

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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

Years Ended September 30, 2018 and 2017

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

Financial Statements

Years Ended September 30, 2018 and 2017

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Belau Submarine Cable Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of net position of Belau Submarine Cable Corporation (BSCC), a component unit of the Republic of Palau (ROP), as of September 30, 2018 and 2017, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise BSCC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BSCC. as of September 30, 2018 and 2017, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis (MD&A) on pages 3 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 28, 2019 on my consideration of the BSCC's internal control over financial reporting and our tests of its compliance with certain provision of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing on internal controls over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering BSCC's internal control over financial reporting and compliance.



Koror, Republic of Palau
April 28, 2019

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

Management's Discussion and Analysis
September 30, 2018

Management's Discussion and Analysis

This section of Belau Submarine Cable Corporation's (BSCC) annual financial report presents management's analysis of its financial performance during the fiscal year ended September 30, 2018. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes which follows this section. Responsibility for the completeness and fairness of this information rests with the Corporation.

As management of the Belau Submarine Cable Corporation, a component unit of the Republic of Palau (ROP), we offer readers of the Corporation's financial statements this narrative overview and analysis of the financial activities of the Corporation for the fiscal year ended September 30, 2018. We encourage readers to consider the information presented in conjunction with the Corporation's financial statements, and accompanying notes to the financial statements.

Using This Annual Report

BSCC's financial statements are designed to emulate corporate presentation models whereby all Corporation activities are consolidated into one total. The focus of the Statements of Net Position is designed to be similar to bottom line results for the Corporation. This Statement combines and consolidates current financial resources (short-term spendable resources) with capital assets. The Statements of Revenues, Expenses, and Changes in Net Position focus on BSCC's start-up activities, which are supported by loans from the Republic of Palau (for construction of the network) and by operating revenues after Ready for Service was declared on December 7, 2017. This approach is intended to summarize and simplify the user's analysis of cost of various BSCC services to the public.

BSCC Structure

BSCC was established in 2015 by RPPL9-47 (the BSCC Act), to progress a project initiated by the World Bank and Asian Development Bank (ADB) to provide international submarine fiber optic connectivity for the Republic of Palau (ROP). ADB remains as the sole financier. BSCC has provisionally applied for a license to operate a wholesale network in ROP in January 2018 in accordance with RPPL 10-17 of 2017 (the Telecoms Act).

The sole shareholder in BSCC is the Minister of Finance. A Board of Directors is appointed by the ROP government.

BSCC was in its first year of operations during the fiscal year ended September 30, 2018. BSCC was established as a state-owned corporation to procure, own and manage a submarine fiber optic cable for the Republic of Palau.

BELAU SUBMARINE CABLE CORPORATION
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Management's Discussion and Analysis
September 30, 2018

Overview of Financial Statements

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

Basic Financial Statements

The *Statement of Net Position* reflects the financial position of the Corporation as of September 30, 2018. It shows the assets owned or controlled, deferred outflows of resources, related liabilities and other obligations, deferred inflows of resources, and the categories of net position. Net position is an accounting concept defined as total assets and deferred outflows less total liabilities and deferred inflows. Since the Corporation is in its first year as an operating entity, there are limited deferred outflows and inflow of resources reported in the accompanying financial statements. As such, it represents the residual of all other elements presented in the Statements of Net Position of the Corporation.

The *Statements of Revenues, Expenses, and Changes in Net Position* reflects the results of operations and other changes for the year ended September 30, 2018 and 2017. It shows revenues and expenses, both operating and non-operating, and reconciles the beginning net position amount to the ending net position amount, which is shown on the Statements of Net Position described above.

The *Statements of Cash Flows* reflect the inflows and outflows of cash for the year ended September 30, 2018 and 2017. It shows the cash activities by type and reconciles the beginning cash amount to the ending cash amount, which is shown on the *Statements of Net Position*, described above. In addition, this Statement reconciles cash flows from operating activities to operating profit on the *Statements of Revenues, Expenses, and Changes in Net Position* described above.

Notes to the Financial Statements

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

Current Status of Project

The initial scope of the project was completed well within the \$25M funding envelope. It included:

- An Indefeasible Right of Use (IRU) with Globe Telecom International (GTI) of Philippines for five 100 Gigabit per second wavelengths on the SEA-US cable that was Ready For Service (RFS) in July 2017. That is, at the time of writing this analysis, SEA-US is already completed and in operation. The IRU is a capacity ownership contract for

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September 30, 2018

the span from the Palau Branching Unit (BU) 3a to the Guam Telecom (GTA) Cable Landing Station in Guam.

- Construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, a Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths.
- Construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, approximately 210 km, including all CLS Submarine Line Terminating Equipment (SLTE), Power Feed Equipment (PFE), Network Protection Equipment (NPE) and network management systems and equipment, plus industry standard spares.

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

The original scope of the project was completed well under budget and ahead of schedule. The network was placed in service on December 7th 2017.

BSCC's business model is shaped by the provisions of the BSCC Act. BSCC is a wholesale carrier, selling only to Retail Service Providers, at full economic cost (including financing cost). There is a single product, wholesale capacity between Palau and Guam. In such a capital-intensive commodity business, the key to maximizing the overall goals of improved services at significantly lower unit prices, is to ensure that the construction cost is managed effectively, with an uncompromising focus on quality. Expected cost to complete the full scope (including the network extension to Airai) is \$22M.

The network has been running at 99.96% availability (only one significant interruption, of 4 hours, as a result of a repair on the SEA-US trunk, in May 2018) since the start of the confidence trial on September 11, 2017.

Sales have exceeded expectations and are currently as of May 2019 at 4 Gbits/sec.

BELAU SUBMARINE CABLE CORPORATION
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Management's Discussion and Analysis
September 30, 2018

Financial Statements for the Year Ended September 30, 2018 and 2017

Statements of Net Position

<u>ASSETS</u>	<u>2018</u>	<u>2017</u>
Current assets	\$ 1,379,259	\$ 124,731
Capital assets, net	17,842,122	13,870,569
Other assets	<u>26,880</u>	<u>-</u>
Total assets	<u>\$ 19,248,261</u>	<u>\$ 13,995,300</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Long-term debt	\$ 18,733,998	\$ 13,816,173
Net Position	<u>514,263</u>	<u>125,127</u>
Total liabilities and net position	<u>\$ 19,248,261</u>	<u>\$ 13,941,300</u>

Statements of Revenues and Expenses and Changes in Net Position

	<u>2018</u>	<u>2017</u>
Revenue	\$ 2,185,968	\$ -
Operating expenses	<u>1,796,886</u>	<u>179,872</u>
Operating income (loss)	389,082	(179,872)
Nonoperating revenues	<u>26</u>	<u>26</u>
Change in net position	389,108	(179,846)
Net position, beginning of year	<u>125,127</u>	<u>304,973</u>
Net position, end of year	<u>\$ 514,235</u>	<u>\$ 125,127</u>

BELAU SUBMARINE CABLE CORPORATION

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Management's Discussion and Analysis

September 30, 2018

Financial Statements for the Year Ended September 30, 2018 and 2017, continued

Statements of Cash Flows

	<u>2018</u>	<u>2017</u>
Net Cash flows from operating activities	\$ 1,237,821	\$ (179,872)
Net cash provided by (used for) capital and related financing activities	(43,347)	28,479
Net Cash flows from investing activities	<u>54</u>	<u>26</u>
Net change in cash	1,194,528	(151,367)
Cash, beginning of year	<u>124,731</u>	<u>276,098</u>
Cash, end of year	<u>\$ 1,319,259</u>	<u>\$ 124,731</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:		
Operating income (loss)	\$ 389,082	\$ (179,872)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	935,619	-
Increase in other assets	<u>(86,880)</u>	<u>-</u>
	<u>\$ 1,237,821</u>	<u>\$ (179,872)</u>

The main movement in Statement of Net Position and Statement of Revenues, Expenses and Changes in Net Position items between FY 2018 and FY 2017 reflects the fact that BSCC moved from a construction focus to operations. The balance of Construction Work in-Progress in FY 2017 was completed and transferred to fixed assets in 2018. Accordingly, depreciation becomes a significant expense totaling approximately \$936,000 in FY 2018, and a range of operational expenditures were incurred that were not required in FY 2017.

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

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

BSCC has been servicing interest on debt from operational revenues since December 2018 (interest during construction was capitalized).

BSCC has hired a CEO and an Operations Support Officer to construct and manage the network.

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Management's Discussion and Analysis
September 30, 2018

Economic Factors and Business Plan that will affect the Future

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

BSCC developed a Business Plan for fiscal years 2019 – 2023 which is briefly discussed below.

The Plan focuses on completing the network extension to Airai in 2019, the elimination of further potential single points of failure in BSCCnet, and the further refinement of operational processes. Forecast expenditure on general expenses for 2019 is \$887K, with another \$361K of specialist operational services. With interest expense of \$486K and \$600K added to reserves, total forecast expenditure is \$2.333M.

In August 2018 BSCC issued bonus capacity to double the speed available to each of the three Retail Service Providers (RSPs) and reduced prices by 30% to reflect the lower unit costs. This action will stimulate growth, but is likely to defer reorder points for each RSP. This plan assumes further sales will be made from 2021 onwards.

Business Objectives

The primary business objective of BSCC is to

Provide ICT Service Providers in Palau with equal access to high quality wholesale capacity at the lowest pricing commensurate with full cost recovery.

The focus of the Business Plan is the consolidation of the gains flowing from the newly constructed submarine link providing international connectivity to ROP. The business issues addressed by the Plan are:

- (a) Construct CAP-A Extension.
- (b) Consolidate operational process to ensure excellent network performance.
- (c) Work with other parties in the ROP telecommunications market to ensure effective market performance.
- (d) Work with relevant authorities to ensure effective disaster planning for international connectivity.
- (e) Develop BSCC capability, including staff recruitment and network resilience.
- (f) Define key operational arrangements including ongoing management, marine maintenance, landing party agreements and Network Operations Center (NOC).
- (g) Establish the expenditures and revenues associated with the development and operations of BSCCnet.
- (h) Set out the financing arrangements to underpin BSCC and the project.
- (i) Analyze risks associated with the company's activities.

BELAU SUBMARINE CABLE CORPORATION
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Management's Discussion and Analysis
September 30, 2018

Strategic Framework

BSCC's price positioning is defined by the BSCC Act. Accordingly, BSCC will operate pricing regimes that support servicing and repayment of debt and business costs, rather than maximize profits.

BSCC is a wholesale supplier in the ROP telecommunication market. This enables the lowest possible cost structure, as BSCC supplies raw capacity to Retail Service Providers (RSPs), rather than telecommunications services to end-user customers, avoiding the need to invest in complex product support and billing systems, sales and marketing capability and customer support systems. By positioning as a wholesaler, BSCC also avoids the difficult position of having to compete with its own customers, who are much better resourced to develop, supply and support telecommunications services in the retail market.

BSCC offers the same capacity products, pricing, payment options and terms and conditions to all eligible customers (i.e. licensed RSPs).

Because BSCCnet will be relatively small in terms of capacity in service compared to other intercontinental submarine networks, and is likely to have relatively few customers (perhaps no more than four in the medium term), its operational needs will not justify extensive fulltime roles. Accordingly, BSCC outsources the majority of its business functions in network operations and management, finance, IT and legal.

Our Network

The international route is a repeatered connection from Ngeremlengui Cable Landing Station (CLS) to a Branching Unit on the SEA-US main cable, with onward transport on SEA-US to the GTA CLS in Guam.

BSCC plans to construct a network extension to the airport site and establish a new Capacity Access Point there. The procurement process is ongoing at this time. In the absence of definitive pricing for this work, the Plan assumes that BSCC will draw down the full \$25M loan available.

Our Technology

The network technology deployed for BSCCnet is identical to that used for the main SEA-US cable, based on the latest available commercial technology, utilizing 100 Gbit/sec wavelengths, supplied by NEC.

BSCC has currently lit one of five 100 Gbit/sec wavelengths over which it holds an IRU with Globe Telecom of Philippines. The link between the GTA CLS and CAP-G, provided by GTA of Guam, is currently configured at 10 Gbit/sec. This potential bottleneck and single point of failure will be addressed by provision of a diverse link during the year 2019.

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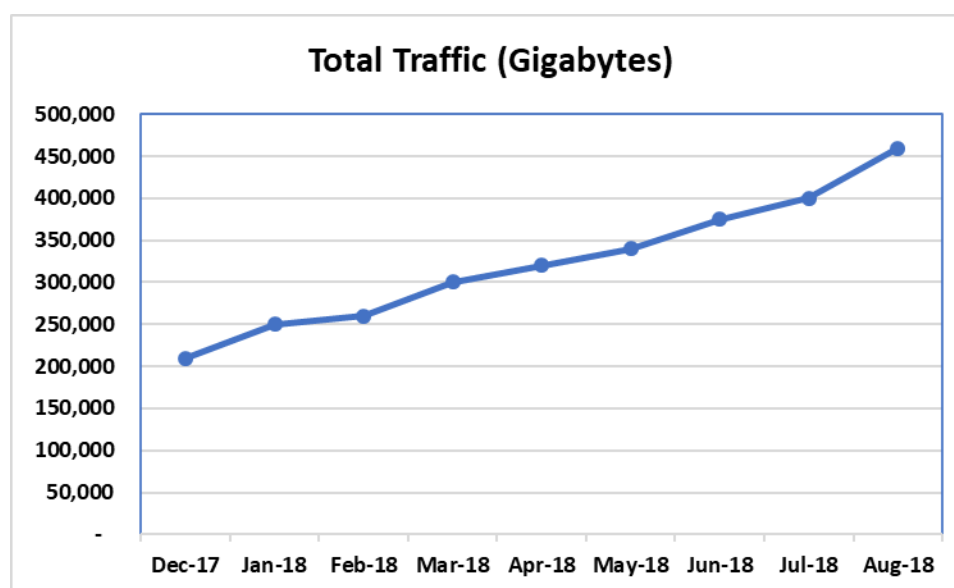
Management's Discussion and Analysis

September 30, 2018

The core submarine network is augmented by twin Ciena network routers in both CAP-N and CAP-G to facilitate resilient and flexible management of customer access. The same standard interface will be available to BSCC's RSP customers at CAP-A. BSCC can support up to 10 Gbit/sec on current network configuration.

Marketing Capacity

Pre-BSCCnet, total satellite capacity use for ROP was estimated at 400 Mbps. There was an immediate increase to 1,000 MBPs by March 2018. In the next six months since Ready for Service, BSCCnet traffic doubled again to 2,000 Mbps. Total download volumes have been growing at about 10% per month.



BSCC's previous 2018 - 2022 Business Plan revenue forecasts for 2018 were \$2.7M and for 2019 \$3.3M. If one customer were to reorder one additional 1 Gbit/sec, the most likely case if the price schedule was unchanged, revenue would increase to \$4.5M per annum, 50% above plan, and another reorder very likely within 12 months. Further, the 2018 - 2022 BP uses very conservative capacity growth rates. With two customers close to reorder point already, further sales would jeopardize the "full cost recovery" objective, with revenues outstripping expenditures by a considerable margin.

BSCC has adopted a solution that combines both approaches: the issue of matching bonus capacity, that would double the speed available to each RSP, plus a 30% price reduction to align pricing to the new effective unit cost. This was implemented in September 2018 and underpins this Business Plan. The Plan assumes 58% growth in 2021, 32% in 2022 and 36% in 2023, but no further capacity sales in 2019 and 2020.

BELAU SUBMARINE CABLE CORPORATION
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Management's Discussion and Analysis
September 30, 2018

Market and Regulatory

The Palau telecommunications market is competitive, regulated by the Bureau of Communications established under RPPL 10-17 of 2017 (the Telecoms Act). Regulation remains in its infancy, with significant uncertainty. It is expected that a Regulator will be appointed in 2019.

The ROP telecommunications market is still largely dominated by the incumbent provider, Palau National Communications Corporation. The main competitor is Palau Telecom, which has operated a Wi-Fi network and is expanding into mobile and possibly fixed line customer access. Palau Wi-Fi continues to operate a small operation focused on tourist hotels. The Telecoms Act (2017) provides for a moratorium on new market entrants until January 1, 2020, with provision for a further extension of up to three years.

The Republic of Palau is the world's first all-IP network. RSPs agreed to establish an open interconnection regime in August 2018. BSCC will cooperate with the RSPs to implement open interconnection by 2019. BSCC supports minimum regulatory complexity consistent with orderly allocation of public resources such as spectrum and numbering.

Requests for Information

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

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

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

Statements of Net Position
September 30, 2018 and 2017

<u>ASSETS</u>	<u>2018</u>	<u>2017</u>
Current assets:		
Cash	\$ 1,319,259	\$ 124,731
Accounts receivable	<u>60,000</u>	<u>-</u>
Total current assets	<u>1,379,259</u>	<u>124,731</u>
Capital Assets:		
Depreciable capital asset, net	11,420,027	402,201
Indefeasible right of use, net	6,422,095	4,007,600
Capital asset under construction	-	9,406,768
Other assets	<u>26,880</u>	<u>-</u>
Total capital assets, net	<u>17,869,002</u>	<u>13,816,569</u>
Total assets	<u>\$ 19,248,261</u>	<u>\$ 13,941,300</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Non-current Liabilities:		
Long-term debt	\$ 18,733,998	\$ 13,816,173
Commitments		
Net Position:		
Net investments in capital assets	(891,876)	396
Unrestricted	<u>1,406,139</u>	<u>124,731</u>
Total net position	<u>514,263</u>	<u>125,127</u>
Total liabilities and net position	<u>\$ 19,248,261</u>	<u>\$ 13,941,300</u>

See accompanying notes to financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Statements of Revenues and Expenses and Changes in Net Position
Years Ended September 30, 2018 and 2017

	2018	2017
Revenue	\$ 2,185,968	\$ -
Operating expenses:		
Depreciation and amortization	935,619	-
Professional fees	229,142	26,000
Salaries and wages	228,814	85,723
Customer service center support	76,000	-
Capacity purchase	43,512	-
Travel	41,590	29,397
Marine maintenance	39,864	-
Director fees	38,244	-
Insurance	22,495	-
Rent	20,753	9,770
Utilities	19,792	3,661
Advertising	19,490	-
Network operating center	18,500	-
Communications	15,991	3,278
Office	12,773	4,730
Meals and entertainment	9,335	5,295
Bank service charges	1,324	10,246
Miscellaneous	23,648	1,772
Total operating expenses	1,796,886	179,872
Operating income (loss)	389,082	(179,872)
Nonoperating revenues:		
Interest income	26	26
Total nonoperating revenues	26	26
Change in net position	389,108	(179,846)
Net position, beginning of year	125,127	304,973
Net position, end of year	\$ 514,235	\$ 125,127

See accompanying notes to financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Cash received from customers for services	\$ 2,099,088	\$ -
Cash paid to suppliers for goods and services	<u>(861,267)</u>	<u>(179,872)</u>
	<u>1,237,821</u>	<u>(179,872)</u>
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(2,302,237)	(7,134,467)
Acquisition of indefeasible right of use	(2,658,935)	(885,400)
Proceeds from long-term debt	<u>4,917,825</u>	<u>8,048,346</u>
Net cash provided by capital and related financing activities	<u>(43,347)</u>	<u>28,479</u>
Cash flows from investing activities:		
Interest received on cash in bank	<u>54</u>	<u>26</u>
Net change in cash	1,194,528	(151,367)
Cash, beginning of year	<u>124,731</u>	<u>276,098</u>
Cash, end of year	<u>\$ 1,319,259</u>	<u>\$ 124,731</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:		
Operating income (loss)	\$ 389,082	\$ (179,872)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	935,619	-
Increase in accounts receivable	(60,000)	-
Increase in other assets	<u>(26,880)</u>	<u>-</u>
	<u>\$ 1,237,821</u>	<u>\$ (179,872)</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2018 and 2017

(1) Organization and Summary of Significant Accounting Policies

Organization

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

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

Basis of Accounting and Presentation

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

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

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

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

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

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

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

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

Net investment in capital assets:

Capital assets net of accumulated depreciation, reduced by the outstanding principal balances of debt attributable to the acquisition, construction or improvements of those assets. Deferred outflows of resources and deferred inflows of resources that are - attributable to the acquisition, construction, or improvement of those assets or related debt should be included in this component of net position. At September 30, 2018 and 2017, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of net position.

Restricted:

Restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. At September 30, 2018 and 2017, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of restricted net position.

Unrestricted:

Net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position. Unrestricted net position may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties. At September 30, 2018 and 2017, BSCC did not have any deferred outflows of resources, and deferred inflows of resources to be included as a component of net position.

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

Notes to Financial Statements
September 30, 2018 and 2017

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

Cash

For the purposes of the Statement of Net Assets and Statement of Cash Flows, BSCC considers cash to be cash on hand plus cash in checking and savings accounts. All of BSCC's cash deposits are with a federally insured bank, \$250,000 of which is subject to coverage by federal insurance and is within insurable limits as of September 30, 2018 and 2017.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. BSCC capitalizes buildings, land improvements and equipment that have a cost of \$200 or more and an estimated useful life of at least five years. The cost of maintenance and repairs is charged to expense. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets which range from 3 to 40 years.

Capital Asset Under Construction

The capital asset under construction represents the cost incurred for the submarine fiber optic spur to-date totaling \$9,406,768 as of September 30, 2017 and also includes related capitalized interest totaling \$157,973. This includes the construction of a Cable Landing Station (CLS) in Ngeremlengui, including a 120-foot tower to support customer IP Radio equipment, Beach Manhole (BMH), beach bulkhead, armored conduits linking the BMH and the bulkhead, mains, auxiliary diesel and back up battery power systems and sea, ground and station earths. It also includes the construction of a submarine fiber optic spur from the BMH to BU3a on SEA-US, including all CLS Submarine Line Terminating Equipment, Power Feed Equipment, Network Protection Equipment and network management systems and equipment, plus industry standard spares. Construction was completed as of September 30, 2018.

Indefeasible Right of Use

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

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(1) Summary of Significant Accounting Policies, Continued

Net Position

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

Pensions

BSCC does not participate or contribute 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. BSCC is exempt from contributing to the ROP Pension plan pursuant to RPPL 9-47 and it was not included in the most recent actuarial study conducted for the ROP Civil Service Trust Fund. The Fund issues a stand-alone financial report which is available at its office site.

Management Estimates

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

Revenues

Revenue from capacity use agreements is recognized when earned in accordance with applicable terms.

Non-operating Revenues and Expenses

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

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(1) Summary of Significant Accounting Policies, Continued

Income Taxes

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

Recently Adopted Accounting Pronouncements

During the year ended September 30, 2018, the Corporation implemented the following GASB pronouncements:

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, effective for periods beginning after June 15, 2016. This Statement replaces Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement No. 43, and Statement No. 50, *Pension Disclosures*.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*. This Statement requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions of this Statement are effective for fiscal years beginning after December 15, 2015. The implementation of this statement did not have a material impact on the Corporation's financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans*. This Statement addresses an issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. GASB Statement No. 78 was effective for fiscal year ending September 30, 2017. The implementation of this statement did not have a material impact on the Corporation's financial statements.

In December 2015, GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. GASB Statement No. 79 was effective for fiscal year ending September 30, 2017. The implementation of this statement did not have a material impact on the Corporation's financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(1) Summary of Significant Accounting Policies, Continued

Recently Adopted Accounting Pronouncements, Continued

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units*. The Statement is intended to provide clarity about how certain component units incorporated as not-for-profit corporations should be presented in the financial statements of the primary state or local government. GASB Statement No. 80 was effective for fiscal year ending September 30, 2017. The implementation of this statement did not have a material impact on the Corporation's financial statements.

In June 2015, GASB issued statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective for periods beginning after June 15, 2017. This Statement replaces the requirement of Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefit Plans Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans. GASB Statement No. 75 was effective for the Corporation for fiscal year ending September 30, 2018.

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. The implementation of this Statement did not have a material impact on the Corporation'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. The implementation of this Statement did not have a material impact on the Corporation's financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(1) Summary of Significant Accounting Policies, Continued

Recently Adopted Accounting Pronouncements, Continued

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*. This Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). GASB Statement No. 85 was effective for the fiscal year ending September 30, 2018. The implementation of this Statement did not have a material impact on the Corporation's financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. GASB Statement No. 86 was effective for the fiscal year ending September 30, 2018. The implementation of this Statement did not have a material impact on the Corporation's financial statements.

Upcoming Accounting Pronouncements

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations. GASB Statement No. 83 will be effective for the fiscal year ending September 30, 2019. Management has not evaluated the impact that the implementation of this Statement will have on the Corporation's financial statements.

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 will be effective for reporting periods after December 15, 2018. Management has not evaluated the impact that the implementation of this Statement will have on the Corporation's financial statements.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
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(1) Summary of Significant Accounting Policies, Continued

Recently Adopted Accounting Pronouncements, Continued

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. GASB Statement No. 87 will be effective for the fiscal year ending September 30, 2021.

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 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.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. The objectives of the 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. This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019.

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Notes to Financial Statements
September 30, 2018 and 2017

(1) Summary of Significant Accounting Policies, Continued

Recently Adopted Accounting Pronouncements, Continued

In August 2018, GASB issued Statement No. 90, *Majority Equity Interest*. The primary objective of this Statement is 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 the 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 fair value. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018.

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

(2) Deposits and investments

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

Deposits

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

- | | |
|------------|--|
| Category 1 | Deposits that are federally insured or collateralized with securities held by BSCC or its agent in the BSCC's name; |
| Category 2 | Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the BSCC's name; or |

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(2) Deposits and investments, Continued

Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in BSCC's name and noncollateralized deposits.

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

For credit risk in the case of deposits, there is the risk that in the event of a bank failure, BSCC's deposits may not be returned to it. As of September 30, 2018 and 2017, the carrying amount of BSCC's total cash in checking and savings was \$1,319,259 and \$124,731 with a corresponding bank balance of \$1,299,138 and \$124,731, respectively. From these deposits, \$250,000 at September 30, 2018 and 2017 was subject to coverage by FDIC. BSCC does not require collateralization of bank accounts, and therefore, amounts in excess of insurable limits are uncollateralized and are subject to custodial credit risk.

Investments

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

Category 1 Investments that are insured or registered, or securities held by BSCC or its agent in BSCC's name;

Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the BSCC's name; or

Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty's trust department or agent but not in BSCC's name.

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

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(2) Deposits and investments, Continued

As of September 30, 2018, and 2017, BSCC did not have investments subject to GASB Statement No. 40.

(3) Capital Assets

Capital asset activity for the years ended September 30, 2018 and 2017 are as follows:

	<u>Estimated Useful Lives</u>	<u>Balance 9/30/2017</u>	<u>Additions</u>	<u>Transfers In (Out)</u>	<u>Balance 09/30/2018</u>
Buildings and Improvements	5 - 25 yrs	\$ -	\$ 284,907	\$ 394,801	\$ 679,708
Plant & Equipment	5 - 10 yrs	-	151,790	-	151,790
Submarine Terminal Equipment	20 - 25 yrs	-	-	3,336,009	3,336,009
Submarine Cable	20 - 25 yrs	-	1,857,792	5,518,236	7,376,028
Support Equipment	3 - 5 yrs	-	-	552,523	552,523
Vehicles	3 - 5 yrs	-	7,748	7,400	15,148
Depreciable capital assets		402,201	-	(402,201)	-
Capital asset under construction		9,406,768	-	(9,406,768)	-
		9,808,969	2,302,237	-	12,111,206
Accumulated depreciation		-	(691,179)	-	(691,179)
Net capital assets		<u>\$ 9,808,969</u>	<u>\$ 1,611,058</u>	<u>\$ -</u>	<u>\$ 11,420,027</u>
		<u>Balance 9/30/2016</u>	<u>Additions</u>	<u>Transfers Disposals</u>	<u>Balance 09/30/2017</u>
Non-depreciable capital asset		\$ 275	\$ -	\$ (275)	\$ -
Depreciable capital assets		-	401,926	275	402,201
Capital asset under construction		2,674,227	6,732,541	-	9,406,768
		2,674,502	7,134,467	-	9,808,969
Accumulated depreciation		-	-	-	-
Net capital assets		<u>\$ 2,674,502</u>	<u>\$ 7,134,467</u>	<u>\$ -</u>	<u>\$ 9,808,969</u>

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(4) Indefeasible Right of Use (IRU) Agreement

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

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

Total purchase price is \$6.7 million and was fully paid as of September 30, 2018. The amortization of the IRU commenced in November 2017, which was the IRU RFS date. The Corporation recognized amortization expense totaling \$244,440 for the year ended September 30, 2018.

(5) Long-Term Liabilities

Long-term liabilities of BSCC consist solely of notes payable. The changes in in long-term liabilities for the years ended September 30, 2018 and 2017 are as follows:

	Outstanding October 1, 2017	Increases	Decreases	Outstanding September 30, 2018	Current	Noncurrent
Notes Payable	\$ 13,816,173	\$4,917,825	-	\$ 18,733,998	-	\$ 18,733,998
	<u>\$ 13,816,173</u>	<u>\$4,917,825</u>	<u>\$ -</u>	<u>\$ 18,733,998</u>	<u>\$ -</u>	<u>\$ 18,733,998</u>
	Outstanding October 1, 2016	Increases	Decreases	Outstanding September 30, 2017	Current	Noncurrent
Notes Payable	\$ 5,767,827	\$8,048,346	-	\$ 13,816,173	-	\$ 13,816,173
	<u>\$ 5,767,827</u>	<u>\$8,048,346</u>	<u>\$ -</u>	<u>\$ 13,816,173</u>	<u>\$ -</u>	<u>\$ 13,816,173</u>

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(5) Long-Term Liabilities, Continued

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

Under the Project Agreement, ADB has agreed to:

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

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

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(5) Long-Term Liabilities, Continued

Long-term debt at September 30, 2018 and 2017 is as follows:

	2018	2017
<p>Loan payable under the Ordinary Loan Agreement, guaranteed by the ROP government, with a 20-year term after the grace period ends on June 1, 2021 when the first payment is due, interest at LIBOR plus 0.05% per annum and payable every June 1 and December 1. Principal is to be repaid at 2.5% of the total principal amount outstanding on each payment date.</p>	\$ 12,358,889	\$ 9,108,626
<p>Loan payable under the Special Operations Loan Agreement, guaranteed by the ROP government, with a 20-year term after the grace period ends on June 1, 2021 when the first payment of \$213,250 becomes due, interest at 2.5% per annum and payable every June 1 and December 1.</p>	<u>6,375,109</u>	<u>4,707,547</u>
	<u>\$ 18,733,998</u>	<u>\$ 13,816,173</u>

As of September 30, 2018, amounts available under the Ordinary and Special Operations Loan Agreements that may be drawn in subsequent years approximate \$4.1 million and \$2.2 million, respectively. Given the uncertainty in predicting when additional drawdowns will occur, presentation of future principal and interest amortization is not possible at this time.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(6) Capacity Use, Lease and Other Commitments

Commencing December 2017, BSCC leases telecommunications capacity with various customers located in the Republic of Palau under a three-year capacity use agreement with total quarterly customer payments in the amount of \$670,500.

Future minimum receipts under the capacity lease agreements are as follows:

<u>Years ended September 30,</u>	
2019	\$ 2,682,000
2020	2,682,000
2021	<u>670,500</u>
Total future receipts	<u>\$ 6,034,500</u>

Effective December 2017, BSCC leases commercial space under a five-year lease agreement at an annual rate of \$3,498, payable in advance.

Additionally, BSCC has entered into various third-party support agreements with terms ranging from 12 months to 7 years.

Future commitments resulting from the service agreements are as follows:

<u>Years ended September 30,</u>	
2019	\$ 180,500
2020	180,500
2021	180,500
2022	180,500
2023	161,700
Thereafter	<u>203,800</u>
Total future service commitments	<u>\$ 1,087,500</u>

During October 2017, BSCC executed a capacity service agreement with a third-party provider for a period of 7 years at an estimated charge of \$4,800 per month.

BELAU SUBMARINE CABLE CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(6) Capacity Use, Lease and Other Commitments, Continued

During December 2018, BSCC engaged a third-party to construct a fiber optic cable extension linking the Cable Landing Station at the Ngeremlengui Cable Landing Station Customer Access Point (CAP-N) to a new Capacity Access Point in Airai. The construction, which has a contract value of \$1.5 million, will be funded by the existing loan facilities with ADB. The connection, which will provide a medium to long-term solution for customer access, aims for greater network capacity to support anticipated future demand. No construction costs were incurred as of September 30, 2018.

(7) Fair Value of Financial Instruments

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

(8) Risk Management

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

BSCC is self-insured for underwater cables.

Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, would include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported during the year ended September 30, 2018 and 2017.

(9) Subsequent Events

In preparing the accompanying financial statements and these footnotes, management has evaluated subsequent events through April 28, 2019, which is the date the financial statements were available to be issued. There were no such events requiring disclosure or adjustment to the accompanying financial statements.

BELAU SUBMARINE CABLE CORPORATION
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INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

Years Ended September 30, 2018 and 2017



INDEPENDENT AUDITORS' 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

Board of Directors
Belau Submarine Cable 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 Belau Submarine Cable Corporation (the Corporation), which comprise the statement of net position as of September 30, 2018 and 2017, and the related statements of revenues, expenses and changes in net position and the statement of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 28, 2019.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Belau Submarine Cable Corporation'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Belau Submarine Cable Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Belau Submarine Cable Corporation'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*.

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 organization'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.



Koror, Republic of Palau
April 28, 2019

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

INDEPENDENT AUDITORS' REPORT
REGARDING LOAN FUND EXPENDITURES

Year Ended September 30, 2018



BURGER · COMER · MAGLIARI
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT
REGARDING LOAN FUND EXPENDITURES

Board of Directors
Belau Submarine Cable 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 of America, the financial statements of Belau Submarine Cable Corporation (BSCC), net position of Belau Submarine Cable Corporation (BSCC), a component unit of the Republic of Palau, as of September 30, 2018 and 2017, 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 BSCC's basic financial statements and have issued our report thereon dated April 28, 2019.

In connection with our audit, nothing came to our attention that caused us to believe that BSCC failed to comply with the terms, covenants, provisions, or conditions of section 2.09 of the Project Agreement dated March 7, 2016 with Asian Development Bank, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Program Agreement, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of Belau Submarine Cable Corporation and Asian Development Bank and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Burger Comer Magliari".

Koror, Republic of Palau
April 28, 2019