FEDERATED STATES OF MICRONESIA TELECOMMUNICATIONS CORPORATION

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

FINANCIAL STATEMENTS, ADDITIONAL INFORMATION AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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

Table of Contents
Years Ended September 30, 2012 and 2011

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

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, 2012 and 2011, 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, 2012 and 2011, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 31, 2012, 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 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule of operating expenses on page 24 and the schedule of expenditures of federal awards on page 25 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of operating expenses and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the financial statements as a whole.

Deloitte + Touche LLP

December 31, 2012

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

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

Our discussion and analysis of the Federated States of Micronesia Telecommunications Corporation (FSMTC) financial performance provides an overview of the FSMTC financial activities for the fiscal year then ended September 30, 2012. 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, 2012. Please read it in conjunction with the financial statements and the notes thereto, which follow this discussion and analysis. Fiscal year 2011 and 2010 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 the FSM. The FSMTC also provides Cable TV in the State of Kosrae, and Digital Broadcast Television (DBTV) to both Yap and Chuuk States. Yap's former Wireless TV broadcasting, which was analog in nature, was replaced by DBTV in FY2011.

The FSMTC is under the governance of an appointed 5-member Board of Directors by the President of the FSM and the Governors of each State, which has oversight over both the FSMTC, Cable TV in Kosrae and DBTV in Yap & Chuuk. The Chief Executive Officer (CEO) is also an ex-officio non-voting member of the Board.

The FSMTC provides telecommunications services which include Plain Old Telephone Services (POTS) to 7,235 active subscribers. Other telecommunications services provided are National and International Overseas Calls, Internet Services, Mobile Cellular Services, Cable Television in the State of Kosrae with 232 active subscribers, DBTV in the State of Chuuk with 260 active subscribers and DBTV in the State of Yap with 226 active subscribers.

The FSMTC relies on calls made to and from outside of the FSM and calls within the FSM, which account for 20.35% of FSMTC's FY2012 operating revenues as compared with 21.90% of the FSMTC's FY2011 operating revenues. During FY2012, FSMTC realized a decrease in Call revenue of $319,505 (or 10.32%) as compared to FY2011. Management believes that the decrease was caused by the increase in internet usage and the increase in ADSL Internet subscribers in FY2012. Increases in Cellular services on the National level continue to also contribute to the decline in Domestic Tolls.

Internet Services (Wifi, Dial Up, ADSL & FM Domain) account for 29.66% of FSMTC's FY2012 operating revenues as compared with 28.30% of FSMTC'S FY 2011 operating revenues. During FY2012, FSMTC realized an increase in Internet service revenues of $531,256 (or 15.11%) as compared to FY2011. More and more customers are moving to unlimited internet service by subscribing to ADSL which contributed to the increase in internet revenue.

Mobile services account for 27.47% of FSMTC's FY2012 operating revenues as compared with 24.90% of FSMTC'S FY2011 operating revenues. During FY2012, FSMTC realized an increase in mobile service revenues of $231,668 (or 6.59%) as compared to FY2011. This increase can be attributed to the tariff change which took effect at the beginning of fiscal year 2012.

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 summarizes the financial condition and operations of the FSMTC for FY2012, FY2011 and FY2010:

	2012	2011	2010
Assets:			
Cash and cash equivalents	$ 1,254,195	$ 496,202	$ 519,268
TCD's and investments in securities	1,468,405	4,739,288	5,640,774
Receivables and prepayments	1,227,891	1,098,308	1,712,810
Inventory	680,442	744,379	821,936
Total current assets	4,630,933	7,078,177	8,694,788
Property, plant and equipment	48,169,976	51,469,465	52,777,579
Other non-current assets	3,290,671	3,436,923	3,583,175
	$ 56,091,580	$ 61,984,565	65,055,542
Liabilities:			
Current liabilities	$ 3,158,691	$ 5,862,955	$ 5,073,361
Non-current liabilities	28,987,140	30,497,987	31,912,503
Total liabilities	32,145,831	36,360,942	36,985,864
Net Assets:			
Invested in capital assets, net of related debt	20,962,941	22,973,530	23,221,821
Restricted	85,866	-	-
Unrestricted	2,896,942	2,650,093	4,847,857
Total net assets	23,945,749	25,623,623	28,069,678
	$ 56,091,580	$ 61,984,565	$ 65,055,542

The total assets of FSMTC decreased compared to prior year. The statements of net assets reveals that the decrease in total assets is primarily the result of an increase in depreciation and withdrawals from TCD’s and investments in securities.

The total liabilities of FSMTC decreased by $4,215,111 compared with prior year. This reduction in total liabilities can be attributed to the repayment of short term borrowings from Morgan Stanley of $2,331,054, RUS note repayments of $1,435,152 and payments to various vendors.

The equity of FSMTC was affected by the change in both assets and liabilities and decreased by a net loss from operations of $2,037,874. During FY2012, FSM Telecom received a capital grant from the FSM National Government of $360,000 for purposes of upgrading ADSL services for the entire country.

During FY2012, total cash received from telecommunications services exceeded the amounts paid to vendors and employees for goods and services. This resulted in net cash provided by operating activities of $3,713,998 as compared with $4,166,771 in FY2011.

The cash and cash equivalents at the end of FY2012 are $1,254,195 as compared to $496,202 at the end of the prior year. The net cash provided during FY2012 exceeded net cash used from operations, mainly due to investment withdrawal and contribution from operations. The FSMTC withdrew $3,556,850 from its marketable securities with Morgan Stanley to support its cash flow requirements for operations and to payoff short term borrowings of $2,331,054.

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 statements 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, 2012, 2011 and 2010.

	2012	2011	2010
Operating revenues	$ 13,986,609	$ 13,568,945	$ 13,527,512
Operating expenses	(14,794,097)	(14,617,252)	(14,779,111)
Net operating loss	(807,488)	(1,048,307)	(1,251,599)
Interest income and others	282,748	120,340	787,533
Interest expense	(1,513,134)	(1,518,088)	(1,302,187)
Increase (decrease) in net assets	(2,037,874)	(2,446,055)	(1,766,253)
Capital grants	360,000	-	-
Net assets beginning of year	25,623,623	28,069,678	29,835,931
Net assets, end of year	$ 23,945,749	$ 25,623,623	$ 28,069,678

Total operating revenue in FY2012 increased by $417,664 (or 3.80%) compared to FY2011. The increase is mainly due to increase in ADSL and Mobile revenues. Operating expenses in FY2012 increased by $176,845 (or 1.21%) compared to FY2011 operating expenses. This increase in operating expenses can be attributed to a new tax being imposed on FSM Telecom. CB No. 17-01, a bill for an act to further amend section 208 of title 21 of the code of the Federated States of Micronesia, as amended by Public Law No. 11-26, for purposes of making the Telecommunications Corporation subject to the gross revenue tax. With the new Cable TV service in Chuuk in full year of operation, more operating expenses were incurred in FY2012 as compared to FY2011.

The FSMTC investments in property, plant and equipment, net of accumulated depreciation, amounted to $48,169,976 in FY2012 and $51,469,465 in FY2011. 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 Utilities Services) amounted to $30,497,706 of which $1,510,566 is classified as the current portion. Interest on funded debts paid during FY 2012 approximated $1,503,931, net of capitalized interest of $5,810 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 19, 2008, United States Department of Agriculture Rural Development notified the FSMTC that based on the preliminary review of it "B " loan application, the FSMTC was qualified to borrow an additional amount of $13,120,000. At September 30, 2012, the FSMTC has drawn-down $12,136,034 from RUS for the purpose of funding the Fiber Optic Cable projects. The loan proceeds were to purchase 8 wavelengths of the fiber capacity of two fibers of the Kwajealein Cable System (KCS) as a capital lease for 25 years or Indefeasible right to use (IRU). 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 FSM economy is expected to decline from an estimated growth of 1.4% in FY2012 to an estimated growth of 0.8% for FY 2013. The decline in economic activity is as expected as the FAA and Japan airport development projects wind down. Unless, there is an accelerated release of infrastructure grants into the economy, business activities are likely to remain stagnant. Coupled with a stagnant economy, the cost of utility and fuel are eroding the bottom line FSM Telecommunications Corporation (FSMTC). FSMTC, in an effort to counteract the effect of higher operating costs, implemented increases in tariffs for its network access, directory assistance and mobile charges. As a result, these areas are seeing increasing revenues. Exactly how much the net effect these measures will hold out will be reassessed in the next fiscal year.

The Corporation had just completed the Mobile Services expansion in Pohnpei, Chuuk, Yap & Kosrae. Because of the subtstantial contribution of Mobile Services to revenue, FSMTC is committed to maintaining a more reliable service to the people. With this expansion, communication connectivity using mobile services within the FSM and out to the world will improve. The Corporation has modern, state of the art equipment and tariff rates that we feel are very reasonable compared with other telephone companies in the Pacific Region.

In addition to the mobile services investments, FSMTC also completed its virtualization project which was approved in April 2011. This project ensured a more robust seamless IP network that not only saw a massive reduction in number of physical servers (37 to 7), but also a much more power savings stack of virtual servers (62% less power). Expansion of ADSL Backhaul in all of the States of the FSM is now complete. Because of the huge demand in internet service, management believes that this new infrastructure will contribute to the increase in revenue. The integration of the Fiber Optic Cable in Pohnpei to the FSMTC network services is not possible without the procurement of appropriate equipment and overhaul of existing IP services (VOIP, SIP and Data). The Fiber Optic provisioning in Pohnpei will have little effect on the FSM States of Chuuk, Kosrae, and Yap without significant improvements in domestic satellite connectivity.

The FSM Telecommunications Corporation (FSMTC) and Palau National Communications Corporation (PNCC) signed a Memorandum of Understanding on August 9, 2011 to act jointly to acquire, deploy, manage, operate and maintain an underwater fiber-optic cable to the State of Yap in the FSM and to Palau. The MOU established a partnership between both companies now known as Caroline Cable Consortium (CCC). FSMTC is working with all stakeholders including Yap State leadership, FSM Government and international financial organizations such as World Bank and ADB to ensure that Yap States does not miss an opportunity to participate in submarine fiber optic landing.

Most of the telecommunications services provided in other more developed 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 to further develop our island nation. FSMTC will continue to seek improved technologies to better serve its customers and at the same time bring significant operating savings.

Management's Discussion and Analysis for the year ended September 30, 2011 is set forth in FSMTC'S report on the audit of financial statements, which is dated December 22, 2011. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be viewed at the Office of the FSM National 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/CEO or Rodelio A. Pulmano, Senior Vice President/CFO at email addresses john.sohl@fsmtc.fm and rodelio.pulmano@fsmtc.fm, respectively, or please write to us at P.O. Box 1210, Kolonia, Pohnpei FM 96941.

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

Statements of Net Assets
September 30, 2012 and 2011

	2012	2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,254,195	$ 496,202
Time certificates of deposit	176,315	175,855
Investment in securities	1,292,090	4,563,433
Accounts receivable, net of an allowance for doubtful accounts of $1,080,733 and $837,062 in 2012 and 2011, respectively	302,086	398,723
Receivables from carriers	328,545	195,648
Advances to employees	12,779	2,610
Inventory	680,442	744,379
Accrued interest and other accrued earnings	185,244	131,578
Other receivables and prepaid expenses	399,237	369,749
Total current assets	4,630,933	7,078,177
Property, plant and equipment, net	48,169,976	51,469,465
Indefeasible right of use, net	3,290,671	3,436,923
	$ 56,091,580	$ 61,984,565
LIABILITIES AND NET ASSETS		
Current liabilities:		
Short-term borrowings	$ -	$ 2,331,054
Current maturities of long-term debt	1,510,566	1,434,871
Accounts payable, trade	447,541	859,873
Accounts payable, construction	283,740	567,480
Deferred revenue-debit cards	170,055	80,114
Accrued leave payable	133,175	122,189
Other accrued liabilities	613,614	467,374
Total current liabilities	3,158,691	5,862,955
Long-term debt, net of current portion	28,987,140	30,497,987
Total liabilities	32,145,831	36,360,942
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	20,962,941	22,973,530
Restricted - expendable	85,866	-
Unrestricted	2,896,942	2,650,093
Total net assets	23,945,749	25,623,623
	$ 56,091,580	$ 61,984,565

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, 2012 and 2011

	2012	2011
Operating revenues:		
Internet	$ 4,048,114	$ 4,002,506
Mobile charges	3,748,526	3,516,858
Overseas tolls	2,777,032	3,096,537
External carriers	1,794,165	1,644,337
Net access	1,759,485	1,627,204
Recovery of bad debts	96,365	218,226
ICTV Kosrae cable charges	82,382	98,489
ICTV Yap cable charges	75,563	71,501
ICTV Chuuk cable charges	105,083	70,279
Miscellaneous	195,787	35,407
Discounts	(695,893)	(812,399)
Total operating revenues	13,986,609	13,568,945
Operating expenses:		
Corporate operations	2,684,944	2,413,088
Plant operations	1,844,047	1,986,793
Consumer operations	1,265,089	1,412,803
Internet expense	1,736,411	1,604,231
Cable and wire	1,846,922	1,918,376
Earth station	1,173,317	1,199,877
General support	1,097,506	1,192,646
Wireless telephone	1,506,607	1,311,476
Central office	544,418	611,521
Terminal equipment	583,898	566,310
ICTV expense	510,938	400,131
Total operating expenses	14,794,097	14,617,252
Loss from operations	(807,488)	(1,048,307)
Nonoperating revenues (expenses):		
Interest expense	(1,513,134)	(1,518,088)
Investment income	282,748	120,340
Total nonoperating revenues (expenses), net	(1,230,386)	(1,397,748)
Change in net assets	(2,037,874)	(2,446,055)
Capital grants	360,000	-
Total net assets at beginning of year	25,623,623	28,069,678
Total net assets at end of year	$ 23,945,749	$ 25,623,623

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, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from subscribers, long distance carriers and other customers	$ 13,986,624	$ 13,782,633
Cash paid to suppliers for goods and services	(6,678,839)	(5,986,084)
Cash paid to employees	(3,593,787)	(3,629,778)
Net cash provided by operating activities	3,713,998	4,166,771
Cash flows from noncapital financing activities:		
Net borrowings under (repayment of) line of credit facility	(2,331,054)	78,698
Interest paid on line of credit facility	(15,473)	(78,110)
Net cash provided by (used for) noncapital financing activities	(2,346,527)	588
Cash flows from capital and related financing activities:		
Proceeds from federal grant	360,000	-
Additions to property, plant and equipment	(1,584,486)	(2,375,267)
Repayments of RUS long-term debt	(1,435,152)	(1,206,075)
Interest paid on RUS long-term debt and others	(1,503,931)	(1,631,801)
Net cash used for capital and related financing activities	(4,163,569)	(5,213,143)
Cash flows from investing activities:		
Net purchases, sales and maturities of investments	(283,208)	(97,620)
Withdrawals from investments	3,556,850	1,000,000
Interest and dividends received on investment securities and others	280,449	120,338
Net cash provided by investing activities	3,554,091	1,022,718
Net change in cash and cash equivalents	757,993	(23,066)
Cash and cash equivalents at beginning of year	496,202	519,268
Cash and cash equivalents at end of year	$ 1,254,195	$ 496,202
Reconciliation of loss from operations to net cash provided by operating activities:		
Loss from operations	$ (807,488)	$ (1,048,307)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization	4,752,297	4,484,736
(Increase) decrease in assets:		
Accounts receivable	96,637	30,021
Receivable from carriers	(132,897)	190,254
Advances to employees	(10,169)	25,046
Inventory	63,937	77,557
Accrued interest and other accrued earnings	(53,666)	(14,473)
Other receivables and prepaid expenses	(29,488)	383,654
Increase (decrease) in liabilities:		
Accounts payable, trade	(412,332)	141,335
Deferred revenue-debit cards	89,941	7,886
Accrued leave payable	10,986	(3,831)
Other payables and accrued expenses	146,240	(107,107)
Net cash provided by operating activities	$ 3,713,998	$ 4,166,771

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. The Corporation is governed by a five member Board of Directors. One member is appointed by the President of the FSM with the advice and consent of the FSM Congress. The Governor of each State of the FSM appoints one member of the Board with the advice and consent of the respective State legislatures. The Chief Executive Officer of the Corporation serves as an ex officio member of the Board but has no right to vote.

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 has elected not to apply FASB Statements and Interpretations issued after 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.

(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.

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.

(1) Summary of Significant Accounting Policies, Continued

Inventory

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

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, 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, 2012 and 2011, 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.

Income Taxes

Corporate profits are not subject to income tax in the FSM. The FSM National Government imposes a gross revenue tax (GRT) of 3% on revenues. The Corporation is specifically exempt from any taxes except import taxes in accordance with its enabling legislation for the year ended September 30, 2011. Effective October 1, 2011, the Corporation's enabling legislation was modified and the Corporation is now subject to gross revenue taxes. Other than GRT, the Corporation is specifically exempt from any taxes in accordance with its enabling legislation for the years ending September 30, 2012 and 2011.

(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 2012, the Corporation implemented the following pronouncements:

- GASB 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 the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus,* which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity,* and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management has not yet determined the effect of implementation of this statement on the financial statements of the Corporation.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities,* which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Corporation.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012,* which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Corporation.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans,* which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions,* which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Corporation.

(1) Summary of Significant Accounting Policies, Continued

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.

Reclassifications

Certain balances in the 2011 presentation have been reclassified to conform to the 2012 presentation.

(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

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

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, 2012 and 2011, the carrying amount of the Corporation's total cash and cash equivalents and time certificates of deposit was $1,430,510 and $672,057, respectively, and the corresponding bank balances were $1,287,601 and $637,623, respectively, all of which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2012 and 2011, bank deposits in the amount of $770,993 and $577,059, 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

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, 2012 and 2011, 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.

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, 2012 and 2011, there were no investments in any one issuer that exceeded 5% of total investments.

As of September 30, 2012 and 2011, investments at fair value are as follows:

	2012	2011
Fixed income:		
U.S. Treasury obligations	$ 159,280	$ 624,800
U.S. Government agencies	55,738	297,077
Corporate notes	201,701	922,941
International bonds	-	44,447
	416,719	1,889,265

(3) Deposits and Investments, Continued

B. Investments, Continued

Other investments:		
Domestic and international equities	829,140	2,460,770
Money market funds	36,231	213,398
	$ 1,282,090	$ 4,563,433

As of September 30, 2012, 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	$ 45,711	$ 80,299	$ 33,270	$ -	$ 159,280
U.S. Government agencies	Aaa/P-1	20,870	34,868	-	-	55,738
Corporate notes	A1/P-1	20,905	32,513	18,688	-	72,106
Corporate notes	A2/P-1	-	53,380	27,461	-	80,841
Corporate notes	Aa2/P-1	15,629	-	-	-	15,629
Corporate notes	Aa3/P-1	15,214	-	17,911	-	33,125
		$ 118,329	$ 201,060	$ 97,330	$ -	$ 416,719

As of September 30, 2011, 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	$ 182,925	$ 256,900	$ 184,975	$ -	$ 624,800
U.S. Government agencies	Aaa/P-1	77,905	219,172	-	-	297,077
International bonds	AA1/AA	-	44,447	-	-	44,447
Corporate notes	A1/P-1	-	157,664	130,495	-	288,159
Corporate notes	A2/P-1	111,025	108,037	-	-	219,062
Corporate notes	Aa2/P-1	-	169,803	-	-	169,803
Corporate notes	Aa3/P-1	-	140,703	105,214	-	245,917
		$ 371,855	$ 1,096,726	$ 420,684	$ -	$ 1,889,265

C. Equity Investment, at Cost

On October 7, 2011, the Corporation invested $10,000 in Caroline Cable Corporation (CCC). The equity investment in CCC represents 10,000 shares of common stock and a 1/3 ownership interest. The primary purpose of CCC shall be to engage in the commercial enterprise of acquiring, owning, deploying, managing, maintaining, operating, and repairing a new or used underwater fiber-optic cable to the Republic of Palau with a spur running from a branching unit on the main cable to the State of Yap, Federated States of Micronesia.

(4) Property, Plant and Equipment

Capital asset activities of the Corporation for the years ended September 30, 2012 and 2011 are as follows:

	Estimated Useful Lives	Balance October 1, 2011	Additions	Retirements	Balance September 30, 2012
General support	5-35 years	$ 16,459,520	$ 540,593	$ -	$ 17,000,113
Central office	20 years	11,680,546	384,782	-	12,065,328
Earth station	20 years	5,600,527	48,874	-	5,649,401
Terminal equipment	5-20 years	3,490,160	80,016	-	3,570,176
Cellular network	10-20 years	17,750,622	275,116	-	18,025,738
Internet equipment	8 years	2,098,421	534,968	-	2,633,389
Pole, cable and wiring	15-20 years	44,413,211	11,031	-	44,424,242
Total		101,493,007	1,875,380	-	103,368,387
Accumulated depreciation		(50,963,680)	(4,606,045)	-	(55,569,725)
		50,529,327	(2,730,665)	-	47,798,662
Plant under construction		940,138	(568,824)	-	371,314
Property, plant and equipment, net		$ 51,469,465	$ (3,299,489)	$ -	$ 48,169,976

	Estimated Useful Lives	Balance October 1, 2010	Additions	Retirements	Balance September 30, 2011
General support	5-35 years	$ 15,173,297	$ 1,360,919	$ (74,696)	$ 16,459,520
Central office	20 years	10,990,625	689,921	-	11,680,546
Earth station	20 years	5,600,527	-	-	5,600,527
Terminal equipment	5-20 years	3,172,879	317,281	-	3,490,160
Cellular network	10-20 years	14,655,122	3,095,500	-	17,750,622
Internet equipment	8 years	1,743,431	354,990	-	2,098,421
Pole, cable and wiring	15-20 years	44,197,024	216,187	-	44,413,211
Total		95,532,905	6,034,798	(74,696)	101,493,007
Accumulated depreciation		(46,699,892)	(4,338,484)	74,696	(50,963,680)
		48,833,013	1,698,314	-	50,529,327
Plant under construction		3,944,566	(3,004,428)	-	940,138
Property, plant and equipment, net		$ 52,777,579	$ (1,308,114)	$ -	$ 51,469,465

(5) Capitalized Interest

Interest is capitalized on all construction-in-progress pursuant to ASC 835-20, *Capitalization of Interest*, provided that the construction period exceeds one year. Interest capitalized on qualifying construction-in-progress was $5,810 and $190,931 during the years ended September 30, 2012 and 2011, 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 made certain payments of $3,656,301. 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, 2012 and 2011, accumulated amortization expense of $365,630 and $219,378, respectively, has been recorded.

(7) Long-term Debt

	2012	2011
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. The loans were originally in the amounts of $32,000,000 and $12,136,000 and the proceeds were used for capital related purposes.	$ 30,497,706	$ 31,932,858

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
2013	$ 1,510,566	$ 1,489,511	$ 3,000,077
2014	1,586,759	1,413,318	3,000,077
2015	1,667,941	1,332,136	3,000,077
2016	1,752,305	1,247,772	3,000,077
2017	1,843,782	1,156,295	3,000,077
2018 - 2022	10,729,272	4,271,113	15,000,385
2023 - 2027	11,407,081	1,271,546	12,678,627
	$ 30,497,706	$ 12,181,691	$ 42,679,397

(7) Long-term Debt, Continued

A summary of changes in long-term liabilities for the years ended September 30, 2012 and 2011 are as follows:

	Balance October 1, 2011	Increases	Decreases	Balance September 30, 2012	Due Within one Year
Notes payable:					
Rural Utilities Service	$ 31,932,858	$ -	$ (1,435,152)	$30,497,706	$1,510,566

	Balance October 1, 2010	Increases	Decreases	Balance September 30, 2011	Due Within one Year
Notes payable:					
Rural Utilities Service	$ 33,138,933	$ -	$(1,206,075)	$31,932,858	$1,434,871

(8) Short-term Borrowings

A schedule of the Corporation's short-term borrowings as of September 30, 2012 and 2011 is as follows:

	2012	2011
Line of credit facility of approximately $4,464,580, interest at 5.25% per annum, collateralized by certain eligible investment securities.	$ -	$ 2,331,054

During the year ended September 30, 2011, the Corporation drew down against this line of credit facility in the amount of $78,698 with no repayments. During the year ended September 30, 2012, no additional drawdowns were made and the outstanding balance was fully paid through liquidation of related collaterized investment securities.

(9) Commitments and Contingencies

Leases

The Corporation has fourteen operating leases as of September 30, 2012. Six are residential real estate leases for contract employees, which have a term of one or two years. Three represent thirty-year leases for satellite stations of Yap, Pohnpei, and Kosrae. Three are for land sites for state offices with 25-35 year terms beginning in 1988 for Pohnpei and Yap and 1990 for Kosrae. Two are for land site lease 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 2016.

(9) Commitments and Contingencies, Continued

Leases, Continued

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

Year ending September 30;	Total
2013	$ 1,943,440
2014	1,647,101
2015	1,095,409
2016	30,407
2017	9,816
2018 - 2022	23,937
2023 - 2027	8,820
	$ 4,758,930

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 ($18,658,589 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 $100,000 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, 2012, the Corporation entered into various contracts for construction and expansion of its facilities and services. Approximately $3,419,580 is outstanding under these contracts as of September 30, 2012.

(9) Commitments and Contingencies, Continued

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 FSM National Government. As of September 30, 2012 and 2011, receivables from the FSM National Government amounted to $35,491 and $148,338, respectively. During the year ended September 30, 2012, the Corporation received a capital grant of $360,000 through the FSM National Government, of which $85,866 is undisbursed as of September 30, 2012.

(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, 2012 and 2011 were $359,323 and $386,166, respectively. Management is of the opinion that the plan does not represent an asset or liability of the Corporation. At September 30, 2012 and 2011, plan assets were $4,348,568 and $3,928,412, respectively.

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, 2012 and 2011

	2012	2011
Depreciation and amortization	$ 4,752,297	$ 4,484,736
Salaries and wages	3,627,418	3,642,454
Circuit lease	2,208,335	1,961,596
Utilities	1,320,032	951,077
Repairs and maintenance	489,000	1,246,598
Cost of sales	419,076	479,664
Import tax expense	384,001	50,552
Travel	240,824	364,249
Petroleum and lubricants	205,308	245,563
Rental expenses	187,270	187,747
Communications	154,472	182,075
Contractual services	141,715	141,263
Supplies	113,991	145,102
ICTV affiliated	104,393	95,961
Training	83,641	13,455
Insurance	73,888	77,212
Freight	51,009	53,101
Professional fees	38,011	57,370
Publications and printing	37,748	23,992
Representation	34,339	44,664
Advertising	20,418	38,810
Miscellaneous	106,911	130,011
	$ 14,794,097	$ 14,617,252

See Accompanying Independent Auditors' Report.

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

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2012

U.S. Department of Agriculture

Rural Utilities Service Loan Funding:

Approved Purposes	Loan Proceeds Approved as of September 30, 2012	Loan Proceeds Received During FY 2012	Total Disbursements on Contracts During FY 2012
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	-	-
CT. B-16E	274,500	-	-
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	-	-
Interest Income		-	-
	$ 52,332,958	$ -	$ -

RUS Construction Fund account balance as of October 1, 2011	$ 5,084
Excess of Disbursements over Loan Proceeds	(5,077)
Interest earned on RUS account net of miscellaneous bank charges as of September 30, 2012	(7)
RUS Construction Fund account balance as of September 30, 2012	$ -

U.S. Department of the Interior

Compact Sector funds received in a subrecipient capacity from the FSM National Government (CFDA #15.875)	$ 274,134

See Accompanying Independent Auditors' Report.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

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, 2012, and have issued our report thereon dated December 31, 2012. 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

Management of the Corporation is responsible for establishing and maintaining effective 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 *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, 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 31, 2012.

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 31, 2012