

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

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**REPORT ON THE AUDIT OF FINANCIAL  
STATEMENTS IN ACCORDANCE  
WITH OMB CIRCULAR A-133**

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**YEARS ENDED SEPTEMBER 30, 2004 AND 2003**

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

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Years Ended September 30, 2004 and 2003

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## INDEPENDENT AUDITORS' REPORT

Chairman  
Board of Directors  
Federated States of Micronesia  
Telecommunications Corporation:

We have audited the accompanying statement of net assets of the FSM Telecommunications Corporation (FSMTC), a component unit of the Federated States of Micronesia National Government, as of September 30, 2004 and 2003, and the related statements of revenue, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of FSMTC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

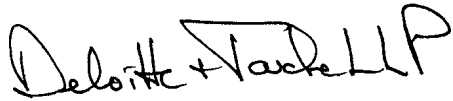
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of FSMTC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of FSMTC as of September 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3-4 is not a required part of the basic financial statements but is supplementary information required by the GASB. This supplementary information is the responsibility of FSMTC's management. We have applied certain limited procedures to such information, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were performed for the purpose of forming an opinion on the basic financial statements of FSMTC taken as a whole. The accompanying schedule of operating expenses (page 16) is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This schedule is the responsibility of the management of FSMTC. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2005, on our consideration of FSMTC's internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

March 4, 2005

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Management Discussion and Analysis  
Year Ending September 30, 2004

The following discussion and analysis of the financial performance and activity of the Federated States of Micronesia Telecommunications Corporation (FSMTC) is to provide an introduction and understanding of the basic financial statements of the FSMTC for the year ended September 30, 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The FSMTC is a public corporation of the Federated States of Micronesia National Government and is a primary provider of telecommunications services throughout the Federated States of Micronesia (FSM) and to points outside of the FSM. The FSMTC also provides Cable TV in the State of Kosrae. It is under the governance of an appointed 5-member Board of Directors by the President and the Governor of each of the States, which has oversight over both the FSMTC and Cable TV in Kosrae. The General Manager, who is the Chief Executive Officer, is also an ex-officio non-voting member of the Board.

The FSMTC provides telecommunications services which include Plain Old Telephone Services (POTS) to little over 10,000 subscribers. Other telecommunications services provided are National and International Overseas Calls, Internet Services, Mobile Cellular Services and Cable Television in the State of Kosrae. The FSMTC relies on calls made to and from outside of FSM and calls within the FSM, which account for approximately 48% of the FSMTC generating revenues.

During FY2004, Internet Services accounted for \$2,080,444 or 17% of the FSMTC generated revenues. As of this writing, total Internet subscribers are 1,573.

In FY2004, the Board approved \$2.6 million for improvement of the cellular coverage for the States of Pohnpei, Chuuk and Yap. The Mobile services account for \$1,802,325 or 15% of the FSMTC generated revenues in FY2004. At October 31, 2004, the total mobile subscribers were 11,611, broken down as follows: Pohnpei 6,231, Chuuk 2,043, Yap, 2,519 and Kosrae 818.

The following table summarizes the financial condition and operations of the FSMTC for FY2004 and FY2003:

	<u>2004</u>	<u>2003</u>
Assets:		
Property, plant and equipment	\$ 42,699,142	\$ 43,552,406
Cash and cash equivalents	3,387,526	2,811,443
TCD and Investment in securities and Intelsat	9,797,795	9,590,880
Receivables and prepayments	2,377,162	2,747,142
Other assets	<u>482,517</u>	<u>467,338</u>
	<u>\$ 58,744,142</u>	<u>\$ 59,169,209</u>
Current liabilities	\$ 1,444,714	\$ 1,510,058
Notes payable – long-term	25,253,521	25,978,382
Net asset	<u>32,045,907</u>	<u>31,680,769</u>
	<u>\$ 58,744,142</u>	<u>\$ 59,169,209</u>

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Management Discussion and Analysis  
Year Ending September 30, 2004

	<u>2004</u>	<u>2003</u>
Revenues, Expenses and Changes in Net Assets:		
Operating revenues	\$ 11,944,507	\$ 11,247,373
Operating expenses	<u>(11,359,385)</u>	<u>(10,157,094)</u>
Net operating revenues	585,122	1,090,279
Interest income and others	950,837	1,014,314
Interest expense	<u>(1,170,821)</u>	<u>(1,046,200)</u>
Increase in net assets	<u>365,138</u>	<u>1,058,393</u>
Net assets at end of year	\$ <u>32,045,907</u>	\$ <u>31,680,769</u>

Overall there were only minor changes in the balance sheet components. However, during FY2004, total amount received from telecommunication services exceeded the amount paid to vendors and employees for goods and services. This resulted in an increase in cash and cash equivalent of \$576,083. Total cash and cash equivalents at the end of FY2004 is \$3,387,526. The statement of cash flows showed that net cash used for capital and related financing activities exceeded net cash used for operating activities by \$348,605.

Total revenues in FY2004 exceeded FY2003 by \$697,134. Most of this increase was attributed to the increase in revenues collected from mobile users. Operating expenses in FY2004 increased by \$1,202,291 or 12%. The increase is mostly due to an increase in power usage from plant operations in Chuuk and Kosrae. Another account that contributed to this increase in expenses was consumer operations for cost of goods sold advertisement.

The FSMTC investment in property, plant, and equipment, net of accumulated depreciation, amounted to \$42,699,142 in FY2004 and \$43,552,406 in FY2003. The decrease was caused by depreciation and the retirement of \$298,797 of equipment.

FSMTC's notes payable with the U.S. Department of Agriculture (Rural Utility Services) amounted to \$25,963,658, of which, \$710,137 was classified as the current portion of the note. The interest on funded debts paid during FY2004 was \$1,170,821. The principal amount paid during FY2004 was \$690,334.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Statements of Net Assets  
September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<u>ASSETS</u>		
Current assets:		
Cash	\$ 3,387,526	\$ 2,811,443
Time deposits	105,231	204,189
Investments in securities	8,782,450	8,476,577
Accounts receivable, net of an allowance for doubtful accounts of \$3,180,225 and \$2,525,423 in 2004 and 2003, respectively	963,909	1,030,028
Receivables from carriers, net	387,908	898,784
Advances to employees	34,515	32,736
Inventory	416,669	416,726
Accrued interest and other accrued earnings	255,744	442,362
Other receivables and prepaid expenses	<u>735,086</u>	<u>343,232</u>
Total current assets	15,069,038	14,656,077
Investment-Intelsat	910,114	910,114
Deferred charges	65,848	50,612
Property, plant and equipment, net	<u>42,699,142</u>	<u>43,552,406</u>
	<u>\$ 58,744,142</u>	<u>\$ 59,169,209</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Notes payable-current portion	\$ 710,137	\$ 675,620
Accounts payable, trade	122,913	52,077
Deferred revenue-debit cards	2,391	97,030
Accrued leave payable	122,992	123,132
Other payables and accrued expenses	<u>486,281</u>	<u>562,199</u>
Total current liabilities	1,444,714	1,510,058
Long-term portion of notes payable	<u>25,253,521</u>	<u>25,978,382</u>
Total liabilities	<u>26,698,235</u>	<u>27,488,440</u>
Commitments and contingencies		
Net assets:		
Investment in capital assets, net of related debt	16,735,484	16,898,404
Unrestricted	<u>15,310,423</u>	<u>14,782,365</u>
Total net assets	<u>32,045,907</u>	<u>31,680,769</u>
	<u>\$ 58,744,142</u>	<u>\$ 59,169,209</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Statements of Revenue, Expenses, and Changes in Net Assets  
Years Ended September 30, 2004 and 2003

	2004	2003
Operating revenues:		
Overseas tolls	\$ 4,301,250	\$ 4,702,482
Internet	2,080,444	1,670,097
Net access	2,040,363	2,327,233
Mobile charges	1,802,325	454,033
External carriers	1,450,421	1,896,583
ICTV Kosrae cable charges	122,156	102,781
Miscellaneous	147,548	94,164
Total operating revenues	11,944,507	11,247,373
Operating expenses:		
Corporate operations	1,952,524	1,851,736
Consumer operations	1,870,874	1,415,789
Plant operations	1,231,775	816,135
Cable and wire	1,160,888	1,201,359
Earth station	1,100,616	1,068,486
General support	856,113	766,938
Internet expense	779,884	637,057
Bad debts	687,696	597,976
Central office	677,798	720,030
Terminal equipment	477,470	588,585
Wireless telephone - Ulithi	388,044	315,138
ICTV expense	175,703	177,865
Total operating expenses	11,359,385	10,157,094
Earnings from operations	585,122	1,090,279
Nonoperating revenues (expenses):		
Interest income - general	21,353	27,397
Interest expense	(1,170,821)	(1,046,200)
Gain on sale of fixed assets	5,852	13,422
Investment loss - ICTV-Pohnpei	-	(97,929)
Investment earnings, net	923,632	1,071,424
Total nonoperating expenses, net	(219,984)	(31,886)
Increase in net assets	365,138	1,058,393
Total net assets at beginning of year	31,680,769	30,622,376
Total net assets at end of year	\$ 32,045,907	\$ 31,680,769

See accompanying notes to financial statements.



**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Statements of Cash Flows  
Years Ended September 30, 2004 and 2003

	2004	2003
Cash flows from operating activities		
Cash received from customer:	\$ 12,411,627	\$ 11,582,269
Cash paid to suppliers and employees for goods and service	(5,255,287)	(4,863,906)
Cash paid to employees	(3,506,332)	(3,026,393)
Net cash provided by operating activities	3,650,008	3,691,970
Cash flows from capital and related financing activities		
Repayments of notes payable	(690,344)	(657,784)
Additions to property, plant and equipment	(2,143,300)	(3,636,646)
Proceeds from sale of fixed assets	5,852	13,422
Interest paid on loan payable	(1,170,821)	(1,046,200)
Net cash used for capital and related financing activities	(3,998,613)	(5,327,208)
Cash flows from investing activities		
Withdrawals from time deposits	100,000	-
Withdrawals from investments	624,484	2,400,000
Purchase of time deposits	-	(720,204)
Interest earned - investments	200,204	126,783
Net cash provided by investing activities	924,688	1,806,579
Net increase in cash	576,083	171,341
Cash at beginning of year	2,811,443	2,640,102
Cash at end of year	\$ 3,387,526	\$ 2,811,443
Reconciliation of earnings from operations and to net cash provided by operating activities		
Earnings from operations	\$ 585,122	\$ 1,090,279
Adjustments to reconcile earnings from operations to net cash provided by operating activities		
Depreciation and amortization	2,996,564	2,887,137
Bad debt	828,883	609,210
(Increase) decrease in assets		
Accounts receivable, net	(762,764)	(189,211)
Receivables from carriers	510,876	(57,654)
Advances to employees	(1,779)	(2,106)
Inventory	57	(62,030)
Deferred charges	(15,236)	(41,157)
Other receivables and prepaid expenses	(391,854)	(158,588)
Increase (decrease) in liabilities		
Accounts payable, trade	70,836	(337,867)
Deferred revenue-debit card	(94,639)	13,708
Accrued leave payable	(140)	9,668
Other payables and accrued expenses	(75,918)	(69,419)
Net cash provided by operating activities	\$ 3,650,008	\$ 3,691,970

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

(1) Organization and Summary of Significant Accounting Policies

Organization

The Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation) is established as a public corporation under the laws of the Federated States of Micronesia, the purpose of which is to provide telecommunications services, except radio and television broadcasting, throughout the FSM and to points outside the FSM. The Corporation began its operations in October 1983 and is a component unit of the Federated States of Micronesia National Government.

Basis of Accounting

Funding was made available under Section 215(a)(2) and Section 215(b)(2) of the Compact of Free Association and through loan funds from the United States Department of Agriculture (USDA) Rural Utilities Service (RUS).

The Corporation operates as a component unit-proprietary fund type of the FSM National Government. A component unit-proprietary fund is used to account for those operations that are financed and operated in a manner similar to private business and where the board decides that the determination of revenues earned, costs incurred and/or net income is necessary for management. Because it is a component unit-proprietary fund, the Corporation uses the accrual basis of accounting. Expenses are recorded by function in order to meet the reporting requirements as imposed by the RUS. Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Corporation has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Corporation maintains a chart of accounts as prescribed by the Uniform System of Accounts for telecommunication companies of the United States Federal Communications Commission's Rules.

The Corporation has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No.'s 37 and 38. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following three net asset categories:

- Invested in capital assets, net of related debt:

Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

Basis of Accounting, Continued

- Restricted:
  - Nonexpendable – Net assets subject to externally imposed stipulations that require the Corporation to maintain them permanently.
  - Expendable – Net assets whose use by the Corporation is subject to externally imposed stipulations that can be fulfilled by actions of the Corporation pursuant to those stipulations or that expire by the passage of time.

- Unrestricted:

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Net Assets

Net assets represent the residual interest in the Corporation's assets after liabilities are deducted and consist of three sections: invested in capital assets, net of related debt, restricted and unrestricted. Net assets invested in capital assets, net of debt include capital assets, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or by legislation. The Corporation has no restricted net assets at September 30, 2004 and 2003.

All other net assets are unrestricted.

Cash

For the purposes of the balance sheets and the statements of cash flows, cash is defined as cash in bank checking and savings accounts, money market funds and commercial paper with original maturities of three months or less from the date of acquisition. Time deposits with original maturities in excess of three months are separately classified. The Corporation does not require collateralization of its cash in excess of Federal Deposit Insurance Corporation (FDIC) limits; therefore \$300,000 as of September 30, 2004 and 2003 is insured by the FDIC. The remaining balances are uninsured and uncollateralized.

Investments in Securities

Investments in securities are carried at market value in accordance with the requirements of Governmental Accounting Standards Board Statement No. 31.

Generally, the Corporation can invest in bonds and other indebtedness of the U.S. and in preferred or common stock of any corporation created or existing under the laws of the U.S. or any U.S. state, territory, or commonwealth. Additionally, a maximum of 10% of the total portfolio may be invested in non-U.S. equities.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

Investments in Securities, Continued

Investments in securities comprise the following as of September 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Equities	\$ 5,677,719	\$ 4,924,654
U.S. government obligations	1,004,864	1,000,986
Corporate bonds and others	<u>2,099,867</u>	<u>2,550,937</u>
	\$ <u>8,782,450</u>	\$ <u>8,476,577</u>

Net investment income comprises the following for the years ended September 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Interest and dividends	\$ 167,738	\$ 194,739
Unrealized earnings on investments	<u>755,894</u>	<u>876,685</u>
Net investment income	\$ <u>923,632</u>	\$ <u>1,071,424</u>

All investments in securities are held in the Corporation's name.

Management 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 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.

Allowance for Doubtful Accounts

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 collectibility of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables charged to expenses.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets.

Capitalization Policy

The Corporation capitalizes buildings, land improvements and equipment that have a cost of \$2000 or more and an estimated useful life of at least five years.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

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

Inventory

Materials and supplies are valued at cost, which approximates market, using the first-in-first-out (FIFO) method.

Investments in Companies

The Corporation accounts for its investments in companies in which it has between a 20-50% ownership by the equity method. Investments in which the Corporation's ownership is less than 20% are accounted for using at cost.

Receivables

Accounts receivable are due from businesses and individuals located within the FSM. Receivables from international carriers are due from entities within the United States and Japan.

Compensated Absences

It is the Corporation's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. No liability is reported for unpaid accumulated sick leave. Vacation pay is accrued when incurred.

Plant Under Construction

Plant under construction represents the accumulated costs of unfinished capital projects. These costs will be capitalized as property, plant and equipment upon completion of each project.

Advertising Cost

Advertising costs are charged to operations when incurred.

Operating and Non-Operating Revenues and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of telecommunication services, except radio and television broadcastings. Non-operating revenues and expenses result from non-recurring income and costs such as interest and investment gains and losses.

(2) Investment - IntelSat

In September 1994, the Corporation became a member of the International Telecommunications Satellite organization (IntelSat). The Corporation paid its initial capital investment share of \$910,114 representing a .05% valuation of the operating agreement at the time of acquisition. At September 30, 2004 and 2003, the investment balance of \$910,114 is carried at cost. Interest earned on this investment was \$0 during the years ended September 30, 2004 and 2003.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

**(3) Investment – Island Cable Television**

On December 8, 1998, FSM Telecommunications Corporation acquired a 50% ownership in Island Cable Television - Pohnpei for \$450,000. The Corporation recorded this investment under the equity method of accounting. Goodwill of \$383,062 resulting from the purchase was being amortized over a period of fifteen (15) years. The remaining goodwill balance of \$325,603 as of September 30, 2002 was written-off pursuant to FASB Statement No. 142, "Accounting for Goodwill and Intangible Assets."

The Corporation's pro rata share of (loss) was \$0 and (\$97,929) for the years ended September 30, 2004 and 2003, respectively.

**(4) Property, Plant and Equipment, Net**

Property, plant and equipment, net as of September 30, 2004 and 2003, is as follows:

	Estimated Useful Lives	Beginning Balance October 1, 2003	Transfers and Additions	Transfers and Deletions	Ending Balance September 30, 2004
General support	5-35 years	\$ 12,189,286	\$ 1,597,651	\$ (62,134)	\$ 13,724,803
Central office	20 years	9,630,526	-	-	9,630,526
Earth station	20 years	5,031,016	-	-	5,031,016
Terminal equipment	5-20 years	4,319,105	-	(235,766)	4,083,339
Cellular network	10-20 years	3,410,114	947,502	-	4,357,616
Internet equipment	8 years	636,530	-	(897)	635,633
Pole, cable and wiring	15-20 years	<u>32,123,475</u>	<u>391,372</u>	<u>-</u>	<u>32,514,847</u>
Total		67,340,052	2,936,525	(298,797)	69,977,780
Accumulated depreciation		<u>(26,789,660)</u>	<u>(2,996,564)</u>	<u>298,797</u>	<u>(29,487,427)</u>
		40,550,392	(60,039)	-	40,490,353
Plant under construction		<u>3,002,014</u>	<u>1,325,674</u>	<u>(2,118,899)</u>	<u>2,208,789</u>
Property, plant and equipment, net		<u>\$ 43,552,406</u>	<u>\$ 1,265,635</u>	<u>\$ (2,118,899)</u>	<u>\$ 42,699,142</u>
		Beginning Balance October 1, 2002	Transfers and Additions	Transfers and Deletions	Ending Balance September 30, 2003
General support	5-35 years	\$ 12,050,250	\$ 324,186	\$ (185,150)	\$ 12,189,286
Central office	20 years	9,555,907	74,619	-	9,630,526
Earth station	20 years	5,010,860	20,156	-	5,031,016
Terminal equipment	5-20 years	4,151,268	167,837	-	4,319,105
Cellular network	10-20 years	-	3,410,113	-	3,410,113
Internet equipment	8 years	498,365	138,165	-	636,530
Pole, cable and wiring	15-20 years	<u>30,656,331</u>	<u>1,467,145</u>	<u>-</u>	<u>32,123,476</u>
Total		61,922,981	5,602,221	(185,150)	67,340,052
Accumulated depreciation		<u>(24,065,009)</u>	<u>(2,901,159)</u>	<u>176,508</u>	<u>(26,789,660)</u>
		37,857,972	2,701,062	(8,642)	40,550,392
Plant under construction		<u>4,944,895</u>	<u>2,934,377</u>	<u>(4,877,258)</u>	<u>3,002,014</u>
Property, plant and equipment, net		<u>\$ 42,802,867</u>	<u>\$ 5,635,439</u>	<u>\$ (4,885,900)</u>	<u>\$ 43,552,406</u>

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

(5) Capitalized Interest

Interest is capitalized on all construction-in-progress pursuant to FASB 34, "Capitalization of Interest Costs" provided that the construction period exceeds one year. Interest capitalized on all construction-in-progress was \$144,269 and \$304,337 during the years ended September 30, 2004 and 2003, respectively.

(6) Notes Payable

	<u>2004</u>	<u>2003</u>
Loan payable to Rural Utilities Service (RUS), with a 35 year term, interest at 5%, collateralized by the Corporation's specific ground leases and essentially all other assets. Pursuant to a loan agreement dated August 1, 1990, the Corporation is required to make monthly payments of both principal and interest to RUS.	\$ 25,963,658	\$ 26,654,002
Less: current portion	<u>710,137</u>	<u>675,620</u>
Long-term portion of notes payable	\$ <u>25,253,521</u>	\$ <u>25,978,382</u>

Future minimum principal and interest payments on notes payable for subsequent years ending September 30, are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 710,137	\$ 1,298,183	\$ 2,008,320
2006	745,644	1,262,676	2,008,320
2007	782,926	1,225,394	2,008,320
2008	822,072	1,186,248	2,008,320
2009	863,176	1,145,144	2,008,320
2010 through 2014	5,008,073	5,033,527	10,041,600
2015 through 2019	6,391,710	3,649,890	10,041,600
2020 through 2024	8,157,622	1,883,978	10,041,600
2025 through 2026	<u>2,482,298</u>	<u>154,020</u>	<u>2,636,318</u>
	\$ <u>25,963,658</u>	\$ <u>16,839,060</u>	\$ <u>42,802,718</u>

A summary of changes in long-term liabilities during fiscal year 2004 and 2003, follows:

	<u>Outstanding Balance September 30, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding Balance September 30, 2004</u>	<u>Current</u>	<u>Noncurrent</u>
Note payable to Rural Utilities Service	\$26,654,002	\$ -	\$690,344	\$25,963,658	\$710,137	\$25,253,521
	<u>Outstanding Balance September 30, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding Balance September 30, 2003</u>	<u>Current</u>	<u>Noncurrent</u>
Note payable to Rural Utilities Service	\$27,311,786	\$ -	\$657,784	\$26,654,002	\$675,620	\$25,978,382

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

(7) Commitments and Contingencies

Leases

The Corporation has fifteen operating leases as of September 30, 2004. Seven are residential real estate leases for contract employees, which have a term of one year or two years. Three represent leases for satellite stations of Yap, Pohnpei, and Kosrae with thirty-year leases. Three are for land site leases for three of the four state offices with 25-35 year terms beginning in 1988 for Pohnpei and Yap and 1990 for Kosrae. One is for a training center and one is for the previous central office on Pohnpei; both for 25 year terms beginning in 1983 for the training center and 1994 for the old central office. The Corporation has also entered into various circuit leases expiring through 2015 and 2016.

The approximate future minimum annual lease payments payable by the Corporation are as follows:

<u>Year ending September 30:</u>	<u>Total</u>
2005	\$ 467,716
2006	414,336
2007	358,176
2008	358,176
2009	358,076
2010-2014	1,778,594
2015-2019	376,278
2020-2024	17,640
2025-2029	<u>1,764</u>
	\$ <u>4,130,756</u>

Self Insurance

The Corporation purchases insurance to cover risks associated with its buildings and equipment (\$11,336,500 of coverage) and vehicles (up to \$1 million of coverage per vehicle per incident). Additionally, the Corporation purchases fidelity insurance coverage for selected employees (total coverage of \$2,204,000) and workmen's compensation insurance (coverage of up to \$50,000 per employee). The Corporation also purchases general liability insurance in connection with operations (up to \$1 million per occurrence). The Corporation does not purchase insurance for its Outside Plant. As most of these items are underground, the Corporation is of the opinion that losses from such, if any, will be minimal. Therefore, the Corporation is self insured for Outside Plant and all other risks not encompassed in the forgoing. Management is of the opinion that no material losses have resulted from this practice.

Construction Commitments

During the year ended September 30, 2004, the Corporation entered into various contracts for construction and expansion of its facilities and services. Approximately \$2,115,729 is outstanding under these contracts as of September 30, 2004.



**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements  
September 30, 2004 and 2003

(9) Related Party Transactions

The Corporation's services are provided to its shareholders at the same rates as are charged to third parties. The Corporation is a component unit of the Federated States of Micronesia National Government. As of September 30, 2004, the Corporation has receivables from the National Government of approximately \$402,957 (\$218,712 at September 30, 2003).

(10) Retirement Plan

The Corporation's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees received from the FSM Social Security System. The Plan is a contributory plan in which the Corporation contributes 10 percent of the participant's annual salary, and the participant contributes 3 or more percent from his or her annual salary. Participation is optional. The Corporation's controller is the designated Plan administrator. Contributions to the Plan during the years ended September 30, 2004 and 2003 were \$215,774 and \$195,339, respectively. Management is of the opinion that the plan does not represent an asset or liability of the Corporation. For the years ended September 30, 2004 and 2003, plan assets were \$2,756,833 and \$2,378,760, respectively.

(11) External Carriers

External carriers located in other countries are subject to oversight policies from their respective regulatory agencies. Currently, U.S. regulatory agencies are contemplating a reduction of the tariff rate used by the Corporation for settlement with certain U.S. carriers. The ultimate outcome of this matter and the related impact on FSM Telecommunications Corporation cannot be predicted at this time.

(12) Adoption of New Accounting Standard

In fiscal year 2005, FSMTC will be implementing GASB Statement No.42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The Corporation has not evaluated the financial statement impact of GASB No. 42.

(13) Sale of Investment

On January 28, 2005, Zeus Merger One Limited purchased all of Intelsat's issued and outstanding shares. The outcome of the sale will be reflected in the 2005 financial statements.

(14) Typhoon Repairs

In April 2004, a typhoon struck Yap causing significant damage to the Corporation's properties. Costs of the repairs were estimated at \$171,244 of which 75% or \$128,433 will be reimbursed by the Federal Emergency Management Agency in the subsequent year.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Schedule of Operating Expenses  
Years Ended September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Salaries and wages	\$ 3,504,413	\$ 3,033,955
Depreciation	2,999,448	2,887,137
Circuit lease	828,883	609,210
Bad debt	687,696	597,976
Contractual services	562,218	582,367
Utilities	519,416	504,011
Travel	374,111	267,577
Advertising	368,834	329,473
Repairs and maintenance	368,710	224,958
Cost of Sales	349,447	-
Communications	286,748	538,581
Insurance	71,736	59,153
Freight	58,611	37,109
Representation	47,752	23,491
Import tax expense	45,950	38,396
ICTV taping services	41,202	34,650
Petroleum and lubricants	35,670	46,817
Rental expenses	35,042	31,964
Land leases	28,032	11,945
Publications and printing	27,256	39,544
Supplies	21,972	71,908
Professional fees	16,163	98,425
ICTV affiliated	264	27,718
Recruitment	-	4,650
Miscellaneous	<u>79,811</u>	<u>56,079</u>
Total	\$ <u>11,359,385</u>	\$ <u>10,157,094</u>

See Accompanying Independent Auditors' Report.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Chairman  
Board of Directors  
Federated States of Micronesia  
Telecommunications Corporation:

We have audited the financial statements of the Federated States of Micronesia Telecommunications Corporation (FSMTC), as of and for the year ended September 30, 2004, and have issued our report thereon dated March 4, 2005. We conducted our audit 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.

Internal Control Over Financial Reporting

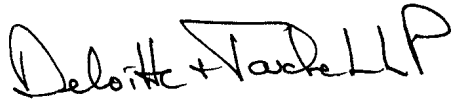
In planning and performing our audit, we considered FSMTC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financing reporting that, in our judgment, could adversely affect FSMTC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 04-1 and 04-2.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we consider none of the reportable conditions described above to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether FSMTC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors and management of FSMTC, federal awarding agencies, the Rural Utilities Service, supplemental lenders, pass-through entities, the cognizant audit and other federal agencies, 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 "Deloitte + Stacke LLP". The signature is written in a cursive, slightly slanted style.

March 4, 2005

## **INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Chairman  
Board of Directors  
Federated States of Micronesia  
Telecommunications Corporation:

### Compliance

We have audited the compliance of the Federated States of Micronesia Telecommunications Corporation (FSMTC) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2004. FSMTC's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 22). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of FSMTC's management. Our responsibility is to express an opinion on FSMTC's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about FSMTC's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on FSMTC's compliance with those requirements.

In our opinion, FSMTC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2004.

### Internal Control Over Compliance

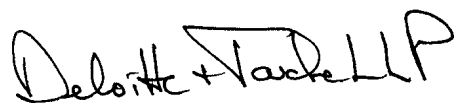
The management of FSMTC is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered FSMTC's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control on compliance and its operation that we consider to be material weaknesses.

#### Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of Federated States of Micronesia Telecommunications Corporation as of and for the year ended September 30, 2004, and have issued our report thereon dated March 4, 2005. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 21) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the Federated States of Micronesia Telecommunications Corporation. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Directors and management of FSMTC, federal awarding agencies, the Rural Utilities Service, supplemental lenders, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

March 4, 2005

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Schedule of Expenditures of Federal Awards  
Schedule of Contracts  
Rural Utilities Service Loan Funding (CFDA #10.851)  
Year Ended September 30, 2004

	Loan Proceeds Approved as of <u>September 30, 2004</u>	Loan Proceeds Received During <u>FY 2004</u>	Total Disbursements On Contracts During <u>FY2004</u>
F/A 1	\$ 411,584	\$ -	\$ -
Work Orders	422,905	-	-
CT. A-4	90,688	-	-
CT. A-5	1,191,004	-	-
CT. A-6	650,676	-	-
CT. A-7	3,108,615	-	-
CT. A-8	3,500,000	-	-
CT. A-9	1,108,149	-	-
CT. A-10	636,505	-	-
CT. A-11	1,193,317	-	-
CT. A-12	1,422,800	-	-
CT. A-13	19,440,795	-	-
CT. A-14X	1,988,002	-	-
CT. A-1E	275,625	-	-
CT. A-2E	4,008,263	-	-
CT. A-3A	304,109	-	-
Operating equipment	387,263	-	-
Pre-Loan	<u>55,000</u>	<u>-</u>	<u>-</u>
	\$ <u>40,195,300</u>	\$ <u>-</u>	\$ <u>-</u>
Excess of Disbursements over Proceeds		\$ -	
Unused Loan Funds as of September 30, 2004		-	
Interest earned on RUS account net of miscellaneous bank charges		<u>-</u>	
Unused Loan Funds as of September 30, 2004		\$ <u>-</u>	

The above loan program is received in a direct capacity from the grantor. In addition, the loan payable to Rural Utilities Service, totaling \$25,963,658 at September 30, 2004, was tested for detailed compliance in accordance with OMB Circular A-133 requirements.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2004

**Part I - Summary of Auditors' Results**

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion as of September 30, 2004.
2. Reportable conditions in internal control over financial reporting were identified.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were not identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. The Organization's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Rural Utilities Service	10.851

8. No Type B programs as those terms are defined in OMB Circular A-133 are administered by the Organization.
9. The Organization did qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**Part II - Financial Statement Findings Section**

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
04-1	Timely Collection of Receivables	\$ -	23
04-2	Investment	\$ -	24

**Part III - Federal Award Findings and Questioned Cost Section**

No matters are reportable.



**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Timely Collection of Receivables

Finding No. 04-1

Criteria: Management should employ a consistent policy to ensure timely collection of receivables and this policy should incorporate the assessment of an adequate allowance for doubtful debts.

Condition: It appears that aged receivables approximating \$513,896 are carried on the books without an attendant reserve. Timely collection of these receivables is not occurring. This matter was addressed during the audit process and an allowance for doubtful accounts was provided for.

Cause: The cause of this condition appears to be that management is of the opinion that collection can occur through an offset against payables recorded to the respective debtors.

Effect: The effect of this condition is a potential adverse impact on cash flows.

Recommendation: We recommend that FSM Telecommunications Corporation evaluate its receivables by executing a collection plan that would include formulating a necessary allowance for doubtful accounts.

Auditee Response: The Management totally agrees with the findings and recommendations of this audit and is very mindful of the problems with its accounts receivables. It should be noted this is a very problematic area. Given the current economic conditions of the FSM, financial activities are relevantly slow thus contributing to delayed payments on debts incurred with FSMTC. To tackle this problem, the management is currently working on a collection plan which will be implemented on June 1, 2005. This collection plan will be aimed at controlling credit limits and streamlining the customers' aging of accounts to prevent high receivables. In addition to this, management is currently looking into prepaid arrangement for fixed telephone lines.

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Investment

Finding No. 04-2

Criteria: The FSMTC investment policy requires that certain asset allocations be met.

Condition: We found investment allocations did not comply with current policy.

Cause: The cause of this condition is that certain investments are more profitable than others. Therefore, management is reluctant to require a reallocation as investment returns are meeting expectations. Management addressed this matter with the Board and resolution has yet to occur.

Effect: The effect of this condition is potential noncompliance with the policy.

Prior Year Status: This matter was addressed to management in our 2002 and 2003 report.

Recommendation: We recommend that the FSMTC ensure that investment allocations are maintained in accordance with the policy or that the policy be amended.

Auditee Response: The Management also agrees with the findings and recommendations and the Office of the Controller has been tasked to look into the possibility of amending the Investment Policy to resolve this finding from reappearing in the yearly audits. The amendment should consider the Investment Managers to maintain cash, on a reasonable time, during Trades.