# FEDERATED STATES OF MICRONESIA TELECOMMUNICATIONS CORPORATION

## (A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)

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## FINANCIAL STATEMENTS, ADDITIONAL INFORMATION AND INDEPENDENT AUDITORS' REPORT

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## YEARS ENDED SEPTEMBER 30, 2010 AND 2009

**FEDERATED STATES OF MICRONESIA**
**TELECOMMUNICATIONS CORPORATION**
**(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)**

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Years Ended September 30, 2010 and 2009

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# INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the accompanying statements of net assets of the Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation), a component unit of the FSM National Government, as of September 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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 the Corporation'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 the Corporation as of September 30, 2010 and 2009, 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 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were conducted for the purpose of forming an opinion on the Corporation's basic financial statements. The accompanying schedule of operating expenses (page 25) is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the Corporation. Such information has been subjected to the auditing procedures applied by us in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects 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 6 2010, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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 considered in assessing the results of our audit.

Deloitte + Touche LLP

December 6, 2010

Years Ended September 30, 2010 and 2009

Our discussion and analysis of the Federated States of Micronesia Telecommunication Corporation (FSMTC) financial performance provides an overview of the FSMTC financial activities for the fiscal year then ended September 30, 2010. This discussion has been prepared by the FSMTC Management to further provide an introduction and understanding of the basic financial statements for the year ended September 30, 2010. Please read it in conjunction, with the financial statements and the notes thereto, which follow this discussion and analysis. Fiscal year 2009 and 2008 comparative information has been included, where appropriate.

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 FSM. The FSMTC also provides Cable TV in the State of Kosrae and a wireless TV broadcasting system in the State of Yap.

The FSMTC is under the governance of an appointed 5-member Board of Directors by President of the FSM and Governor of each States, which has oversight over both the FSMTC, Cable TV in Kosrae and wireless TV broadcasting in Yap. The General Manager, who is the President and 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 8,441 active subscribers. Other telecommunications services provided are National and International Overseas Calls, Internet Services, Mobile Cellular Services, Cable Television in State of Kosrae, and Wireless TV in State of Yap.

The FSMTC relies on calls made to and from outside of FSM and calls within the FSM, which account for 23.10% of FSMTC's FY 2010 operating revenues as compared with 25.35% of the FSMTC's FY 2009 operating revenues. During FY 2010, FSMTC realized a decrease in Call revenue of $6,266 (or 0.19%) as compared to FY 2009. Management believes that the decrease was caused by the increase in internet usage and mobile services.

Internet Services account for 25.9% of FSMTC's FY 2010 operating revenues as compared with 25.5% of FSMTC's FY 2009 operating revenues. During FY 2010, FSMTC realized an increase in Internet service revenues of $359,714 (or 9.8%) as compared to FY 2009. As of September 30, 2010, total internet subscribers were 3,084, up from 1,313 in FY 2009.

Mobile services account for 24.2 % of FSMTC's FY2010 operating revenues as compared with 19.6% of FSMTC's FY 2009 operating revenues. During FY 2010, FSMTC realized an increase in mobile service revenues of $875,199 (or 25.4%) as compared to FY 2010. In FY10, the FSMTC invested an additional $105,085 as an upgrade to its Mobile network system. At September 30, 2010, total mobile subscribers were 62,825 up from 42,776 in FY 2009. Total mobile subscribers are broken down as follows: Pohnpei 28,961 (up from 19,972 in FY 2009), Chuuk 18,104 (up from 11,625 in FY 2009), Yap 10,926 (up from 7,700 in FY 2009) and Kosrae 4,834 (up from 3,479 in FY2009).

Statement of Net Assets

The statement of net assets presents the assets, liabilities, and net assets as of the end of the fiscal year. This statement is a point of time financial statement. The purpose of the statement of net assets is to present to the readers of the financial statements a fiscal snapshot of the FSMTC. The statement of net assets presents end-of-year data concerning assets (current and noncurrent), liabilities (current and noncurrent), and net assets (assets minus liabilities).

From the data presented, readers of the statement of net assets are able to determine the assets available to continue the operations of the FSMTC. They also are able to determine how much the FSMTC owes vendors and lending institutions. Finally, the statement of net assets provides a picture of the net assets (assets minus liabilities), which is a useful indicator of whether the financial position of the FSMTC is improving or deteriorating.

The following table summarizes the financial condition and operations of the FSMTC for FY2010, FY2009 and for FY2008:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Assets: | | | |
| Cash and cash equivalents | $ 519,268 | $ 482,043 | $ 774,009 |
| TCD's and investment in securities | 5,640,774 | 7,455,594 | 7,692,779 |
| Receivables and prepayments | 1,712,810 | 2,674,240 | 2,122,049 |
| Inventory | 821,936 | 576,317 | 657,118 |
| Total current assets | 8,694,788 | 11,188,194 | 11,245,955 |
| Property, plant and equipment | 56,360,754 | 53,391,534 | 44,435,621 |
| Total assets | 65,055,542 | 64,579,728 | 55,681,576 |
| Liabilities: | | | |
| Current liabilities | $ 5,073,361 | $ 2,647,863 | $ 2,774,620 |
| Noncurrent liabilities | 31,912,503 | 32,095,934 | 22,824,013 |
| Total liabilities | 36,985,864 | 34,743,797 | 25,598,633 |
| Net assets: | | | |
| Invested in capital assets, net of related debt | 23,221,821 | 20,366,732 | 21,611,207 |
| Unrestricted | 4,847,857 | 9,469,199 | 9,524,603 |
| Total net assets | 28,069,678 | 29,835,931 | 31,135,180 |
| | $ 65,055,542 | $ 64,579,728 | $ 55,681,576 |

The total assets of FSMTC increased when compared with prior year. The statement of assets reveals that the increase in total assets is primarily the result of an increase in capital assets, which represents FSMTC's investment in plant under construction associated with the new Fiber Optic project and the roll out of the ADSL and other related internet features.

The total liabilities of FSMTC increased by $2,242,067 compared with prior year. The primary cause of this change is the increase in long-term debt associated with the Rural Utilities Service (RUS) loan for the new Fiber Optic project.

Total equity of FSMTC was affected by the change in both assets and liabilities and decreased by $1,766,253.

During FY 2010, total cash received from telecommunication services exceeded the amounts paid to vendors and employees for goods and services. This resulted in net cash provided by operating activities of $3,508,238 as compared with $2,680,979 in FY 2009.

Total cash and cash equivalents at the end of FY 2010 is $519,268 as compared to $482,043 in FY 2009. The net cash used during FY 2010 exceeded the net cash provided from operations, mainly due to the acquisition of new capital assets for the Fiber Optic project. The FSMTC withdrew $2,500,000 from its marketable securities with Morgan Stanley Smith Barney to support its cash flow requirements for the Cellular expansion projects, the deployment of the ADSL and the VDSL features and related Net Work upgrade in FY 2010. FSMTC also borrowed from its investments during FY 2010 in the total amount of $2,200,000 with interest at 5.25%.

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets as presented on the statement of net assets are based on the activity presented in the statement of revenues, expenses and changes in net assets. The purpose of this statement is to present the revenues received by the FSMTC, both operating and non-operating, and expenses incurred by the FSMTC, operating and non-operating, any other revenues, expenses, gains, and losses received or spent by the FSMTC.

Generally speaking, operating revenues are generated from the provision of telecommunications goods and services to various customers. Operating expenses are those expenses incurred to acquire or produce the goods or services provided in return for the operating revenues, and to carry out the mission of the FSMTC. Non-operating revenues are revenues received for which goods or services are not provided. For example, investment income is non-operating because it is earned without providing telecommunications goods or services.

The following table summarizes the financial operations of the FSMTC for the years ended September 30, 2010, 2009, and 2008:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Operating revenues | $ 13,527,512 | $ 12,948,819 | $ 12,464,999 |
| Operating expenses | (14,779,111) | (13,587,453) | (13,500,363) |
| Net operating (loss) income | (1,251,599) | (638,634) | (1,035,694) |
| Interest income and others | 641,964 | 484,432 | (1,207,233) |
| Interest expense | (1,156,618) | (1,145,677) | (771,071) |
| Increase (decrease) in net assets | (1,766,253) | (1,299,879) | (3,013,998) |
| Net assets beginning of year | 29,835,931 | 31,135,810 | 34,149,808 |
| Net asset, end of year | $ 28,069,678 | $ 29,835,931 | $ 31,135,810 |

Total revenue in FY 2010 increased by $578,693 (or 4.28%) compared to FY 2009. The increase in FY 2010 revenues was due to increase in Mobile services revenue and Internet services revenue. Operating expenses in FY 2010 increased by $1,191,658 (or 8.8%) compared to FY 2009 operating expenses. Most of the increase was attributed to the increase in depreciation expense, the Intelsat Circuit Lease, the Service Level Agreement with various vendors that provided the equipment to the Cellular Net Work and the switches and other related.

The FSMTC investments in property, plant, and equipment, net of accumulated depreciation, amounted to $56,360,754 in FY2010 and $53,391,534 in FY2009. For additional information concerning capital assets, please refer to note 4 to the accompanying financial statements.

FSMTC's notes payable with the US Department of Agriculture (Rural Utility Services) amounted to $33,138,932 of which $1,226,430 is classified as the current portion. This represented an overall increase in long-term debt of $12,136,034, net of current year principal repayments of $949,509. Interest on funded debts paid during FY 2009 approximated $1,102,786, net of capitalized interest of $567,524 in accordance with FASB 34, associated with construction projects that exceed one year. For additional information concerning the FSMTC's long-term debt, please refer to note 7 to the accompanying financial statements.

On November 1, 2005, The FSMTC Board of Directors approved a comprehensive Strategic Plan to direct the Corporation for the next 5 years from 2006 to 2011. The purpose of this Plan is for management directional tool for policy development as well as program delivery. It will guide the board, management, and staff in dealing with the challenges due to the continuous changes in technology.

Based on the plan, FSMTC is committed to spend $104,225,504 during the next 5 years with expected revenues of $87,217,204, the aggregate shortfall is $17 million. As a result, FSMTC may end up having to borrow from international financial markets to cover the shortfall or to tap into its cash reserve to cover it.

On November 19, 2008, United States Department of Agriculture Rural Development notified the FSMTC that based on the preliminary review of its "B" loan application, the FSMTC was qualified to borrow an additional amount of $13,120,000. At September 30, 2009, the FSMTC has drawn-down $11,072,394 from RUS for the purpose of funding the Fiber Optic Cable projects and at September 2010, the FSMTC has drawn-down $1,163,640, with the total drawn-down at $12,136,034. The loan proceeds of $3,708,000 was to purchase 8 wavelengths of the fiber capacity of two fibers of the Kwajalein Cable System (KCS) as a capital lease for 25 years. The remaining balance of the loan is for electronics, engineering, and construction of the undersea facilities between Pohnpei and the KCS network branch

## Economic Outlook

The Corporation is in the process of expanding its Mobile Services, in Pohnpei, Chuuk, Yap and Kosrae the Board of Directors had approved $3,283,522 for such upgrade. Management believes that with this expansion, communication connectivity using mobile services within the Nations and out to world will improve. The Corporation has modern, state of art equipment and tariff rates that we feel are very reasonable compared with other telephone companies in the Pacific Region.

Most of the telecommunication services provided in other more develop countries are available in the Federated States of Micronesia. These modern telecommunications services should go a long way in assisting the Federated States of Micronesia in its efforts to attract investors and further develop our island nations.

The Board of Directors in its meeting of April 13-14, 2010 approved the sum of $525,000, of which $225,000 for ADSL2+ backhual and $300,000 Core Network (Virtualization) Project. In summary the purpose, is that, the integration of the Fiber Optic Cable in Pohnpei to the FSMTC network services is not possible without the procurement of appropriate equipment and an overhaul of exiting IP services (VOIP and Data). The Fiber Optic provisioning in Pohnpei will have little effect on the FSM States of Chuuk, Kosrae, and Yap without significant improvements to the domestic satellite connectivity.

The new Core Network and associated satellite connectivity upgrades will position FSMTC for further growth in the IP sector, and provide the ability to offer new services such as DSL, increasing IP revenue streams while providing superior customer satisfaction and increased Internet speeds.

WiFi Network upgrade pilot projects, the FSMTC with the approved sum of $75,000 by the Board of Directors in its meeting of April 13-14, 2010, for the purposes of the Internet upgrade in Chuuk lagoon, The upgrade in summary is necessary to re-design the WiFi network in order to provide better products to customers and to recover revenues which are current lost from WiFi services being unavailable.

The Board of Directors also approved $1,616,188 in its meeting of April 13-14 2010 for upgrade of Digital Broadcasting TV in Yap State and installation of Digital Broadcasting TV in Chuuk State. With these rollouts, FSMTC will anticipate another increase in revenue in years to come.

Under the FSMTC Five Year Strategic Plan under expenditures categories, the Fiber Optic estimate was for $15,859,230 for the projects, but with RUS approval of the funds of $13,120,000.00, the Corporation will be anticipating a reduction of approximately $2,739,230, which will reduce the original forecast of $104,225,504.

Management's Discussion and Analysis for the year ended September 30, 2009 is set forth in FSMTC'S report on the audit of financial statements, which is dated December 7, 2009. That discussion and Analysis explains the major factors impacting the 2009 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

**Financial Contact**

This financial report is designed to provide all interested users with a general overview of the Federated States of Micronesia Telecommunications Corporation. If you have questions about this report or need additional financial information, please contact John Sohl, President or Marcelino Semens at email addresses jsohl@mail.fm or msemens@mail.fsm, respectively, or please write us at P.O. Box 1210, Kolonia, Pohnpei 96941.

**FEDERATED STATES OF MICRONESIA**
**TELECOMMUNICATIONS CORPORATION**
**(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)**

Statements of Net Assets
September 30, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 519,268 | $ 482,043 |
| Time certificates of deposit | 174,963 | 114,674 |
| Investment in securities | 5,465,811 | 7,340,920 |
| Accounts receivable, net of an allowance for doubtful accounts of $1,151,453 and $638,497 in 2010 and 2009, respectively | 428,744 | 969,435 |
| Receivables from carriers | 385,902 | 519,410 |
| Advances to employees | 27,656 | 9,838 |
| Inventory | 821,936 | 576,317 |
| Accrued interest and other accrued earnings | 117,105 | 163,387 |
| Other receivables and prepaid expenses | 753,403 | 1,012,170 |
| Total current assets | 8,694,788 | 11,188,194 |
| Property, plant and equipment, net | 52,777,579 | 49,918,048 |
| Indefeasible right of use | 3,583,175 | 3,473,486 |
| | $ 65,055,542 | $ 64,579,728 |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities: | | |
| Short-term borrowings | $ 2,252,356 | $ 308,150 |
| Current maturities of long-term debt | 1,226,430 | 928,868 |
| Accounts payable, trade | 718,538 | 245,074 |
| Accounts payable, construction | 103,308 | 103,308 |
| Deferred revenue-debit cards | 72,228 | 125,373 |
| Accrued leave payable | 126,020 | 111,212 |
| Other accrued liabilities | 574,481 | 825,878 |
| Total current liabilities | 5,073,361 | 2,647,863 |
| Long-term debt, net of current portion | 31,912,503 | 32,095,934 |
| Total liabilities | 36,985,864 | 34,743,797 |
| Commitments and contingencies | | |
| Net assets: | | |
| Invested in capital assets, net of related debt | 23,221,821 | 20,366,732 |
| Unrestricted | 4,847,857 | 9,469,199 |
| Total net assets | 28,069,678 | 29,835,931 |
| | $ 65,055,542 | $ 64,579,728 |

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA**
**TELECOMMUNICATIONS CORPORATION**
**(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)**

Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended September 30, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| Operating revenues: | | |
| Internet | $ 3,662,037 | $ 3,302,323 |
| Overseas tolls | 3,266,778 | 3,273,044 |
| Mobile charges | 3,433,624 | 2,558,425 |
| External carriers | 1,674,511 | 1,796,123 |
| Net access | 1,750,300 | 1,788,884 |
| ICTV Kosrae cable charges | 101,585 | 91,656 |
| ICTV Yap cable charges | 48,448 | 57,775 |
| Uncollectible | (533,592) | (102,402) |
| Miscellaneous | 123,821 | 182,991 |
| Total operating revenues | 13,527,512 | 12,948,819 |
| Operating expenses: | | |
| Corporate operations | 2,391,772 | 2,335,919 |
| Plant operations | 1,988,259 | 1,786,489 |
| Consumer operations | 2,175,999 | 1,782,747 |
| Internet expense | 1,638,395 | 1,520,684 |
| Cable and wire | 1,452,885 | 1,300,642 |
| Earth station | 1,353,218 | 1,293,820 |
| General support | 1,215,514 | 1,124,590 |
| Wireless telephone | 1,181,269 | 1,080,260 |
| Central office | 634,226 | 661,124 |
| Terminal equipment | 466,302 | 394,249 |
| ICTV expense | 281,272 | 306,929 |
| Total operating expenses | 14,779,111 | 13,587,453 |
| Loss from operations | (1,251,599) | (638,634) |
| Nonoperating revenues (expenses): | | |
| Interest expense | (1,302,187) | (1,139,815) |
| Investment income | 787,533 | 478,570 |
| Total nonoperating revenues (expenses), net | (514,654) | (661,245) |
| Change in net assets | (1,766,253) | (1,299,879) |
| Total net assets at beginning of year | 29,835,931 | 31,135,810 |
| Total net assets at end of year | $ 28,069,678 | $ 29,835,931 |

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA**
**TELECOMMUNICATIONS CORPORATION**
**(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)**

Statements of Cash Flows
Years Ended September 30, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| Cash flows from operating activities: | | |
| Cash received from subscribers, long distance carriers and other customers | $ 14,168,566 | $ 12,976,375 |
| Cash paid to suppliers for goods and services | (7,079,624) | (6,430,256) |
| Cash paid to employees | (3,580,704) | (3,865,140) |
| Net cash provided by operating activities | 3,508,238 | 2,680,979 |
| Cash flows from noncapital financing activities: | | |
| Net borrowings under line of credit facility | 1,943,807 | 308,150 |
| Interest paid on line of credit facility | (53,832) | (29,848) |
| Net cash provided by noncapital financing activities | 1,889,975 | 278,302 |
| Cash flows from capital and related financing activities: | | |
| Proceeds from issuance of RUS long-term debt | 1,063,640 | 11,072,394 |
| Additions to property, plant and equipment | (6,152,303) | (9,320,374) |
| Payments made under IRU capital lease agreement | (109,689) | (3,473,486) |
| Repayments of RUS long-term debt | (949,510) | (872,006) |
| Interest paid on RUS long-term debt | (1,670,709) | (1,379,392) |
| Net cash used for capital and related financing activities | (7,818,571) | (3,972,864) |
| Cash flows from investing activities: | | |
| Net purchases, sales and maturities of investments | (215,700) | (151,133) |
| Withdrawals from investments | 2,500,000 | 700,000 |
| Interest and dividends received on investment securities and others | 173,283 | 172,750 |
| Net cash provided by investing activities | 2,457,583 | 721,617 |
| Net change in cash and cash equivalents | 37,225 | (291,966) |
| Cash and cash equivalents at beginning of year | 482,043 | 774,009 |
| Cash and cash equivalents at end of year | $ 519,268 | $ 482,043 |
| Reconciliation of loss from operations to net cash provided by operating activities: | | |
| Loss from operations | $ (1,251,599) | $ (638,634) |
| Adjustments to reconcile loss from operations to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,860,296 | 3,827,373 |
| Bad debts | 533,592 | 102,402 |
| (Increase) decrease in assets: | | |
| Accounts receivable | 7,099 | 3,557 |
| Receivable from carriers | 133,508 | (206,678) |
| Advances to employees | (17,818) | 10,389 |
| Inventory | (245,619) | 80,801 |
| Accrued interest and other accrued earnings | 46,282 | 153,845 |
| Other receivables and prepaid expenses | 258,767 | (615,706) |
| Increase (decrease) in liabilities: | | |
| Accounts payable, trade | 473,464 | 110,225 |
| Deferred revenue-debit cards | (53,145) | (54,415) |
| Accrued leave payable | 14,808 | (2,851) |
| Other payables and accrued expenses | (251,397) | (89,329) |
| Net cash provided by operating activities | $ 3,508,238 | $ 2,680,979 |
| Summary of noncash financing activities: | | |
| Plant under construction | $ - | $ 274,137 |
| Accounts payable, construction | - | (274,137) |
| | $ - | $ - |

See accompanying notes to financial statements.

## (1) Summary of Significant Accounting Policies

### Nature of Operations

The Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation), a component unit of the FSM National Government, is a local exchange carrier (LEC) and an international exchange carrier providing local telephone service, cellular service, Internet access, long distance telecommunication services, and digital wireless TV. The Corporation serves commercial and residential customers in the four states that comprise the FSM - Chuuk, Kosrae, Pohnpei and Yap.

### Organization

The Corporation was 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 and began its operations in October 1983.

### Basis of Accounting

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Corporation implemented 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 maintains a chart of accounts in accordance with the Uniform System of Accounts for telephone companies of the United States Federal Communications Commission's Rules, and in conformity with accounting principles generally accepted in the United States of America (GAAP). Additionally, the Corporation utilizes the accrual basis of accounting.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No.'s 37 and 38, 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.

- Restricted:

  - Nonexpendable - Net assets subject to externally imposed stipulations that require the Corporation to maintain them permanently.

## (1) Summary of Significant Accounting Policies

### Basis of Accounting, Continued

- 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.

The Corporation has no restricted net assets at September 30, 2010 and 2009.

- 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.

### Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity date within three months of the date acquired by the Corporation. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified in the statements of net assets. Certificate of deposit investment accounts established and set aside for future capital expenditure projects are classified within investment in securities.

### Investments

Investments and related investment earnings are reported at fair value using quoted market prices. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

### Accounts Receivable

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

Accounts receivable are stated at the amount management expects to collect on outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection effects are written off through a charge to the valuation allowance and a credit to accounts receivable.

### Inventory

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

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

### Property, Plant and Equipment

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

### Plant Under Construction

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

### Indefeasible Right of Use

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

### Valuation of Long-Lived Assets

The Corporation, using its best estimates based on reasonable and supportable assumptions and projections, reviews assets for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable. Impaired assets are reported at the lower of cost or fair value. At September 30, 2010 and 2009, no assets had been written down.

### 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 earned.

### Advertising Cost

Advertising costs are charged to operations when incurred.

### Income Taxes

Corporate profits are not subject to income tax in the FSM. The FSM National Government imposes a gross revenue tax of 3% on revenues. The Corporation is specifically exempt from any taxes except import taxes in accordance with its enabling legislation.

(1) Summary of Significant Accounting Policies, Continued

Revenue Recognition and Classification

Billings for local service revenue and basic internet service are rendered monthly in advance. Advance billings are recorded as a liability and are subsequently transferred to income in the period earned. Prepaid card revenues are recorded when the cards are sold.

Long distance network services revenues and usage-sensitive internet service revenues are based on a per-minute charge paid by the end user or other telecommunications service providers. These revenues are billed in arrears, but are recognized in the month that service is provided.

The Corporation records all revenue generated from providing telecommunications services as operating revenue, including local service, long distance, internet, and cellular services.

Non-operating revenues and expenses consist of investment earnings, interest paid on long-term debt, and grant funds received.

New Accounting Standards

During fiscal year 2010, the Entity implemented the following pronouncements:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes.

- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements.

- GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, and Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, for calculating the annual required contribution (ARC) adjustment.

- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the Entity.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Entity.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the Entity.

Management Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## (2) Investment - Island Cable Television

On December 8, 1998, the 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.

## (3) Deposits and Investments

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

The deposit and investment policies of the Corporation are governed by the Board of Directors. As such, the Board of Directors is authorized to delegate certain responsibilities to third parties. Investment managers have discretion to purchase, sell, or hold the specific securities to meet the objectives set forth in the investment policy.

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.

### A. Deposits

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

Category 1 Deposits that are federally insured or collateralized with securities held by the Corporation or its agent in the Corporation's name;

Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Corporation's name; or

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

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

(3) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2010 and 2009, the carrying amount of the Corporation's total cash and cash equivalents and time certificates of deposit were $694,231 and $596,717, respectively, and the corresponding bank balances were $725,989 and $695,521, respectively, all of which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2010 and 2009, bank deposits in the amount of $406,570 and $360,117, respectively, were FDIC insured. The Corporation does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. The Corporation has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

B. Investments

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

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

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

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

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

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the Corporation's investment policy.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Corporation will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. As of September 30, 2010 and 2009, the Corporation's investments are held in the name of the Corporation and are administered by investment managers subject to Securities Investor Protection Corporation insurance in accordance with the Corporation's investment policy.

(3) Deposits and Investments, Continued

B. Investments, Continued

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Corporation's investment policy states that all fixed income securities shall have a Moody's, Standard & Poor's and/or Fitch's credit rating of no less than "BBB."

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Corporation. As of September 30, 2010 and 2009, there were no investments in any one issuer that exceeded 5% of total investments.

As of September 30, 2010 and 2009, investments at fair value are as follows:

| | 2010 | 2009 |
|---|---|---|
| Fixed income: | | |
| U.S. Treasury obligations | $ 624,892 | $ 407,439 |
| U.S. Government agencies | 304,767 | 489,407 |
| Corporate notes | 1,112,033 | 1,409,944 |
| International bonds | 43,698 | 82,645 |
| | 2,085,390 | 2,389,435 |
| Other investments: | | |
| Domestic and international equities | 3,225,212 | 4,557,641 |
| Money market funds | 155,209 | 393,844 |
| | $ 5,465,811 | $ 7,340,920 |

As of September 30, 2010, the Corporation's investments in debt securities were as follows:

| | Moody's Credit Rating | Investment Maturities (In Years) Less Than 1 | 1 to 5 | 6 to 10 | Greater Than 10 | Fair Value |
|---|---|---|---|---|---|---|
| U.S. Treasury obligations | Aaa/P-1 | $ - | $ 520,228 | $ 104,664 | $ - | $ 624,892 |
| U.S. Government agencies | Aaa/P-1 | | 304,767 | - | - | 304,767 |
| International bonds | Aa1/P-1 | - | 43,698 | - | - | 43,698 |
| Corporate notes | A1/P-1 | 50,913 | 196,840 | 146,531 | - | 394,284 |
| Corporate notes | A2/P-1 | 83,246 | 256,330 | - | - | 339,576 |
| Corporate notes | Aa2/P-1 | - | 174,484 | - | - | 174,484 |
| Corporate notes | Aa3/P-1 | - | 87,188 | 116,501 | - | 203,689 |
| | | $ 134,159 | $ 1,583,535 | $ 367,696 | $ - | $ 2,085,390 |

## (3) Deposits and Investments, Continued

### B. Investments, Continued

As of September 30, 2009, the Corporation's investments in debt securities were as follows:

| | Moody's Credit Rating | Investment Maturities (In Years) Less Than 1 | 1 to 5 | 6 to 10 | Greater Than 10 | Fair Value |
|---|---|---|---|---|---|---|
| U.S. Treasury obligations | Aaa/P-1 | $ 317,438 | $ 90,002 | $ - | $ - | $ 407,440 |
| U.S. Government agencies | Aaa/P-1 | 489,407 | - | - | - | 489,407 |
| International bonds | AA1/AA | - | 82,645 | - | - | 82,645 |
| Corporate notes | A1/P-1 | 404,004 | 136,029 | - | - | 540,033 |
| Corporate notes | A2/P-1 | 246,046 | 219,799 | - | - | 465,845 |
| Corporate notes | Aa2/P-1 | - | 254,841 | - | - | 254,841 |
| Corporate notes | Aa3/P-1 | - | - | 149,224 | - | 149,224 |
| | | $ 1,456,895 | $ 783,316 | $ 149,224 | $ - | $ 2,389,435 |

## (4) Property, Plant and Equipment

Capital asset activities of the Corporation for the years ended September 30, 2010 and 2009 are as follows:

| | Estimated Useful Lives | Balance October 1, 2009 | Additions | Retirements | Balance September 30, 2010 |
|---|---|---|---|---|---|
| General support | 5-35 years | $ 14,785,666 | $ 416,759 | $ (29,129) | $ 15,173,296 |
| Central office | 20 years | 10,960,958 | 29,666 | - | 10,990,624 |
| Earth station | 20 years | 5,524,894 | 75,633 | - | 5,600,527 |
| Terminal equipment | 5-20 years | 3,041,470 | 131,410 | - | 3,172,880 |
| Cellular network | 10-20 years | 13,897,623 | 757,499 | - | 14,655,122 |
| Internet equipment | 8 years | 1,394,375 | 388,326 | (39,271) | 1,743,430 |
| Pole, cable and Wiring | 15-20 years | 33,813,782 | 10,383,242 | - | 44,197,024 |
| Total | | 83,418,768 | 12,182,535 | (68,400) | 95,532,903 |
| Accumulated depreciation | | (42,907,996) | (3,860,296) | 68,400 | (46,699,892) |
| | | 40,510,772 | 8,322,239 | - | 48,833,011 |
| Plant under construction | | 9,407,276 | 5,157,323 | (10,620,031) | 3,944,568 |
| Property, plant and equipment, net | | $ 49,918,048 | $ 13,479,562 | $ (10,620,031) | $ 52,777,579 |

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

| | Estimated Useful Lives | Balance October 1, 2008 | Additions | Retirements | Balance September 30, 2009 |
|---|---|---|---|---|---|
| General support | 5-35 years | $ 14,506,232 | $ 310,565 | $ (31,131) | $ 14,785,666 |
| Central office | 20 years | 10,956,576 | 4,382 | - | 10,960,958 |
| Earth station | 20 years | 5,409,001 | 115,893 | - | 5,524,894 |
| Terminal equipment | 5-20 years | 2,949,006 | 92,464 | - | 3,041,470 |
| Cellular network | 10-20 years | 13,792,538 | 105,085 | - | 13,897,623 |
| Internet equipment | 8 years | 1,293,928 | 100,447 | - | 1,394,375 |
| Pole, cable and Wiring | 15-20 years | 33,811,818 | 1,964 | - | 33,813,782 |
| Total | | 82,719,099 | 730,800 | (31,131) | 83,418,768 |
| Accumulated depreciation | | (39,111,754) | (3,827,373) | 31,131 | (42,907,996) |
| | | 43,607,345 | (3,096,573) | - | 40,510,772 |
| Plant under construction | | 828,276 | 8,579,000 | - | 9,407,276 |
| Property, plant and equipment, net | | $ 44,435,621 | $ 5,482,427 | $ - | $ 49,918,048 |

## (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 $567,524 and $263,563 during the years ended September 30, 2010 and 2009, respectively.

## (6) Indefeasible Right of Use (IRU)

On January 12, 2009, the Corporation entered into an IRU Capital Lease agreement with a third party for the exclusive use of 8 wave lengths of fiber capacity of the two fibers of the Kwajalein Cable System (KCS) which runs between Guam and Kwajalein and which is known as the "HANTRU1 System". Under the terms of the agreement, the Corporation is required to make certain payments, totaling $3,656,301, of which $3,473,486 was paid as of September 30, 2009, and the remaining $182,815 was paid as of September 30, 2010. The initial term of the agreement is for a period of 10 years commencing on the date the Corporation is initially granted access, and which term is automatically renewable for a further 10 year period and an additional 5 year period thereafter. Prior to the tenth and twentieth anniversary dates, the Corporation has the option to terminate this agreement; however, such is subject to prior approval of the Rural Utilities Services (RUS) of the U.S. Department of Agriculture. The Corporation's policy is to amortize the right of use over the 25 year period. As of September 30, 2010, amortization expense of $73,126 has been recorded.

## (7) Long-term Debt

| | 2010 | 2009 |
|---|---|---|
| Loans payable to RUS, with a 35 year term, interest at 5%, collateralized by the Corporation's specific ground leases and essentially all other assets. Pursuant to loan agreements dated August 1, 1990 and March 12, 2009, the Corporation is required to make monthly payments of both principal and interest to RUS. | $ 33,138,932 | $ 33,024,802 |

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 |
|---|---|---|---|
| 2011 | $ 1,226,430 | 1,632,937 | 2,859,367 |
| 2012 | 1,467,155 | 1,565,010 | 3,032,165 |
| 2013 | 1,544,994 | 1,487,171 | 3,032,165 |
| 2014 | 1,624,039 | 1,408,126 | 3,032,165 |
| 2015 | 1,707,128 | 1,325,037 | 3,032,165 |
| 2016 - 2020 | 9,934,633 | 5,226,192 | 15,160,826 |
| 2021 - 2029 | 15,634,553 | 2,696,837 | 18,331,391 |
| | $ 33,138,932 | $ 15,341,311 | $ 48,480,244 |

A summary of changes in long-term liabilities for the years ended September 30, 2010 and 2009 are as follows:

| | Balance October 1, 2009 | Increases | Decreases | Balance September 30, 2010 | Due Within one Year |
|---|---|---|---|---|---|
| Note payable: Rural Utilities Service | $ 33,024,802 | $1,063,640 | $ (949,510) | $33,138,932 | $ 1,226,430 |

| | Balance October 1, 2008 | Increases | Decreases | Balance September 30, 2009 | Due Within one Year |
|---|---|---|---|---|---|
| Note payable: Rural Utilities Service | $ 22,824,414 | $11,072,394 | $ (872,006) | $ 33,024,802 | $ 928,868 |

## (8) Short-term Borrowings

A schedule of the Corporation's short-term borrowings as of September 30, 2010 and 2009 is as follows:

| | 2010 | 2009 |
|---|---|---|
| Line of credit facility of approximately $4,464,580, interest at 5.25% per annum, collateralized by certain eligible investment securities. | $ 2,252,356 | $ 308,150 |

During the year ended September 30, 2010 and 2009, the Corporation drew down against this line of credit facility in the amount of $2,200,000 and $1,784,213 and made corresponding repayments of $309,626 and $1,476,063, respectively. Proceeds from this line of credit facility were primarily for the purpose of funding the operations of the Corporation. The 2010 balance includes $53,832 of interest that has been assessed and added to the facility balance.

## (9) Commitments and Contingencies

### Leases

The Corporation has sixteen operating leases as of September 30, 2010. Eight are residential real estate leases for contract employees, which have a term of one or two years. Three represent leases for satellite stations of Yap, Pohnpei, and Kosrae with thirty-year leases. Three are for land site for three of state offices with 25-35 year terms beginning in 1988 for Pohnpei and Yap and 1990 for Kosrae. Two are for land site leases for the previous central office and for the southeast remote switch on Pohnpei; both for 15 year terms beginning in 1994. The Corporation has also entered into various circuit leases expiring through 2010 and 2016.

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

| Year ending September 30; | Total |
|---|---|
| 2011 | $1,544,282 |
| 2012 | 1,350,352 |
| 2013 | 1,164,979 |
| 2014 | 1,117,899 |
| 2015 | 1,037,499 |
| 2016 - 2020 | 37,234 |
| 2021 - 2025 | 15,876 |
| | $ 6,268,121 |

## (9) Commitments and Contingencies, Continued

### Operation, Management and Repair (OM&R) Agreement

On March 2, 2009, the Corporation, along with the Marshall Islands National Telecommunications Authority (MINTA), entered into an OM&R agreement with a third party for the purpose of operating, maintaining, and repairing the "Micronesian Addition", which is a subset of the HANTRU1 System. The term of the agreement coincides with the term of the IRU Capital Lease agreement wherein the Corporation and MINTA are required to each make monthly payments of $6,400 less certain service credits, and which are subject to inflationary adjustments and an annual incremental increase of 3%.

### Self Insurance

The Corporation purchases insurance to cover risks associated with its buildings and equipment ($23,792,017 of coverage) and vehicles (up to $1,000,000 of coverage per vehicle per incident). Additionally, the Corporation purchases fidelity insurance coverage for selected employees (total coverage of $2,454,000) 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 $1,000,000 per occurrence). There have been no significant reductions in coverage, and there have been no settlements in excess of insurance coverage for the past three years. 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, 2010, the Corporation entered into various contracts for construction and expansion of its facilities and services. Approximately $4,406,059 is outstanding under these contracts as of September 30, 2010.

### 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 the Corporation cannot be predicted at this time.

### Litigation

In the ordinary course of business, claims have been filed against the Corporation. Management does not believe that the plaintiffs will prevail and the ultimate outcome is currently not determinable. Therefore, no provision has been recorded in the accompanying financial statements for losses, if any, that may result.

## (10) Related Party Transactions

The Corporation's services are provided to its affiliates 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, 2010 and 2009, receivables from the FSM National Government amounted to $208,244 and $225,807, respectively.

## (11) 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, 2010 and 2009 were $352,485 and $359,109, 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, 2010 and 2009, plan assets were $3,964,636 and $3,786,527, respectively.

## (12) Subsequent Events

No events have occurred subsequent to September 30, 2010 but before December 6, 2010, the date the financial statements were available to be issued, that required consideration as adjustments to, or disclosures in, the financial statements.

**FEDERATED STATES OF MICRONESIA**
**TELECOMMUNICATIONS CORPORATION**
**(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)**

Schedule of Operating Expenses
Years Ended September 30, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| Depreciation | $ 3,929,890 | $ 3,827,373 |
| Salaries and wages | 3,577,694 | 3,721,091 |
| Circuit lease | 2,264,324 | 2,228,075 |
| Utilities | 926,695 | 959,494 |
| Advertising | 811,172 | 643,784 |
| Repairs and maintenance | 791,008 | 478,787 |
| Contractual services | 654,895 | 299,357 |
| Travel | 346,150 | 215,017 |
| Cost of sales | 497,935 | 287,468 |
| Communications | 210,626 | 225,311 |
| Supplies | 125,404 | 104,368 |
| ICTV affiliated | 98,459 | 138,479 |
| Insurance | 82,956 | 83,913 |
| Rental expenses | 82,824 | 52,287 |
| Petroleum and lubricants | 68,083 | 77,781 |
| Representation | 59,529 | 40,175 |
| Import tax expense | 57,691 | 37,956 |
| Training | 52,154 | 47,332 |
| Freight | 52,147 | 26,363 |
| Publications and printing | 25,783 | 6,086 |
| Professional fees | 22,242 | 21,959 |
| Miscellaneous | 41,450 | 64,997 |
| | $ 14,779,111 | $ 13,587,453 |

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 OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the financial statements of the Federated States of Micronesia Telecommunications Corporation (the Corporation), as of and for the year ended September 30, 2010, and have issued our report thereon dated December 6, 2010. 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 the Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Corporation in a separate letter dated December 6, 2010.

This report is intended solely for the information and use of the Board of Directors and management of the Corporation, 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 6, 2010

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**INDEPENDENT AUDITORS' REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the financial statements of the Federated States of Micronesia Telecommunications Corporation (the Corporation) as of and for the year ended September 30, 2010, and have issued our report thereon dated December 6, 2010. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the Corporation's basic financial statements. The accompanying schedule of expenditures of federal awards (page 29) is presented for purposes 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 Corporation. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Deloitte & Touche LLP

December 6, 2010

**FEDERATED STATES OF MICRONESIA**
**TELECOMMUNICATIONS CORPORATION**
**(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)**

Schedule of Expenditures of Federal Awards
Rural Utilities Service Loan Funding
Year Ended September 30, 2010

| Approved Purposes | Loan Proceeds Approved as of September 30, 2010 | Loan Proceeds Received During FY 2010 | Total Disbursements on Contracts During FY 2010 |
|---|---|---|---|
| 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. B-15 | 8,206,857 | 607,305 | 601,649 |
| CT. B-16E | 305,000 | 274,500 | 274,640 |
| CT. A-1E | 275,625 | | |
| CT. A-2E | 4,008,263 | - | - |
| CT. A-3A | 304,109 | - | - |
| Operating Equipment | 387,263 | - | - |
| Pre-Loan | 55,000 | - | - |
| IRU Capital Lease | 3,656,301 | 182,815 | 182,815 |
| Interest Income | | (980) | - |
| | $ 52,363,458 | $ 1,063,640 | $ 1,059,104 |

| | |
|---|---|
| RUS Construction Fund account balance as of October 1, 2009 | $ 904 |
| Excess of Disbursements over Loan Proceeds | 4,536 |
| Interest earned on RUS account net of miscellaneous bank charges as of September 30, 2010 | (356) |
| RUS Construction Fund account balance as of September 30, 2010 | $ 5,084 |

See Accompanying Independent Auditors' Report.