PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

Years Ended December 31, 2019 and 2018

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

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December 31, 2019

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Palau National Communications Corporation

We have audited the accompanying financial statements of the Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, which comprise the statements of net position as of December 31, 2019 and 2018, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the PNCC'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.

Auditor's Responsibility

Our responsibility is to express opinions 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. 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.

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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the PNCC as of December 31, 2019 and 2018, and the respective changes in financial position and cash flows thereof 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 4 through 9, the Schedule of Budgetary Comparison information on page 49, Schedule of Proportionate Share of the Net Pension Liability on page 52, and the Schedule of Pension Contributions on page 53, as listed on the table of contents, 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 Financial Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Palau National Communications Corporation's basic financial statements. The Schedules of Functional Expenses on page 50 and 51 are presented for the purposes of additional analysis and are not a required part of the basic financial statements. These schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 2, 2020, on our consideration of the PNCC'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 effectiveness of the PNCC's 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 the PNCC's internal control over financial reporting and compliance.

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BURGER COMER MAGLIARI

Koror, Republic of Palau
June 2, 2020

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Management's Discussion and Analysis
December 31, 2019

This section of Palau National Communications Corporation's (PNCC) annual financial report presents the analysis of its financial performance during the fiscal year ended December 31, 2019 with comparisons to prior years ended December 31, 2018 and 2017. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes which follows this section.

BUSINESS OVERVIEW

OUR SERVICES

PNCC is a full-service telecommunications provider that offers nationwide coverage for all services, including Local and Long-Distance Telephone, GSM Mobile, Internet, and Digital TV. The 5-year subscriber trend shows PalauCel (GSM Mobile) and PalauNet (Internet) grew about 36% and 95%, respectively. The growth in PalauNet subscriptions was mainly due to the increase in HomeNet sign-ups. Internet revenue continues to grow with more customers using HomeNet and prepaid Internet access to Wi-Fi Hotspots.

PNCC's build-up of GSM coverage and launching of 4G service in late 2017 have accelerated usage of mobile telephone services.

Five Year Growth Trend
2015-2019

Year End December 31	2015	2016	2017	2018	2019
GSM Mobile	**24,193**	**25,770**	**26,546**	**26,524**	**32,868**
Postpaid	2,245	2,523	2,916	3,123	3,914
Prepaid	21,948	23,247	23,630	23,401	28,954
Fixed Line (Telephone)	**7,204**	**7,048**	**7,088**	**7,166**	**6,801**
Business/Government	3,298	3,110	3,071	3,047	2,897
Residential	3,906	3,938	4,017	4,119	3,904
Internet	**2,003**	**2,348**	**3,001**	**3,619**	**3,901**
PalauNet	579	759	1,008	1,302	1,086
DSL	286	293	328	309	364
Domestic Leased Line/VLAN	60	63	67	62	31
Wi-Fi Hotspots	140	157	195	214	237
HomeNet	938	1,076	1,403	1,732	2,183
Digital TV	**3,827**	**4,129**	**4,138**	**3,786**	**3,370**
Single Dwelling	3,081	3,240	3,260	2,939	2,623
Multi Units	746	889	878	847	747

FINANCIAL HIGHLIGHTS

For year ended December 30, 2019, total assets decreased by $2,368,450 which included deferred outflows; however, PNCC's capital assets increased by $372,327 due to the capitalization of new projects and network upgrades. In addition, an additional $1,000,000 was invested with Raymond James and $100,000 with Fidelity Investment under the Bank of Guam.

With the implementation of Governmental Accounting Standards Board (GASB) Statements 67 and 68 in 2014, pension liabilities kicked in forwarding a negative net position of $9.1 million in 2015. The net income of $3,988,844 realized in 2016 reduced total negative position down to $5.1 million at the end of 2016 and $4,142,899 net income in 2017 largely reduced the negative position to $.9 million at the end of 2017. The 2018 net income amounting to $2,007,412 had fully covered the negative position of $.9 million from 2017 making it a positive $1,034,658 at the end of 2018. However, the 2019 negative net income of $1,184,029 reduced the $1,034,658 from 2018 and ended the year 2019 with negative $149,371 net position.

STATEMENTS OF NET POSITION

Years ended December 31, 2019, 2018, and 2017

	2019	2018	2017
ASSETS			
Current assets			
Cash	$ 296,738	$ 787,197	$ 503,649
Restricted cash and cash equivalents	250,113	3,818,176	3,817,433
Receivables, net	1,988,686	2,118,155	1,706,140
Inventories	519,658	432,493	290,165
Prepaid expenses	217,705	46,214	2,070
Total current assets	**3,272,900**	**7,202,235**	**6,319,457**
Investments	2,222,750	1,033,439	1,128,147
Other noncurrent assets	60,773	54,300	54,300
Plant and equipment, net	22,267,832	21,895,505	20,894,693
Total assets	**27,824,255**	**30,185,479**	**28,396,597**
Deferred outflows from pension	2,000,476	2,007,702	1,291,628
Total Assets and Deferred Outflows	**$ 29,824,731**	**$ 32,193,181**	**$ 29,688,225**
LIABILITIES AND NET POSITION			
Current liabilities			
Current portion of long-term debt	$ 1,531,736	$ 1,463,147	$ 1,442,907
Accounts payable	1,028,617	1,109,509	111,767
Payable to carriers, net	-	17,357	94,067
Accrued expenses	465,262	348,609	317,192
Unearned revenues	900	220	4,208
Customer deposits	621,054	669,363	635,862
Total current liabilities	**3,647,569**	**3,608,205**	**2,606,003**
Note payable, net of current portion	15,839,333	17,373,552	18,830,846
Net pension liability	8,712,379	8,539,634	7,980,506
Total liabilities	**28,199,281**	**29,521,391**	**29,417,355**
Deferred inflows from pension	1,774,821	1,637,132	1,243,624
Net position:			
Invested capital assets, net of related debt	4,896,763	3,058,806	620,940
Restricted - Debt service reserve	250,113	3,818,176	3,817,433
Unrestricted	(5,296,247)	(5,842,324)	(5,411,127)
Total net position	**(149,371)**	**1,034,658**	**(972,754)**
Total Liabilities and Net Position	**$ 29,824,731**	**$ 32,193,181**	**$ 29,688,225**

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Years ended December 31, 2019, 2018, and 2017

	2019	2018	2017
Operating revenues			
GSM Mobile	$ 7,371,235	$ 8,545,157	$ 7,591,804
PalauNet	3,094,399	3,972,763	3,872,611
Local	1,507,815	1,526,232	1,480,114
Digital TV	1,448,376	1,668,337	1,722,417
Miscellaneous	247,797	146,419	122,030
Long Distance	186,416	237,184	292,014
Provision for doubtful accounts	(121,536)	(142,214)	(70,912)
Total Operating Revenues	**13,734,502**	**15,953,878**	**15,010,078**
Operating expenses			
Plant specific operations	6,290,280	6,534,939	4,394,655
Corporate operations	2,853,615	1,886,911	1,508,999
Depreciation	2,669,183	2,217,905	2,294,473
Customer service operations	1,674,426	1,520,148	1,305,878
Plant non-specific operations	610,465	744,017	489,837
Total Operating Expenses	**14,097,969**	**12,903,920**	**9,993,842**
Earnings from operations	**$ (363,467)**	**$ 3,049,958**	**$ 5,016,236**
Nonoperating income (expenses):			
Unrealized gain (loss) on investments	59,488	(128,981)	40,572
Realized gain on investments	49,370	30,561	63,254
Interest (expense)	(840,515)	(914,311)	(978,964)
Gain/(Loss) on investments	9,899	25,903	19,698
Gain/(Loss) on retirement of equipment	-	-	62,924
Other income (expense)	(98,804)	(55,718)	(80,821)
Total nonoperating income (expenses), net	**(820,562)**	**(1,042,546)**	**(873,337)**
Change in net position	**(1,184,029)**	**2,007,412**	**4,142,899**
Net position at beginning of year	1,034,658	(972,754)	(5,115,653)
Net position at end of year	**$ (149,371)**	**$ 1,034,658**	**$ (972,754)**

Total operating revenues decreased by 14% from $15.9 million in 2018 to $13.7 million in 2019. Decrease in total revenues is attributable to decrease in the revenues from GSM Mobile operations and the PalauNet revenues.

Operating expenses had increased by 9% or $1,194,049 in 2019 over 2018 attributed to both increase in Corporate Operations and Depreciation expense.

Earnings from operations decreased by 112% from $3,049,958 in 2018 to negative $363,467 in 2019. In compliance with GASB Statements 67 & 68, $8.5 million in 2018 and $8.7 million in 2019 pension liabilities resulted in a cumulative deficit of $149,371 at the end of 2019 as the net position for the year.

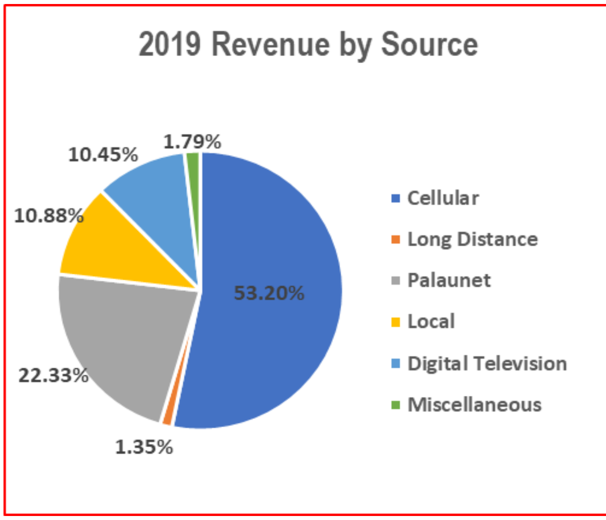
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

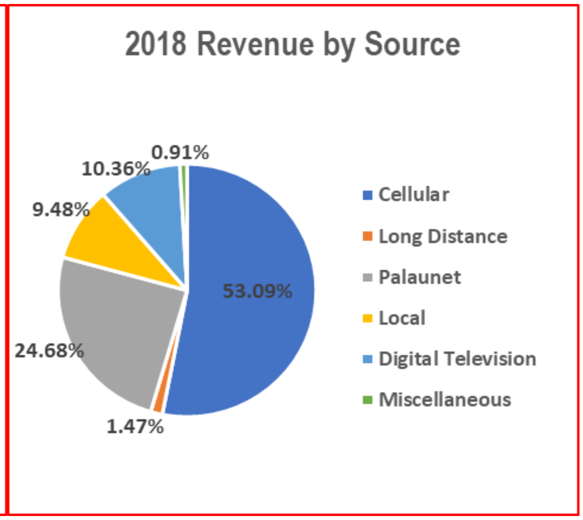
	2019	2018	Increase(Decrease) Dollar	Percent	2017
Operating revenues	$ 13,734,502	$ 15,953,878	$ (2,219,376)	-13.91%	$ 15,010,078
Operating expenses	$ (14,097,969)	$ (12,903,920)	$ (1,194,049)	9.25%	$ (9,993,842)
Operating income	$ (363,467)	$ 3,049,958	$ (3,413,425)	-111.92%	$ 5,016,236
Non-operating income (expenses)	$ (820,562)	$ (1,042,546)	$ 221,984	-21.29%	$ (873,337)
Change in net position	**$ (1,184,029)**	**$ 2,007,412**	**$ (3,191,441)**	**-158.98%**	**$ 4,142,899**

REVENUE BY SOURCE

Revenue Source	2019	2018	Increase/(Decrease Dollar	Percent	2017
Cellular	$ 7,371,235	$ 8,545,157	$ (1,173,922)	-13.74%	$ 7,591,804
Long Distance	186,416	237,184	$ (50,768)	-21.40%	292,014
Palaunet	3,094,399	3,972,763	$ (878,364)	-22.11%	3,872,611
Local	1,507,815	1,526,232	$ (18,417)	-1.21%	1,480,114
Digital Television	1,448,376	1,668,337	$ (219,961)	-13.18%	1,722,417
Miscellaneous	247,797	146,419	$ 101,378	69.24%	122,030
Provision for doubtful accts	(121,536)	(142,214)	$ 20,678	-14.54%	(70,912)
Total	**$ 13,734,502**	**$ 15,953,878**	$ (2,219,376)	-13.91%	**$ 15,010,078**

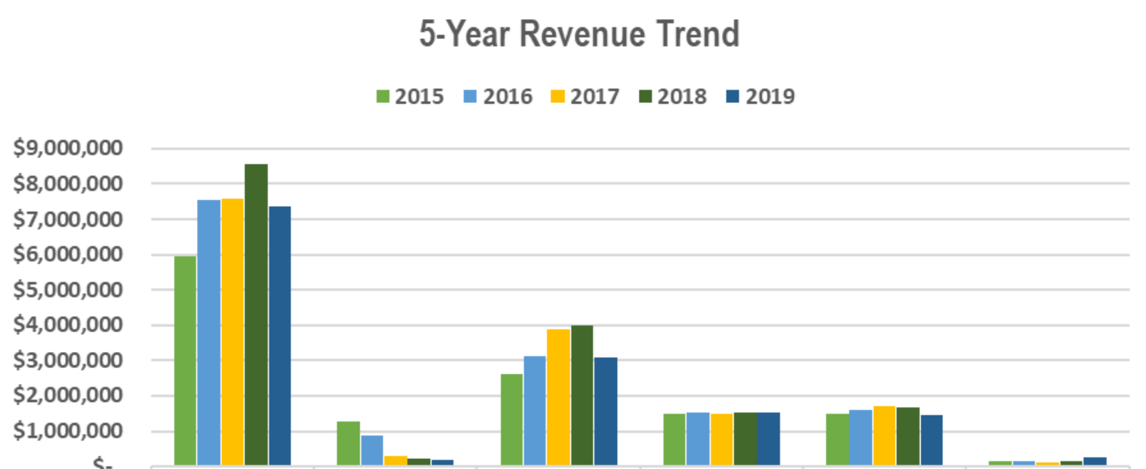
Cellular operations which contributed the highest source of revenue over the previous years went down by 13.7% in year 2019 including Palaunet (22%) and Long Distance (21%). Revenues for Digital Television and Internet also reduced by 13% and 1% respectively. The decline in Long Distance and Digital Television revenue is due to the reliance on Internet for entertainment and communication.





Summarized in the chart above are the major revenue sources. For 2019, the cellular operations contributed 53.20% of the total operating revenues.

The chart below shows the change in revenues by source over the past five years.



	Cellular	Long Distance	Palaunet	Local	Digital Television	Miscellaneous
2015	$5,959,990	1,277,358	2,626,066	1,488,461	1,480,427	139,692
2016	$7,547,338	855,996	3,109,626	1,525,895	1,585,141	140,936
2017	$7,591,804	292,014	3,872,611	1,480,114	1,722,417	122,030
2018	$8,545,157	237,184	3,972,763	1,526,232	1,668,337	146,419
2019	$7,371,235	186,416	3,094,399	1,507,815	1,448,376	247,797

SUMMARY OF FINANCIAL RESULTS AND STRATEGIC PLANNING

Summary of Financial Results for 2019

As shown in the Statement of Revenues, Expenses and Changes in Net Position, PNCC's 2019 revenue decreased by 13.91% over the previous year. The negative change in net position at end of 2019 diminished the 2018 positive net position of $1,034,658.

- Telephony: The revenue for fixed line service has a decrease of 3.9% in 2019.
- PalauNet: The revenues resulted in a decrease of 22.11% compared to 2018.
- PalauCel: The revenues resulted in a decrease of 13.74% compared to 2018.
- DTV: The revenues resulted in a decrease of 13.18% compared to 2018.

PNCC Strategic Planning Process

The PNCC's 5-year Mid-Term Business Plan (2014-2018) developed with the expert assistance of Mr. Akira Maeda in 2013 provides a road map for financial sustainability of the corporation. Based on the Business Plan, PNCC implemented a 3G platform in 2015 to advance its GSM cellular services. Expansion of 3G service coverage into the whole Babeldaod, Peleliu and Angaur was completed in 2016.

In 2017, PNCC implemented the more advanced 4G services and will continue looking into future economic and technological growth.

CONTACTING PNCC'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of PNCC's finances and to demonstrate PNCC's transparency, accountability and stewardship for the money it receives. The Management's Discussion and Analysis for the year ended December 31, 2019 is set forth in the report on the audit of PNCC. The discussion and analysis explains the major factors impacting the 2019 financial statements. If you have questions or need additional information, please contact the Chief Financial Officer at the Palau National Communications Corporation, P.O. Box 99, Koror, Republic of Palau 96940, or e-mail rramarui@pnccpalau.com or call 587-9000.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

FINANCIAL SECTION

Years Ended December 31, 2019 and 2018

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Net Position
December 31, 2019 and 2018

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	2019	2018
Current assets:		
Cash (Notes 2, 3, 6 and 9)	$ 296,738	$ 787,197
Receivables: (Notes 2, 6 and 9)		
Trade	1,822,812	1,976,055
Related party (Note 5)	729,230	687,464
Carriers, net	557,422	425,769
Other receivable	15,173	43,282
Allowance for doubtful accounts (Note 2)	(1,135,951)	(1,014,415)
Total receivables, net	1,988,686	2,118,155
Inventories, net (Notes 2 and 6)	519,658	432,493
Prepaid expenses	217,705	46,214
Total current assets	3,022,787	3,384,059
Investments (Notes 2 and 3)	2,222,750	1,033,439
Restricted cash and cash equivalents (Notes 2, 3, 6 and 9)	250,113	3,818,176
Other noncurrent assets (Note 2)	60,773	54,300
Capital assets, net (Notes 2, 4, 6)	22,267,832	21,895,505
Total assets	27,824,255	30,185,479
Deferred outflows of resources:		
Deferred outflows from pension (Note 2)	2,000,476	2,007,702
Total assets and deferred outflows of resources	$ 29,824,731	$ 32,193,181

LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION

	2019	2018
Current liabilities:		
Current portion of long-term debt (Notes 6 and 9)	$ 1,531,736	$ 1,463,147
Accounts payable (Note 8)	1,028,617	1,109,509
Payable to carriers, net (Note 8)	-	17,357
Accrued expenses (Notes 2 and 9)	465,262	348,609
Unearned revenues (Notes 2 and 9)	900	220
Customer deposits (Notes 2 and 9)	621,054	669,363
Total current liabilities	3,647,569	3,608,205
Note payable, net of current portion (Notes 6 and 9)	15,839,333	17,373,552
Net pension liability (Notes 2 and 6)	8,712,379	8,539,634
Total liabilities	28,199,281	29,521,391
Deferred inflows of resources:		
Deferred inflows from pension (Note 2)	1,774,821	1,637,132
Commitments and contingencies (Note 8)		
Net position (Note 2):		
Net investment in capital assets	4,896,763	3,058,806
Restricted for:		
Debt service and reserve	250,113	3,818,176
Unrestricted	(5,296,247)	(5,842,324)
Total net position	(149,371)	1,034,658
Total liabilities, deferred inflows of resources and net position	$ 29,824,731	$ 32,193,181

See accompanying notes to financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Revenues, Expenses and Changes in Net Position
For The Years Ended December 31, 2019 and 2018

	2019	2018
Operating revenues (Note 6):		
Cellular	$ 7,371,235	$ 8,545,157
Palaunet	3,094,399	3,972,763
Digital television	1,448,376	1,668,337
Local	1,507,815	1,526,232
Long distance	186,416	237,184
Miscellaneous	247,797	146,419
Provision for doubtful accounts	(121,536)	(142,214)
Total net operating revenues	13,734,502	15,953,878
Operating expenses:		
Plant specific:		
Operations	6,290,280	6,534,939
Depreciation (Note 4)	2,669,183	2,217,905
Corporate office	2,853,615	1,886,911
Customer service	1,674,426	1,520,148
Plant non-specific operations	610,465	744,017
Total operating expenses	14,097,969	12,903,920
Operating income (loss)	(363,467)	3,049,958
Nonoperating income (expense):		
Unrealized gain (loss) on investments	59,488	(128,981)
Realized gain on investments	49,370	30,561
Income on investments	9,899	25,903
Other income (expense), net	(98,804)	(55,718)
Interest expense (Note 6)	(840,515)	(914,311)
Total nonoperating income (expense), net	(820,562)	(1,042,546)
Change in net position	(1,184,029)	2,007,412
Net position (deficit) at beginning of year (Note 2)	1,034,658	(972,754)
Net position (deficit) at end of year	$ (149,371)	$ 1,034,658

See accompanying notes to financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Cash Flows
For the Years Ended December 31, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Cash received from customers	$ 13,834,554	$ 15,383,067
Cash payments to suppliers for goods and services	(8,213,102)	(7,249,369)
Cash payments to employees	(3,001,890)	(2,246,544)
Net cash provided by operating activities	2,619,562	5,887,154
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(3,041,509)	(3,218,717)
Additions from restricted cash and cash equivalents	-	(743)
Transfers from restricted cash and cash equivalents	3,568,063	-
Interest paid	(840,515)	(914,311)
Repayment of long-term debt	(1,465,630)	(1,437,054)
Net cash used in financing activities	(1,779,591)	(5,570,825)
Cash flows from investing activities:		
Other income	(98,804)	(55,718)
Proceeds from sale and maturities of investment securities	301,586	101,512
Purchase of investment securities	(1,533,212)	(78,575)
Net cash used in investing activities	(1,330,430)	(32,781)
Net change in cash	(490,459)	283,548
Cash at beginning of year	787,197	503,649
Cash at end of year	$ 296,738	$ 787,197

See accompanying notes to financial statements.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Statements of Cash Flows, Continued
For the Years Ended December 31, 2019 and 2018

	2019	2018
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	$ (363,467)	$ 3,049,958
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:		
Depreciation	2,669,183	2,217,905
Unrealized gain on investments	(59,488)	128,981
Provision for doubtful accounts	121,536	142,214
Other income (expense), net	98,804	55,718
Realized gain on investments	(49,370)	30,651
Income on investments	(9,899)	(25,903)
(Increase) decrease in assets:		
Receivables:		
Trade	334,267	(1,000,381)
Related party	(41,766)	89,498
Carriers, net	(131,653)	171,150
Other receivable	28,109	(4,689)
Deferred outflows from pension	7,226	(716,074)
Inventories	(87,165)	(142,328)
Prepaid expenses	(171,491)	(44,144)
Other noncurrent assets	(6,473)	-
Increase (decrease) in liabilities:		
Accounts payable	(80,892)	997,742
Payable to carriers, net	(17,357)	(76,710)
Accrued expenses	116,653	31,417
Customer deposits	(48,309)	33,501
Unearned revenues	680	(3,988)
Deferred inflows from pension	137,689	393,508
Net pension liability	172,745	559,128
Net cash provided by operating activities	$ 2,619,562	$ 5,887,154

See accompanying notes to financial statements.

(1) Organization

Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau (ROP), was created on August 23, 1982, under the provisions of the Republic of Palau Public Law (RPPL) 1-40. The law created a wholly owned government corporation managed by five (5) members of 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 PNCC is to establish and operate communications services as a communication common carrier within the ROP. PNCC conducts its operations on land and in buildings provided by the National Government of the ROP. PNCC has four divisions: PNCC, PNCC Wireless (Wireless), Digital Cable Television (DTV) formerly known as Island Cable Television (ICTV), and Palaunet, which provides local and long distance telephone services, cellular telecommunications services and equipment, digital cable television services, and internet services, respectively, within the ROP.

(2) Summary of Significant Accounting Policies

The accounting policies of PNCC conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. 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.

A. Basis of Presentation

The financial statements of PNCC have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental entities. In 2012, PNCC adopted 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. Prior to the issuance of Statement No. 62, PNCC applied the standards and principles outlined in GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary and Other Governmental Entities that Use Proprietary Fund Accounting.* GASB Statement No. 62, which supersedes Statement No. 20, is the primary resource for accounting guidance and principles.

(2) Summary of Significant Accounting Policies, continued

A. Basis of Presentation, continued

PNCC 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 the statement of financial position.

PNCC follows the business-type activities requirements of GASB Statement No. 34. This approach requires the following components of PNCC'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,* required the PNCC 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 December 31, 2019 and 2018, PNCC has deferred outflows of resources and deferred inflows of resources that are 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 December 31, 2019 and 2018, PNCC have deferred outflows of resources and deferred inflows of resources that was included as a component of restricted net position.

(2) Summary of Significant Accounting Policies, continued

A. Basis of Presentation, ccontinued

PNCC's component of net position, continued

Restricted net position, continued

The PNCC's restricted net position categories are as follows:

Nonexpendable: Net position subject to externally imposed stipulations that require PNCC to maintain them permanently. At December 31, 2019 and 2018, PNCC did not have any nonexpendable net position.

Expendable: Net position whose use by PNCC is subject to externally imposed stipulations that can be fulfilled by actions of the PNCC pursuant to those stipulations or release of those stipulations by the passage of time.

Assets that have been assigned as collateral for the Rural Utilities Service (RUS) loan are classified as restricted.

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 December 31, 2019 and 2018, PNCC had deferred outflows of resources and deferred inflows of resources that are included as a component of net position.

B. Measurement Focus and Basis of Accounting

Measurement focus refers to timing of recognition, that is, when revenues and expenditures, expenses, and transfers and assets, deferred outflows of resources, liabilities and deferred inflows of resources are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The accrual basis of accounting is utilized by proprietary funds. Under the accrual method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred. PNCC uses the accrual basis of accounting.

(2) Summary of Significant Accounting Policies, continued

B. Measurement Focus and Basis of Accounting, continued

PNCC maintains a chart of accounts in accordance with the Uniform System of Accounts for telephone companies of the United States of America Federal Communication Commission's Rules, and in conformity with accounting principles generally accepted in the United States of America (GAAP).

C. 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.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for uncollectible accounts receivable and management's estimate of depreciation expense which is based on estimated useful lives of the respective assets. The allowance for uncollectible accounts receivable is determined based on management estimates. While management believes the amount is adequate, the ultimate uncollectible balance may differ from the amounts provided.

D. Budget

In accordance with the ROP Code, the Board of Directors of PNCC adopts an annual budget on a proprietary fund basis and the budget is used as a management tool throughout the accounting cycle. All operating and capital expenditures and revenues are identified in the budgeting process. PNCC's budget is presented to the Olbiil Era Kelulau (OEK) for its review and comments no later than sixty days (60 days) before the budget's effective date (November 1). Pursuant to regulation of the ROP, after PNCC has repaid the RUS loan, PNCC is required to submit a detailed and itemized budget to the OEK for its approval no later than 60 days before it is to take effect.

Throughout the year, PNCC monitors and evaluates expenditure levels and patterns. The Board of Directors may authorize revisions to the budget based on the availability of financial resources. Formal budget revisions are authorized in the same manner as original budget submissions.

(2) Summary of Significant Accounting Policies, continued

D. Budget, continued

The supplementary information in the Management's Discussion and Analysis in pages 4 to 9 includes PNCC's analysis of the significant variations and major factors impacting the 2019 and prior years within its five-year strategic plan and the currently known reasons for those significant variations that PNCC expects to affect its liquidity or ability to provide future services.

E. Recently Issued Accounting Pronouncements

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*. This Statement is to improve 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. GASB Statement No. 81 was effective for the fiscal year ending September 30, 2018. Management does not believe that the implementation of this Statement had a material effect on PNCC's financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues*. This Statement addresses certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans,* No. 68, *Accounting and Financial Reporting for Pensions,* and 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 Statements 67 and 68.* This Statement 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 of Practice for financial reporting purposes; and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. GASB Statement No. 82 was effective for the fiscal year ending September 30, 2018. Management does not believe that the implementation of this Statement had a material effect on PNCC's financial statements.

In November 2016 GASB Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance of this Statement. GASB Statement No. 83 was effective for the fiscal year ending September 30, 2019. The implementation of this Statement did not have a material effect on the PNCC's financial statements.

(2) Summary of Significant Accounting Policies, continued

E. Recently Issued Accounting Pronouncements, continued

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities.* This Statement improves guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. GASB Statement No. 84 is effective for reporting periods after December 15, 2018. Management does not believe that the implementation of this Statement had a material effect on PNCC's financial statements.

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 PNCC for the fiscal year ending December 15, 2019. Management does not believe that the implementation of this Statement will have a material effect on the PNCC's financial statements.

In March 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements.* The Statement's objective is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in the notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Management does not believe that the implementation of this Statement had a material effect on the PNCC's financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. GASB Statement No. 89 will be effective for the fiscal year ending December 15, 2019. Management does not believe that the implementation of this Statement will have a material effect on the PNCC's financial statements.

(2) Summary of Significant Accounting Policies, continued

E. Recently Issued Accounting Pronouncements, continued

In March 2018, GASB issued Statement No. 90, *Majority Equity Interests – An Amendment of GASB Statements No. 14 and 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at the fair value. GASB Statement No. 90 will be effective for the fiscal year ending December 15, 2019.

New Accounting Pronouncement

In May 2019, GASB issued Statement No. 91 *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosure. GASB Statement No. 91 will be effective for the fiscal year ending December 15, 2020.

In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. More comparable reporting will improve the usefulness of information for users of state and local government financial statements. This Statement addresses a variety of topics and includes specific provisions about leases; reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan; applicability of Statements No. 73 and 84 for postemployment benefits, measurements of liabilities (and assets, if any) related to asset retirement obligations (AROs) in a government acquisition; reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers; reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature and terminology used to refer to derivative instruments. GASB Statement No. 92 will be effective for the fiscal year ending June 15, 2021.

(2) Summary of Significant Accounting Policies, continued

E. Recently Issued Accounting Pronouncements, continued

New Accounting Pronouncement, continued

In April 2020, GASB is issued Statement No. 93, *Replacement of Interbank Offered Rates* (IBOR). The primary objective of this Statement is to address those and other accounting and financial reporting implications of the replacement of IBOR. GASB Statement No. 93 will be effective for the fiscal year ending September 30, 2021.

In April 2020, GASB issued Statement No. 93, *Postponement of the Effective Dates of Certain Authoritative Guidance,* which postpones the effective dates of GASB Statements No. 84, 89, 90 and 91 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. GASB Statement No. 93 will be effective for the fiscal year ending September 30, 2021.

The PNCC is currently evaluating whether or not the above listed new GASB pronouncements will have a significant impact on its financial statements.

F. Assets, Liabilities and Net Position

Cash

Cash in the statement of cash flows includes cash on hand and cash in checking and savings accounts.

Restricted Cash and Cash equivalents

Restricted cash and cash equivalents, including amounts restricted for repayment of debt owed to Rural Utilities Service (RUS), amounts restricted for contracts approved by the RUS and RUS revenues, are separately classified in the Statements of Net Position.

Receivables and Allowance for Doubtful Accounts

PNCC grants credit on an unsecured basis to individuals, businesses and governmental entities that are situated in the Republic of Palau, the United States of America, Japan and the Territory of Guam.

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 evaluations of the collectability of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables charged to expense.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Allowance for Doubtful Accounts

An analysis of the change in allowance for doubtful accounts for the years ended December 31, 2019 and 2018 is as follows:

	2019	2018
Balance at beginning of the year	$ 1,014,415	$ 872,201
Current year provision	121,536	142,214
Allowance for doubtful accounts	-	-
Balance at end of year	$ 1,135,951	$ 1,014,415

Inventories

Inventories comprise telecommunication equipment, parts and cables and are stated at the lower of cost (average cost method) or market.

Investments

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the PNCC. At December 31, 2019 and 2018, there were no investments in any one issuer that exceeded five percent (5%) of total investments.

PNCC has formal policies in place as of December 31, 2019 and 2018 to address investment risks. The following investment policy governs the investment of assets of PNCC:

General:

- Any restrictions set forth by applicable law governing limits, size, or quality of investments, if more stringent than those of this investment policy, will be the governing restriction.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Investments, continued

- U.S. and non-U.S. common stocks, ADRs (American Depository Receipts), convertible bonds, preferred stocks, fixed-income securities, mutual funds and short-term securities are permissible investments.

- No individual security of any issuer, other than that of the United States Government, shall constitute more than 10% (at cost) of any Investment Manager’s portfolio.

- Holdings of any issuer shall constitute no more than 5% of the outstanding securities of such issuer.

- Investments in a registered mutual fund managed by the Investment Manager are subject to prior approval by the Board of Directors.

- The following securities and transactions are not authorized: letter stock and other unregistered securities; non-negotiable securities; commodities or other commodity contracts; and short sales or margin transactions. Options and futures are restricted, except by petition to the Board of Directors for approval.

Equities:

- Consistent with the desire to maintain broad diversification, allocations to any economic or industry sector should not be excessive. Comparisons to peer group characteristics will be used to evaluate and to assure consistency of each manager’s stated strategy and style.

- Equity holdings shall be restricted to readily marketable securities of corporations that are actively traded on the major exchanges and over the counter.

- The Investment Managers shall have the discretion to invest a portion of the assets in cash reserves when they deem appropriate. However, the Investment Managers will be evaluated against their peers on the performance of the total funds under their direct management.

- Common stock and preferred stock of any institution or entity created or existing under the laws of the United States of America or any state, district, territory, or District of Columbia, or of any foreign country are permissible investments.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Investments, continued

U.S. Fixed Income:

- All fixed income securities (with the exception of U.S. Treasury or Agency securities which are unrated) shall have a Moody's, Standard & Poor's and/or a Fitch's credit quality rating of no less than "BBB".

- No more than 20% of the market value of the portfolio shall be rated less than single "A" quality, unless the Investment Manager has specific written authorization. Total portfolio quality (capitalization weighted) shall maintain an "A" minimum rating.

Cash/Cash Equivalents:

- The following investments will be permitted:
  1. U.S. Government obligations, U.S. Government agency obligations, and U.S. Government instrumentality obligations.

  2. Commercial Paper: All commercial paper issuers must maintain an "A-1" rating by Standard & Poor's Corporation and a "P-1" rating by Moody's Investor Service and be issued by corporations having total assets in excess of one billion dollars ($1,000,000,000).

  3. Certificates of Deposit: All certificate of deposit issuers must have a minimum capital of ten million dollars ($10,000,000).

  4. Repurchase Agreements: Repurchase agreements must be collateralized with either: (1) U.S. Treasury or Agency Securities with a market value of 102%, marked to market daily; or (2) money market instruments which meet the qualifications of the Statement and with a market value of 102%, marked to market daily.

  5. Money Market Funds: Money Market Funds must be registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940.

- No single issue shall have a maturity of greater than one (1) year.

- The money market funds must have an average maturity of less than one (1) year.

GASB Statement No. 40 requires entities to provide information about the credit risk associated with their investments by disclosing the credit quality ratings.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Capital Assets

Capital assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation expense is provided using the straight-line method over the estimated useful lives of the respective assets. Major improvements and betterments which increase the usefulness and efficiency or prolong the life of the asset are capitalized, while the costs of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, are charged to expense as these costs are incurred.

Depreciation expense for all capital assets is provided for on the straight-line basis over the following estimated useful lives:

	Estimated Useful Lives
Telecommunications equipment	5 - 25 years
Central office equipment	3 - 17 years
Building and general support equipment	3 - 30 years
Cable television equipment	2 - 20 years
Wireless equipment	3 - 15 years
Furniture and fixtures	5 - 10 years
Vehicles	6 years

Review of Carrying Value of Capital Assets for Impairment

PNCC reviews the carrying value of capital assets for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors. The management of PNCC does not believe that any impairment exists for the years ending December 31, 2019 and 2018.

Capitalization of Interest

Interest is capitalized by PNCC when it is determined to be material. PNCC capitalizes interest in accordance with GASB Statement No. 62. Interest is capitalized for costs incurred on funds used to construct or acquire property, plant and equipment. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset’s estimated useful life.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Other noncurrent assets

Other noncurrent assets represent refundable deposits related to PNCC's subscription of television channels and programs for its digital television services. At December 31, 2019 and 2018, refundable deposit was $60,773 and $54,300, respectively, and are reflected as other noncurrent assets in the accompanying financial statements.

Compensated Absences

Compensated absences are those absences for which employees will be paid, such as annual vacation leave and health (sick) leave. PNCC recognizes all vested vacation leave benefits accrued by its employees when earned. Employees are credited annual leave with pay of 80, 120, and 160 hours per year depending upon their length of service with PNCC. An employee cannot carry over to the following calendar year accumulated annual vacation leave in excess of 80 hours for 5 to 9 years of service, and 120 hours for employees with over 10 years of service. However, a carryover of additional annual leave may be allowed upon request and approval by the Management when it is determined to be in the interest of PNCC. At December 31, 2019 and 2018 accrued annual leave totaled $116,516 and $95,963, respectively, and is included in the Statements of Net Position as a component of accrued expenses. At December 31, 2019 and 2018, all compensated absences are current. For the years ended December 31, 2019 and 2018, annual vacation leave taken totaled $135,233 and $113,679, respectively, and is included in the Statements of Revenues, Expenses and Changes in Net Position as a component of operating expenses. No liability is recorded for non-vesting accumulating rights to receive health or sick pay benefits.

Unearned revenues

Unearned revenues consist of cash payments received from customers for which goods or services have not been earned or realized, and prepaid long distance sales in which actual traffic minutes were used and processed after the reporting period. At December 31, 2019 and 2018, unearned revenues from prepaid telecom billings were $900 and $220, respectively. Management has not determined the unearned revenue from prepaid long-distance sales.

Customer deposits

Customer deposits consist of subscriber deposits, installation fees and amounts received for related services and subscriptions to be provided in future periods. PNCC's requirement of customer deposit amount varies depending on the type of service or subscription applied for. These deposits are eligible for refunding after twelve (12) consecutive months of prompt payment history. If a deposit is held on an account at the time services are terminated, the deposit will be applied to the unpaid balance and a refund check is issued for the remainder.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Customer deposits, continued

Refunds are not automatic; the customer must request a refund. There is no interest paid on customer deposits. At December 31, 2019 and 2018, customer deposits totaled $621,054 and $669,363, respectively.

Advertising Costs

Advertising costs are expensed as incurred. For years ended December 31, 2019 and 2018, advertising costs totaled $2,050 and $2,855, respectively, and are included as a component of customer service operations expense reported in the Statements of Revenues, Expenses and Changes in Net Position.

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. PNCC determined the differences between expected and actual experience with regard to economic or demographic factors in the measurement of the total pension liability, pension contributions made subsequent to the measurement date and changes in proportion and difference between PNCC pension contributions and proportionate share of contributions qualify for reporting in this category.

Deferred Inflows of Resources

In additions 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 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. PNCC has determined the difference between projected and actual earnings on pension plan investments qualify for reporting in this category.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Pensions

Pensions are required to be recognized and disclosed using the accrual basis of accounting. PNCC recognizes a net pension liability for the defined benefit pension plan in which it participates, which represents PNCC's proportional share of excess total pension liability over the pension plan assets – actuarially calculated – of a defined benefit, cost sharing multi-employer plan. Changes in the net pension liability during the period are recorded as pension expense, or as deferred inflows of resources or deferred outflows of resources, depending on the nature of the change, in the period incurred. Those changes in net pension liability that are recorded as deferred inflows of resources or as deferred outflows of resources, that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience, are amortized over the weighted-average remaining service life of all participants in the qualified pension plan and recorded as a component of pension expense beginning with the period in which they are incurred. Projected earnings on qualified pension plan investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five-year period beginning with the period in which the difference occurred.

Retirement Plan and Benefits

PNCC 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 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. On April 30, 2013, RPPL 9-2 eliminated the mandatory service retirement after thirty years of service. After December 31, 2013, no employee shall be entitled to pension benefits until reaching the age of sixty.

In accordance with the directives of RPPL 5-7, which provides that "no person who retires after October 1, 1997, may receive benefits under the Plan unless he or she has contributed to the Plan for at least five years or has made actuarially equivalent lump sum contributions". In accordance with RPPL 9-2, members who retire after April 30, 2013 must not receive benefits greater than thirty thousand dollars per year.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Retirement Plan and Benefits, continued

Further, the amount of benefits that a member receives should not be recalculated if the member is re-employed after the member begins receiving benefits under the Fund. Additionally, a member should not receive benefits during the time the member is re-employed subsequent to retirement.

Republic of Palau Public Law (RPPL) 2-26 is the authority under which benefit provisions and contributions rates are established. Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and are deducted from the member dollar for dollar by the employer. Under the provisions of RPPL 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.

RPPL 10-8 and RPPL 10-12 was effective October 1, 2018 to increase the new rate of contribution for social security from 6% to 7%. Member contribution rates are established by RPPL 10-8 and RPPL 10-12 at seven percent (7%) of total payroll and are deducted from the member dollar for dollar by the employer. Under the provisions of RPPL 10-8 and RPPL 10-12, 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.

Actuarial Assumptions

The total pension liability was determined by an actuarial valuation of all assumptions as of September 30, 2018, for the same measurement date, using the following assumptions:

Actuarial Cost Method:	Normal costs are calculated under the entry age normal method
Amortization Method:	Level dollar, open with remaining amortization period of 30 years
Asset Valuation Method:	Market Value of Assets
Investment Income:	7.5% per year, net of investment expenses, including price inflation
Inflation:	3%

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Actuarial Assumptions, continued

Interest on Members Contribution:	5% per year
Salary Increase:	3% per year
Expenses:	$300,000 added to normal cost
Mortality:	RP 2000 Combined Mortality Table, set forward four years for all members except disability recipients, where the table is set forward ten years.
Termination of Employment:	5% for ages 20 to 39, 0% for all other ages.

Disability:

Age	Disability
25	0.21%
30	0.18%
35	0.25%
40	0.35%
45	0.50%
50	0.76%
55	1.43%
60	2.12%

Retirement Age:	100% at age 60
Form of Payment:	Single: Straight life annuity; Married: 100% joint and survivor
Marriage Assumption:	80% of the workers are assumed to be married and males are assumed to be 3 years older than their spouses. Beneficiaries are assumed to be the opposite gender of the member.
Duty vs Non-Duty Related Disability:	100% duty related
Refund of Contributions:	80% terminated vested members elect a refund of contributions

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Actuarial Assumptions, continued

Final Average Earnings:	Deferred vested members missing data for their final average earnings are assumed to have earned the average amount of current deferred vested members.
Benefits:	Retirees and beneficiaries missing data for their monthly benefit amount are assumed to receive the average benefit of current retirees or beneficiaries, respectively.

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 in evaluating the Fund's funding status on a going-concern basis, and evaluate progress made in accumulating adequate assets to pay benefits when due.

Investment Rate of Return

The long-term expected rate of return on the Fund's investment of 7.5% was determined using log-normal distribution analysis, creating a best-estimate range for each asset class.

As of September 30, 2018 (the measurement date), the arithmetic real rates of return for each major investment class are as follows:

Assets Class	Target Allocation	Expected Rate of Return
US Large Cap Equity	20%	8.70%
US Small/Mid Cap Equity	5%	9.13%
International Equity	15%	9.19%
Emerging Markets	10%	12.52%
US Aggregate Fixed Income	35%	3.82%
Global Broad Fixed Income	10%	3.40%
Global REIT	5%	8.33%

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Actuarial Assumptions, continued

Discount Rate

The discount rate used to measure the total pension liability was 4.16% at the current measurement date (September 30, 2018) and 3.62% at the prior measurement date. The discount rate was determined using the current assumed rate of return until the point where the plan fiduciary net position is negative. Using the current contribution rates, a negative position happens in 2023 for the 2018 measurement date. For years on or after 2023, a discount rate of 4.09% is used. This rate is based on the Bond Buyer General Obligation 20-year Municipal Bond Index Rate.

Sensitivity of Net Pension Liability to Changes in the Discount Rate

The following schedule presents PNCC's proportionate share of the net pension liability as of September 30, 2018, calculated using the discount rate of 4.16%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1% lower (3.16%) or 1% higher (5.16%) from the current rate.

	1% Decrease in Discount Rate 3.16%	Current Discount Rate 4.16%	1% Increase in Discount Rate 5.16%
Net Pension Liability	$ 10,019,893	$ 8,712,379	$ 7,621,967

Deferred Outflows and Inflows of Resources

At December 31, 2019 and 2018, PNCC reported total deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2019		2018	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 687,051	$ 130,099	$ 786,137	$ 166,906
Net difference between projected and actual earnings on pension plan investment	24,798	37,966	47,015	41,732
Change in assumptions	778,982	1,202,564	998,535	808,978
PNCC contributions subsequent to the measurement date	-	-	-	-
Changes in proportion and difference between PNCC contribution and proportionate shares of contributions	509,645	404,192	176,015	619,516
Total	$ 2,000,476	$ 1,774,821	$ 2,007,702	$ 1,637,132

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Deferred outflows resulting from contributions subsequent to measurement date will be recognized as reduction of the net pension liability in the following year. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions at December 31, 2019 will be recognized in pension expense as follows:

Year ending December 31,		
2020	$	50,441
2021	$	40,798
2022	$	59,470
2023	$	111,378
2024	$	464
Thereafter	$	(36,896)

Medical and Life Insurance Benefit

In April 2010, the Republic of Palau (ROP) enacted RPPL 8-14 *"The National Healthcare Financing Act"*. The law requires each resident in the Republic of Palau to have coverage for healthcare costs. The law establishes a national Medical Savings Fund and a Health Insurance System in the ROP.

In October 2010, in compliance with the requirements of RPPL 8-14, PNCC began withholding from its employees 2.5% of gross earnings each pay period, with a matching employer share (a 5% combined contribution) for remittance to the ROP Social Security Administration that administers the Medical Savings Fund and Palau Health Insurance. For the years ended December 31, 2019, 2018 and 2017, PNCC's employer's share paid to the Social Security Administration for these costs was $239,844, $213,423 and $195,442, respectively, and is included as a component of payroll burden in the Schedule of Functional Expenses.

Taxes

Based on the enactment of RPPL 1-40, PNCC is exempt from all national and state non-payroll taxes or fees. In accordance with RPPL 10-17 Telecommunications Regulatory Framework, the Bureau of Revenue and Taxation will be collecting 15% of gross revenue from any company providing telecommunications service in the Republic of Palau. This collection will be deposited into a restricted account, for payment pursuant to PNC Title 15, § 437. RPPL 10-17 has an effective date of March 1, 2018. Pursuant to RPPL 10-17, the Republic will assume the scheduled monthly payment to REA/RUS which is effective March 1, 2018.

(2) Summary of Significant Accounting Policies, continued

F. Assets, Liabilities and Net Position, continued

Taxes, continued

In accordance with RPPL 10-17, PNCC shall continue to be a Public Corporation and shall be subject to the corporate laws of the Republic. Effective January 1, 2018, PNCC is subject to 4% gross revenue taxes. “Gross revenue tax” is 4% on the total gross of all business revenues or total sums of all receipts from sources within the Republic whether in the form of cash or property derived from business, from the exploitation of capital whether in the form of receipts from the disposition of capital assets, interests, dividends, royalties, rentals, fees or otherwise, however, such receipts may be labeled without deduction or offset of any kind or nature.

Operating and Non-operating Revenues and Expenses

PNCC’s Statements of Revenues, Expenses and Changes in Net Position distinguishes between operating and non-operating revenues and expenses. Operating revenues and expenses result from exchange transactions associated directly from the operation and maintenance of telecommunication services and equipment, cellular telecommunication operations, DTV operations, and Palaunet operation services. Nonexchange revenues and expenses resulting from nonrecurring income and costs such as interest income and expense are reported as non-operating revenues.

Net Position

Net position is the residual of assets and deferred outflows of resources over liabilities and deferred inflows of resources in a statement of financial position. At December 31, 2018, PNCC’s net position is $1,034,658, meaning that total assets exceeded total liabilities. Net position consists of three components: net investment in capital assets net of related debt; restricted - expendable and nonexpendable; and unrestricted. Net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of the related debt. Net position is reported as restricted when constraints are imposed by third parties or enabling legislation. At December 31, 2019, PNCC had a negative net position totaling $149,371.

When program expenses are incurred, where there are both restricted and unrestricted resources available to finance the program, expenses are first applied to restricted resources before using unrestricted resources.

(3) Deposits and Investments Risk

Deposits

GASB Statement No. 3 requires government entities to categorize deposits to give an indication of the level of credit risk assumed by the entity at year-end based on the following categories:

Category 1 - deposits that are federally insured or collateralized with securities held by PNCC or by its agent in PNCC'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 PNCC'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 PNCC's name and non-collateralized deposits.

At December 31, 2019 and 2018, the carrying amount of PNCC's cash balances was $296,738 and $787,197, respectively. The corresponding bank balances as of December 31, 2019 and 2018 were $532,937 and $908,446, respectively. From these deposits, $412,299 and $691,226, respectively, were subject to coverage by the Federal Deposit Insurance Corporation (FDIC) with the remaining balance exceeding insurable limits. PNCC does not require collateralization of bank accounts, and therefore, deposits in excess of FDIC insurance coverage are uncollateralized.

Investments

Governmental accounting standards require that the investments reported as of the balance sheet date be categorized according to level of credit risk. The level of credit risk is defined as follows:

Category 1 - insured and registered for which the securities are held by PNCC or by its agent in PNCC's name;

Category 2 - uninsured and registered for which the securities are held by the broker's or dealer's trust department or agent in PNCC's name; and

Category 3 - uninsured and unregistered for which the securities are held by the broker or dealer or by its trust department or agent but not in PNCC's name.

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments

Investment and related investment earnings are reported at fair value using quoted market prices. Fair value is the price that would be received to sell an asset paid to transfer a liability (i.e. the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined. The PNCC categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles.

The hierarchy is based on the valuation inputs used to measure the fair value of the assets. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant observable inputs; Level 3 inputs are significant unobservable inputs. PNCC has the following fair value measurements:

		Fair Value Measurement Using		
Investments by fair value level	12/31/2019	Level 1	Level 2	Level 3
Fixed income securities:				
Corporate Bonds	$ 256,129	$ -	$ 256,129	$ -
U.S. Treasury	307,765	307,765	-	-
Federal Agencies	70,442	-	70,442	-
Equity securities:				
U.S. Equities	1,084,607	1,084,607	-	-
Non-U.S. Equities	225,014	225,014	-	-
Total investments by fair value level	$ 1,943,957	$ 1,617,386	$ 326,571	$ -
Investments measured at net asset value (NAV):				
Exchanged-traded funds	$ 36,315			
Investments measured at cost based measure:				
Money market funds	$ 242,478			
Total investments	$ 2,222,750			

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

		Fair Value Measurement Using		
Investments by fair value level	12/31/2018	Level 1	Level 2	Level 3
Fixed income securities:				
Corporate Bonds	$ 165,033	$ -	$ 165,033	$ -
U.S. Treasury	167,825	167,825	-	-
Federal Agencies	62,056	-	62,056	-
Equity securities:				
U.S. Equities	407,951	407,951	-	-
Non-U.S. Equities	189,619	189,619	-	-
Total investments by fair value level	$ 992,484	$ 765,395	$ 227,089	$ -
Investments measured at net asset value (NAV):				
Exchanged-traded funds	$ 15,699			
Investments measured at cost based measure:				
Money market funds	$ 25,256			
Total investments	$ 1,033,439			

Restricted Cash and Cash Equivalents

PNCC's restricted cash and cash equivalents must comply with Section 22 of the Pledge of Assets and Agreement to Create Trust (Rural Electrification Administration "REA" Loan Agreement), wherein PNCC is required to maintain a funded reserve in such amount that the balance of the funds covered by the First Note shall at no time be less than the outstanding principal and unpaid interest of the First Note. The reserve shall be maintained in accordance with a plan submitted to and approved in writing by the Administrator of REA (now the Rural Utilities Service or "RUS").

The balance of the reserve shall comply with the abovementioned Section 22 no later than one year from the date of this first advance of funds covered by the First Note. Thereafter, PNCC must maintain such compliance continuously. Assets held in the reserve must be held by a bank or institution or other depository whose funds are insured by the Federal government and shall consist of (a) Federal government securities held in PNCC's name; (b) other securities by an institution whose senior unsecured debt obligations are rated in any of the top three categories by a nationally recognized rating organization; or (c) cash. All of PNCC's restricted cash and cash equivalents with a market value of $250,113 and $3,818,176 as of December 31, 2019 and 2018, respectively, were deposited in FDIC insured financial institutions.

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

On December 31, 2015, PNCC's Emergency Reserve Fund (the Fund) has been invested with Raymond James as the new investment consultant, which holds the investments in PNCC's name. The PNCC's Board of Directors is responsible for directing and monitoring the investment management of the Fund. The Board of Directors currently has no specific projected contribution or distribution requirements for the Fund. The Board of Directors shall, from time to time, designate accumulated reserves to be contributed to and managed under the auspices of the Fund. The Fund will be invested in such a way that adequate funds can be made available within a short period of time, should a distribution need arise.

At December 31, 2019 and 2018, PNCC's investment portfolios at fair value are as follows:

	2019			2018		
	Allocation		Market	Allocation		Market
	Actual	Policy	Value	Actual	Policy	Value
Fixed income securities:						
Corporate Bonds			$ 256,129			$ 165,033
U.S. Treasury			307,765			167,825
Federal Agencies			70,442			62,056
Total fixed income	29%	36%	634,336	38%	36%	394,914
Equity securities:						
U.S. Equities	49%	43%	1,084,607	40%	43%	407,951
Non-U.S. Equities	10%	19%	225,014	18%	19%	189,619
Total equity securities			1,309,621			597,570
Exchange-traded funds	1%	1%	36,315	2%	1%	15,699
Cash and cash equivalents	11%	1%	242,478	2%	1%	25,256
Total investments	100%	100%	$ 2,222,750	100%	100%	$ 1,033,439

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

At December 31, 2019 and 2018, PNCC's fixed income securities had the following ratings and maturities:

As of December 31, 2019

Investment type	Fair Value	Investment maturities (in years): Less than 1	1-5	6-10	More than 10	Rating: Moody	Standard & Poor
Corporate bonds	$ 20,025	$ -	$ -	$ 20,025	$ -	Baa2	BBB
Corporate bonds	19,668	-	-	19,668	-	A3	A-
Corporate bonds	19,280	-	-	19,280	-	A2	A
Corporate bonds	20,207	-	-	20,207	-	A2	A-
Corporate bonds	19,928	-	-	19,928	-	Baa3	BBB
Corporate bonds	19,664	-	-	19,664	-	Baa2	BBB
Corporate bonds	19,528	-	-	19,528	-	A3	A-
Corporate bonds	19,148	-	-	19,148	-	A3	A-
Corporate bonds	19,162	-	-	19,162	-	A3	BBB+
Corporate bonds	20,000	-	-	20,000	-	A2	A-
Corporate bonds	19,090	-	-	19,090	-	Baa2	BBB
Corporate bonds	19,931	-	-	-	19,931	Baa1	A-
Corporate bonds	20,498	-	-	20,498	-	A2	A-
Federal agencies	51,149	-	51,149	-	-	Aaa	AA+
Federal agencies	19,293	-	19,293	-	-	Aaa	AA+
U.S. Treasury	39,102	-	-	-	39,102	Aaa	No rating
U.S. Treasury	30,410	-	-	-	30,410	Aaa	No rating
U.S. Treasury	32,312	-	-	32,312	-	Aaa	No rating
U.S. Treasury	33,246	-	33,246	-	-	Aaa	No rating
U.S. Treasury	25,681	-	-	25,681	-	Aaa	No rating
U.S. Treasury	31,871	-	-	31,871	-	Aaa	No rating
U.S. Treasury	18,539	-	-	18,539	-	Aaa	No rating
U.S. Treasury	25,162	-	25,162	-	-	Aaa	No rating
U.S. Treasury	32,444	-	-	32,444	-	Aaa	No rating
U.S. Treasury	38,998	-	-	38,998	-	Aaa	No rating
Total	$ 634,336	$ -	$ 128,850	$ 416,043	$ 89,443		

(3) Deposits and Investments Risk, continued

Fair Value Measurement of the Investments, continued

As of December 31, 2018

		Investment maturities (in years)				Rating	
Investment type	Fair Value	Less than 1	1-5	6-10	More than 10	Moody	Standard & Poor
Corporate bonds	$ 11,919	$ -	$ -	$ 11,919	$ -	Baa2	BBB
Corporate bonds	12,838	-	-	12,838	-	Baa1	BBB
Corporate bonds	12,055	-	-	12,055	-	A2	A
Corporate bonds	12,510	-	-	12,510	-	A3	A-
Corporate bonds	11,390	-	-	11,390	-	Baa3	BBB
Corporate bonds	11,731	-	-	11,731	-	Baa2	BBB
Corporate bonds	11,720	-	-	11,720	-	A3	BBB+
Corporate bonds	9,561	-	-	-	9,561	Baa1	BBB+
Corporate bonds	11,288	-	-	11,288	-	A3	BBB+
Corporate bonds	12,380	-	-	12,380	-	A2	A-
Corporate bonds	11,953	-	-	11,953	-	A3	A1
Corporate bonds	11,781	-	-	11,781	-	A3	A-
Corporate bonds	11,870	-	-	-	11,870	Baa1	A
Corporate bonds	12,037	-	-	-	12,037	A2	A-
Federal agencies	33,171	-	33,171	-	-	Aaa	AA+
Federal agencies	28,885	-	28,885	-	-	Aaa	AA+
U.S. Treasury	24,962	-	-	-	24,962	Aaa	No rating
U.S. Treasury	7,965	-	-	-	7,965	Aaa	No rating
U.S. Treasury	12,184	-	-	-	12,184	Aaa	No rating
U.S. Treasury	24,679	-	-	-	24,679	Aaa	No rating
U.S. Treasury	16,625	-	-	16,625	-	Aaa	No rating
U.S. Treasury	28,349	-	28,349	-	-	Aaa	No rating
U.S. Treasury	20,391	-	-	20,391	-	Aaa	No rating
U.S. Treasury	15,995	-	-	15,995	-	Aaa	No rating
U.S. Treasury	16,675	-	16,675	-	-	Aaa	No rating
Total	$ 394,914	$ -	$ 107,080	$ 184,576	$ 103,258		

(4) Capital Assets

PNCC's capital assets for the years ended December 31, 2019 and 2018 are summarized below as follows:

	Balance at December 31, 2018	Additions	Transfers/ Retirements	Balance at December 31, 2019
Regulated capital assets				
Cables and transmission lines	$ 27,671,780	$ 337,514	$ -	$ 28,009,294
Transmission equipment	9,749,475	-	-	9,749,475
Buildings	9,604,850	400,209	-	10,005,059
Central office equipment	3,102,624	401,493	-	3,504,117
General support equipment	2,374,435	80,401	-	2,454,836
Customer premises wiring and equipment	1,454,858	1,160	-	1,456,018
Vehicles	700,253	122,800	-	823,053
Furniture and fixtures	34,013	-	-	34,013
Regulated capital assets, at cost	54,692,288	1,343,577	-	56,035,865
Accumulated depreciation	(43,474,514)	(1,448,792)	-	(44,923,306)
Regulated capital assets, at net book value	11,217,774	(105,215)	-	11,112,559
Non-regulated capital assets				
Cable television	3,294,326	232,170	-	3,526,496
Cellular	13,787,335	85,734	-	13,873,069
Palaunet	1,984,071	162,769	-	2,146,840
Non-regulated capital assets, at cost	19,065,732	480,673	-	19,546,405
Accumulated depreciation	(9,728,745)	(1,220,390)	-	(10,949,135)
Non-regulated capital assets, at net book value	9,336,987	(739,717)	-	8,597,270
Construction in progress	1,340,744	3,041,510	(1,824,251)	2,558,003
Total	$ 21,895,505	$ 2,196,578	$ (1,824,251)	$ 22,267,832

(4) Capital Assets, continued

	Balance at December 31, 2017	Additions	Transfers/ Retirements	Balance at December 31, 2018
Regulated capital assets				
Cables and transmission lines	$ 27,386,050	$ -	$ 285,730	$ 27,671,780
Transmission equipment	9,743,265	-	6,210	9,749,475
Buildings	9,189,871	-	414,979	9,604,850
Central office equipment	1,015,327	-	2,087,297	3,102,624
General support equipment	2,330,283	-	44,152	2,374,435
Customer premises wiring and equipment	1,434,385	-	20,473	1,454,858
Vehicles	654,772	-	45,481	700,253
Furniture and fixtures	34,013	-	-	34,013
Regulated capital assets, at cost	51,787,966	-	2,904,322	54,692,288
Accumulated depreciation	(42,207,974)	(1,266,540)	-	(43,474,514)
Regulated capital assets, at net book value	9,579,992	(1,266,540)	2,904,322	11,217,774
Non-regulated capital assets				
Cable television	3,209,034	-	85,292	3,294,326
Cellular	10,698,925	-	3,088,410	13,787,335
Palaunet	1,432,160	-	551,911	1,984,071
Non-regulated capital assets, at cost	15,340,119	-	3,725,613	19,065,732
Accumulated depreciation	(8,777,380)	(951,365)	-	(9,728,745)
Non-regulated capital assets, at net book value	6,562,739	(951,365)	3,725,613	9,336,987
Construction in progress	4,751,962	3,218,717	(6,629,935)	1,340,744
Total	$ 20,894,693	$ 1,000,812	$ -	$ 21,895,505

Depreciation expense for the years ended December 31, 2019 and 2018 was $2,669,183 and $2,217,905, respectively, and is reported in the Statements of Revenues, Expenses and Changes in Net Position.

(5) Related Party Transactions

In the ordinary course of business, PNCC provides local and long distance telephone services, cellular telecommunications services and equipment, digital cable television services, and internet services, to the National government of the Republic of Palau and its component units. These services are provided at the same service rates and delinquent fees charged to all third-party customers. As of December 31, 2019 and 2018, amounts due from the Republic of Palau and its component units totaled $729,230 and $687,464, respectively.

(6) Long-term debt

Long-term debt as of December 31, 2019 and 2018 are summarized below:

	2019	2018
Mortgage note payable to Rural Utilities Services (RUS) at 4.59% per annum, payable in monthly installments of $192,181, and due October 2029. The note is collateralized by substantially all of PNCC's assets and a pledge of its revenues.	$ 17,371,069	$ 18,836,699
Less current portion	1,531,736	1,463,147
Long-term debt, net of current portion	$ 15,839,333	$ 17,373,552

RUS Mortgage Note

The original RUS note of $39,143,000 approved in 1992 was unconditionally guaranteed by ROP and stipulates that ROP will make debt service payments to RUS in the event of default. On April 8, 2009, RUS approved the request of PNCC to rescind the remaining balance of $395,047 of the mortgage note which had not been advanced. The RUS Mortgage and Security Agreement sets out certain financial ratios that must be met before a dividend can be declared. If these ratios are not met, dividends may only be declared with a written approval of RUS.

The management of PNCC believes it is in compliance with the RUS mortgage loan covenants at December 31, 2019 and 2018.

(6) Long-term debt, continued

Future minimum principal and interest payments for the RUS mortgage are as follows:

Years ending December 31,	Principal	Interest	Total
2020	$ 1,531,736	$ 774,440	$ 2,306,176
2021	1,603,537	702,635	2,306,172
2022	1,678,708	627,464	2,306,172
2023	1,757,402	548,770	2,306,172
2024	1,850,906	455,266	2,306,172
2025-2029	8,948,780	916,511	9,865,291
	$ 17,371,069	$ 4,025,086	$ 21,396,155

At December 31, 2019 and 2018, the changes in the long-term liabilities are as follows:

	Balance January 1, 2019	Additions	Reductions	Balance December 31, 2019	Current	Noncurrent
Rural Utilities Services	$ 18,836,699	$ -	$ 1,465,630	$ 17,371,069	$ 1,531,736	$ 15,839,333
Net Pension Liability	8,539,634	172,745	-	8,712,379	-	8,712,379
	$ 27,376,333	$ 172,745	$ 1,465,630	$ 26,083,448	$ 1,531,736	$ 24,551,712

	Balance January 1, 2018	Additions	Reductions	Balance December 31, 2018	Current	Noncurrent
Rural Utilities Services	$ 20,228,471	$ -	$ 1,391,772	$ 18,836,699	$ 1,463,147	$ 17,373,552
Chunghwa Telecom Company, net of discount	30,237	-	30,237	-	-	-
National Information Solutions Cooperative, net of discount	15,045	-	15,045	-	-	-
Net Pension Liability	7,980,506	559,128	-	8,539,634	-	8,539,634
	$ 28,254,259	$ 559,128	$ 1,437,054	$ 27,376,333	$ 1,463,147	$ 25,913,186

Interest expense paid in 2019 and 2018 amounted to $840,515 and $914,311, respectively.

(7) Commitments and Contingencies

Commitments

PNCC entered into an equipment purchase agreement for the installation of equipment and upgrade of Fourth Generation (4G) and (3G) Network (NodeB) plus LTE license for multiple modes of additional 1800MHz – 2100Mhz. Under this agreement, PNCC agreed to purchase the equipment and installations of accessories for the required upgrade total of $374,540. The contract calls for a down payments of 50% or $187,270 on or before December 31, 2019.

The remaining balance is to be paid in six months at $31,212 per month from January 1, 2020 to July 30, 2020. Interest will be applied to the unpaid balance at the rate of 2% per annum. As of December 31, 2019, PNCC had paid $187,270 to the vendor under this contract. Since the equipment installation upgrade is still in progress, the payment has been recognized as prepaids to the contractor. At December 31, 2019, future payments under this contract were $187,270.

The Company entered in a five-year lease agreement effective May 24, 2019 and expiring May 23, 2024. The Company was required to make an advance payment of $200,000, then commencing on the third year, the Company is required to make payments of $12,000 per month payable in advance by no later than the 10th day of each month.

The Company has a lease on a land easement agreement effective of May 21, 2019 and expiring May 20, 2024. The agreement calls for monthly payments of $182. Rent under this lease is recognized at $2,220 per year.

The Company has a lease on a land easement agreement effective of March 1, 2019 and expiring March 1, 2024. The agreement calls for monthly payments of $700. Rent under this lease is recognized at $8,400 per year.

The Company has a lease on a land easement agreement effective of March 1, 2019 and expiring March 1, 2024. The agreement calls for monthly payments of $700. Rent under this lease is recognized at $8,400 per year.

The Company has a lease on a land easement agreement effective of August 8, 2019 and expiring August 7, 2027. The agreement calls for monthly payments of $1,000. Rent under this lease is recognized at $12,000 per year.

The Company entered into a five-year network equipment maintenance agreement effective March 1, 2019 and expiring March 1, 2024. The agreement calls for annual commitments of $2,980.

The Company entered into a three-year broadcast connectivity agreement effective October 14, 2019 and expiring October 14, 2022. The agreement calls for quarterly payments of $540. The service fee is recognized at $2,160 per year.

(7) Commitments and Contingencies, continued

Commitments, continued

The Company entered into a three-year broadcast connectivity agreement effective August 22, 2019 and expiring August 22, 2022. The agreement calls for monthly payments of $287. The service fee is recognized at $3,444 per year.

The Company entered into a three-year broadcast connectivity agreement effective August 16, 2019 and expiring August 15, 2022. The agreement calls for monthly payments of $287. The service fee is recognized at $3,444 per year.

The Company entered into a three-year broadcast connectivity agreement effective December 12, 2019 and expiring December 11, 2022. The agreement calls for monthly payments of $287. The service fee is recognized at $3,444 per year.

The Company entered into a broadcaster licensing agreement effective September 1, 2019 and expiring June 30, 2022. The agreement calls for an annual payment of $500.

The Company entered into a security service agreement effective April 1, 2019 and expiring May 31, 2021. The agreement calls for monthly payments of $5,425. The service fee is recognized at $65,100 per year.

Future minimum lease and services payments were as follows:

2020	$ 433,000
2021	208,000
2022	178,000
2023	168,000
2024	75,000
Thereafter	32,000
	$ 1,094,000

Contingencies

Risk Management

PNCC 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. PNCC has elected to purchase commercial insurance coverage for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the past three years. PNCC is self-insured for buried cables and customer premises wirings.

(7) Commitments and Contingencies, continued

Risk Management, continued

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 within the last three years.

Claims and Litigation

In the normal course of business, PNCC is involved in various claims and litigation or has received several claims that are pending review or are expected to go to litigation. Management believes that any liability it may incur would not have a material adverse effect on its financial condition or its results of operations.

Health (Sick) Leave

PNCC's policy is to record expenditures for health (sick) leave when the leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated sick leave at December 31, 2019 and 2018 was $1,216,774 and $1,197,315 respectively.

(8) 401(k) Profit Sharing Plan

The Company has adopted a retirement plan (a "401(k) plan) which covers substantially all employees meeting certain eligibility requirements. Participants may contribute a portion of their pretax income into a retirement fund. At the Company's discretion, participants' contributions are matched up to 5% by the Company. For the year ended December 31, 2019, the Company's discretionary profit-sharing contribution was $33,152. The contributions are recorded as a component of plant specific operations expenses reported in the Statement of Revenues, Expenses and Changes in net position.

(9) Fair Value of Financial Instruments

PNCC's financial instruments are cash and cash equivalents, accounts receivable, other assets, investments, accounts payable, payable to carriers, accrued expenses, unearned revenue, customer deposits, notes payable, and long-term debt. The recorded values of these instruments for cash and cash equivalents, accounts receivable, other assets, investments and accounts payable, payable to carriers, accrued expenses, unearned revenues, and the current portion of long-term debt approximate their fair values based on their short-term nature. The recorded value of customer deposits approximates its fair value as the amount payable on demand at the reporting date. The recorded value of RUS note payable approximates its fair value, as interest approximates market rates.

(10) Reclassifications

Certain amounts presented in 2018 have been reclassified to conform to the 2019 financial statement presentation. These reclassifications did not affect the change in net position or the total net position.

(11) Subsequent Event

PNCC has evaluated subsequent events through May 21, 2020, the date the financial statements were available to be issued. There were no such events requiring disclosure.

In December 2019, an outbreak of a novel strain of coronavirus (COVID-19) originated in Wuhan, China and has since spread to other countries, including the U.S and throughout Micronesia. On March 11, 2020, the World Health Organization characterized COVID-19 as a pandemic. In addition, multiple jurisdictions in the U.S. have declared a state of emergency. It is anticipated that these impacts will continue for some time. Future potential impacts may include disruptions on the Company’s employees’ ability to work or the customers’ ability to pay monthly services. Changes to the operating environment may increase operating costs. Additional impacts may include the ability of customers to continue making payments as a result of job loss or other pandemic related issues. The future effects of these issues are unknown.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

SUPLEMENTARY SCHEDULES

Year Ended December 31, 2019

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Supplementary Information
Schedule of Budget vs Actual (GAAP Basis)
For the Year Ended December 31, 2019

	Budget				Variance
	Original	Revisions	Final	Actual	Favorable (Unfavorable)
Operating revenues:					
Cellular	$ 9,788,067	$ -	$ 9,788,067	$ 7,371,235	$ (2,416,832)
Palaunet	4,373,294	-	4,373,294	3,094,399	(1,278,895)
Digital television	1,701,916	-	1,701,916	1,448,376	(253,540)
Local	1,418,784	-	1,418,784	1,507,815	89,031
Long distance	199,105	-	199,105	186,416	(12,689)
Miscellaneous	136,341	-	136,341	247,797	111,456
Provision for doubtful accounts	-	-	-	(121,536)	(121,536)
Total operating revenues	17,617,507	-	17,617,507	13,734,502	(3,883,005)
Operating expenses:					
Plant specific operations	6,073,911	-	6,073,911	6,290,280	(216,369)
Depreciation	2,328,761	-	2,328,761	2,669,183	(340,422)
Customer service operations	1,599,574	-	1,599,574	1,674,426	(74,852)
Corporate operations	1,541,947	-	1,541,947	2,853,615	(1,311,668)
Plant non-specific operations	526,653	-	526,653	610,465	(83,812)
Total operating expenses	12,070,846	-	12,070,846	14,097,969	(2,027,123)
Operating income	5,546,661	-	5,546,661	(363,467)	(5,910,128)
Non-operating income (expenses):					
Interest expense	(1,195,616)	-	(1,195,616)	(840,515)	355,101
Unrealized gain on investment	-	-	-	59,488	59,488
Realized gain on investments	-	-	-	49,370	49,370
Non-operating income	(16,931)	-	(16,931)	-	16,931
Income on investment	-	-	-	9,899	9,899
Gain (loss) on disposal of equipment	(89,288)	-	(89,288)	-	89,288
Other expense	(279)	-	(279)	(98,804)	(98,525)
Total nonoperating expenses, net	(1,302,114)	-	(1,302,114)	(820,562)	481,552
Change in net position	$ 4,244,547	$ -	$ 4,244,547	$ (1,184,029)	$ (5,428,576)

See Accompanying Independent Auditor's Report.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Supplementary Schedule of Functional Expenses
For The Year Ended December 31, 2019
(With Comparative Totals for 2018)

	Plant Specific					Plant	Total	
	Depreciation	Operations	Corporate	Customer Relations	Total	non-specific operations	Operating Expenses 2019	2018
Outside services	$ -	$ 4,103,061	$ 202,540	$ 829,404	$ 5,135,005	$ 1,012	$ 5,136,017	$ 5,609,530
Salaries and wages	-	1,059,237	961,009	605,284	2,625,530	376,360	3,001,890	956,828
Depreciation	2,669,183	-	-	-	2,669,183	-	2,669,183	2,217,905
Others	-	48,149	659,638	49,036	756,823	28,050	784,873	1,477,545
Utilities	-	657,690	-	-	657,690	-	657,690	592,988
Payroll burden	-	130,754	131,515	130,948	393,217	152,472	545,689	263,528
Gross revenue taxes	-	-	493,386	-	493,386	-	493,386	582,068
Training	-	11,171	191,187	36,158	238,516	13,540	252,056	197,048
Materials and supplies	-	174,209	2,268	864	177,341	30,348	207,689	444,046
Bad debts	-	-	-	-	-	-	-	142,214
Insurance	-	-	86,924	-	86,924	-	86,924	62,681
Fuel	-	61,048	9,389	7,590	78,027	2,829	80,856	27,279
Legal fees	-	-	57,641	-	57,641	-	57,641	46,401
Office supplies	-	965	34,751	12,128	47,844	4,777	52,621	38,177
Clearance	-	40,758	-	-	40,758	1,077	41,835	216,587
Postage	-	-	20,413	-	20,413	-	20,413	29,027
Board fees	-	-	9,207	-	9,207	-	9,207	6,304
Rent	-	-	-	-	-	-	-	30,000
Allocation	-	3,238	(6,253)	3,014	(1)	-	(1)	(36,236)
	$ 2,669,183	$ 6,290,280	$ 2,853,615	$ 1,674,426	$ 13,487,504	$ 610,465	$ 14,097,969	$ 12,903,920

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Supplementary Schedule of Functional Expenses by Division
For The Year Ended December 31, 2019
(With Comparative Totals for 2018)

	Depreciation	Operations	Corporate	Customer Relations	Total Operating Expenses By Division 2019	Total Operating Expenses By Division 2018
Telephony:						
Outside services	$ -	$ 2,339,835	$ 202,540	$ 45,703	$ 2,588,078	$ 2,199,507
Salaries and wages	-	394,388	961,009	596,587	1,951,984	688,977
Depreciation	1,448,792	-	-	-	1,448,792	1,266,541
Others	-	11,210	659,638	6,902	677,750	1,072,537
Utilities	-	657,690	-	-	657,690	592,988
Business gross revenue tax	-	-	493,386	-	493,386	582,068
Payroll burden	-	69,175	131,515	130,746	331,436	20,808
Training	-	4,950	191,187	36,158	232,295	177,963
Materials and supplies	-	125,256	2,268	864	128,388	312,982
Bad debts	-	-	-	-	-	142,214
Insurance	-	-	86,924	-	86,924	62,681
Fuel	-	53,294	9,389	7,590	70,273	6,280
Legal fees	-	-	57,641	-	57,641	46,401
Office supplies		180	34,751	12,017	46,948	-
Clearance	-	32,484	-	-	32,484	188,882
Postage	-	-	20,413	-	20,413	-
Board fees	-	-	9,207	-	9,207	6,304
Rent	-	-	-	-	-	30,000
Allocation	-	-	(6,253)	(2,846)	(9,099)	(474,455)
	1,448,792	3,688,462	2,853,615	833,721	8,824,590	6,922,678
Cellular:						
Depreciation	880,153	-	-	-	880,153	686,157
Salaries and wages	-	86,793	-	-	86,793	-
Outside services	-	86,518	-	-	86,518	111,679
Others	-	28,992	-	42,000	70,992	62,831
Materials and supplies	-	4,577	-	-	4,577	1,428
Training	-	1,327	-	-	1,327	6,296
Payroll burden	-	402	-	-	402	-
Clearance	-	-	-	-	-	338
Allocation	-	-	-	4,964	4,964	115,058
	880,153	208,609	-	46,964	1,135,726	983,787
Palaunet:						
Outside services	-	1,676,700	-	-	1,676,700	2,480,828
Depreciation	161,713		-	-	161,713	102,566
Salaries and wages	-	157,527	-	-	157,527	-
Payroll burden	-	54,463	-	-	54,463	-
Training	-	4,814	-	-	4,814	-
Others	-	2,421	-	-	2,421	138,085
Materials and supplies	-	2,003	-	-	2,003	(957)
Clearance	-	1,359	-	-	1,359	-
Allocation	-	3,238	-	-	3,238	(1,010)
	161,713	1,902,525	-	-	2,064,238	2,719,512
Digital TV:						
Outside services	-	8	-	783,701	783,709	817,459
Salaries and wages	-	420,529	-	8,697	429,226	-
Depreciation	178,525	-	-	-	178,525	162,641
Materials and supplies	-	42,373	-	-	42,373	163,967
Fuel	-	7,754	-	-	7,754	6,359
Payroll burden	-	6,714	-	202	6,916	1,075
Clearance	-	6,915	-	-	6,915	23,024
Others	-	5,526	-	134	5,660	169,465
Office supplies	-	785	-	111	896	-
Training	-	80	-	-	80	7,979
Allocation	-	-	-	896	896	181,957
	178,525	490,684	-	793,741	1,462,950	1,533,926
	$ 2,669,183	$ 6,290,280	$ 2,853,615	$ 1,674,426	$ 13,487,504	$ 12,159,903

See Accompanying Independent Auditor's Report.

Palau National Communications Corporation
(A Component Unit of the Republic of Palau)

Required Supplemental Information (Unaudited)
Schedule of Proportionate Share of the Net Pension Liability
Last 10 Fiscal Years*

	2018	2017	2016	2015	2014
Civil Service Pension Trust Fund (Plan) total net pension liability	$ 250,868,784	$ 259,395,005	$ 249,453,960	$ 215,546,176	$ 204,281,232
PNCC proportionate share of the net pension liability	$ 8,712,379	$ 8,539,634	$ 7,980,506	$ 7,015,927	$ 7,163,121
PNCC proportionate share of the net pension liability	3.473%	3.292%	3.199%	3.255%	3.506%
PNCC's covered-employee payroll**	$ 2,037,433	$ 1,907,250	$ 1,694,398	$ 1,578,557	$ 1,648,460
PNCC's proportionate share of the net pension liability as a percentage of its covered employee payroll	427.62%	447.75%	470.99%	444.45%	434.53%
Plan Fiduciary net position as a pencentage of the total pension liability	10.24%	10.18%	10.55%	11.54%	14.01%

* This data is presented for those years for which information is available.
** Covered-employee payroll data from the actuarial valuation date with a one-year lag.

See Accompanying Independent Auditors' Report.

Palau National Communications Corporation
(A Component Unit of the Republic of Palau)

Required Supplemental Information (Unaudited)
Schedule of Pension Contributions
Last 10 Fiscal Years*

	2018	2017	2016	2015	2014
Actuarially determined contribution	$ 601,245	$ 565,547	$ 461,242	$ 354,787	$ 372,513
Contribution in relation to the actuarially determined contribution	122,246	114,435	100,271	94,083	97,071
Contribution (excess) deficiency	$ 478,999	$ 451,112	$ 360,971	$ 260,704	$ 275,442
PNCC's covered-employee payroll**	$ 2,037,433	$ 1,907,250	$ 1,694,398	$ 1,578,557	$ 1,648,460
PNCC's proportionate share of the net pension liability	6.00%	6.00%	5.92%	5.96%	5.89%

* This data is presented for those years for which information is available.
** Covered-employee payroll data from the actuarial valuation date with a one-year lag.

See Accompanying Independent Auditors' Report.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND ON COMPLIANCE

Year Ended December 31, 2019

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Palau National Communications Corporation

We have audited, in accordance with the 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, the financial statements of the Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, as of and for the year ended December 31, 2019, and the related notes to the financial statements, which collectively comprise PNCC's basic financial statements and have issued our report thereon dated June 2, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered PNCC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PNCC's internal control. Accordingly, we do not express an opinion on the effectiveness of PNCC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses and consider findings 2019-01 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider Finding 2019-02 described in the accompany schedule of findings and responses to be significant deficiencies.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether PNCC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

PNCC's Response to Findings

PNCC's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. PNCC's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BURGER COMER MAGLIARI
Koror, Republic of Palau
June 2, 2020

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Schedule of Findings and Responses
Year Ended December 31, 2019

SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? X yes ___ no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? X yes ___ no
- Noncompliance material to financial statements? ___ yes X no

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

CURRENT YEAR FINDINGS:

Finding No.: 2019-01
Area : Customer Deposits

Criteria:

PNCC's customer deposits consist of subscriber deposits, installation fees and amounts received for related services and subscriptions to be provided in future periods. PNCC's policy requirement of customer deposit amount varies depending on the type of service or subscription applied for. Deposits are eligible for refunding after twelve (12) consecutive months of prompt payment history. If a deposit is held on an account at the time services are terminated, the deposit will be applied to the unpaid balance and refund check is issued for the remainder. Refunds are not automatic; the customer must request a refund.

Condition:

The year-end deposit listings totaled $621,054 representing numerous inactive customer deposits over 10 years old, and whose deposits can be applied to the customer's unpaid balance. As noted in prior year findings, accounts receivable that are potential for write-off approximate $2.5 million and the corresponding customer deposit was not applied to reduce the write-off.

Cause:

Because there is no formalized accounts receivable collection policy, internal control policies have not been implemented to determine when and how customer deposits should be applied to past-due or terminated account balances. Additionally, some customers no longer pursue request for a deposit refund because of the time and effort involved.

Effect:

The propriety of some customer deposits may not be a liability and might be a recovery of previously provided allowance for uncollectibility of accounts receivable outstanding for over 12 years.

Prior Year Status:

The lack of internal control and a formalized accounts receivable collection policy over customer deposits was cited as finding in the audit in 2013 through 2018 audits of PNCC.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2019-01, continued
Area : Customer Deposits

Recommendation:

Management should review and revise its procedures over maintaining, accounting for and application of customer deposits in relation to accounts receivable and the allowance for doubtful accounts. Management review of this area can result in a reduction in the number and amount of delinquent and potential uncollectible accounts receivable. An in-house study should be conducted to determine to what extent, if any, deposits should be applied to the receivable allowance account. In January 2017, PNCC implemented the formal procedure by effective reviewing the customer's deposit account on a monthly basis in relation to account receivable and the allowance for doubtful accounts balances. As of December 31, 2019, the implementation of procedures is incomplete.

Auditee Response and Corrective Action Plan:

PNCC agrees with this finding and after thorough reconciliation, customer deposits will be applied to outstanding customer account balances in accordance with PNCC's Accounts Receivable Write-off policy. The CFO will ensure procedures are adhered to. The Company will keep observing the effectiveness of implemented procedures.

This is a finding is a repeat and unresolved.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2019-02
Area : Unearned revenues from prepaid long distance sales and prepaid airtime

Criteria:

Written policies and procedures should exist to reconcile actual long-distance minutes billed by international carrier amounts to the general ledger control accounts on a monthly and year-end basis. Recognition of revenues from international prepaid calling cards/airtime should only be recognized when actual minutes are used.

Condition:

Periodic reconciliations and evaluation are not performed for long distance revenue or for prepaid international calling card and prepaid airtime based on actual minutes used. When customers do not use all of the time value of international prepaid calling card, the unused portion of the dollar value of the prepaid calling card (commonly known as breakage), may be estimated based on historical trends. At December 31, 2019, deferred revenues from unused long-distance prepaid card and wireless airtime were not calculated and recognized.

Cause:

There is a deficiency in the network system for determining unused minutes representing unearned revenue from prepaid long-distance card and prepaid airtime wireless. There also a lack of internal control policies and procedures to ensure that long distance revenues are reconciled with outbound minutes billed by international carriers on a periodic basis.

Effect:

Prepaid long-distance card sales and prepaid wireless card sales may be overstated by deferred revenues from unused minutes.

Prior Year Status:

The lack of reconciliation of actual minutes billed by international carriers and actual minutes used for prepaid airtime to revenue control totals was reported as finding in the audit of PNCC for the years 2007 through 2018.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2019-02, continued
Area : Unearned revenues from prepaid long distance sales and prepaid airtime

Recommendation:

PNCC should document and adhere to existing policies and procedures over the reconciliation of long-distance minutes and international prepaid calling card/airtime. Minutes billed by international carriers should be reconciled to long distance revenue control on a periodic basis. Recognition of revenues from international prepaid calling cards/airtime should only be recognized when actual minutes are used. Unearned revenues should be recognized from unused prepared debusch and airtime.

Auditee Response and Corrective Action Plan:

PNCC agrees with this finding. The Chief Financial Officer will ensure regular monthly reconciliation of long-distance revenues will be carried out. Efforts will continue to procure and implement a system capable of generating data needed to support accounting of deferred/unearned airtime minutes.

This is a finding is a repeat and unresolved.

PRIOR YEAR FINDINGS:

Finding No.: 2016-01
Area : Allowance for Doubtful Accounts

Criteria:

Policies and procedures should be documented and maintained for calculating the allowance for uncollectible accounts receivable. The purpose of this policy and procedure is to document the process for estimating the allowance for doubtful accounts for accounts receivable. Proper internal control over financial reporting requires that an allowance for uncollectible accounts receivable be calculated and reported in a timely manner. These policies and procedures should include formal written credit approval policies and procedures to manage and reduce the risk of write off of uncollectible accounts.

Condition:

PNCC performs an evaluation of its doubtful accounts only at year-end, and not periodically. The analysis of changes of allowances for bad debts for the last six (6) years is as follows:

	As of December 31,					
	2015	2014	2013	2012	2011	2010
Balance, beginning of year	$ 3,417,963	$ 4,214,265	$ 4,083,262	$ 3,503,641	$ 3,195,114	$ 3,195,114
Current year provisions	53,636	249,587	274,923	778,427	308,527	-
Written-off	(929,387)	(1,045,889)	(143,920)	(198,806)	-	-
Balance, end of year	$ 2,542,212	$ 3,417,963	$ 4,214,265	$ 4,083,262	$ 3,503,641	$ 3,195,114

Cause:

PNCC does not have formalized policies and procedures for estimating the amount of uncollectible accounts receivable to be recorded as an allowance for doubtful accounts.

SECTION II – FINDINGS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No.: 2016-01, continued
Area : Allowance for Doubtful Accounts

Effect:

Uncollectable old accounts estimated at $2.5 million or 73% are ageing in the receivable trial balance and are not written-off and removed from the general ledger and subsidiary ledger. The potential exists for inappropriate or fraudulent write-offs to occur and not be detected in a timely manner. Management may make significant decisions based on inaccurate information.

Recommendation:

PNCC management should formalize collection procedures over control of accounts receivable. These policies and procedures should provide guidance on recording, collecting, and writing off accounts receivable and returned checks. We recommend that past-due balances be reviewed monthly. When truly uncollectible accounts are identified, they should be written-off and removed from the books. This process, however, should not occur until all collection efforts are exhausted and the account is no longer worth pursuit.

Auditee Response and Corrective Action Plan:

PNCC agrees with this Finding. The PNCC Board of Directors has adopted "Accounts Receivable Policy". The Chief Financial Officer will work with Finance & Administration Department staff to prepare clear procedures for account write-off, procedures for account reconciliations and procedures for collections. Once procedures are implemented, CFO will ensure they are adhered to at all times.

Prior Year Status:

Corrective action has been taken. In March 2016, the Company formally implemented the collection procedure over control of account receivable, monthly evaluation of past due balances was regularly evaluated in any relation with account receivable. PNCC has set up an appropriate amount of allowance to cover for any bad debts. Accounts that were identified as uncollectible and removed from the books. This procedure will continue to be observed. This finding is considered resolved.

PALAU NATIONAL COMMUNICATIONS CORPORATION
(A Component Unit of the Republic of Palau)

Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Telecommunications Borrowers

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Year Ended December 31, 2019

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS FOR TELECOMMUNICATIONS BORROWERS

To the Board of Directors
Palau National Communications Corporation:

We have audited 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, the financial statements of the Palau National Communications Corporation (PNCC), a component unit of the Republic of Palau, which comprise the statement of net position as of December 31, 2019, and the related statement of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 2, 2020. In accordance with Government Auditing Standards, we have also issued our report dated June 2, 2020, on our consideration of PNCC's internal control over financial reporting on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred above and our separate letter regarding recommendations concerning certain matters related to internal control, also dated June 2, 2020 related to our audit, have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that PNCC failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, Policy on Audits of Rural Utilities Service Borrowers, Section 1773.33 and clarified in the RUS policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding PNCC's noncompliance with above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, as except of the comments noted below, we noted no matters regarding PNCC's accounting and records to indicate that PNCC did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;

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- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials and supplies.
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system in the contract that covers all or substantially all of the telecommunication system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in accordance with generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements addressed in 7 CFR Part 1733.33(g); and
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. At December 31, 2019, PNCC had no investments in subsidiary and affiliated companies that needed to be accounted for on either the cost or equity basis in accordance with the requirement of 7 CFR Part 1733.33(i).

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This report is intended solely for the information and use of the management of PNCC, the Board of Directors and the Rural Utilities Service and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Burger Comer Magliari

BURGER COMER MAGLIARI
Koror, Republic of Palau
June 2, 2020

Unresolved Prior Year Comments
Year Ended December 31, 2019

STATUS OF PRIOR YEAR FINDINGS RESULTS

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section of this report on page 57 through 62.