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, 2018 AND 2017

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, 2018 and 2017

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation), a component unit of the FSM National Government, which comprise the statements of net position as of September 30, 2018 and 2017, and the related statements of revenues, expenses, and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

Deloitte.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 10 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. This supplementary information is the responsibility of the Corporation's management. 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The Other Supplementary Information listed in the accompanying table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of the Corporation's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such 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 Other Supplementary Information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2018 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 financing reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Corporation's internal control over financial reporting and compliance.

Deloitte & Touche LLP

December 20, 2018

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 ended September 30, 2018. 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, 2018. Please read it in conjunction with the financial statements and the notes thereto, which follow this discussion and analysis. Fiscal year 2017 and 2016 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. Pohnpei and Yap State are now connected to submarine fiber optic cable and soon to be connected are the States of Chuuk and Kosrae. Pohnpei's submarine fiber optic cable was funded by a loan from Rural Utilities Corporation (RUS-USDA), whereas the submarine fiber optic cable for Chuuk, Yap and Kosrae is being funded by grants from World Bank.

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 and Chuuk. The President/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 **7,080** active subscribers (Pohnpei – **3,569**, Chuuk – **1,077**, Yap - **1,440,** Kosrae - **994**). Other telecommunications services provided are National and International Overseas Calls, Internet Services, Mobile Cellular Services with **19,820** active subscribers (Pohnpei – **8,592**, Chuuk – **6,678**, Yap – **3,767**, Kosrae - **783**), Cable Television in the State of Kosrae with **198** active subscribers, DBTV in the State of Chuuk with **272** active subscribers and DBTV in the State of Yap with **229** active subscribers.

In the past FSMTC relies on calls made to and from outside of the FSM and calls within the FSM, which account for **7.39%** of FSMTC's FY2018 operating revenues as compared with **9.77%** of the FSMTC's FY2017 operating revenues. During FY2018, FSMTC realized a **decrease** in Overseas and Domestic Call Revenue of **$330,536** (or –**23.90%**) as compared to FY2017. Management believes that the decrease was caused by the increase in internet usage and the increase in ADSL Internet subscribers in FY2018. With the introduction of smart phones and accessibilities to unlimited internet, subscribers were able to utilize such technology to place overseas calls through the use of applications available in the internet in which most of these applications are free. Accessing internet through mobile infrastructure using 3G, 4G & LTE technologies further makes it more convenient for the subscribers to use various apps to bypass the traditional voice calls. The availability of so many OTTs (Over the Top Applications) in the internet which are continuously being developed to be more efficient is really hurting the overseas toll revenue.

Internet Services (Wi-Fi, Dial Up, ADSL & FM Domain) account for **39.46%** of FSMTC's FY2018 operating revenues as compared with **36.75%** of FSMTC'S FY 2017 operating revenues. During FY2018, FSMTC realized an **increase** in Internet service revenues of **$412,500** (or **7.93%**) as compared to FY2017. More and more customers are moving to unlimited internet service by subscribing to ADSL which contributed to the increase in internet revenue. It is expected that data services will continue to dominate the telecom services in terms of revenue contribution. With the cost of bandwidth getting cheaper and cheaper more and more customers are moving to data services.

Mobile services account for **30.33%** of FSMTC's FY2018 operating revenues as compared with **25.89%** of FSMTC'S FY2017 operating revenues. During FY2018, FSMTC realized an **increase** in mobile service revenues of **$650,572** (or **17.75%**) as compared to FY2017. Mobile phones are now considered as a major personal and business accessory. With the introduction of more voice/data plans, more and more customers are enticed to register to save some money and enjoy the internet and mobile services. Roaming is also a big factor in the increase in this revenue category since data roaming was just recently introduced in the FSM market.

Net inbound carrier (external carriers) revenue account for **7.13%** of FSMTC's FY2018 operating revenues as compared with **11.92%** of FSMTC's FY2017 operating revenues. During FY2018, FSMTC realized a **decrease** in net carrier revenues of **$673,117** (or **-39.89%**) as compared to FY2017. The huge drop in settlement revenue can be attributed to upgrades on OTTS (Over the top services) on INTERNET such as Skype, Facebook messenger, Viber, Whatsapps, etc. Last year's dramatic increase in revenue was due to increase in settlement rates. However, the increase was short-lived as customers became smarter and migrated to IP based voice calling.

Statement of Net Position

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

From the data presented, readers of the statement of net position 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 position provides a picture of the net position (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 of the FSMTC for FY2018, FY2017 and FY2016:

	2018	2017	2016
Assets:			
Cash and cash equivalents	$ 969,672	$ 1,589,393	$ 1,390,344
TCD's and investments in securities	2,268,944	2,089,322	1,913,187
Receivables and prepayments	1,623,584	1,725,090	2,049,131
Inventory	971,237	734,893	650,750
Total current assets	5,833,437	6,138,698	6,003,412
Advance payment to vendor	326,500	201,250	201,250
Property, plant and equipment	31,879,267	34,371,230	37,543,038
Other non-current assets	2,649,159	2,559,411	2,705,663
	$40,688,363	$43,270,589	$46,453,363

The following summarizes the financial condition of the FSMTC for FY2018, FY2017 and FY2016:, Continued

	2018	2017	2016
Liabilities:			
Current liabilities	$ 5,353,577	$ 5,022,672	$ 4,844,550
Non-current liabilities	18,125,719	20,216,133	23,181,573
Total liabilities	23,479,296	25,238,805	28,026,123
Net Position:			
Net investment in capital assets	12,758,061	10,551,009	11,391,032
Restricted	0	0	0
Unrestricted	4,451,006	7,480,685	7,036,208
Total net position	17,209,067	18,031,784	18,427,240
	$40,688,363	$43,270,589	$46,453,363

The total liabilities of FSMTC **decreased** by **$1,759,509** (or **–6.97%**) compared with prior year. This decrease is due to RUS loan, 3G revenue sharing repayments and updated payments with major vendors and suppliers.

The equity of FSMTC was affected by the change in both assets and liabilities and **decreased** by a **net loss** of **$822,717.**

During FY2018, 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 **$3,528,309** as compared with **$3,996,066** in FY2017.

The cash and cash equivalents at the end of FY2018 are **$969,672** as compared to **$1,589,393** at the end of the prior year. The **decrease** in cash and cash equivalents can be attributed to increase in capital assets as a result of migration from satellite to fiber optic connectivity in Yap and also increase in marketing cost due to the implementation of the marketing plan. The migration from satellite to fiber optic left some overlapping contracts with the satellite providers that caused duplication in the connectivity expenses.

Statement of Revenues, Expenses and Changes in Net Position

Changes in total net position as presented on the statement of net position are based on the activity presented in the statements of revenues, expenses and changes in net position. 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, 2018, 2017 and 2016.

	2018	**2017**	**2016**
Operating revenues	$14,232,283	$14,159,193	$14,538,582
Operating expenses	14,959,436	14,144,129	14,367,279
Net operating –loss/income	-727,153	15,064	171,303
Operating grants	795,228	559,979	563,730
Interest income and others	179,317	185,497	87,043
Interest expense	-1,070,109	-1,249,545	-1,303,682
Net non-operating – loss/income	-822,717	-489,005	-481,606
Capital grants	0	93,549	0
Net position beginning of year	18,031,784	18,427,240	18,908,846
Net position, end of year	$17,209,067	$18,031,784	$18,427,240

Total operating revenue in FY2018 **increased** by **$73,090** (or **0.52%**) compared to FY2017. Although international voice and carrier revenue continues to decrease, data and mobile revenue are now the new bloodline for the company. Operating expenses in FY2018 **increased** by **$815,307** (or **5.76%**) compared to FY2017 operating expenses. This increase can be attributed to satellite commitments that are now overlapping with fiber optic connectivity.

The FSMTC investments in property, plant and equipment, net of accumulated depreciation, amounted to **$31,139,080** in FY2018 and **$34,021,683** in FY2017. This decrease of **$2,882,603** (or **–8.47%**) is primarily due to depreciation expenses. For additional information concerning capital assets, please refer to note 4 to the accompanying financial statements.

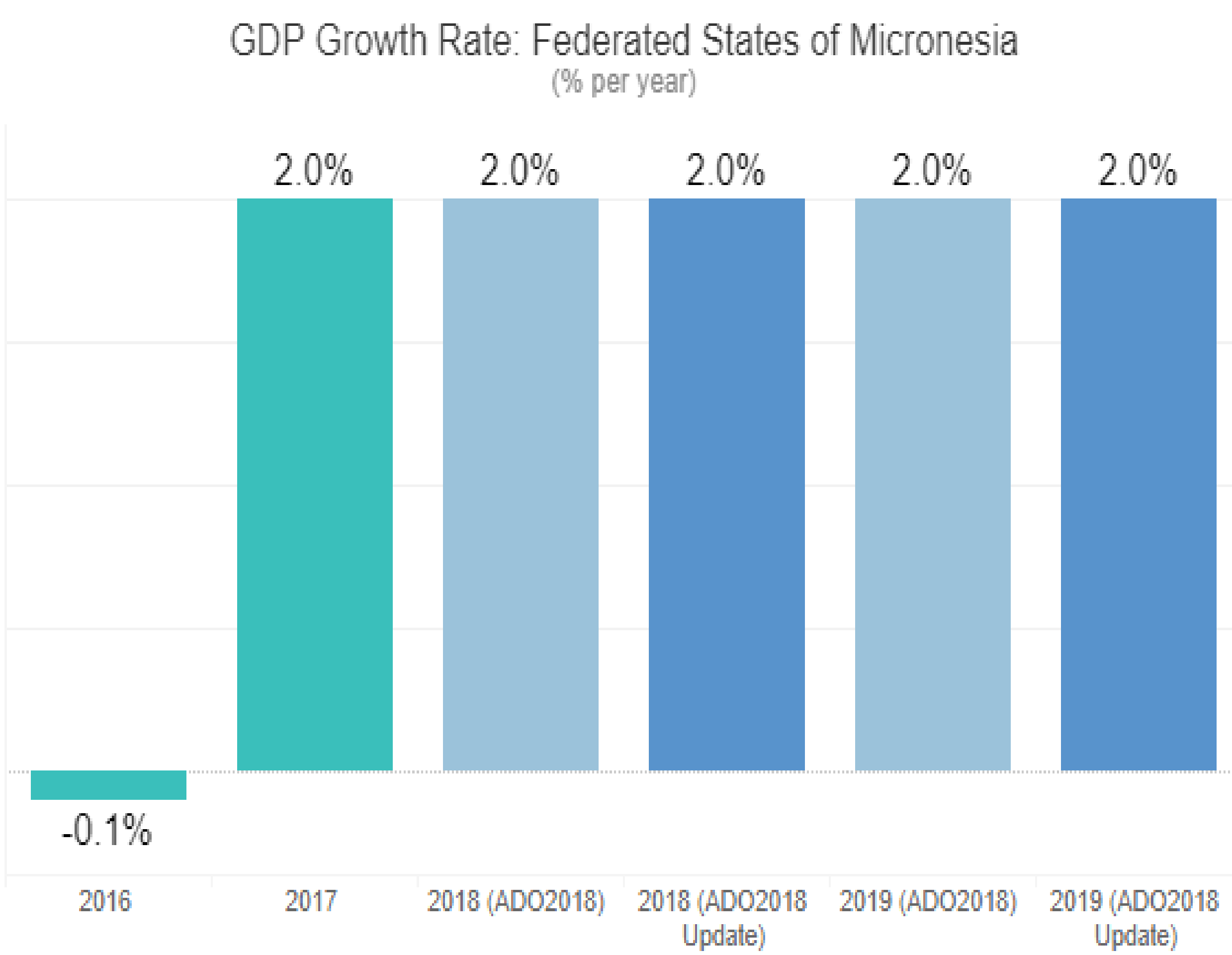
FSMTC’s notes payable with the US Department of Agriculture (Rural Utilities Services) amounted to **$20,163,889** of which **$2,038,170** is classified as the current portion. For additional information concerning the FSMTC’s long term debt, please refer to note 7 to the accompanying financial statements.

Economic Outlook

Economic data released after the Asian Development Outlook (ADO) 2018 was published in April show that the economy contracted by 0.1% in FY2017. Growth is projected to return in FY2018 but below the ADO 2018 forecast. The downward revision partly reflects the temporary suspension of infrastructure grants for new projects under the compact with the United States after the Federated States of Micronesia failed to establish an adequate project management system. Growth for FY is projected to be the same as FY2019.

Economic indicators for the Federated States of Micronesia

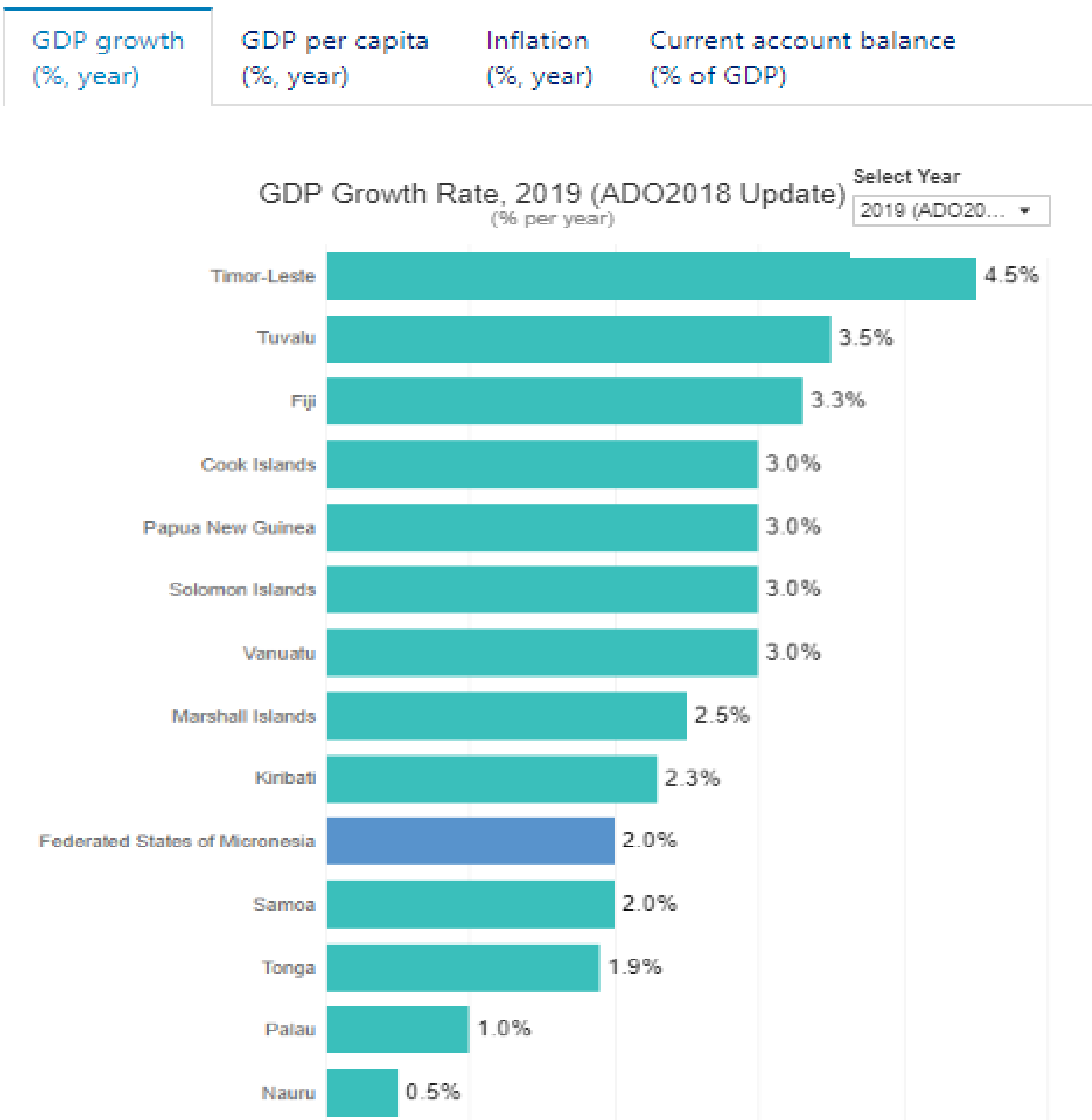
GDP growth (%, year) | GDP per capita (%, year) | Inflation (%, year) | Current account balance (% of GDP)



Source: Asian Development Bank. *Asian Development Outlook 2018 Update*

Comparative economic forecasts for Pacific countries

The latest available economic data for the Federated States of Micronesia compared to countries in the Pacific.



Source: Asian Development Bank. *Asian Development Outlook 2018 Update*

On May 4, 2017, together with Belau Submarine Cable Corporation (BSCC; Republic of Palau) and the Government of the Federated States of Micronesia (FSM), announced it has commenced construction of three submarine cable links that will connect the islands of Palau, Yap and Chuuk to the rest of the world. Said cable landed in Yap September 7, 2017 and in Chuuk September 12, 2017. Installation of Chuuk-Pohnpei (CP) cable to final splice point was completed September 22, 2017.

BSCC, backed by a loan from the Asian Development Bank (ADB), signed a supply contract with NEC to construct the spur to Palau, while FSM, backed by a grant from the World Bank (WB), signed a supply contract with NEC to construct the spur to Yap, and signed an additional agreement this year for the extension from Pohnpei to Chuuk. The spurs to Palau and Yap both interconnect with the SEA-US cable (under construction by NEC, connecting the Philippines and Indonesia to the west coast of the United States via Guam and Hawaii). The extension from Pohnpei, the capital of FSM, to Chuuk branches out of another existing cable linking FSM, the Marshall Islands and Guam. All three routes feature transmission speeds of 100 Gigabit per second (Gbps) per channel.

The FSM Government with funding from the WB is implementing the largest donor funded telecom project in the Pacific which includes implementation of market liberalization and regulatory reforms in tandem with new investments in the delivery of broadband connectivity to the FSM states of Yap, Chuuk, and Kosrae. Overall project implementation responsibilities resides in the DTCI with its principal office at P.O. Box PS- 2, Palikir, Pohnpei, FSM 96941. For more information, visit www.ict.fm. An ownership and implementation responsibility for the fiber optic cable systems is transferring from DTCI to the newly established FSM Telecommunications Cable Corporation (FSMTCC). FSMTCC, as owner of the Yap and Chuuk cable systems, will provide open bandwidth access to the international cable systems for all domestic telecommunications operators.

The average household with superfast broadband will benefit from: Streaming HDTV programmes, E-learning can be delivered at optimal speeds at any time of the day (currently much education is streamed at 'quiet' periods to avoid congestion); faster photo and video uploads, particularly when others are also accessing these services; audio and video downloads happen almost instantaneously avoiding delays and replicating the services that we are beginning to get used to in our work/school environments, and better ping rates and multiple character rendering for gamers, allowing more interactivity***. With all these new services brought about by fiber optic connectivity and new outside plant, 3G/4G LTE upgrade in Chuuk and its outer islands, FSMTC is looking forward to enhanced revenue sources.***

Submarine fiber optic cable landed and connected Yap State in July 2018 and Chuuk State is expected to be connected to fiber optic in February 2019. With this huge broadband for the islands, telecommunications services will be better, faster and cheaper. FSMTC is committed to bring reliable and cost-effective communication services to every household in the FSM. 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, 2017 is set forth in the Corporation's report on the audit of financial statements, which is dated December 11, 2017. That Discussion and Analysis explains the major factors impacting the 2017 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 Mr. Fredy Perman, President/CEO or Rodelio A. Pulmano, Senior Vice President/CFO at email addresses fredy.perman@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 Position
September 30, 2018 and 2017

	2018	2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 969,672	$ 1,589,393
Time certificates of deposit	278,479	278,174
Investment in securities	1,990,465	1,811,148
Accounts receivable, net of an allowance for doubtful accounts of $897,940 and $957,476 in 2018 and 2017, respectively	486,260	539,460
Receivables from international carriers	321,729	318,046
Advances to employees	5,539	9,444
Inventory	971,237	734,893
Accrued interest and other accrued earnings	198,686	122,560
Other receivables, net of an allowance for doubtful accounts of $110,526 and $209,705 in 2018 and 2017, respectively, and prepaid expenses	611,370	735,580
Total current assets	5,833,437	6,138,698
Advance payment to vendor	326,500	201,250
Capital assets:		
Nondepreciable capital assets	740,187	349,547
Capital assets, net of accumulated depreciation	31,139,080	34,021,683
Indefeasible right of use, net	2,649,159	2,559,411
	$ 40,688,363	$ 43,270,589
LIABILITIES AND NET POSITION		
Current liabilities:		
Current maturities of long-term debt	$ 2,038,170	$ 1,939,102
Current maturities of contract liability	1,606,476	1,664,896
Accounts payable, trade	266,974	149,491
Unearned income	89,499	161,749
Customer deposits	449,908	470,089
Accrued leave payable	157,626	140,977
Other accrued liabilities	744,924	496,368
Total current liabilities	5,353,577	5,022,672
Contract liability, net of current portion	-	54,640
Long-term debt, net of current portion	18,125,719	20,161,493
Total liabilities	23,479,296	25,238,805
Commitments and contingencies		
Net position:		
Net investment in capital assets	12,758,061	10,551,099
Unrestricted	4,451,006	7,480,685
Total net position	17,209,067	18,031,784
	$ 40,688,363	$ 43,270,589

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION
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Statements of Revenues, Expenses, and Changes in Net Position
Years Ended September 30, 2018 and 2017

	2018	2017
Operating revenues:		
Internet	$ 5,616,137	$ 5,203,637
Mobile charges	4,316,720	3,666,148
Net access	2,066,952	2,036,885
Overseas tolls	1,052,422	1,382,958
External carriers	1,014,487	1,687,604
Miscellaneous	171,377	168,872
ICTV Chuuk cable charges	87,476	89,785
ICTV Yap cable charges	53,053	55,911
ICTV Kosrae cable charges	47,385	53,198
Recovery of bad debts	44,191	58,424
Discounts	(237,917)	(244,229)
Total operating revenues	14,232,283	14,159,193
Operating expenses:		
Internet expense	3,242,922	2,649,319
Corporate operations	2,530,707	2,506,236
Cable and wire	1,840,419	1,763,682
Plant operations	1,676,652	1,710,366
Wireless telephone	1,663,833	1,837,417
Consumer operations	1,578,493	1,314,487
General support	1,096,391	1,118,275
Terminal equipment	513,053	512,171
Central office	368,213	397,667
ICTV expense	297,563	146,268
Earth station	151,190	188,241
Total operating expenses	14,959,436	14,144,129
Income (loss) from operations	(727,153)	15,064
Nonoperating revenues (expenses):		
Operating subsidy from the FSM National Government	795,228	559,979
Interest expense	(1,070,109)	(1,249,545)
Net change in fair value of investments	179,317	185,497
Total nonoperating revenues (expenses), net	(95,564)	(504,069)
Loss before capital contributions	(822,717)	(489,005)
Capital contributions	-	93,549
Change in net position	(822,717)	(395,456)
Total net position at beginning of year	18,031,784	18,427,240
Total net position at end of year	$ 17,209,067	$ 18,031,784

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from subscribers, long distance carriers and other customers	$ 14,113,243	$ 14,439,510
Cash paid to suppliers for goods and services	(7,292,245)	(7,158,278)
Cash paid to employees	(3,292,689)	(3,285,166)
Net cash provided by operating activities	3,528,309	3,996,066
Cash flows from noncapital financing activities:		
Operating subsidy received from FSM National Government	795,228	559,979
Cash flows from capital and related financing activities:		
Additions to property, plant and equipment	(1,583,078)	(878,487)
Additions to indefeasible right of use	(240,000)	-
Repayments of RUS long-term debt	(1,936,706)	(1,852,481)
Interest paid on RUS long-term debt	(1,063,371)	(1,147,597)
Principal paid on equipment contract	(113,060)	(479,394)
Interest paid on equipment contract	(7,043)	(101,948)
Capital contributions received	-	93,549
Net cash used for capital and related financing activities	(4,943,258)	(4,366,358)
Cash flows from investing activities:		
Net purchases, sales and maturities of investments	-	10,000
Interest and dividends received on investment securities and others	-	(638)
Net cash provided by (used for) investing activities	-	9,362
Net change in cash and cash equivalents	(619,721)	199,049
Cash and cash equivalents at beginning of year	1,589,393	1,390,344
Cash and cash equivalents at end of year	$ 969,672	$ 1,589,393
Reconciliation of (loss) income from operations to net cash provided by operating activities:		
(Loss) income from operations	$ (727,153)	$ 15,064
Adjustments to reconcile (loss) income from operations to net cash provided by operating activities:		
Depreciation and amortization	4,225,293	4,196,547
(Increase) decrease in assets:		
Accounts receivable	53,200	(15,294)
Receivables from international carriers	(3,683)	240,970
Advances to employees	3,905	(2,663)
Inventory	123,523	(84,143)
Accrued interest and other accrued earnings	(76,126)	6,378
Other receivables and prepaid expenses	(235,657)	94,650
Advance payment to vendor	(125,250)	-
Increase (decrease) in liabilities:		
Accounts payable, trade	117,483	(115,947)
Unearned income	(72,250)	7,670
Accrued leave payable	16,649	1,421
Customer deposits	(20,181)	40,593
Other accrued liabilities	248,556	(389,180)
Net cash provided by operating activities	$ 3,528,309	$ 3,996,066

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

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. 37, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and No. 34*, establish 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 position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted - net position 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 position at September 30, 2018 and 2017.

- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position 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.

(1) Summary of Significant Accounting Policies, Continued

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 position. 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 price that would be received to sell an asset or paid to transfer a liability (ie, the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

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.

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.

(1) Summary of Significant Accounting Policies, Continued

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, 2018 and 2017, no assets had been written down.

Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. The Corporation has no items that qualify for reporting in this category.

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.

Unearned Income

Unearned income includes amounts received for telecommunications services prior to the end of the fiscal year but related to the subsequent accounting period.

Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. The Corporation has no items that qualify for reporting in this category.

Income Taxes

Corporate profits are not subject to income tax in the FSM. Instead, the FSM National Government imposes a gross revenue tax (GRT) of 3% on gross revenues earned. The Corporation is subject to GRT; however, the Corporation is specifically exempt from any other taxes in accordance with its enabling legislation for the years ended September 30, 2018 and 2017.

(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 result from capital, financing and investing activities and consist of investment earnings, interest paid on long-term debt, and grant funds received.

New Accounting Standards

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

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments.

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements,* which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

- GASB Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits).

- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

The implementation of these statements did not have a material effect on the Corporation's financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61,* which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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 deferred outflows of resources, liabilities and deferred inflows of resources, 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

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.

As of September 30, 2018 and 2017, the carrying amount of the Corporation's total cash and cash equivalents and time certificates of deposit was $1,248,151 and $1,867,567, respectively, and the corresponding bank balances were $1,314,495 and $1,928,949, respectively, all of which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2018 and 2017, bank deposits in the amount of $376,011 and $374,725, 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.

(3) Deposits and Investments, Continued

B. Investments, Continued

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, 2018 and 2017, 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, 2018 and 2017, there were no investments in any one issuer that exceeded 5% of total investments.

As of September 30, 2018 and 2017, investments at fair value are as follows:

	2018	2017
Fixed income:		
U.S. Treasury obligations	$ 180,477	$ 155,152
U.S. Government agencies	-	38,995
Corporate notes	225,804	228,174
	406,281	422,321
Other investments:		
Domestic and international equities	1,544,688	1,359,338
Money market funds	39,496	29,489
	$ 1,990,465	$ 1,811,148

As of September 30, 2018, 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	$ 10,155	$ 103,895	$ 66,427	$ -	$ 180,477
Corporate notes	AA3/P-1	-	14,989	-	-	14,989
Corporate notes	A1/P-1	3,991	38,406	-	-	42,397
Corporate notes	A2/P-1	-	31,828	9,691	-	41,519
Corporate notes	A3-/P-1	10,043	30,013	9,677	-	49,733
Corporate notes	BAA1/P-2	8,052	9,730	20,185	-	37,967
Corporate notes	BAA2/P-2-3	-	20,220	18,979	-	39,199
		$ 32,241	$ 249,081	$ 124,959	$ -	$ 406,281

(3) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2017, 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	$ 15,072	$ 85,251	$ 54,829	$ -	$ 155,152
U.S. Government agencies	Aaa/P-1	38,995	-	-	-	38,995
Corporate notes	AA3/P-1	-	15,378	-	-	15,378
Corporate notes	A1/P-1	10,054	33,663	9,812	-	53,529
Corporate notes	A2/P-1	20,332	43,674	-	-	64,006
Corporate notes	A3-/P-1	-	20,385	10,107	-	30,492
Corporate notes	BAA1/P-2	-	16,771	-	-	16,771
Corporate notes	BAA2/P-2-3	-	18,266	19,265	-	37,531
Corporate notes	BAA3/P-3	-	10,467	-	-	10,467
		$ 84,453	$ 243,855	$ 94,013	$ -	$ 422,321

The Corporation categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The Corporation has the following recurring fair value measurements as of September 30, 2018 and 2017:

	September 30, 2018	Fair Value Measurements Using: Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	$ 180,477	$ -	$ 180,477	$ -
U.S. Government agencies	-	-	-	-
Corporate notes	225,804	-	225,804	-
Total fixed income	406,281	-	406,281	-
Equity securities:				
U.S. equities	1,129,972	1,129,972	-	-
Non U.S. equities	414,716	414,716	-	-
Total equity securities	1,544,688	1,544,688	-	-
Total investments by fair value level	1,950,969	$ 1,544,688	$ 406,281	$ -
Investments measured at amortized cost:				
Money market funds	39,496			
	$ 1,990,465			

(3) Deposits and Investments, Continued

B. Investments, Continued

	September 30, 2017	Fair Value Measurements Using: Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	$ 155,152	$ -	$ 155,152	$ -
U.S. Government agencies	38,995	-	38,995	-
Corporate notes	228,174	-	228,174	-
Total fixed income	422,321	-	422,321	-
Equity securities:				
U.S. equities	1,039,862	1,039,862	-	-
Non U.S. equities	319,476	319,476	-	-
Total equity securities	1,359,338	1,359,338	-	-
Total investments by fair value level	1,781,659	$ 1,359,338	$ 422,321	$ -
Investments measured at amortized cost:				
Money market funds	29,489			
	$ 1,811,148			

Equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Fixed income securities classified in Level 2 of the fair value hierarchy are valued using matrix-based or model-based pricing techniques. These pricing techniques, which are obtained from various sources, assume normal market conditions and are based on large volume transactions.

(4) Capital Assets

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

	Estimated Useful Lives	Balance October 1, 2017	Additions	Retirements	Balance September 30, 2018
General support	5-35 years	$ 16,534,542	$ 393,208	$ (131,531)	$ 16,796,219
Central office	20 years	12,139,906	69,096	-	12,909,002
Earth station	20 years	6,519,918	8,712	-	6,528,630
Terminal equipment	5-20 years	3,484,038	138,451	(5,958)	3,616,531
Cellular network	10-20 years	22,730,419	246,357	-	22,976,776
Internet equipment	8 years	3,374,801	208,093	(26,319)	3,556,575
Pole, cable and wiring	15-20 years	44,385,732	130,218	-	44,515,950
Total		109,169,356	1,194,135	(163,808)	110,199,683
Accumulated depreciation		(75,147,673)	(4,075,041)	162,111	(79,060,603)
		34,021,683	(2,880,906)	(1,697)	31,139,080
Plant under Construction		349,547	856,759	(466,119)	740,187
Property, plant and equipment, net		$ 34,371,230	$ (2,024,147)	$ (467,816)	$ 31,879,267

(4) Capital Assets, Continued

	Estimated Useful Lives	Balance October 1, 2016	Additions	Retirements	Balance September 30, 2017
General support	5-35 years	$ 16,919,084	$ 273,368	$ (657,910)	$ 16,534,542
Central office	20 years	12,098,186	41,720	-	12,139,906
Earth station	20 years	6,437,768	93,652	(11,502)	6,519,918
Terminal equipment	5-20 years	3,487,330	47,273	(50,565)	3,484,038
Cellular network	10-20 years	22,603,482	126,937	-	22,730,419
Internet equipment	8 years	3,211,059	197,470	(33,728)	3,374,801
Pole, cable and wiring	15-20 years	44,385,732	-	-	44,385,732
Total		109,142,641	780,420	(753,705)	109,169,356
Accumulated depreciation		(71,850,545)	(4,050,295)	753,167	(75,147,673)
		37,292,096	(3,269,875)	(538)	34,021,683
Plant under Construction		250,942	98,605	-	349,547
Property, plant and equipment, net		$ 37,543,038	$ (3,171,270)	$ (538)	$ 34,371,230

(5) Indefeasible Right of Use (IRU)

In 2009, the Corporation entered into an IRU Capital Lease agreement with a third party for the exclusive use of eight 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 ten 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.

In 2018, the Corporation entered into another IRU Capital Lease agreement with a third party for the exclusive use of capacity of the fiber cable system which runs between Guam and mainland of United States of America. Under the terms of the agreement, the Corporation made certain payments of $240,000. The initial term of the agreement is for a period of fifteen years commencing on the date the Corporation is initially granted access, and which term is renewable on a month-to-month basis thereafter. The Corporation's policy is to amortize the right of use over the 15-year period.

As of September 30, 2018 and 2017, accumulated amortization expense of $1,247,142 and $1,096,890, respectively, has been recorded.

(6) Long-term Debt

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

	2018	2017
Loans payable to RUS, with a 35 year term, interest at 5% per annum, 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.	$ 20,163,889	$ 22,100,595

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
2019	$ 2,038,170	$ 961,907	$ 3,000,077
2020	2,142,446	857,631	3,000,077
2021	2,252,058	748,019	3,000,077
2022	2,367,278	632,799	3,000,077
2023	2,488,392	511,685	3,000,077
2024 - 2028	7,561,210	1,036,420	8,597,630
2029 - 2030	1,314,335	48,445	1,362,780
	$ 20,163,889	$ 4,796,906	$ 24,960,795

These notes are subject to certain coverage ratio requirements. The Corporation is not in compliance with its ratio requirements as of September 30, 2018. Management is of the opinion that the lender is aware of this matter and will not call the debt. Therefore, the debt is classified in accordance with expected future payouts.

A summary of changes in long-term debt for the years ended September 30, 2018 and 2017 are as follows:

	Balance October 1, 2017	Increases	Decreases	Balance September 30, 2018	Due Within One Year
Notes payable:					
Rural Utilities Service	$ 22,100,595	$ -	$ (1,936,706)	$ 20,163,889	$ 2,038,170

	Balance October 1, 2016	Increases	Decreases	Balance September 30, 2017	Due Within One Year
Notes payable:					
Rural Utilities Service	$ 23,953,076	$ -	$ (1,852,481)	$ 22,100,595	$ 1,939,102

(7) Commitments and Contingencies

Leases

The Corporation has various operating leases as of September 30, 2018. Three are residential real estate leases for contract employees, which have a term of one or two years.

Three are for land sites for state offices with 25-35 year terms beginning in 1988 for Pohnpei and Yap and 1990 for Kosrae. There is one land site lease for the southeast remote switch on Pohnpei with a 15-year term beginning in 1994. The Corporation has also entered into various circuit leases expiring through 2025.

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

Year ending September 30,	Total
2019	$ 644,715
2020	385,751
2021	312,788
2022	159,788
2023	6,788
2024 - 2025	10,454
	$ 1,520,284

Operation, Management and Repair (OM&R) Agreement

In 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 ($10,099,944 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 $950,000) 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.

(7) Commitments and Contingencies, Continued

Construction and Other Commitments

The Corporation has entered into various contracts for construction and expansion of its facilities and services. Approximately $3,857,177 is outstanding under these contracts as of September 30, 2018.

The Corporation has entered into a $4 million contract with Acclinks Communications, Inc. for a Third Generation (3G) Mobile Network Partnership Agreement signed on September 12, 2013. As of September 30, 2018 and 2017, the Corporation recognized $1,606,476 and $1,719,536, respectively, as a contract liability that will be paid through revenue sharing as agreed per payment terms. The Corporation pays 10% of total 3G revenue and 5% of 2G revenue to Acclinks as the interest and technical support fee for 5 years starting from the commencement of the 3G services.

A summary of changes in other long-term liabilities for the years ended September 30, 2018 and 2017 is as follows:

	Balance October 1, 2017	Increases	Decreases	Balance September 30, 2018	Due Within One Year
Contract liability	$ 1,719,536	$ -	$ (113,060)	$ 1,606,476	$ 1,606,476

	Balance October 1, 2016	Increases	Decreases	Balance September 30, 2017	Due Within One Year
Contract liability	$ 2,198,930	$ -	$ (479,394)	$ 1,719,536	$ 1,664,896

Future minimum payments payable by the Corporation under this contract are as follows:

Year ending September 30,	Principal	Interest	Total
2019	$ 1,606,476	$ 202,402	$ 1,808,878

The FSM National Government paid $1.2 million for a $1.5 million project for network upgrade and mobile extension for Chuuk State and the project was in progress as of September 30, 2018. The Corporation will record related improvement and extension of fixed assets when the project is completed.

The Corporation has entered into various contract service agreements to improve internet capacity in the States of Chuuk, Kosrae and Yap.

Future minimum payments payable by the Corporation under these contracts are as follows:

Year ending September 30,	Total
2019	$ 1,939,739
2020	1,393,239
2021	1,310,739
2022	1,310,739
2023	1,310,739
2024 - 2028	6,553,695
2029 - 2033	6,553,695
	$ 20,372,585

(7) 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.

Cable System in Chuuk and Yap State

The FSM National Government paid $8 million for the purchase and installation of a fiber optic cable system to serve Chuuk and Yap State as part of the conditions for a grant from World Bank and the installation was in progress as of September 30, 2018. The FSM National Government will request a reimbursement from the World Bank and the Corporation collected installation costs for Yap State from FSMT Cable Corporation, a component unit of the FSM National Government. Total installation costs in Yap State are estimated to be approximately $1 million by management. The Corporation pays monthly charges for the services provided by FSMT Cable Corporation based on actual costs incurred.

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.

(8) 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, 2018 and 2017, receivables from the FSM National Government amounted to $43,939 and $70,502, respectively.

During the years ended September 30, 2018 and 2017, the Corporation received operating subsidies of $795,228 and $559,979, respectively, from the FSM National Government for the purpose of operation of the O3B Network projects.

(9) Retirement Plan

The Corporation's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees received from the FSM Social Security System. The Plan is a contributory plan in which the Corporation contributes 10 percent of the participant's annual salary, and the participant contributes 3 or more percent from his or her annual salary. Participation is optional. The Corporation's controller is the designated Plan administrator. Employer contributions to the Plan during the years ended September 30, 2018 and 2017 were $224,352 and $217,010, respectively, and employee contributions were $138,811 and $132,009, respectively. Management is of the opinion that the plan does not represent an asset or liability of the Corporation. At September 30, 2018 and 2017, plan assets were $4,796,596 and $4,681,273, respectively.

(10) Subsequent Event

In November 2018, the Corporation entered into a $550,000 agreement with the FSM National Government (FSMNG) to install network components of the Cable Landing Station in Chuuk. The Corporation received $350,000 from FSMNG in December 2018.

The Corporation is in process of requesting RUS for a loan restructure.

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, 2018 and 2017

	2018	2017
Depreciation and amortization	$ 4,225,293	$ 4,196,547
Salaries and wages	3,323,815	3,294,496
Circuit lease	2,762,999	2,175,445
Utilities	1,117,077	1,140,476
Repairs and maintenance	881,831	1,023,138
Cost of sales	598,906	440,765
Taxes	396,208	388,157
Contractual services	268,891	174,897
Travel	268,871	330,621
Rental expenses	144,037	130,486
Petroleum and lubricants	142,704	103,036
Advertising	113,675	47,919
Communications	106,811	119,087
Training	86,815	11,682
Freight	75,119	41,242
Supplies	70,411	82,953
ICTV affiliated	59,608	75,289
Professional fees	59,167	118,970
Insurance	50,658	61,893
Representation	36,117	41,704
Land lease	19,764	15,703
Publications and printing	19,217	24,617
Miscellaneous	131,442	105,006
	$ 14,959,436	$ 14,144,129

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, 2018

U.S. Department of Agriculture

Rural Utilities Service Loan Funding:

Approved Purposes	Loan Proceeds Approved as of September 30, 2018	Loan Proceeds Received During FY 2018	Total Disbursements on Contracts During FY 2018
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	-	-
	$ 52,332,958	$ -	$ -

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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation), which comprise the statement of net position as of September 30, 2018, and the related statements of revenues, expenses, and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 20, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Deloitte.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as item 2018-001.

The Corporation's Response to Findings

The Corporation's response to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Corporation's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

December 20, 2018

Loan Noncompliance

Finding No. 2018-001

Criteria: Section 5.12, *TIER Requirement*, of the RUS Loan Agreements state the required Times Interest Earned Ratio (TIER) rate that is to be maintained. Such provision has also been stated under the preliminary review of "B" Loan letter dated November 19, 2008 requiring at least 1.5 commencing December 31, 2012.

Condition: Per examination of RUS Form 479 for the year ended December 31, 2017, submitted by the Corporation on February 5, 2018, the TIER rate reported was 0.45, which is less than the criteria.

Cause: The cause of the above condition is insufficient earnings to cover interest on funded debt as of December 31, 2017, the RUS loan reporting period, which resulted in a TIER rate less than the minimum requirement.

Effect: The effect of the above condition is noncompliance with the criteria.

Prior Year Status: Noncompliance with Section 5.12 of the RUS Loan Agreements was reported as a finding in the audits of the Corporation for fiscal years 2013 through 2017.

Recommendation: We recommend compliance with the criteria.

Views of Auditee and Planned Corrective Actions:

See the auditee-prepared corrective action plan.

Unresolved Prior Year Findings
Year Ended September 30, 2018

Summary Schedule of Prior Audit Findings

Finding Number	Finding Title	Status
2018-001	Loan Noncompliance	Not Corrected or Resolved. See corrective action plan - Finding 2018-001

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CORRECTIVE ACTION PLAN
2 CFR § 200.511(c)
Year Ended September 30, 2018

Finding Number	Corrective Action Plan	Anticipated Completion Date	Responsible Person (Contact details)
2018-001	Management is fully aware of the situation as to the non-compliance to the TIER required by RUS, due to the fact that the Corporation has been experiencing major losses for the last 10 years including FY2018. Although the loss recovery is noticeable over the last 5 years, the operations of the company has been improving. We have also employed an expert or a consultant to help us find new sources of revenue other the ones we had been offering. Management had been lobbying at FSM Congress for more capital funding for the expansion and upgrade of the aging telecommunications facilities. The Board of Directors have noticed the weight of the RUS loan financing to the financial condition of the Corporation and had given priority in resolving the issue. We continue to look at the possibilities of loan refinancing or a payment break from RUS. With new facilities, upgraded technologies, support from FSM National Government, aggressive marketing & operational efficiencies, management believes that RUS tier requirements will be met.	Ongoing	Fredy Perman/CEO