FEDERATED STATES OF MICRONESIA TELECOMMUNICATIONS CORPORATION

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

YEARS ENDED SEPTEMBER 30, 2005 AND 2004

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION

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Years Ended September 30, 2005 and 2004

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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, 2005 and 2004, 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, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 18) 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 December 9, 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.

Deloitte & Touche LLP

December 9, 2005

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION

Management Discussion and Analysis
Year Ending September 30, 2005

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, 2005. 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 the 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. On October 10, 2005, a wireless TV broadcasting system was launched in the State of Yap, which is also a subsidiary of FSMTC.

The FSMTC is under the governance of an appointed five member Board of Directors by the President of the FSM and the Governors of each State, that have 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 a little over 10,000 subscribers. Other telecommunications services provided are National and International Overseas Calls, Internet Services, Mobile Cellular Services, Cable Television in the State of Kosrae, and Wireless TV in the State of Yap.

The FSMTC relies on calls made to and from outside of the FSM and calls within the FSM, which account for approximately 40% of the FSMTC generating revenues. During FY2005, Internet Services accounted for $2,034,463 or 17% of the FSMTC generated revenues. As of September 30, 2005, total Internet subscribers users was 1,518 broken down as 41 leased subscribers, 1,406 postpaid subscribers, and 71 prepaid subscribers.

In FY2004, the Board of Directors approved $2.6 million for improvement of the cellular coverage for the States of Pohnpei, Chuuk and Yap. As of September 30, 2005, $1,371,464 was encumbered leaving the unencumbered amount of $1,278,536.

The mobile services accounted for $2,670,692 or 22% of the FSMTC generated revenues in FY2005. At September 30, 2005, the total mobile subscribers was 17,379, broken down as follows: Pohnpei 8,797, Chuuk 3,548, Yap 3,663 and Kosrae 1,371.

The following table summarizes the financial condition and operations of the FSMTC for FY2005 and FY2004:

FEDERATED STATES OF MICRONESIA TELECOMMUNICATIONS CORPORATION

Management Discussion and Analysis, Continued
Year Ending September 30, 2005

Assets:	2005	2004
Property, plant and equipment	$ 42,509,471	$ 42,699,142
Cash and cash equivalents	1,663,535	3,387,526
Time certificate of deposit and investment in securities	13,066,068	8,887,681
Receivables and prepayments	1,811,303	2,377,162
Other assets	736,968	1,392,631
	$ 59,787,345	$ 58,744,142
Current liabilities	$ 1,766,254	$ 1,444,714
Notes payable – long-term	24,558,245	25,253,521
Net assets	33,462,846	32,045,907
	$ 59,787,345	$ 58,744,142
Revenues, expenses and changes in net assets:		
Operating revenues	$ 12,042,016	$ 11,944,507
Operating expenses	(11,700,881)	(11,359,385)
Net operating earnings	341,135	585,122
Interest income and others	2,327,492	950,837
Interest expense	(1,251,688)	(1,170,821)
Increase in net assets	1,416,939	365,138
Net asset end of year	$ 33,462,846	$ 32,045,907

Overall there were only minor changes in the balance sheet components. However, during FY2005, the total amount received from telecommunication services exceeded the amount paid to vendors and employees for goods and services. This resulted in net cash provided by operating activities amounted to $4,243,509 per the cash flow statement.

Total cash and equivalents at the end of FY05 is $1,663,535 as compared to $3,387,526 in FY04. The decrease was due to the additional long term investments purchased during FY05. The statement of cash flow showed that net cash used for capital and related financing activities exceeded net cash provided by operating activities by ($751,142).

Total revenues in FY2005 increased by $97,509 as compared to FY2004. A decrease in overseas tolls was contributed from the decrease in International voice traffic which can be attributed to the rate reduction made effective in October 2004 (FY05). However, there is a huge revenue recovery from Mobile Cellular services in FY05. Operating Expenses in FY05 increased by $341,496 or 3%. Most of the increase is contributed from the increase in depreciation expenses for general purpose computers (Management Information System Software & Hardware). Other contributors to this increase were Mobile Cellular Expense due to an increase in depreciation expense.

The FSMTC investments in property, plant, and equipment, net of accumulated depreciation, amounted to $42,699,142 in FY2004 and $42,509,471 in FY2005. The decrease was caused by the increase in depreciation expense and the retirement of equipment of $104,473.

FSMTC's Notes Payable with the US Department of Agriculture (Rural Utility Services) amounted to $25,235,941 of which, $746,523 was classified as the current portion. The interest on debt paid during FY2005 was $1,251,688, net of capitalized interest of $298,476 in accordance with FASB 34, associated with construction projects that exceed one year. The principal amount paid during FY2005 was $727,717.

During FY05, FSMTC received $1,940,016 from the sale of the FSMTC shares with IntelSat. FSMTC was not able to keep the stock with the new owner of IntelSat, which is Zues. The proceeds from the sales were calculated at 83,334 shares times the sale price of $18.75 per share.

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION

Statements of Net Assets
September 30, 2005 and 2004

	2005	2004
ASSETS		
Current assets:		
Cash	$ 1,663,535	$ 3,387,526
Time deposits	206,834	105,231
Investments in securities	12,859,234	8,782,450
Accounts receivable, net of an allowance for doubtful accounts of $3,692,175 and $3,180,225 in 2005 and 2004, respectively	555,223	963,909
Receivables from carriers, net	389,545	387,908
Advances to employees	22,526	34,515
Inventory	559,035	416,669
Accrued interest and other accrued earnings	248,958	255,744
Other receivables and prepaid expenses	595,051	735,086
Total current assets	17,099,941	15,069,038
Investment-Intelsat	-	910,114
Deferred charges	177,933	65,848
Property, plant and equipment, net	42,509,471	42,699,142
	$ 59,787,345	$ 58,744,142
LIABILITIES AND NET ASSETS		
Current liabilities:		
Notes payable-current portion	$ 746,523	$ 710,137
Accounts payable, trade	121,386	122,913
Deferred revenue-debit cards	48,080	2,391
Accrued leave payable	115,176	122,992
Other payables and accrued expenses	735,089	486,281
Total current liabilities	1,766,254	1,444,714
Long-term contracts payable	68,827	-
Long-term portion of notes payable	24,489,418	25,253,521
Total liabilities	26,324,499	26,698,235
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	17,204,703	16,735,484
Unrestricted	16,258,143	15,310,423
Total net assets	33,462,846	32,045,907
	$ 59,787,345	$ 58,744,142

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, 2005 and 2004

	2005	2004
Operating revenues:		
Overseas tolls	$ 3,686,908	$ 4,301,250
Internet	2,034,463	2,080,444
Net access	2,058,468	2,040,363
Mobile charges	2,670,692	1,802,325
External carriers	1,339,341	1,450,421
ICTV Kosrae cable charges	126,457	122,156
Miscellaneous	125,687	147,548
Total operating revenues	12,042,016	11,944,507
Operating expenses:		
Consumer operations	1,907,596	1,870,874
Corporate operations	1,821,644	1,952,524
Plant operations	1,406,394	1,231,775
Cable and wire	1,242,863	1,160,888
General support	1,092,182	856,113
Earth station	1,045,293	1,100,616
Internet expense	815,543	779,884
Central office	738,887	677,798
Bad debts	504,666	687,696
Wireless telephone - Ulithi	484,632	388,044
Terminal equipment	456,917	477,470
ICTV expense	184,264	175,703
Total operating expenses	11,700,881	11,359,385
Earnings from operations	341,135	585,122
Nonoperating revenues (expenses):		
Interest income - general	22,742	21,353
Interest expense	(1,251,688)	(1,170,821)
Gain on sale of fixed assets	-	5,852
Compact of Free Association Section 215(b)	32,068	-
Investment earnings, net	2,272,682	923,632
Total nonoperating revenues (expenses), net	1,075,804	(219,984)
Increase in net assets	1,416,939	365,138
Total net assets at beginning of year	32,045,907	31,680,769
Total net assets at end of year	$ 33,462,846	$ 32,045,907

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION

Statements of Cash Flows
Years Ended September 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Cash received from customers	$ 12,595,886	$ 12,411,627
Cash paid to suppliers for goods and services	(4,864,443)	(5,255,287)
Cash paid to employees	(3,487,934)	(3,506,332)
Net cash provided by operating activities	4,243,509	3,650,008
Cash flows from capital and related financing activities:		
Repayments of notes payable	(727,717)	(690,344)
Additions to property, plant and equipment	(3,047,314)	(2,143,300)
Proceeds from sale of fixed assets	-	5,852
Interest paid on loan payable	(1,251,688)	(1,170,821)
Contributions from compact	32,068	-
Net cash used for capital and related financing activities	(4,994,651)	(3,998,613)
Cash flows from investing activities:		
(Additions) withdrawals from time deposits	(100,000)	100,000
(Additions) withdrawals from investments	(2,834,003)	624,484
Proceeds from sale of Intelsat	1,940,016	-
Interest earned - investments	21,138	200,204
Net cash (used for) provided by investing activities	(972,849)	924,688
Net (decrease) increase in cash	(1,723,991)	576,083
Cash at beginning of year	3,387,526	2,811,443
Cash at end of year	$ 1,663,535	$ 3,387,526
Reconciliation of earnings from operations and to net cash provided by operating activities:		
Earnings from operations	$ 341,135	$ 585,122
Adjustments to reconcile earnings from operations to net cash provided by operating activities:		
Depreciation and amortization	3,236,985	2,996,564
Bad debts	504,666	687,696
(Increase) decrease in assets:		
Accounts receivable, net	(95,980)	(621,577)
Receivables from carriers	(1,637)	510,876
Advances to employees	11,989	(1,779)
Inventory	(142,366)	57
Deferred charges	(112,085)	(15,236)
Other receivables and prepaid expenses	146,821	(391,854)
Increase (decrease) in liabilities:		
Accounts payable, trade	(1,527)	70,836
Deferred revenue-debit cards	45,689	(94,639)
Accrued leave payable	(7,816)	(140)
Long term contracts payable	68,827	-
Other payables and accrued expenses	248,808	(75,918)
Net cash provided by operating activities	$ 4,243,509	$ 3,650,008

See accompanying notes to financial statements.

(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.

(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.

    The Corporation has no restricted net assets at September 30, 2005 and 2004.

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 of the cash and time deposit balances are insured by the FDIC at September 30, 2005 and 2004. The remaining balances are uninsured and uncollateralized.

Investments in Securities

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 20% of the total portfolio may be invested in non-U.S. equities.

Investments in securities comprise the following as of September 30, 2005 and 2004:

	2005	2004
Equities	$ 8,100,664	$ 5,677,719
U.S. government obligations	1,603,587	1,004,864
Corporate bonds	1,895,010	1,698,356
Money market funds	1,259,973	401,511
	$ 12,859,234	$ 8,782,450

(1) Summary of Significant Accounting Policies, Continued

Investments in Securities, Continued

GASB Statement No. 40 requires entities to provide information about the credit risk associated with their investments by disclosing the credit quality ratings. The following is a listing of the Corporation's corporate bonds at September 30, 2005:

		Year Ending September 30,						
Rating	Interest	2006	2007	2008	2009	2010	Thereafter	Total
AAA	4.63%	$ -	$ -	$ -	$ 99,903	$ -	$ -	$ 99,903
AA	5.45%	75,599	-	-	-	-	-	75,599
AA-	4.25%, 5.75%	-	100,950	-	118,314	-	-	219,264
A+	5.63%, 5.8%, 6%, 6.45%, 6.65%, 7%, 7.5%, 8.25%	-	488,089	-	53,076	-	367,445	908,610
A	5%, 5.75%, 7.88%	-	174,529	-	155,040	-	-	329,569
A-	5.50%	-	126,913	-	-	-	-	126,913
BB+	6.13%	135,152	-	-	-	-	-	135,312
Total		$ 210,751	$ 890,481	$ -	$ 426,333	$ -	$ 367,445	$ 1,895,010

Net investment income comprises the following for the years ended September 30, 2005 and 2004:

	2005	2004
Interest and dividends	$ 284,651	$ 167,738
Unrealized earnings on investments	958,130	755,894
Realized earnings on sale of investment	1,029,901	-
Net investment income	$ 2,272,682	$ 923,632

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.

(1) Summary of Significant Accounting Policies, Continued

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 $2,000 or more and an estimated useful life of at least five years.

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 valued 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.

(1) Summary of Significant Accounting Policies, Continued

Reclassification

Several of the 2004 balances have been reclassified to conform to the 2005 financial statement presentation.

(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, the investment balance of $910,114 is carried at cost. As of September 30, 2005, the investment was sold for $1,940,016.

(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."

(4) Property, Plant and Equipment, Net

Property, plant and equipment, net as of September 30, 2005 and 2004, is as follows:

	Estimated Useful Lives	Beginning Balance October 1, 2004	Transfers and Additions	Transfers and Deletions	Ending Balance September 30, 2005
General support	5-35 years	$ 13,724,803	$ 427,219	$ (104,270)	$ 14,047,752
Central office	20 years	9,630,526	806,622	-	10,437,148
Earth station	20 years	5,031,016	13,200	-	5,044,216
Terminal equipment	5-20 years	4,083,339	179,046	-	4,262,385
Cellular network	10-20 years	4,357,616	745,470	-	5,103,086
Internet equipment	8 years	635,633	123,393	-	759,026
Pole, cable and wiring	15-20 years	32,514,847	677,577	-	33,192,424
Total		69,977,780	2,972,527	(104,270)	72,846,037
Accumulated depreciation		(29,487,427)	(3,236,985)	104,270	(32,620,142)
		40,490,353	(264,458)	-	40,225,895
Plant under construction		2,208,789	1,743,604	(1,668,817)	2,283,576
Property, plant and equipment, net		$ 42,699,142	$ 1,479,146	$ (1,668,817)	$ 42,509,471

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

	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	32,123,475	391,372	-	32,514,847
Total		67,340,052	2,936,525	(298,797)	69,977,780
Accumulated depreciation		(26,789,660)	(2,996,564)	298,797	(29,487,427)
		40,550,392	(60,039)	-	40,490,353
Plant under construction		3,002,014	1,325,674	(2,118,899)	2,208,789
Property, plant and equipment, net		$ 43,552,406	$ 1,265,635	$ (2,118,899)	$ 42,699,142

(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 qualifying construction-in-progress was $298,479 and $144,269 during the years ended September 30, 2005 and 2004, respectively.

(6) Notes Payable

	2005	2004
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.	$ 25,235,941	$ 25,963,658
Less: current portion	746,523	710,137
Long-term portion of notes payable	$ 24,489,418	$ 25,253,521

(6) Notes Payable, Continued

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

Year ending September 30,	Principal	Interest	Total
2006	$ 746,523	$ 1,261,797	$ 2,008,320
2007	783,849	1,224,471	2,008,320
2008	823,042	1,185,278	2,008,320
2009	864,194	1,144,126	2,008,320
2010	907,403	1,100,917	2,008,320
2011 through 2015	5,264,675	4,776,925	10,041,600
2016 through 2020	6,719,207	3,322,393	10,041,600
2021 through 2025	8,575,600	1,466,000	10,041,600
2026	551,448	27,572	579,020
	$ 25,235,941	$ 15,509,479	$ 40,745,420

A summary of changes in long-term liabilities during fiscal year 2005 and 2004, follows:

	Outstanding Balance September 30, 2004	Increases	Decreases	Outstanding Balance September 30, 2005	Current	Noncurrent
Note payable to Rural Utilities Service	$25,963,658	$ -	$727,717	$25,235,941	$746,523	$24,489,418
Long-term contracts	$ -	$68,827	$ -	$ 68,827	$ -	$ 68,827

	Outstanding Balance September 30, 2003	Increases	Decreases	Outstanding Balance September 30, 2004	Current	Noncurrent
Note payable to Rural Utilities Service	$26,654,002	$ -	$690,344	$25,963,658	$710,137	$25,253,521

(7) Commitments and Contingencies

Leases

The Corporation has fifteen operating leases as of September 30, 2005. 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 2025.

(7) Commitments and Contingencies, Continued

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

Year ending September 30:	Total
2006	$ 627,237
2007	542,829
2008	536,229
2009	536,129
2010	536,129
2011-2015	2,658,375
2016-2020	39,939
2021-2025	15,876
	$ 5,492,743

Self Insurance

The Corporation purchases insurance to cover risks associated with its buildings and equipment ($17,530,500 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 $2,379,500) 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, 2005, the Corporation entered into various contracts for construction and expansion of its facilities and services. Approximately $1,929,199 is outstanding under these contracts as of September 30, 2005.

(8) 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, 2005, the Corporation has receivables from the National Government of approximately $264,470 ($402,957 at September 30, 2004).

(9) 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, 2005 and 2004 were $230,485 and $215,774, 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, 2005 and 2004, plan assets were $3,128,162 and $2,756,833, respectively.

(10) 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.

(11) Adoption of New Accounting Standards

In fiscal year 2006, the Corporation will be implementing GASB Statement No.47, *Accounting for Termination Benefits*. The Corporation has not evaluated the financial statement impact of GASB No. 47. In fiscal year 2005, the Corporation implemented GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Management believes GASB Statement No. 42 has no material impact.

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION

Schedule of Operating Expenses
Years Ended September 30, 2005 and 2004

	2005	2004
Salaries and wages	$ 3,492,107	$ 3,504,413
Depreciation	3,236,985	2,999,448
Circuit lease	1,183,284	828,883
Utilities	618,519	519,416
Bad debt	504,666	687,696
Contractual services	402,990	562,218
Repairs and maintenance	362,860	368,710
Travel	346,165	374,111
Advertising	318,769	368,834
Cost of sales	285,500	349,447
Communications	260,943	286,748
Supplies	100,844	21,972
Insurance	74,886	71,736
Import tax expense	71,243	45,950
Petroleum and lubricants	47,983	35,670
Professional fees	42,712	16,163
Publications and printing	41,880	27,256
ICTV taping services	40,577	41,202
Freight	36,453	58,611
Rental expenses	35,042	35,042
Representation	31,922	47,752
ICTV affiliated	14,933	264
Land leases	-	28,032
Miscellaneous	149,618	79,811
Total	$ 11,700,881	$ 11,359,385

See Accompanying Independent Auditors' Report.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN 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, 2005, and have issued our report thereon dated December 9, 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting 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 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weakness.

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.

Deloitte + Touche LLP

December 9, 2005

Deloitte.

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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, 2005. FSMTC's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 24). 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, 2005.

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, 2005, and have issued our report thereon dated December 9, 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 23) 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.

Deloitte & Touche LLP

December 9, 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, 2005

	Loan Proceeds Approved as of September 30, 2005	Loan Proceeds Received During FY 2005	Total Disbursements On Contracts During FY2005
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	55,000	-	-
	$ 40,195,300		

Excess of Disbursements over Proceeds	$ -
Unused Loan Funds as of September 30, 2005	$ -
Interest earned on RUS account net of miscellaneous bank charges	-
Unused Loan Funds as of September 30, 2005	$ -

The above loan program is received in a direct capacity from the grantor. In addition, the loan payable to Rural Utilities Service, totaling $25,235,941 at September 30, 2005, was tested for detailed compliance in accordance with OMB Circular A-133 requirements.

Grantor/CFDA Grantor's Program Title	Federal CFDA Number	Expenditures
Compact of Free Association 215(b) – Pass-through from FSM National Government	15.875	$ 32,068

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION

Schedule of Findings and Questioned Costs
Year Ended September 30, 2005

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion as of September 30, 2005.
2. Reportable conditions in internal control over financial reporting were not 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:

Name of Federal Program or Cluster	CFDA Number
Rural Utilities Service	10.851

8. A threshold of $300,000 was used to distinguish between Type A and Type B programs.
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

No matters are reportable.

Part III - Federal Award Findings and Questioned Cost Section

No matters are reportable.