

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

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

YEARS ENDED SEPTEMBER 30, 2002 AND 2001

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

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Years Ended September 30, 2002 and 2001

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INDEPENDENT AUDITORS' REPORT

Chairman
Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the accompanying balance sheets of the FSM Telecommunications Corporation (FSMTC), a component unit of the Federated States of Micronesia National Government, as of September 30, 2002 and 2001, and the related statements of earnings (loss) and fund equity and cash flows for the years then ended. These financial statements are the responsibility of FSMTC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

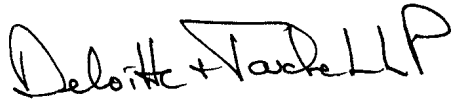
Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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.

The September 30, 2001 financial statements of Island Cable Television (ICTV)-Pohnpei, a 50% investee of FSMTC, have not been audited and the ultimate impact of this matter on the accompanying financial statements as well as the impact on recorded goodwill is uncertain.

In our opinion, except for the effects of adjustments, if any, which would result if we had been able to obtain audited information of a material investee (ICTV-Pohnpei) as set forth in the third paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of FSMTC as of September 30, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were performed for the purpose of forming an opinion on the basic financial statements of FSMTC taken as a whole. The accompanying schedule of operating expenses (page 13) is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This schedule is the responsibility of the management of FSMTC. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effects, if any, of the matter set forth in the third paragraph, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 26, 2002, on our consideration of FSMTC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

December 26, 2002

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Balance Sheets
September 30, 2002 and 2001

	2002	2001
<u>ASSETS (note 6)</u>		
Current assets:		
Cash	\$ 2,640,102	\$ 2,544,188
Time deposits	101,745	3,046,058
Investments in securities	9,188,394	10,403,271
Accounts receivable, net of an allowance for doubtful accounts of \$2,959,768 and \$3,356,241 in 2002 and 2001, respectively (note 9)	1,450,027	691,429
Receivables from carriers, net	841,130	570,469
Advances to employees	30,630	20,418
Inventory	354,696	178,101
Accrued interest and other accrued earnings	540,777	454,299
Other receivables and prepaid expenses	184,644	204,390
Total current assets	15,332,145	18,112,623
Investment-Intelsat (note 2)	910,114	910,114
Investment-ICTV Pohnpei (note 3)	97,929	407,422
Deferred charges	9,455	1,650
Property, plant and equipment, net (note 4)	42,802,867	39,704,451
	\$ 59,152,510	\$ 59,136,260
<u>LIABILITIES AND FUND EQUITY</u>		
Current liabilities:		
Notes payable-current portion (note 6)	\$ 642,731	\$ 611,436
Accounts payable, trade	389,944	93,147
Deferred revenue-debit cards	83,322	76,903
Accrued leave payable	113,464	116,845
Other payables and accrued expenses	631,618	590,219
Total current liabilities	1,861,079	1,488,550
Long-term portion of notes payable (note 6)	26,669,055	27,326,240
Total liabilities	28,530,134	28,814,790
Fund equity:		
Retained earnings (note 12)	30,622,376	30,321,470
Commitments and contingencies (notes 7, 8 and 11)	\$ 59,152,510	\$ 59,136,260

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Statements of Earnings (Loss) and Fund Equity
Years Ended September 30, 2002 and 2001

	2002	2001
Operating revenues:		
Overseas tolls	\$ 4,501,170	\$ 4,981,258
Net access	2,276,810	2,165,554
External carriers	2,099,053	1,811,267
Internet	1,505,228	1,390,775
ICTV Kosrae cable charges	61,822	-
Miscellaneous	179,775	212,633
	<u>10,623,858</u>	<u>10,561,487</u>
Total operating revenues		
Operating expenses:		
Corporate operations	1,415,717	1,448,113
Consumer operations	1,322,167	1,397,957
Cable and wire	1,346,090	1,157,627
Earth station	941,253	910,382
General support	825,615	895,172
Central office	812,401	800,784
Plant operations	748,101	763,116
Internet expense	622,780	370,108
Terminal equipment	612,291	750,020
Wireless telephone - Ulithi	6,194	-
Bad debts	-	219,105
	<u>8,652,609</u>	<u>8,712,384</u>
Total operating expenses		
Earnings from operations	<u>1,971,249</u>	<u>1,849,103</u>
Nonoperating revenues (expenses):		
Compact funding-Section 215 (a)(2) (note 8)	582,361	882,000
Compact funding-Section 215 (b)(2) (note 8)	-	114,814
Interest income - general	73,394	266,536
Interest income - IntelSat (note 2)	-	249,912
Interest expense	(1,209,257)	(1,411,842)
Gain on sale of fixed assets	10,456	13,093
Investment earnings (loss) - ICTV-Pohnpei (note 3)	16,110	(17,849)
Investment loss, net	(1,214,877)	(1,958,910)
Recovery of bad debts	397,073	-
Goodwill impairment loss (note 3)	(325,603)	-
	<u>(1,670,343)</u>	<u>(1,862,246)</u>
Total nonoperating (expenses) revenues, net		
Net earnings (loss)	300,906	(13,143)
Retained earnings at beginning of year	<u>30,321,470</u>	<u>30,334,613</u>
Retained earnings at end of year	<u>\$ 30,622,376</u>	<u>\$ 30,321,470</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Statements of Cash Flows
Years Ended September 30, 2002 and 2001

	2002	2001
Increase (decrease) in cash:		
Cash flows from operating activities:		
Earnings from operations	\$ 1,971,249	\$ 1,849,103
Adjustments to reconcile earnings from operations to net cash provided by operating activities:		
Depreciation and amortization	2,541,489	2,217,351
Recovery of bad debts	397,073	-
(Increase) decrease in assets:		
Accounts receivable, net	(758,598)	342,011
Receivables from carriers	(270,660)	(377,860)
Advances to employees	(10,212)	23,795
Inventory	(176,595)	(74,404)
Deferred charges	(7,805)	-
Other receivables and prepaid expenses	19,746	(6,613)
Increase (decrease) in liabilities:		
Accounts payable, trade	296,797	(41,988)
Deferred revenue-debit cards	6,419	18,841
Accrued leave payable	(3,381)	12,772
Other payables and accrued expenses	41,398	56,631
Net cash provided by operating activities	4,046,920	4,019,639
Cash flows from noncapital financing activities:		
CFSM appropriations-215 (a) (2) (note 8)	582,361	882,000
CFSM appropriations-215 (b) (2) (note 8)	-	114,814
Net cash provided by noncapital financing activities	582,361	996,814
Cash flows from capital and related financing activities:		
Repayments of notes payable	(625,890)	(596,478)
Additions to property, plant and equipment	(5,639,905)	(2,427,764)
Proceeds from sale of fixed assets	10,456	13,093
Interest paid on loan payable	(1,209,257)	(1,411,842)
Net cash used for capital and related financing activities	(7,464,596)	(4,422,991)
Cash flows from investing activities:		
Withdrawals from time deposits	2,944,313	33,942
Interest earned - investments	(13,084)	515,144
Net cash provided by investing activities	2,931,229	549,086
Net increase in cash	95,914	1,142,548
Cash at beginning of year	2,544,188	1,401,640
Cash at end of year	\$ 2,640,102	\$ 2,544,188

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements
September 30, 2002 and 2001

(1) Organization and Summary of Significant Accounting Policies

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

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

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

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

Cash

For the purposes of the balance sheets and the statements of cash flows, cash is defined as cash in bank checking and savings accounts, money market funds and commercial paper with original maturities of three months or less from the date of acquisition. Time deposits with original maturities in excess of three months are separately classified. The Corporation does not require collateralization of its cash in excess of Federal Deposit Insurance Corporation (FDIC) limits; therefore \$300,000 as of September 30, 2002 and 2001 is insured by the FDIC. The remaining balances are uninsured and uncollateralized.

Investments in Securities

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

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

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements
September 30, 2002 and 2001

(1) Summary of Significant Accounting Policies, Continued

Investments in Securities, Continued

Investments in securities comprise the following as of September 30, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
Equities	\$ 4,629,458	\$ 5,981,938
U.S. government obligations	1,596,159	1,138,198
Corporate bonds and others	<u>2,962,777</u>	<u>3,282,135</u>
	\$ <u>9,188,394</u>	\$ <u>10,403,271</u>

Net investment (loss) income comprises the following for the years ended September 30, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
Interest and dividends	\$ 247,339	\$ 283,654
Unrealized loss on investments	<u>(1,462,216)</u>	<u>(2,242,564)</u>
Net investment loss	\$ <u>(1,214,877)</u>	\$ <u>(1,958,910)</u>

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

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables charged to expenses.

Property, Plant and Equipment

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

Inventory

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

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements
September 30, 2002 and 2001

(1) Summary of Significant Accounting Policies, Continued

Investments in Companies

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

Receivables

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

Compensated Absences

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

Plant Under Construction

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

Reclassification

Certain accounts in the 2001 statements have been reclassified to conform with the 2002 presentation.

(2) Investment - IntelSat

In September 1994, the Corporation became a member of the International Telecommunications Satellite organization (IntelSat). The Corporation paid its initial capital investment share of \$910,114 representing a .05% valuation of the operating agreement at the time of acquisition. At September 30, 2002 and 2001, the investment balance of \$910,114 is carried at cost. Interest earned on this investment was \$0 and \$249,912 during the years ended September 30, 2002 and 2001, respectively.

(3) Investment – Island Cable Television

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

The Corporation's pro rata share of income/(loss) was \$16,110 and (\$17,849) for the years ended September 30, 2002 and 2001, respectively.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements
September 30, 2002 and 2001

(4) Property, Plant and Equipment, Net

Property, plant and equipment, net as of September 30, 2002 and 2001, is as follows:

	<u>Estimated Useful Lives</u>	<u>2002</u>	<u>2001</u>
General support	5-35 years	\$ 12,050,250	\$ 11,838,342
Central office	20 years	9,555,907	8,670,223
Earth station	20 years	5,184,033	4,903,665
Terminal equipment	5-20 years	4,063,256	3,662,232
Internet Equipment	8 years	498,365	357,426
Pole, cable and wiring	15-20 years	<u>30,744,343</u>	<u>29,792,150</u>
Total		62,096,154	59,224,038
Accumulated depreciation		<u>(24,065,009)</u>	<u>(21,674,789)</u>
		38,031,145	37,549,249
Plant under construction		<u>4,771,722</u>	<u>2,155,202</u>
Property, plant and equipment, net		\$ <u>42,802,867</u>	\$ <u>39,704,451</u>

(5) Capitalized Interest

Interest is capitalized on all construction-in-progress pursuant to FASB 34, "Capitalization of Interest Costs" provided that the construction period exceeds one year. Interest capitalized on all construction-in-progress was \$173,173 and \$0 during the years ended September 30, 2002 and 2001, respectively.

(6) Notes Payable

	<u>2002</u>	<u>2001</u>
Loan payable to Rural Utilities Service (RUS), with a 35 year term, interest at 5%, collateralized by the Corporation's specific ground leases and essentially all other assets. Pursuant to a loan agreement dated August 1, 1990, the Corporation is required to make monthly payments of both principal and interest to RUS.	\$ 27,311,786	\$ 27,937,676
Less: current portion	<u>642,731</u>	<u>611,436</u>
Long-term portion of notes payable	\$ <u>26,669,055</u>	\$ <u>27,326,240</u>

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements
September 30, 2002 and 2001

(6) Notes Payable, Continued

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

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 642,731	\$ 1,365,589	\$ 2,008,320
2004	674,867	1,333,453	2,008,320
2005	708,611	1,299,709	2,008,320
2006	744,041	1,264,279	2,008,320
2007	781,243	1,227,077	2,008,320
Thereafter	<u>23,760,293</u>	<u>13,106,768</u>	<u>36,867,061</u>
	\$ <u>27,311,786</u>	\$ <u>19,596,875</u>	\$ <u>46,908,661</u>

(7) Commitments and Contingencies

The Corporation has fifteen operating leases as of September 30, 2002. Eight are residential real estate leases for contract employees, which have a term of one year. Three represent leases for satellite stations of Yap, Pohnpei, and Kosrae with thirty-year leases. Three are for land site leases for three of the four state offices with 25-35 year terms beginning in 1988 for Pohnpei and Yap and 1990 for Kosrae. One is for a training center and one is for the previous central office on Pohnpei; both for 25 years terms beginning in 1983 for the training center and 1994 for the old central office. The Corporation has also entered into various circuit leases expiring through 2015 and 2016.

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

<u>Year ending:</u>	<u>Total</u>
September 30, 2003	\$ 578,096
September 30, 2004	550,346
September 30, 2005	543,746
September 30, 2006	543,146
September 30, 2007	543,146
Thereafter	<u>4,370,034</u>
	\$ <u>7,128,514</u>

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements
September 30, 2002 and 2001

(7) Commitments and Contingencies, Continued

Self Insurance

The Corporation purchases insurance to cover risks associated with its buildings and equipment (\$9,775,604 of coverage) and vehicles (up to \$1 million of coverage per vehicle per incident). Additionally, the Corporation purchases fidelity insurance coverage for selected employees (total coverage of \$2,204,000) and workmen's compensation insurance (coverage of up to \$50,000 per employee). The Corporation also purchases general liability insurance in connection with operations (up to \$1 million per occurrence). The Corporation does not purchase insurance for its Outside Plant. As most of these items are underground, the Corporation is of the opinion that losses from such, if any, will be minimal. Therefore, the Corporation is self insured for Outside Plant and all other risks not encompassed in the forgoing. Management is of the opinion that no material losses have resulted from this practice.

Construction Commitments

During the year ended September 30, 2002, the Corporation entered into various contracts for construction and expansion of its facilities and services. Approximately \$3,406,433 is outstanding under these contracts as of September 30, 2002.

(8) Compact Funding

Funds are made available under Section 215 (a) (2) of the Compact of Free Association for the use of the Corporation's operations and maintenance of its communications systems. These funds are granted for fifteen years commencing in 1986. The Corporation received Compact funds for the years ended September 30, 2002 and 2001, in the amounts of \$582,361 and \$882,000, respectively. The Compact of Free Association is currently under renegotiation. The effects of the renegotiation efforts on the Corporation cannot be determined at this time.

On June 23, 1987, Congress passed Public Law No. 5-5 which appropriated \$7,320,000 from the General Fund of the Federated States of Micronesia for capital projects of the Corporation. Section 215 (b) (2) of the Compact provides that these funds shall be for the purpose of acquiring such communications hardware as may be located within the FSM or for such other current or capital account activity as may be selected. The Corporation received \$0 and \$114,814 for the years ended September 30, 2002 and 2001, respectively.

(9) Related Party Transactions

The Corporation's services are provided to its shareholders at the same rates as are charged to third parties. The Corporation is a component unit of the Federated States of Micronesia National Government. As of September 30, 2002, the Corporation has receivables from the National Government of approximately \$226,719 (\$283,669 at September 30, 2001).

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Notes to Financial Statements
September 30, 2002 and 2001

(10) Retirement Plan

The Corporation's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees received from the FSM Social Security System. The Plan is a contributory plan in which the Corporation contributes 10 percent of the participant's annual salary, and the participant contributes 3 or more percent from his or her annual salary. Participation is optional. The Corporation's controller is the designated Plan administrator. Contributions to the Plan during the years ended September 30, 2002 and 2001 were \$196,101 and \$199,586, respectively. Management is of the opinion that the plan does not represent an asset or liability of the Corporation. For the years ended September 30, 2002 and 2001, plan assets were \$1,455,578 and \$1,395,843, respectively.

(11) External Carriers

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

(12) Adoption of New Accounting Standard

Effective October 1, 2001, the Corporation adopted GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions." GASB No. 33 establishes more uniform revenue recognition criteria and financial reporting standards regarding the timing and recognition of the results of nonexchange transactions involving cash and other financial and capital resources. The provisions of GASB No. 33 were applied to all periods presented and had no material impact on those statements.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Schedule of Operating Expenses
Years Ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Salaries and wages	\$ 2,761,684	\$ 2,994,071
Depreciation	2,541,489	2,198,198
Circuit lease	577,101	744,395
Contractual services	490,697	84,826
Utilities	474,417	490,166
Advertising	348,174	390,806
Repairs and maintenance	334,921	414,956
Communications	298,230	259,887
Travel	259,407	275,402
Supplies	93,839	127,710
Freight	90,426	66,274
Professional fees	60,636	152,208
Insurance	60,540	74,651
ICTV taping services	37,800	-
Petroleum and lubricants	37,064	31,676
Import tax expense	35,894	39,430
Rental expenses	35,850	51,625
Land leases	27,864	18,414
Representation	25,669	40,963
Publications and printing	8,932	7,893
ICTV affiliated	5,046	-
Bad debts	-	219,105
Miscellaneous	<u>46,929</u>	<u>29,728</u>
Total	\$ <u>8,652,609</u>	\$ <u>8,712,384</u>

See Accompanying Independent Auditors' Report.



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

Chairman
Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the financial statements of the Federated States of Micronesia Telecommunications Corporation (FSMTC), as of and for the year ended September 30, 2002, and have issued our report thereon dated December 26, 2002, which report was qualified due to the absence of audited information in 2001 to support an investment in a material investee. 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.

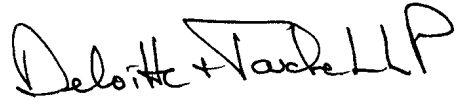
Compliance

As part of obtaining reasonable assurance about whether FSMTC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that we have reported to management of FSMTC in a separate letter dated December 26, 2002.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered FSMTC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of FSMTC in a separate letter dated December 26, 2002.

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

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

December 26, 2002



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

Chairman
Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

Compliance

We have audited the compliance of the Federated States of Micronesia Telecommunications Corporation (FSMTC) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2002. FSMTC's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 20). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of FSMTC's management. Our responsibility is to express an opinion on FSMTC's compliance based on our audit.

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

In our opinion, FSMTC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2002.

Internal Control Over Compliance

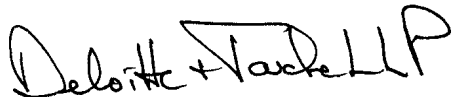
The management of FSMTC is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered FSMTC's internal control over compliance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

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

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of Federated States of Micronesia Telecommunications Corporation as of and for the year ended September 30, 2002, and have issued our report thereon dated December 26, 2002, which report was qualified due to the absence of audited information in 2001 to support an investment in a material investee. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (pages 18 and 19) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the Federated States of Micronesia Telecommunications Corporation. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

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

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

December 26, 2002

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

	<u>Funds Received</u>	<u>Funds Expended</u>
Compact of Free Association:		
Section 215 (a) (2) for operating assistance	\$ 582,361	\$ 582,361
Section 215 (b) (2) for capital projects	<u> -</u>	<u> -</u>
Total Compact of Free Association	\$ <u>582,361</u>	\$ <u>582,361</u>

The above program bears CFDA #15.875 and the grantor agency is the U.S. Department of the Interior. The above funds are received initially by the National Government of the Federated States of Micronesia and are then passed to the FSM Telecommunications Corporation in a subrecipient capacity.

The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Schedule of Expenditures of Federal Awards, Continued
Schedule of Contracts
Rural Utilities Service Loan Funding (CFDA #10.851)
Year Ended September 30, 2002

	Loan Proceeds Approved as of <u>September 30, 2002</u>	Loan Proceeds Received During <u>FY 2002</u>	Total Disbursements On Contracts During <u>FY2002</u>
F/A 1	\$ 411,584	\$ -	\$ -
Work Orders	422,905	-	-
CT. A-4	90,688	-	-
CT. A-5	1,191,004	-	-
CT. A-6	650,676	-	-
CT. A-7	3,108,615	-	-
CT. A-8	3,500,000	-	-
CT. A-9	1,108,149	-	-
CT. A-10	636,505	-	-
CT. A-11	1,193,317	-	-
CT. A-12	1,422,800	-	-
CT. A-13	19,440,795	-	-
CT. A-14X	1,988,002	-	-
CT. A-1E	275,625	-	-
CT. A-2E	4,008,263	-	-
CT. A-3A	304,109	-	-
Operating equipment	387,263	-	-
Pre-Loan	<u>55,000</u>	<u>-</u>	<u>-</u>
	\$ <u>40,195,300</u>	\$ <u>-</u>	\$ <u>-</u>
Excess of Disbursements over Proceeds		\$ -	
Unused Loan Funds as of September 30, 2002		-	
Interest earned on RUS account net of miscellaneous bank charges		<u>-</u>	
Unused Loan Funds as of September 30, 2002		\$ <u>-</u>	

The above loan program is received in a direct capacity from the grantor. In addition, the loan payable to Rural Utilities Service, totaling \$27,311,786 at September 30, 2002, was tested for detailed compliance in accordance with OMB Circular A-133 requirements.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2002

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion as of September 30, 2002.
2. Reportable conditions in internal control over financial reporting were not identified.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were not identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. The Organization's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Compact of Free Association	15.875
Rural Utilities Service	10.851

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

Part II - Financial Statement Findings Section

No matters are reportable.

Part III - Federal Award Findings and Questioned Cost Section

No matters are reportable.

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Summary Schedule of Prior Audit Findings
Year Ended September 30, 2002

There are no prior audit findings relative to Federal awards.



INDEPENDENT AUDITORS' MANAGEMENT LETTER REPORT

Chairman
Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the financial statements of the Federated States of Micronesia Telecommunications Corporation (FSMTC) for the year ended September 30, 2002, and have issued our report thereon dated December 26, 2002, which report was qualified due to the absence of audited information to support an investment in a material investee. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR Part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of FSMTC for the year ended September 30, 2002, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

Management is responsible for establishing and maintaining internal control over financial reporting. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses.

7 CFR Part 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR Part 1773.33(e)(2) and related party transactions. In addition, our audit of the financial statements also included the procedures specified in 7 CFR Part 1773.38-.45. Our objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon. The additional matters tested also include a schedule of investments in subsidiary and affiliated companies, which is attached to this report, upon which we express an opinion.

No reports (other than our Independent Auditors' Report on the financial statements, our Independent Auditors' Report on Compliance and on Internal Control over Financial Reporting Based Upon the Audit Performed in Accordance with *Government Auditing Standards* and our Independent Auditors' Report on Compliance and Internal Control Over Compliance Applicable to Each Major Federal Award Program, the Schedule of Expenditures of Federal Awards (all dated December 26, 2002) or summary of recommendations related to our audit have been furnished to management.

Our comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters as required by 7 CFR Part 1773.33 are presented below.

COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING

We noted no matters regarding FSMTC's internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records;
- The process for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts, and;
- The materials control.

COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS

Compliance with laws, regulations, contracts, and grants is the responsibility of FSMTC's management. At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts and grants. The procedures we performed are summarized as follows:

- No procedures were performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract, agreement, or leases between the borrower and an affiliate of FSMTC for the year ended September 30, 2002 as no such contracts, agreements or leases were so executed.

The borrower has submitted its Form 479 to the RUS and the Form 479, Financial and Statistical Report, as of December 31, 2001, represented by the borrower as having been submitted to RUS, is in agreement with FSMTC's records in all material respects. The borrower has not submitted or prepared a Form 479 as of September 30, 2002. The borrower represents that it will now submit Form 479, including adjustments arising from the September 30, 2002 audit to RUS.

COMMENTS ON OTHER ADDITIONAL MATTERS

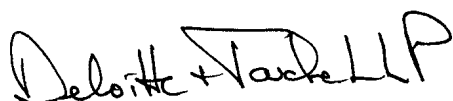
In connection with our audit of the financial statements of FSMTC, nothing came to our attention that caused us to believe that FSMTC failed to comply with respect to:

- the reconciliation of subsidiary plant records to the controlling general ledger plant accounts addressed at 7 CFR Part 1773.33(c)(1);
- the clearing of construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2);
- the retirement of plant addressed at 7 CFR Part 1773.33(c)(3) and (4);
- approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR Part 1773.33(c)(5); and
- the disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards (SFAS) No. 57, "Related Party Transactions," for the year ended September 30, 2002, in the financial statement referred to in the first paragraph of this report addressed at 7 CFR Part 1773.33(e);
- the detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of investments required by 7 CFR Part 1773.33 (i) attached hereto is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information is the responsibility of FSMTC's management. This information has been subject to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for our inability to obtain audited information for 2001 to support the carrying value of the investment in ICTV – Pohnpei, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

* * * * *

This report is intended solely for the information and use of the Board of Directors, management, the RUS and supplemental lenders, and the cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.



December 26, 2002

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

Schedule of Investments
Year Ended September 30, 2002

Investment in Intelsat	\$ 910,114
Investment in ICTV-Pohnpei	<u>97,929</u>
Total	\$ <u>1,008,043</u>

See Accompanying Independent Auditors' Management Letter Report.