPL 5-41 for capital acquisitions. The Center has recorded the \$307,000 as contributed capital as the amount was used for building improvements during the year ended September 30, 2001.

The Center conducts its operations on land without charge in the State of Koror, through a land settlement agreement dated February 3, 1997 between ROP, the Palau Public Lands Authority, the Koror State Government and the Koror State Public Lands Authority. The land settlement agreement stipulates that ROP will retain the use of the land for as long as it is used for the Center and as long as no commercial or other profit-making ventures are conducted on the premises.

(7) Risk Management

The Center 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. The Center has elected to purchase commercial automobile insurance from independent third parties for the risks of loss to which it is exposed with respect to the use of motor vehicles. Settled claims have not exceeded this commercial coverage since November 20, 1998. For other risks of loss to which it is exposed, the Center has elected not to purchase commercial insurance. Instead, the Center believes it is more economical to manage its risks internally. Claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No material losses have resulted from the Center's risk management activities.

(8) Restatement

The Center had previously recorded inventory and contributed capital of \$209,888 during the period from inception (November 20, 1998) through September 30, 2000. The Center has determined that \$153,524 of this amount was also recorded as contributed buildings. Accordingly, inventory and contributed capital as of September 30, 2000 have been reduced by \$153,524 for this correction of error.