

Financial Statements and  
Other Financial Information

**Guam Telephone Authority**  
(A Public Corporation)

*Years ended September 30, 2004 and 2003  
with Report of Independent Auditors*

Guam Telephone Authority  
(A Public Corporation)

Financial Statements and  
Other Financial Information

Years ended September 30, 2004 and 2003

**Contents**

Report of Independent Auditors .....	1
Management's Discussion and Analysis .....	3
Audited Financial Statements	
Statements of Net Assets .....	6
Statements of Revenues, Expenses and Changes in Net Assets .....	8
Statements of Cash Flows .....	9
Notes to Financial Statements.....	11
Other Financial Information	
Schedules of Revenues .....	25
Schedules of Expenses .....	26

## Report of Independent Auditors

The Board of Directors  
Guam Telephone Authority

We have audited the accompanying statements of net assets of the Guam Telephone Authority (GTA, a public corporation), a component unit of the Government of Guam, as of September 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of GTA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States 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.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Guam Telephone Authority as of September 30, 2004 and 2003, 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.

As more fully discussed in Note 1, on November 1, 2004, the Governor signed Public Law 27-109 approve the agreements and transactions to privatize the Guam Telephone Authority with the closing date expected to be on December 31, 2004.

Management's discussion and analysis on pages 3 through 5 is not a required part of the basic financial statements but is supplementary information required by the Government Auditing Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the Schedules of Revenues and Expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information is the responsibility of GTA's management. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2004 on our consideration of GTA'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.

*Ernst & Young LLP*

November 19, 2004, except notes 1 and 8 as to which the dates are December 31, 2004

Guam Telephone Authority  
(A Public Corporation)

Management's Discussion and Analysis

September 30, 2004 and 2003

The following Management Discussion and Analysis of Guam Telephone Authority (the Authority) activities and financial performance provide readers with an introduction and overview to the financial statements for the fiscal year ended September 30, 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements and notes, which follow this section.

Guam Telephone Authority was created by Public Law 12-44, pursuant to which the assets and liabilities of the telephone division of the Public Utility Agency of Guam (PUAG) were transferred effective April 1, 1974.

The Authority serves as a local exchange carrier providing telephone network access and call-handling features. Federal Communications Commission (FCC) regulates interstate or long distance access, while Guam Public Utilities Commission (GPUC) regulates local access and services. The Authority also provides cellular, DSL, and other communication services to Guam.

**Using the Financial Statements**

The Authority's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP) as applied to governmental unit. The Governmental Accounting Standards Board (GASB) establishes and sets governmental accounting and financial reporting principles for state and local governments. The Authority implemented GASB 20 and elected not to apply FASB statements and Interpretations issued after November 30, 1989.

For the years ended September 30, 2004 and 2003, the Authority adopted GASB Statement No. 34 "Basic Financial Statements – 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" and GASB No. 38, "Certain Financial Statement Disclosures".

Guam Telephone Authority  
(A Public Corporation)

Management's Discussion and Analysis, continued

September 30, 2004 and 2003

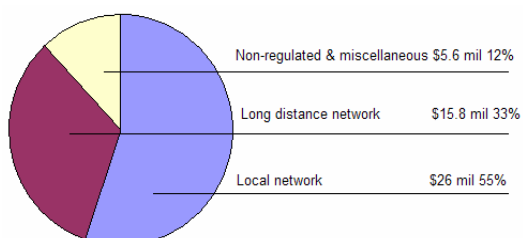
**Financial Data**

	Year ended September 30, 2004	Year ended September 30, 2003	% increase (decrease) from 2003
Operating revenues	\$ 47,025,622	\$ 42,855,794	9.7%
Operating expenses, excluding depreciation	25,201,878	22,261,510	13.2%
Operating income before depreciation	21,823,744	20,594,284	6.0%
Depreciation and amortization	17,286,990	18,041,328	-4.2%
Earnings from operations	4,536,754	2,552,956	77.7%
Non-operating income (expenses), net	(6,698,514)	(12,251,922)	-45.3%
Net decrease in net assets	\$ (2,161,760)	\$ (9,698,966)	-77.7%

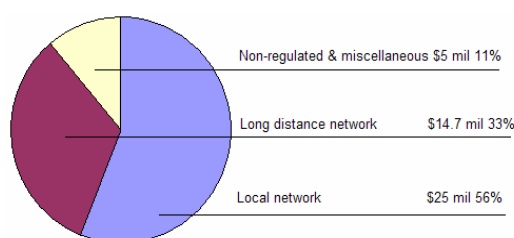
<u>Assets</u>	September 30, 2004	September 30, 2003	% Increase (Decrease) from 2003
Current assets	\$ 25,041,303	\$ 17,964,388	39.4%
Investments	933,800	933,800	0.0%
Property, plant and equipment	117,075,045	131,556,457	-11.0%
Other noncurrent assets, net	113,381	155,900	-27.3%
Total assets	143,163,529	150,610,545	-4.9%

<u>Liabilities and net assets</u>			
Current installments of long-term debt	6,040,035	5,825,461	3.7%
Current liabilities	9,538,661	10,204,000	-6.5%
Long-term debt	95,508,320	100,342,811	-4.8%
Total liabilities	111,087,016	116,372,272	-4.5%
Net assets	\$ 32,076,513	\$ 34,238,273	-6.3%

2004 Revenues



2003 Revenues



Guam Telephone Authority  
(A Public Corporation)

Management's Discussion and Analysis, continued

September 30, 2004 and 2003

**2004 compared to 2003**

Long distance network service revenue increased 5% or \$1 million due to cost reimbursement from Federal Agencies. Basic and non-regulated revenues increased due to demand in custom features and DSL services.

In an effort to improve services and repair damages from tropical storms, Guam Telephone Authority increased labor expense. In addition, the Authority incurred \$1.9 million in privatization expenses.

**Cash flows**

Year ended September 30,	<u>2004</u>	<u>2003</u>
<b>Cash flow provided by (used in)</b>		
Operating activities	\$ 22,553,655	\$ 20,930,874
Investing activities	230,399	185,142
Financing activities	<u>(15,111,272)</u>	<u>(16,105,693)</u>
<b>Increase in cash and cash equivalents</b>	<u>\$ 7,672,782</u>	<u>\$ 5,010,323</u>

Net cash generated from operations are used to fund network expansion, modernization, and repayment of debt, and we plan to meet our ongoing operational cost and capital improvements primarily from our operations.

**Privatization**

Guam Telephone Authority is the last local exchange carrier to be held and operated as a governmental agency in the United States of America. As the technology on global communications is changing, it is imperative that the Agency be able to compete and change as well. As a result, P.L. 26-70 was passed to privatize Guam Telephone Authority.

On November 1, 2004, the Governor signed P.L. 27-109 to approve the Asset Purchase Agreement and transactions to privatize Guam Telephone Authority. On December 30, 2004, the Governor signed Public Law 27-151, which authorizes a payout of accrued sick leave estimated at \$3.6 million upon closing. The closing date was December 31, 2004.

Guam Telephone Authority  
(A Public Corporation)

Statements of Net Assets

	September 30, <u>2004</u>	<u>2003</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents ( <i>Note 2</i> ):		
General funds	\$ 16,272,811	\$ 8,601,419
Construction	<u>1,184,217</u>	<u>1,182,827</u>
Total cash and cash equivalents	17,457,028	9,784,246
Telecommunications accounts receivable, net ( <i>Note 3</i> )	3,140,723	2,740,033
Materials and supplies, net	4,297,595	5,321,733
Prepayments	<u>145,957</u>	<u>118,376</u>
Total current assets	<u>25,041,303</u>	<u>17,964,388</u>
Rural Telephone Bank stock	<u>933,800</u>	<u>933,800</u>
Property, plant and equipment ( <i>Note 4</i> ):		
Telecommunications plant in service	274,165,599	271,029,946
Telecommunications plant under construction	<u>1,837,384</u>	<u>5,450,213</u>
	276,002,983	276,480,159
Less accumulated depreciation	<u>(158,927,938)</u>	<u>(144,923,702)</u>
	117,075,045	131,556,457
Other noncurrent assets, net	<u>113,381</u>	<u>155,900</u>
Total assets	<u>\$ 143,163,529</u>	<u>\$ 150,610,545</u>

See accompanying notes.



Guam Telephone Authority  
(A Public Corporation)

Statements of Net Assets, continued

	September 30, <u>2004</u>	<u>2003</u>
Liabilities and net assets:		
Current liabilities:		
Current installments of long-term debt <i>(Note 5)</i>	\$ 6,040,035	\$ 5,825,461
Accounts payable	2,084,581	2,728,997
Customers' deposits and advance billings	4,270,917	4,087,148
Accrued payroll and employee benefits	1,702,793	1,669,818
Accrued interest	1,134,999	1,203,854
Other current liabilities	<u>345,371</u>	<u>514,183</u>
Total current liabilities	<u>15,578,696</u>	<u>16,029,461</u>
Long-term debt, less current installments <i>(Note 5)</i> :		
Rural Utilities Service mortgage notes	65,217,159	68,483,498
Federal Financing Bank mortgage notes	15,306,388	16,456,186
Rural Telephone Bank mortgage notes	<u>14,984,773</u>	<u>15,403,127</u>
	<u>95,508,320</u>	<u>100,342,811</u>
Total liabilities	<u>111,087,016</u>	<u>116,372,272</u>
Net assets:		
Invested in capital assets	14,391,691	24,184,331
Unrestricted	<u>17,684,822</u>	<u>10,053,942</u>
Total net assets	<u>32,076,513</u>	<u>34,238,273</u>
Commitments and contingencies <i>(Notes 7 and 8)</i>		
Total liabilities and net assets	<u>\$143,163,529</u>	<u>\$150,610,545</u>

Guam Telephone Authority  
(A Public Corporation)

Statements of Revenues, Expenses and Changes in Net Assets

	Year ended September 30,	
	<u>2004</u>	<u>2003</u>
Operating revenues ( <i>Note 5</i> ):		
Basic local network services	\$26,043,099	\$25,132,933
Long distance network services	15,769,355	14,736,784
Non-regulated	4,825,024	4,336,069
Miscellaneous	787,122	761,067
Less uncollectible revenues	( 398,978)	( 2,111,059)
Total operating revenues	<u>47,025,622</u>	<u>42,855,794</u>
Operating expenses ( <i>Note 7</i> ):		
Depreciation and amortization ( <i>Note 4</i> )	17,286,990	18,041,328
Plant specific operations	10,946,822	10,323,622
Corporate operations	6,893,746	5,173,586
Customer operations	3,914,186	3,347,614
Plant non-specific operations	<u>3,447,124</u>	<u>3,416,688</u>
Total operating expenses	<u>42,488,868</u>	<u>40,302,838</u>
Earnings from operations	<u>4,536,754</u>	<u>2,552,956</u>
Other (expense) revenues:		
Interest expense on long-term debt	( 5,766,300)	( 6,030,909)
Disaster casualty loss ( <i>Note 7</i> )	( 1,162,613)	( 3,999,805)
Other income, net	230,399	185,142
Materials and supplies valuation loss	<u>---</u>	<u>( 2,406,350)</u>
Total other (expense) revenues	<u>( 6,698,514)</u>	<u>(12,251,922)</u>
Decrease in net assets	<u>( 2,161,760)</u>	<u>( 9,698,966)</u>
Net assets at beginning of year	<u>34,238,273</u>	<u>43,937,239</u>
Net assets at end of year	<u>\$32,076,513</u>	<u>\$34,238,273</u>

*See accompanying notes.*

Guam Telephone Authority  
(A Public Corporation)

Statements of Cash Flows

	Year ended September 30,	
	<u>2004</u>	<u>2003</u>
<b>Cash flows from operating activities</b>		
Cash received from customers	\$46,759,478	\$46,103,474
Cash payments to suppliers and employees for goods and services	( <u>24,205,823</u> )	( <u>25,172,600</u> )
Net cash provided by operating activities	<u>22,553,655</u>	<u>20,930,874</u>
<b>Cash flows from investing activity</b>		
Interest and dividends on investments and bank accounts	<u>230,399</u>	<u>185,142</u>
<b>Cash flows from capital and related financing activities</b>		
Additions to telecommunications plant	( 4,656,200)	( 5,650,441)
Interest paid on long-term debt	( 5,835,155)	( 6,073,861)
Repayments of long-term debt	( <u>4,619,917</u> )	( <u>4,381,391</u> )
Cash used for capital and related financing activities	( <u>15,111,272</u> )	( <u>16,105,693</u> )
Net increase in cash and cash equivalents	7,672,782	5,010,323
Cash and cash equivalents at beginning of year	<u>9,784,246</u>	<u>4,773,923</u>
Cash and cash equivalents at end of year	<u>\$17,457,028</u>	<u>\$ 9,784,246</u>

*See accompanying notes.*

Guam Telephone Authority  
(A Public Corporation)

Statements of Cash Flows, continued

	Year ended September 30,	
	<u>2004</u>	<u>2003</u>
<b>Reconciliation of earnings from operations to net cash provided by operating activities:</b>		
Earnings from operations	\$ 4,536,754	\$ 2,552,956
Adjustments to reconcile earnings from operations to net cash provided by operating activities:		
Depreciation and amortization	17,286,990	18,041,328
Provision for uncollectible receivables	398,978	2,111,059
Bad debt recoveries	( 533,333)	---
Loss from retirement and write down of equipment	730,528	127,119
Write-off of telecommunication accounts receivables	( 477,216)	( 2,827,234)
Changes in operating assets and liabilities:		
Decrease in telecommunications accounts receivable	210,881	3,803,264
Decrease in materials and supplies	1,024,138	481,642
Increase in prepayments	( 27,581)	( 38,379)
Decrease in accounts payable	( 644,416)	( 3,025,767)
Increase in customers' deposits and advance billings	183,769	160,591
Increase (decrease) in accrued payroll and employee benefits	144,125	( 192,072)
Decrease in accrued annual leave	( 111,150)	( 159,634)
Decrease in other current liabilities	( 168,812)	( 103,999)
Net cash provided by operating activities	<u>\$22,553,655</u>	<u>\$20,930,874</u>

See accompanying notes.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements

September 30, 2004 and 2003

**1. Organization and Summary of Significant Accounting Policies**

**General**

Guam Telephone Authority (the “Authority”) was created by Public Law 12-44, pursuant to which the assets and liabilities of the telephone division of the Public Utility Agency of Guam (PUAG) were transferred to the Authority effective April 1, 1974. In 1991, a separate non-regulated “Cellular Operations” was created utilizing funds advanced by the Authority. As a Government of Guam agency, the Authority and its Cellular Operations are classified as a component unit of the Government of Guam for financial reporting purposes and, therefore, are not subject to taxes.

The Authority follows accounting policies prescribed or authorized by the Federal Communications Commission (FCC) of the United States of America, as provided for in the indenture agreement with the United States Rural Utilities Service (RUS), the Rural Telephone Bank (RTB) and the Federal Financing Bank (FFB). The Authority is also subject to the regulations of the Public Utility Commission of Guam (PUC).

Because of the PUC rate-making process, certain differences arise in the application of accounting principles generally accepted in the United States between regulated and non-regulated businesses. Such differences mainly concern the time at which various items enter into the determination of net earnings in order to follow the principle of matching revenues and expenses.

On May 28, 1997, the Guam Legislature (the “Legislature”) adopted Public Law 24-36 to initiate the process for the privatization of the Authority and to require legislative approval of any plan to privatize the Authority. On December 21, 2001, the Legislature adopted Public Law 26-70, which resulted in the adoption of special rules and regulations for the privatization process and the public disclosure of information relative to such process.

On February 4, 2004, the Legislature adopted Public Law 27-63 to amend certain sections of Public Law 26-70. The amendments were made to account for current economic and market concerns and permits the Authority to proceed with the privatization process. Bid openings for the privatization of the Authority were held on June 7, 2004.

On August 31, 2004, the Authority’s Board of Directors approved the sale of the assets and business of the Authority to TeleGuam Holdings, LLC.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**1. Organization and Summary of Significant Accounting Policies, continued**

**General, continued**

On November 1, 2004, the Governor signed Public Laws 27-109 and 27-110. Public Law 27-109 was enacted to approve the agreements and transactions to privatize the Authority and to amend and reenact certain sections of Public Laws 26-70 and 27-63 to effectuate the privatization of the Authority. Public Law 27-110 was enacted to promote competition and reduce regulation in order to secure lower prices and higher quality telecommunications services. The closing date was December 31, 2004.

On December 17, 2003, the President signed into law the Compact of Free Association Amendments Act of 2003 or House Joint Resolution 63, Public Law 108-188. A new provision in the law authorizes the President, at the request of the Governor of Guam, to release, reduce, or waive, in whole or in part, any amounts owed by the Government of Guam to the United States Government, such as a \$105 million debt owed by the Guam Telephone Authority to the U.S. Department of Agriculture, as an offset for past un-reimbursed Compact-Impact costs. On April 14, 2004, the Government of Guam issued a report to the U.S. Department of Interior identifying \$269 million in un-reimbursed Compact-Impact costs. During August 2004, the Governor requested that the President exercise his authority. As of December 31, 2004 and through the Office of Management and Budget, the President did not grant debt forgiveness as Public Law 108-188 did not contain the necessary appropriations for such an action. However, an extension for consideration was granted through March 31, 2005, and to allow for the required, Congressional appropriations.

**Geographic Area of Customer Base**

The Authority is the sole supplier of local telephone service within Guam. Overseas services are provided by Guam-based private telecommunications companies.

**Basis of Accounting**

The financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States (GAAP) as applied to government units. Government Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities Entities that Use Proprietary Fund Accounting", requires that propriety activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Authority has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**1. Organization and Summary of Significant Accounting Policies, continued**

**Basis of Accounting, continued**

Effective year ended September 30, 2002, the Authority adopted GASB Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments (GASB 34)" as amended by GASB Statement No. 37 and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following four net asset categories:

- Invested in capital assets, net of related debt - represent capital assets, net of accumulated depreciation and net of the outstanding balances of any debt attributable to the acquisition, construction or improvement of those assets.
- Restricted nonexpendable net assets - represent net assets subject to externally imposed stipulations that require the Authority to maintain them permanently.
- Restricted expendable net assets - represent net assets subject to externally imposed stipulations that can be fulfilled by actions of the Authority pursuant to those stipulations or that expire by the passage of time.
- Unrestricted net assets - represent net assets, which do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

The Authority does not have restricted net assets at September 30, 2004 and 2003. At September 30, 2004 and 2003, total net assets includes \$13,557,529 in Contributions from the Government of Guam representing the net assets and liabilities transferred from PUAG in 1974.

Effective year ended September 30, 2002, the Authority also adopted GASB Statement No 38, "Certain Financial Note Disclosures" which requires that certain disclosures be made in the notes to the financial statements concurrent with the implementation of Statement No. 34. While this statement did not affect amounts reported in the financial statements of the Authority, certain note disclosures have been added or amended.

**Cash and Cash Equivalents**

For purpose of the statements of net assets and the statements of cash flows, cash and cash equivalents include cash on hand, cash in banks, cash in money market funds and time certificates of deposit with original maturity dates of ninety days or less.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**1. Organization and Summary of Significant Accounting Policies, continued**

**Materials and Supplies**

Materials and supplies are carried at the lower of cost (moving weighted average) or market net of allowance for inventory obsolescence of \$1,261,466 and \$1,204,965 as of September 30, 2004 and 2003, respectively.

**Rural Telephone Bank Stock**

Rural Telephone Bank stock is issued based on the loan agreement between the Authority and RTB. The Authority's investment in RTB stock is carried at cost and consists of 933,800 shares of \$1 par value Class B stock.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Cost of plant includes an allocation of overhead, including administrative expenses. The Authority also capitalizes the cost of borrowed funds during periods of the construction of projects requiring more than one year to complete. The cost of plant retired or otherwise disposed of, net of sales proceeds plus removal cost, is charged to accumulated depreciation.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

**Licensing Rights**

The FCC granted the Authority licensing rights to operate its Personal Communication Service (PCS) for Channel Blocks E on April 28, 1997. Licensing rights incurred to acquire the PCS license from the FCC are amortized after the Authority's wireless communication service became operational. The license covers an initial period of 10 years, expiring on April 28, 2007, and renewable every five years thereafter for a nominal fee. Licensing rights is reflected as other noncurrent assets, net in the accompanying statements of net assets. For each of the years ended September 30, 2004 and 2003, amortization of licensing rights amounted to \$42,519 and is shown as a component of depreciation and amortization in the accompanying statements of revenues, expenses and changes in net assets.



Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**1. Organization and Summary of Significant Accounting Policies, continued**

**Vacation and Sick Leave**

On February 28, 2003, the Guam Legislature passed Public Law 27-5. Chapter 4 Section 4 of the law reduced the maximum accumulation of annual leave hours from 480 to 320 hours. Chapter 4 Section 3 of the law revised the amount of vacation leave rates credited to employees to 104 and 156 hours per fiscal year depending on their years of service with the Authority. The law also requires that employees who have annual leave in excess of 320 hours as of February 28, 2003 shall have up to and including September 30, 2004, to use the excess leave, or that portion permitted to be credited to sick leave shall be so credited and the remaining excess leave, if any, shall be lost.

Prior to this law, vacation leave rates were credited to employees at rates of 104, 156 or 208 hours per fiscal year depending on their years of service with the Authority.

**Operating Revenues**

*Basic Local Network Services* – consist mainly of the monthly recurring rates for billed local services; one time installation fees associated with the establishment of customer service and other one time non recurring charges.

Monthly fees on services are recognized as revenue on an accrual basis, based on contracted rates, as the service is provided to customers. Installation charges and other one-time fees associated with the establishment of customer service are recognized when the related installation of equipment is complete and the telephone service has been activated.

*Long Distance Network Services* – consist mainly of revenues generated for incoming and outgoing switch access for interstate and international traffic. Also included are end-user revenues from Subscriber Line Charges and the Federal Universal Service Charge that are mandated by the FCC and special access revenues.

Long distance network services are recognized based upon minutes of traffic processed and contracted fees as incurred.

*Non-regulated* – consist of revenues from wireless service derived from the sale of cellular prepaid cards to resellers; monthly service fees from postpaid subscribers, including (a) charges for calls in excess of allocated free minutes and (b) toll charges for international long distance calls; and other landline non-regulated revenues such as (a) pay phone booth revenues, (b) inside wire maintenance, (c) miscellaneous revenues for billing on damages to the Authority's cable and wire facilities by contractors and other private parties.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**1. Organization and Summary of Significant Accounting Policies, continued**

**Operating Revenues, continued**

Revenues from the sale of prepaid cards comprise of proceeds from sales of prepaid cards to resellers. Revenue from sales of prepaid cards are recorded immediately upon sale to resellers.

Postpaid service revenue is recognized based upon minutes of traffic processed and contracted fees for services provided. Charges for value added services are recognized as they are used by the subscriber.

Revenue from pay phone booths are based on amounts collected from various paystations.

**Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

**2. Cash and Cash Equivalents**

At September 30, 2004 and 2003, the Authority has cash balances of \$17,457,028 and \$9,784,246, respectively, deposited in various checking and savings accounts. Of the total deposits, \$442,315 and \$343,204, respectively, is insured by Federal Depository Insurance Corporation and \$6,644,649 and \$5,436,693, respectively, is deposited in trust accounts collateralized by U.S. Treasury Bills and Bonds. The remaining balances are not insured or collateralized.

At September 30, 2004 and 2003, the Authority has time certificate of deposits (TCDs) totaling \$10,698,396 and \$77,371 which earn interest ranging from 1.33% to 1.39% and 5% per annum, respectively. At September 30, 2004 and 2003, \$77,825 and \$77,371, respectively of the TCDs are deposited in money market funds, which are collateralized by open-ended U.S. Treasury Bills and U.S. Treasury Notes.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**3. Telecommunications Accounts Receivable**

Telecommunications accounts receivable at September 30, 2004 and 2003, are summarized as follows:

	<u>2004</u>	<u>2003</u>
Active	\$ 3,512,628	\$ 3,242,570
Inactive	<u>3,794,204</u>	<u>3,799,963</u>
	7,306,832	7,042,533
Interstate	808,931	1,157,103
Others	<u>2,005,184</u>	<u>2,132,192</u>
	10,120,947	10,331,828
Less allowance for doubtful accounts	<u>6,980,224</u>	<u>7,591,795</u>
	<u>\$ 3,140,723</u>	<u>\$ 2,740,033</u>

**4. Property, Plant and Equipment**

Property, plant and equipment as of September 30, 2004 and 2003 are summarized as follows:

	<u>Beginning Balance October 1, 2003</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending Balance September 30, 2004</u>
Poles, cables and wire	\$128,964,628	\$ 2,910,802	\$ ---	\$131,875,430
Central office equipment	83,159,163	2,503,630	( 70,136)	85,592,657
Buildings	21,316,271	522,052	( 421,424)	21,416,899
Customer premise equipment	14,229,533	593,369	(1,485,821)	13,337,081
Cellular radio facilities	9,831,571	545,937	---	10,377,508
Furniture and office equipment	7,807,771	133,606	(1,033,756)	6,907,621
Motor vehicles	2,908,887	---	( 941,446)	1,967,441
Other equipment	<u>1,981,605</u>	<u>42,216</u>	<u>( 163,376)</u>	<u>1,860,445</u>
	270,199,429	7,251,612	(4,115,959)	273,335,082
Less accumulated depreciation	<u>(144,923,702)</u>	<u>(17,244,471)</u>	<u>3,240,235</u>	<u>(158,927,938)</u>
	125,275,727	( 9,992,859)	( 875,724)	114,407,144
Plant under construction	5,450,213	5,004,631	(8,617,460)	1,837,384
Land	<u>830,517</u>	<u>---</u>	<u>---</u>	<u>830,517</u>
	<u>\$131,556,457</u>	<u>\$ ( 4,988,228)</u>	<u>\$ (9,493,184)</u>	<u>\$117,075,045</u>

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**4. Property, Plant and Equipment, continued**

The provision for depreciation, as a percentage of the average balance of telephone plant in service, was 6.3% and 6.7% in 2004 and 2003, respectively. Individual plant depreciable rates for 2004 and 2003 are as follows:

Poles, cables and wire	4%-10%
Central office equipment	5%
Customer premise equipment	2%
Buildings	3%-10%
Furniture and office equipment	10%
Motor vehicles	20%
Cellular radio facilities	8%
Other equipment	20%

Depreciation expense for the years ended September 30, 2004 and 2003 amounted to \$17,244,471 and \$17,998,809, respectively, and is shown as a component of depreciation and amortization in the accompanying statements of revenues, expenses and changes in net assets.

**5. Long-Term Debt**

Long-term debt at September 30, 2004 and 2003 consisted of the following:

	<u>2004</u>	<u>2003</u>
RUS, at 5% per annum, payable in semi-annual installments of:		
\$1,557,000, including interest, due May 2025	\$ 39,066,190	\$ 40,132,752
\$659,000, including interest, due October 2020	14,335,874	14,912,484
\$526,000, including interest, due May 2011	6,297,285	7,016,330
\$308,000, including interest, due April 2017	5,536,278	5,864,260
\$176,000, including interest, due April 2012	2,217,842	2,453,637
\$162,000, including interest, due May 2011	1,958,398	2,179,414

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**5. Long-Term Debt, continued**

	<u>2004</u>	<u>2003</u>
FFB, due December 2014, payable in quarterly installments of:		
\$155,000, including interest at 7.647%	4,392,426	4,665,251
\$114,000, including interest at 5.643%	3,531,184	3,779,043
\$58,200, including interest at 7.496%	1,722,923	1,830,939
\$60,600, including interest at 7.301%	1,668,668	1,774,552
\$26,900, including interest at 6.171%	812,832	868,092
\$27,700, including interest at 7.887%	773,192	820,510
\$22,100, including interest at 6.604%	654,714	698,067
\$19,400, including interest at 7.581%	549,644	583,923
\$15,400, including interest at 5.784%	473,042	505,964
\$15,300, including interest at 6.151%	462,145	493,602
\$14,400, including interest at 5.621%	445,335	476,636
\$13,000, including interest at 6.402%	388,265	414,293
\$5,300, including interest at 6.214%	160,388	171,264
\$5,100, including interest at 7.111%	147,769	157,256
\$4,800, including interest at 6.490%	141,394	150,822
\$4,300, including interest at 7.399%	123,011	130,770
\$300, including interest at 5.865%	10,131	10,833
RTB, payable in semi-annual installments of:		
\$177,000, including interest at 9.5%, due October 2020	2,876,239	2,950,419
\$117,000, including interest at 6.04%, due May 2025	2,604,125	2,664,499
\$104,000, including interest at 6.05%, due May 2025	2,344,939	2,405,011
\$82,000, including interest at 6.05%, due May 2025	1,758,289	1,798,263
\$79,000, including interest at 6.05%, due May 2025	1,613,883	1,672,152
\$49,500, including interest at 6.26%, due May 2025	1,167,808	1,195,973
\$44,700, including interest at 5.56%, due May 2025	1,075,230	1,099,451
\$46,000, including interest at 5.98%, due May 2025	1,045,765	1,069,842
\$31,400, including interest at 5.93%, due May 2025	747,260	764,662
\$12,000, including interest at 6.05%, due May 2025	253,020	259,194
\$7,011, including interest at 5.33%, due July 2025	172,412	176,812
\$930, including interest at 5.96%, due July 2025	<u>20,455</u>	<u>21,300</u>
	101,548,355	106,168,272
Less current installments	( <u>6,040,035</u> )	( <u>5,825,461</u> )
	\$ <u>95,508,320</u>	\$ <u>100,342,811</u>

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**5. Long-Term Debt, continued**

At September 30, 2004, future maturities of long-term debt principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
2005	\$ 6,040,035	\$ 4,415,037	\$ 10,455,072
2006	5,230,957	5,224,115	10,455,072
2007	5,528,082	4,926,990	10,455,072
2008	5,842,699	4,612,373	10,455,072
2009	6,175,884	4,279,188	10,455,072
2010 through 2014	32,008,718	15,962,143	47,970,861
2015 through 2019	22,291,961	8,226,362	30,518,323
2020 through 2024	18,228,607	2,623,297	20,851,904
2025	<u>201,412</u>	<u>6,044</u>	<u>207,456</u>
	<u>\$101,548,355</u>	<u>\$50,275,549</u>	<u>\$151,823,904</u>

Unadvanced loan balance as of September 30, 2004, is as follows:

<u>Federal grantor/ Program title/ Project designation</u>	<u>Authorized amount</u>	<u>Drawndown amount</u>	<u>Unadvanced amount</u>
Rural Telephone Bank Loan: Guam 501-E7, Tamuning	\$16,082,850	\$14,942,323	\$1,140,527

Public Law 21-116 set the Authority's debt limit at \$150,607,800.

Outstanding RUS, RTB and FFB bonds are special obligations of the Authority payable from and collateralized by the proceeds of the bonds, all revenues, and all funds established by the bond indenture. These bonds do not constitute a general indebtedness of the Authority or the Territory of Guam. Revenues are defined in the bond indenture as all revenues, income, rents and receipts derived from the ownership, leasing and operation of the telephone system (System), the proceeds of any insurance covering business interruption loss relating to the System, and interest or dividends received on any moneys or securities (other than the Development Fund) held pursuant to the indenture and paid to the Revenue Fund.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**5. Long-Term Debt, continued**

In accordance with the indenture, the Authority established the following trust accounts to be held and administered by the Trustee for the bondholders.

*Development Fund* – The proceeds of all bonds are to be deposited into the Development Fund. All costs of construction (including acquisitions) of all facilities are to be paid from this fund. Insurance proceeds from physical loss of or damage to any facilities of the System, and proceeds from contractors' performance bonds are to be deposited into this fund. Proceeds from sale or lease-sale of any facilities included in the System shall be maintained in this fund and used to finance future construction.

*Revenue Fund* – All revenues are to be deposited into the Revenue Fund. All costs relating to the system, in addition to the costs for the payment of which moneys from time to time shall have been deposited in the Development Fund and in the Debt Service Fund, are to be paid from the Revenue Fund. The Trustee shall transfer funds from the Revenue Fund to the Debt Service Fund on or before the twenty-fifth (25<sup>th</sup>) day of each calendar month, to the extent such amount is available in the Revenue Fund after paying the monthly operating expenses with respect to the System, an amount equal to one-twelfth (1/12) of the Twelve-Month Debt Service Requirement, as defined in the Indenture. Deficiencies in any month shall be transferred to the Debt Service Fund on the earliest date on which funds become available in the Revenue Fund.

*Debt Service Fund* – The Trustee, on behalf of the Authority, shall make all payments of principal and interest on the bonds from the Debt Service Fund.

Management of the Authority is of the opinion that it has complied with all significant bond covenants with the exception of meeting RUS TIER requirements during the year ended September 30, 2004.

**6. Employees' Retirement Plan**

Employees of the Authority hired before October 1, 1995 are members of the Government of Guam Employees' Retirement System, a defined benefit, contributory pension plan. The plan is administered by the Government of Guam Retirement Fund, to which the Authority contributes based upon a fixed percentage of the payroll for those employees who are members of the Plan.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**6. Employees' Retirement Plan, continued**

As a result of the most recent actuarial valuation performed as of September 30, 2002, it has been determined that for the year ended September 30, 2004, a minimum combined employer and employee contribution rate of 33.89% of covered payroll is required to appropriately fund the current cost, amortize prior service costs and provide for interest on the unfunded accrued liability. As a result of the actuarial valuation performed as of September 30, 2001, it has been determined that for the year ended September 30, 2003, a minimum combined employer and employee contribution rate of 40.98% of covered payroll is required to appropriately fund the current cost, amortize prior service costs and provide for interest on the unfunded accrued liability. Statutory employer contribution rates were 20.81% and 19.675%, respectively, for the years ended September 30, 2004 and 2003. Statutory employee contribution rates were 9.5% for fiscal years ended September 30, 2004 and 2003.

The defined benefit plan utilized the actuarial cost method termed "entry age normal" with an assumed rate of return of 7.5% and an assumed salary scale increase ranging from 4% per annum (for employees with over 21 years of service) to 8.5% per annum (for employees with less than 6 years of service). The most actuarial valuations performed as of September 30, 2002 and 2001, did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net assets available for benefits by sponsor.

On September 29, 1995, the Guam Legislature passed Public Law 23-43, which created the Defined Contribution Retirement System (DCRS). All employees of the Authority, hired after October 1, 1995, are members of the DCRS, a defined contribution, contributory pension plan. The Board of Trustees of the Government of Guam Retirement Fund is responsible for the administration of the DCRS. Investment management and plan administration services for the DCRS are performed by a private firm contracted by the Board of Trustees.

Contributions into the DCRS by members are based on an automatic deduction of 5% of the member's regular base pay. The contribution is periodically deposited into an individual annuity account within the DCRS. Employees are afforded the opportunity to select from different annuity accounts available under the DCRS.

Employer contributions into the DCRS are based on a statutory amount of 20.81% and 19.675%, respectively, of the member's regular base pay for the years ended September 30, 2004 and 2003. Of the amount contributed by the employer, only 5% of the member's regular base pay is deposited into the member's individual annuity account. The remaining 14.675% is contributed towards the unfunded liability of the defined benefit plan.

Members of the DCRS who have completed five years of government service have a vested balance of 100% of both member and employer contributions plus any earnings thereon.



Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**6. Employees' Retirement Plan, continued**

The cost to the Authority for retirement contributions for the years ended September 30, 2004 and 2003 amounted to \$2,406,864 and \$2,725,277, respectively.

Public Law 26-70 states that the Authority has no further responsibility to record future unfunded retirement costs and its deferred liability to the Government of Guam was transferred to the Government of Guam primary account. The Authority's unfunded retirement costs are now recorded within the financial statements of the Government of Guam.

In 2002, the Government of Guam adopted the provisions of GASB No. 27, "Accounting for Pensions by State and Local Governmental Employees".

**7. Commitments and Contingencies**

*Lease*

Rent expense for operating leases totaled \$233,536 and \$296,933, for the years ended September 30, 2004 and 2003, respectively. These expenses are included as components of operating expenses in the accompanying statements of revenues, expenses and changes in net assets. Future obligations under such leases are not significant.

*Medicare*

The Government of Guam and its component units, including the Authority, began withholding and remitting funds to the U.S. Social Security System for the health insurance component of its salaries and wages effective October 1998. Prior to that date, the Government of Guam did not withhold or remit Medicare payments to the U.S. Social Security System. If the Government is found to be liable for Medicare payments on salaries and wages prior to October 1998, an indeterminate liability could result. It has been the practice of the Authority and all other component units of the Government of Guam that payment of this health insurance component is optional prior to October 1998. Therefore, no liability for any amount, which may ultimately arise from this matter has been recorded in the accompanying financial statements.

*Insurance*

The Authority has commercial insurance coverage for owners, landlords and tenants liability, fidelity and forgery, robbery/safe burglary, workmen's compensation, automobile and comprehensive liability.

Guam Telephone Authority  
(A Public Corporation)

Notes to Financial Statements, continued

**7. Commitments and Contingencies, continued**

*Typhoon Damages*

On July 5, 2002 and December 8, 2002, the island of Guam was struck by typhoon Chata'an and super-typhoon Pongsona, respectively. As a result, the Authority suffered damages totaling approximately \$2,711,000 (from typhoon Chata'an) and \$4,890,000 (from super-typhoon Pongsona) to its telecommunication. The island was also struck by tropical storm Tinging during July 2004. The Authority expects much of the damage to be covered by insurance or reimbursements from the Federal Emergency Management Agency (FEMA). For the years ended September 30, 2004 and 2003, typhoon casualty loss, in excess of recoverable amount totaled \$1,162,613 and \$3,999,805, respectively, and is reflected as disaster casualty loss in the accompanying statements of revenues, expenses and changes in net assets.

During 2003, the Authority received approximately \$475,000 in insurance proceeds for typhoon Chata'an and approximately \$321,000 and \$16,000 from FEMA for typhoon Chata'an and super-typhoon Pongsona, respectively. In addition, during 2004, the Authority received approximately \$576,000 in insurance proceeds and \$24,000 from FEMA for super-typhoon Pongsona. However, the ultimate amount collectible is uncertain.

*Litigation*

The Authority is a defendant in various lawsuits and proceedings arising in the normal course of business. While the outcome of these lawsuits and proceedings cannot be predicted with certainty and could have a material adverse effect on the Authority's financial position, results of operations and cash flows, it is the opinion of management, after consulting with legal counsel, that the ultimate disposition of such lawsuits and proceedings will not have a material adverse effect, therefore, no provision for any liability that may result from these claims have been made in the financial statements.

*Debt Covenant*

Article IV, Section 22 of the supplemental RUS Loan Agreement (see Note 5), sets out certain financial ratio requirements. During the years ended September 30, 2004 and 2003, the Authority was not in compliance with this requirement. The impact on the financial statements is not currently determinable.

**8. Subsequent Events**

On December 30, 2004, the Governor signed Public Law 27-151, which authorizes a payout of accrued sick leave estimated at \$3.6 million upon closing. The closing date was December 31, 2004.

## Other Financial Information

Guam Telephone Authority  
(A Public Corporation)

Schedule 1

Schedules of Revenues  
Years ended September 30, 2004 and 2003

2004	Basic Local Revenue	Long Distance	Non - Regulated Revenues	Total
Residential	\$ 9,356,226	\$ 3,102,377	\$ 1,633,892	\$ 14,092,495
Business	12,037,108	11,387,204	1,270,172	24,694,484
Government	3,508,168	1,151,010	518,848	5,178,026
Federal Government	1,141,597	128,764	19,758	1,290,119
Other Non-Regulated	---	---	1,382,354	1,382,354
	<u>\$ 26,043,099</u>	<u>\$ 15,769,355</u>	<u>\$ 4,825,024</u>	<u>\$ 46,637,478</u>
2003	Basic Local Revenue	Long Distance	Non - Regulated Revenues	Total
Residential	\$ 8,368,058	\$ 2,930,240	\$ 1,286,412	\$ 12,584,710
Business	12,110,164	10,724,015	1,737,535	24,571,714
Government	3,740,171	961,327	250,439	4,951,937
Federal Government	914,540	121,202	124,146	1,159,888
Other Non-Regulated	---	---	937,537	937,537
	<u>\$ 25,132,933</u>	<u>\$ 14,736,784</u>	<u>\$ 4,336,069</u>	<u>\$ 44,205,786</u>

Guam Telephone Authority  
(A Public Corporation)

Schedule 2

Schedules of Expenses  
Years ended September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Plant specific operations:		
Salaries, wages and benefits	\$ 6,285,052	\$ 6,150,663
Materials and supplies	974,606	755,944
Overtime	848,294	385,678
Miscellaneous	660,892	488,159
Utilities	512,129	427,360
Repairs and maintenance	401,892	355,742
800 Query Dips	287,530	341,183
Telephone expense	247,602	527,984
Tools and equipment	156,017	58,921
Leased facilities	148,369	285,172
Fuel and oil	143,415	146,839
Outsourcing	131,377	161,147
Custodial service	110,977	125,961
Auto parts and supplies	38,670	112,869
	<u>10,946,822</u>	<u>10,323,622</u>
Corporate operations:		
Salaries, wages and benefits	2,291,456	2,310,835
Consulting - privatization	1,965,682	300
Insurance	1,574,898	1,354,451
Professional fees	395,974	142,068
Miscellaneous	330,107	1,150,267
Overtime	171,378	38,451
Consulting - other	79,738	75,378
Legal fees - off and on island attorneys	40,511	23,090
Material and supplies	25,434	26,122
Computer hardware maintenance	7,957	17
Training	5,618	29,544
Telephone expense	4,993	23,063
	<u>6,893,746</u>	<u>5,173,586</u>
Plant non-specific operations:		
Salaries, wages and benefits	1,824,705	1,997,055
Miscellaneous	816,264	826,545
Utilities	487,462	439,734
Overtime	184,946	72,365
Material and supplies	133,247	72,943
Consulting	500	8,046
	<u>3,447,124</u>	<u>3,416,688</u>
Customer operations:		
Salaries, wages and benefits	2,819,823	2,663,218
Miscellaneous	286,287	1,997
Price and costs studies	273,277	178,491
Overtime	248,858	66,801
Postage and advertising	202,793	293,826
Material and supplies	48,309	84,033
Telephone services	17,674	40,072
Product implementation	17,165	19,176
	<u>3,914,186</u>	<u>3,347,614</u>
Total	<u>\$ 25,201,878</u>	<u>\$ 22,261,510</u>
Total employees at end of year	347	367