

FULLNET COMMUNICATIONS INC
Form 10-K
March 29, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 000-27031

FULLNET COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

OKLAHOMA

(State or other jurisdiction of
incorporation or organization)

73-1473361

(I.R.S. Employer Identification No.)

201 Robert S. Kerr Avenue, Suite 210

Oklahoma City, Oklahoma 73102

(Address of principal executive offices)

(405) 236-8200

(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Title of class

Common Stock, \$0.00001 Par Value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15 (d) of the Exchange Act. Yes No

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

1

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the Common Stock held by non-affiliates computed by reference to the price at which the Common Stock was last sold, or the average bid and asked price of the Common Stock, as of the last business day (June 30, 2011) of registrant's completed second quarter was \$264,207.

As of March 28, 2012, 9,118,161 shares of the registrant's common stock, \$0.00001 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None

Table of Contents

FULLNET COMMUNICATIONS, INC.

FORM 10-K

For the Fiscal Year Ended December 31, 2011

TABLE OF CONTENTS

PART I.

<u>Item 1. Business</u>	4
<u>Item 1A. Risk Factors</u>	11
<u>Item 1B. Unresolved Staff Comments</u>	14
<u>Item 2. Properties</u>	14
<u>Item 3. Legal Proceedings</u>	14

PART II.

<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	15
<u>Item 6. Selected Financial Data</u>	17
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	23
<u>Item 8. Financial Statements and Supplemental Data</u>	23
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	23
<u>Item 9A. Controls and Procedures</u>	23

PART III.

<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	25
<u>Item 11. Executive Compensation</u>	27
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	30
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	32
<u>Item 14. Principal Accounting Fees and Services</u>	32
<u>Item 15. Exhibits, Financial Statement Schedules</u>	33

SIGNATURES

38

Exhibit 31.1 Certification Pursuant to Rules 13a-14(a) and 15d-14(a)

Exhibit 31.2 Certification Pursuant to Rules 13a-14(a) and 15d-14(a)

Exhibit 32.1 Certification Pursuant to Section 906

Exhibit 32.2 Certification Pursuant to Section 906

Table of Contents

Throughout this report the first personal plural pronoun in the nominative case form *we* and its objective case form *us*, its possessive and the intensive case forms *our* and *ourselves* and its reflexive form *ourselves* refer collectively to Fullnet Communications, Inc. and its subsidiaries, and its and their executive officers and directors.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Annual Report on Form 10-K and the information incorporated by reference may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). In particular, we direct your attention to Item 1. Business, Item 1A. Risk Factors, Item 2. Properties, Item 3. Legal Proceedings, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data. We intend the forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding our expected financial position and operating results, our business strategy, our financing plans and the outcome of any contingencies are forward-looking statements. These statements can sometimes be identified by our use of forward-looking words such as *may*, *believe*, *plan*, *will*, *anticipate*, *estimate*, *expect*, *intend* and other phrases of similar meaning. Unknown risks, uncertainties and other factors could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions.

Although we believe that our expectations that are expressed in these forward-looking statements are reasonable, we cannot promise that our expectations will prove to be correct. Our actual results could be materially different from our expectations, including the following:

We may lose subscribers or fail to grow our subscriber base;

We may not successfully integrate new subscribers or assets obtained through acquisitions, if any;

We may fail to compete with existing and new competitors;

We may not adequately respond to technological developments impacting the Internet;

We may experience a major system failure; and

We may not be able to find needed capital resources.

This list is intended to identify some of the principal factors that could cause actual results to differ materially from those described in the forward-looking statements included elsewhere in this report. These factors are not intended to represent a complete list of all risks and uncertainties inherent in our business, and should be read in conjunction with the more detailed cautionary statements included in this Report under the caption Item 1A. Risk Factors, our other Securities and Exchange Commission filings and our press releases.

Table of Contents

PART I

Item 1. Business

General

We are an integrated communications provider offering integrated communications and Internet connectivity to individuals, businesses, organizations, educational institutions and government agencies. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, web hosting, equipment co-location and traditional telephone services. Our overall strategy is to become a successful integrated communications provider for residents and small to medium-sized businesses in Oklahoma.

References to us in this Report include our subsidiaries: FullNet, Inc. (FullNet), FullTel, Inc. (FullTel), and FullWeb, Inc. (FullWeb). Our principal executive offices are located at 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102, and our telephone number is (405) 236-8200. We also maintain Internet sites on the World Wide Web (WWW) at www.fullnet.net, www.fulltel.net and www.callmultiplier.com. Information contained on our Websites is not, and should not be deemed to be, a part of this Report.

Company History

We were founded in 1995 as CEN-COM of Oklahoma, Inc., an Oklahoma corporation, to bring dial-up Internet access and education to rural locations in Oklahoma that did not have dial-up Internet access. We changed our name to FullNet Communications, Inc. in December 1995. Today we are a total solutions provider to individuals and companies seeking a one-stop shop in Oklahoma.

Our current business strategy is to become a successful integrated communications provider in Oklahoma. We expect to grow through the acquisition of additional customers for our carrier-neutral co-location space and traditional telephone services, as well as through the acquisition of Internet service providers.

We market our carrier neutral co-location solutions in our network operations center to other competitive local exchange carriers, Internet service providers and web-hosting companies. Our co-location facility is carrier neutral, allowing customers to choose among competitive offerings rather than being restricted to one carrier. Our network operations center is Telco-grade and provides customers a high level of operative reliability and security. We offer flexible space arrangements for customers and 24-hour onsite support with both battery and generator backup.

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. FullTel activates local access telephone numbers for the cities in which we market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service; our business-to-business network design, connectivity, domain and Web hosting businesses; and traditional telephone services. At December 31, 2011 FullTel provided us with local telephone access in approximately 232 cities.

Our common stock trades on the OTC Bulletin Board under the symbol FULO. While our common stock trades on the OTC Bulletin Board, it is very thinly traded, and there can be no assurance that our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile.

Mergers and Acquisitions

Our acquisition strategy is designed to leverage our existing network backbone and internal operations to enable us to enter new markets in Oklahoma, as well as to expand our presence in existing markets, and to benefit from economies of scale.

Our Business Strategy

As an integrated communications provider, we intend to increase shareholder value by continuing to build scale through both acquisitions and internal growth and then leveraging increased revenues over our fixed-costs base. Our strategy is to meet the customer service requirements of retail, business, educational and government Internet users in our target markets, while benefiting from the scale advantages obtained through being a fully integrated backbone and broadband provider. The key elements of our overall strategy with respect to our principal business operations are described below.

Table of Contents

Target Strategic Acquisitions

The goal of our acquisition strategy is to accelerate market penetration by acquiring Internet service providers in Oklahoma communities and to acquire strategic Internet service providers in Oklahoma City and Tulsa. Additionally, we will continue to build upon our core competencies and expand our technical, customer service staff and sales force in Oklahoma communities. We evaluate acquisition candidates based on their compatibility with our overall business plan of penetrating rural and outlying markets as well as Oklahoma City and Tulsa. When a candidate is acquired, we will integrate our existing Internet, network connectivity and value-added services with the services offered by the acquired company and use either the local sales force or install our own dealer sales force to continue to increase market share. The types of acquisitions targeted by us include Internet service providers located in markets into which we want to expand or to which we may already provide private-label Internet connectivity. Other types of targeted acquisitions include local business-only Internet service providers in markets where we have established points of presence and would benefit from the acquired company's local sale and network solutions sales and technical staff and installed customer base through the potential increase in our network utilization. When assessing an acquisition candidate, we focus on the following criteria:

- o Potential revenue and subscriber growth;
- o Low subscriber turnover or churn rates;
- o Density in the market as defined by a high ratio of subscribers to points of presence (POPs);
- o Favorable competitive environment;
- o Low density network platforms that can be integrated readily into our backbone network; and
- o Favorable consolidation savings.

Generate Internal Sales Growth

We intend to expand our customer base by increasing our marketing efforts. At December 31, 2011, our direct sales force consisted of one individual in our Oklahoma City office coordinating all our business-to-business solutions sales. We currently have independent re-sellers responsible for their individual markets. Our sales force is supported in its efforts by technical engineers and our senior management. In addition, we are exploring other strategies to increase our sales, including other marketing partners such as electric cooperatives. We currently have one of the 20 local Oklahoma electric cooperatives as a marketing partner.

Increase Rural Area Market Share

We believe that the rural areas of Oklahoma are underserved by Internet service providers, and that significant profitable growth can be achieved in serving these markets by providing reliable Internet connectivity at a reasonable cost to the residents and businesses located in these areas. We believe we can obtain a significant Internet service provider and business-to-business market share in Oklahoma. To that end, through our wholly-owned subsidiary, FullTel, we became a licensed competitive local exchange carrier in Oklahoma. Since March 2003 when we installed our telephone switch, FullTel, as a competitive local exchange carrier, has provided local telephone numbers for Internet access.

Enhance Subscribers' Online Experience

We intend to maximize our subscriber retention and add new subscribers by enhancing our services in the following ways:

- o Ease of Use During the first quarter of 2001, we implemented a common, easy to use CD-ROM based software package that automatically configures all of the individual Internet access programs after a one-time entry by the user of a few required fields of information such as, name, user name and password.

Internet Access Services

We provide Internet access services to individual and small business subscribers located in Oklahoma on both a retail and wholesale basis. Through FullNet, we provide our customers with a variety of dial-up and dedicated connectivity, as well as direct access to a wide range of Internet applications and resources, including electronic mail. FullNet's full range of services includes:

- o Private label retail and business direct dial-up connectivity to the Internet and

Table of Contents

o Secure private networks through our backbone network.

Our branded and private label Internet access services are provided through a statewide network with points-of-presence in 232 communities throughout Oklahoma. Points-of-presence are local telephone numbers through which subscribers can access the Internet. Our business services consist of high-speed Internet access services and other services that enable wholesale customers to outsource their Internet and electronic commerce activities. We had approximately 500 and 800 subscribers at December 31, 2011 and 2010, respectively. Additionally, FullNet sells Internet access to other Internet service providers, who then resell Internet access to their own customers under their private label or under the FullNet brand name.

Currently, we offer the following two types of Internet connections:

o Dial-Up Connections

The simplest connection to the Internet is the dial-up account. This method of service connects the user to the Internet through the use of a modem and standard telephone line. Currently, FullNet users can connect via dial-up at speeds up to 56 Kbps. We support these users through the use of sophisticated modem banks located in our facility in Oklahoma City that send data through a router and out to the Internet. We support the higher speed 56K, V.92 MOH and Integrated Services Digital Network connections with state-of-the-art digital modems. With a dial-up connection, a user can gain access to the Internet for e-mail, the World Wide Web, file transfer protocol, news groups, and a variety of other useful applications.

o Leased Line Connections

Many businesses and some individuals have a need for more bandwidth to the Internet to support a network of users or a busy Website. We have the capacity to sell a leased line connection to users. This method of connection gives the user a full-time high-speed (up to 1.5 mbps) connection to the Internet. The leased line solution comes at greater expense to the user. These lines are leased through the telephone companies at a high installation and monthly fee.

We believe that our Internet access services provide customers with the following benefits:

Fast and Reliable Internet Access-We have implemented a network architecture providing exceptional quality and consistency in Internet services, making us one of the recognized backbone leaders in the Oklahoma Internet service provider industry. We offer unlimited, unrestricted and reliable Internet access at a low monthly price. We have designed our network such that our users never have to worry about busy signals due to a lack of available modems. Dial-up access is available for the following modem speeds: 14.4K, 28.8K, 33.6K, K56Flex, 56K V.90, v.92 MOH, ISDN 64K and ISDN 128K. Our dial-up access supports all major platforms and operating systems, including MS Windows, UNIX(R), Mac OS, OS/2 and LINUX. This allows simplified access to all Internet applications, including the World Wide Web, email, and news and file transfer protocol.

Cost-Effective Access-We offer high quality Internet connectivity and enhanced business services at price points that are generally lower than those charged by other Internet service providers with national coverage. Additionally, we offer pre-bundled access services packages under monthly or prepaid plans.

Superior Customer Support-We provide superior customer service and support, with customer care and technical personnel available by telephone and on-line 24 hours per day, 365 days per year.

CLEC Operations

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. CLECs are new phone companies evolved from the Telecommunications Act of 1996 (Telecommunications Act) that requires the incumbent local exchange carriers or ILECs, generally the regional Bell companies including AT&T, to provide CLECs access to their local facilities, and to compensate CLECs for traffic originated by ILECs and terminated on the CLECs network. By adding our own telephone switch and infrastructure to the existing telephone network in March 2003, we offer certain local Internet access for dial-up services in most of Oklahoma. As a CLEC, we may subscribe to and resell all forms of local telephone service in Oklahoma.

While Internet access is the core focus of growth for us, we plan to also provide traditional telephone service throughout Oklahoma.

A core piece of our marketing strategy is the cross pollination between our Internet activities and FullTel's local dial-up service. By organizing and funding FullTel, we gained local dial-up Internet access to approximately 80% of Oklahoma. In return, FullTel gained access to our entire Internet service provider customer base.

Table of Contents

The FullTel data center telephone switching equipment was installed in March 2003. At which time, FullTel began the process of activating local access telephone numbers for every city in Oklahoma within the AT&T service area. At December 31, 2011, FullTel provided us with local telephone access in approximately 232 cities. However, our ability to fully take advantage of these opportunities will be dependent upon the availability of additional capital.

Sales and Marketing

We focus on marketing our services to two distinct market segments: enterprises (primarily small and medium size businesses) and consumers. By attracting enterprise customers who use the network primarily during the daytime, and consumer customers who use the network primarily at night, we are able to utilize our network infrastructure more cost effectively.

Competition

The market for Internet connectivity and related services is extremely competitive. We anticipate that competition will continue to intensify as the use of the Internet continues to expand and grow. The tremendous growth and potential market size of the Internet access market has attracted many new start-ups as well as existing businesses from a variety of industries. We believe a reliable network, knowledgeable salespeople and the quality of technical support currently are the primary competitive factors in our targeted market and that price is usually secondary to these factors.

Our current and prospective competitors include, in addition to other national, regional and local Internet service providers, long distance and local exchange telecommunications companies, cable television, direct broadcast satellite, wireless communications providers and online service providers. While we believe that our network, products and customer service distinguish us from these competitors, most of these competitors have significantly greater market presence, brand recognition, financial, technical and personnel resources than us.

Internet Service Providers

Our current primary competitors include other Internet service providers with a significant national presence that focuses on business customers, including Cox Communications and AT&T. These competitors have greater market share, brand recognition, financial, technical and personnel resources than us. We also compete with regional and local Internet service providers in our targeted markets.

Telecommunications Carriers

The major long distance companies, also known as inter-exchange carriers, including AT&T, Verizon, and Sprint, offer Internet access services and compete with us. Reforms in the federal regulation of the telecommunications industry have created greater opportunities for ILECs, including the Regional Bell Operating Companies or RBOCs, and other competitive local exchange carriers, to enter the Internet connectivity market. In order to address the Internet connectivity requirements of the business customers of long distance and local carriers, we believe that there is a move toward horizontal integration by ILECs and CLECs through acquisitions or joint ventures with, and the wholesale purchase of, connectivity from Internet service providers. The MCI/WorldCom merger (and the prior WorldCom/MFS/UUNet consolidation), GTE's acquisition of BBN, the acquisition by ICG Communications, Inc. of Netcom, Global Crossing's acquisition of Frontier Corp. (and Frontier's prior acquisition of Global Center) and AT&T's purchase of IBM's global communications network are indicative of this trend. Accordingly, we expect that we will experience increased competition from the traditional telecommunications carriers. These telecommunication carriers, in addition to their greater network coverage, market presence, financial, technical and personnel resources also have large existing commercial customer bases.

Cable Companies, Direct Broadcast Satellite and Wireless Communications Companies

Many of the major cable companies are offering Internet connectivity, relying on the viability of cable modems and economical upgrades to their networks, including Media One and Time Warner Cablevision, Inc., Cox Communications and Tele-Communications, Inc. (TCI).

The companies that own these broadband networks could prevent us from delivering Internet access through the wire and cable connections that they own. Our ability to compete with telephone and cable television companies that are able to support broadband transmissions, and to provide better Internet services and products, may depend on future regulation to guarantee open access to the broadband networks. However, in January 1999, the Federal Communications Commission declined to take any action to mandate or otherwise regulate access by Internet service providers to broadband cable facilities at this time. It is unclear whether and to what extent local and state regulatory agencies will take any initiatives to implement this type of regulation, and whether they will be successful in establishing their authority to do so. Similarly, the Federal Communications Commission is considering proposals that could limit the right of Internet service providers to connect with their customers over broadband local telephone lines. In addition to competing directly in the Internet service provider market, both cable and television facilities

Table of Contents

operators are also aligning themselves with certain Internet service providers who would receive preferential or exclusive use of broadband local connections to end users. As high-speed broadband facilities increasingly become the preferred mode by which customers access the Internet, if we are unable to gain access to these facilities on reasonable terms, our business, financial condition and results of operations could be materially adversely affected.

Online Service Providers

The dominant online service providers, including America Online, Incorporated, Comcast, AT&T, Road Runner, Verizon and Earthlink, have all entered the Internet access business by engineering their current proprietary networks to include Internet access capabilities. We compete to a lesser extent with these service providers, which currently are primarily focused on the consumer marketplace and offer their own content, including chat rooms, news updates, searchable reference databases, special interest groups and shopping.

However, America Online's merger with Time-Warner, its acquisition of Netscape Communications Corporation and related strategic alliance with Sun Microsystems enable it to offer a broader array of Internet -based services and products that could significantly enhance its ability to appeal to the business marketplace and, as a result, compete more directly with Internet service providers like us. CompuServe has also announced that it will target Internet connectivity for the small to medium sized business market.

We believe that our ability to attract business customers and to market value-added services is a key to our future success. However, there can be no assurance that our competitors will not introduce comparable services or products at similar or more attractive prices in the future or that we will not be required to reduce our prices to match competition. Recently, many competitive ISPs have shifted their focus from individual customers to business customers.

Moreover, there can be no assurance that more of our competitors will not shift their focus to attracting business customers, resulting in even more competition for us. There can be no assurance that we will be able to offset the effects of any such competition or resulting price reductions. Increased competition could result in erosion of our market share and could have a material adverse effect on our business, financial condition and results of operations.

Government Regulations

The following summary of regulatory developments and legislation is not complete. It does not describe all present and proposed federal, state, and local regulation and legislation affecting the Internet service provider and telecommunications industries. Existing federal and state regulations are currently subject to judicial proceedings, legislative hearings, and administrative proposals that could change, in varying degrees, the manner in which our businesses operate. We cannot predict the outcome of these proceedings or their impact upon the Internet service provider and telecommunications industries or upon our business.

The provision of Internet access service and the underlying telecommunications services are affected by federal, state, local and foreign regulation. The Federal Communications Commission or FCC exercises jurisdiction over all facilities of, and services offered by, telecommunications carriers to the extent that they involve the provision, origination or termination of jurisdictionally interstate or international communications. The state regulatory commissions retain jurisdiction over the same facilities and services to the extent they involve origination or termination of jurisdictionally intrastate communications. In addition, as a result of the passage of the Telecommunications Act, state and federal regulators share responsibility for implementing and enforcing the domestic pro-competitive policies of the Telecommunications Act. In particular, state regulatory commissions have substantial oversight over the provision of interconnection and non-discriminatory network access by ILECs. Municipal authorities generally have some jurisdiction over access to rights of way, franchises, zoning and other matters of local concern.

Our Internet operations are not currently subject to direct regulation by the FCC or any other U.S. governmental agency, other than regulations applicable to businesses generally. However, the FCC continues to review its regulatory position on the usage of the basic network and communications facilities by Internet service providers. Although in an April 1998 Report, the FCC determined that Internet service providers should not be treated as telecommunications carriers and therefore should not be regulated, it is expected that future Internet service provider regulatory status will continue to be uncertain. Indeed, in that report, the FCC concluded that certain services offered over the Internet, including phone-to-phone Internet telephony, may be functionally indistinguishable from traditional telecommunications service offerings, and their non-regulated status may require reexamination.

Changes in the regulatory structure and environment affecting the Internet access market, including regulatory changes that directly or indirectly affect telecommunications costs or increase the likelihood of competition from RBOCs or other telecommunications companies, could have an adverse effect on our business. Although the FCC has decided not to allow local telephone companies to impose per-minute access charges on Internet service providers, and the reviewing court has upheld that decision, further regulatory and legislative consideration of this issue is likely. In addition, some telephone companies are seeking

Table of Contents

relief through state regulatory agencies. The imposition of access charges would affect our costs of serving dial-up customers and could have a material adverse effect on our business, financial condition and results of operations.

In addition to our Internet service provider operations, we have focused attention on acquiring telecommunications assets and facilities, which are subject to regulation. Fulltel, our subsidiary, has received competitive local exchange carrier or CLEC certification in Oklahoma. The Telecommunications Act requires CLECs not to prohibit or unduly restrict resale of their services; to provide dialing parity, number portability, and nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listings; to afford access to poles, ducts, conduits, and rights-of-way; and to establish reciprocal compensation arrangements for the transport and termination of telecommunications traffic. In addition to federal regulation of CLECs, the states also impose regulatory obligations on CLECs. While these obligations vary from state to state, most states require CLECs to file a tariff for their services and charges; require CLECs to charge just and reasonable rates for their services, and not to discriminate among similarly-situated customers; to file periodic reports and pay certain fees; and to comply with certain services standards and consumer protection laws. As a provider of domestic basic telecommunications services, particularly competitive local exchange services, we could become subject to further regulation by the FCC or another regulatory agency, including state and local entities.

The Telecommunications Act has caused fundamental changes in the markets for local exchange services. In particular, the Telecommunications Act and the related FCC promulgated rules mandate competition in local markets and require that ILECs interconnect with CLECs. Under the provisions of the Telecommunications Act, the FCC and state public utility commissions share jurisdiction over the implementation of local competition: the FCC was required to promulgate general rules and the state commissions were required to arbitrate and approve individual interconnection agreements. The courts have generally upheld the FCC in its promulgation of rules, including a January 25, 1999 U.S. Supreme Court ruling which determined that the FCC has jurisdiction to promulgate national rules in pricing for interconnection.

In July 2000, the Eighth Circuit Court issued a decision on the earlier remand from the Supreme Court and rejected, as contrary to the Telecommunications Act, the use of hypothetical network costs, including total element long-run incremental costs methodology (TELRIC), which the FCC had used in developing certain of its pricing rules. The Eighth Circuit Court also vacated the FCC's pricing rules related to unbundled network elements (UNEs), termination and transport, but upheld its prior decision that ILECs' universal service subsidies should not be included in the costs of providing network elements. Finally, the Eighth Circuit Court also vacated the FCC's rules requiring that: (1) ILECs recombine unbundled network elements for competitors in any technically feasible combination; (2) all preexisting interconnection agreements be submitted to the states for review; and (3) the burden of proof for retention of a rural exemption be shifted to the ILEC. The FCC sought review of the Eighth Circuit Court's invalidation of TELRIC and was granted certiorari. On May 13, 2002, the Supreme Court reversed certain of the Eighth Circuit Court's findings and affirmed that the FCC's rules concerning forward looking economic costs, including TELRIC, were proper under the Telecommunications Act. The Supreme Court also restored the FCC's requirement that the ILEC's combine UNEs for competitors when they are unable to do so themselves.

In November 1999, the FCC released an order making unbundling requirements applicable to all ILEC network elements uniformly. UNE-P is created when a competing carrier obtains all the network elements needed to provide service from the ILEC. In December 1999, the FCC released an order requiring the provision of unbundled local copper loops enabling CLECs to offer competitive Digital Subscriber Loop Internet access. The FCC reconsidered both orders in its first triennial review of its policies on UNEs completed in early 2003, as further discussed below.

On August 21, 2003, the FCC released the text of its Triennial Review Order. In response to the remand of the United States Court of Appeals for the District of Columbia circuit, the FCC adopted new rules governing the obligations of ILECs to unbundle the elements of their local networks for use by competitors. The FCC made national findings of impairment or non-impairment for loops, transport and, most significantly, switching. The FCC delegated to the states the authority to engage in additional fact finding and make alternative impairment findings based on a more granular impairment analysis including evaluation of applicability of FCC-established triggers. The FCC created mass market and enterprise market customer classifications that generally correspond to the residential and business markets, respectively. The FCC found that CLECs were not impaired without access to local circuit switching when serving enterprise market customers on a national level. CLECs, however, were found to be impaired on a national level without access to local switching when serving mass market customers. State commissions had 90 days to ask the FCC to waive the finding of no impairment without switching for enterprise market customers. The FCC presumption that CLECs are impaired without access to transport, high capacity loops and mass market switching is subject to a more granular nine-month review by state commissions pursuant to FCC-established triggers and other economic and operational criteria.

The FCC also opened a further notice of proposed rulemaking to consider the pick and choose rules under which a competing carrier may select from among the various terms of interconnection offered by an ILEC in its various interconnection agreements. Comments have been filed, but the FCC has not issued a decision.

Table of Contents

The Triennial Review Order also provided that:

- ILECs are not required to unbundle packet switching as a stand-alone network element.
- Two key components of the FCC's TELRIC pricing rules were clarified. First, the FCC clarified that the risk-adjusted cost of capital used in calculating UNE prices should reflect the risks associated with a competitive market. Second, the FCC declined to mandate the use of any particular set of asset lives for depreciation, but clarified that the use of an accelerated depreciation mechanism may present a more accurate method of calculating economic depreciation.
- CLECs continue to be prohibited from avoiding any liability under contractual early termination clauses in the event a CLEC converts a special access circuit to an UNE.

We are monitoring the Oklahoma state commission proceedings and participating where necessary as the commission undertakes the 90-day and nine-month analyses to establish rules or make determinations as directed by the Triennial Review Order. In addition, numerous petitions and appeals have been filed in the courts and with the FCC challenging many of the findings in the Triennial Review Order and seeking a stay on certain portions of the order. The appeals have been consolidated in the D.C. Circuit Court of Appeals. Oral arguments were heard on January 28, 2004. On March 2, 2004, a three-judge panel in the D.C. Circuit Court of Appeals overturned the FCC's Triennial Review Order with regard to network unbundling rules. A majority of the FCC Commissioners is seeking a court-ordered stay and plan to appeal the ruling to the U.S. Supreme Court. Until all of these proceedings are concluded, the impact of this order, if any, on our CLEC operations cannot be determined.

An important issue for CLECs is the right to receive reciprocal compensation for the transport and termination of Internet traffic. We believe that, under the Telecommunications Act, CLECs are entitled to receive reciprocal compensation from ILECs. However, some ILECs have disputed payment of reciprocal compensation for Internet traffic, arguing that Internet service provider traffic is not local traffic. Most states have required ILECs to pay CLECs reciprocal compensation. However, in October 1998, the FCC determined that dedicated digital subscriber line service is an interstate service and properly tariffed at the interstate level. In February 1999, the FCC concluded that at least a substantial portion of dial-up Internet service provider traffic is jurisdictionally interstate. The FCC also concluded that its jurisdictional decision does not alter the exemption from access charges currently enjoyed by Internet service providers. The FCC established a proceeding to consider an appropriate compensation mechanism for interstate Internet traffic. Pending the adoption of that mechanism, the FCC saw no reason to interfere with existing interconnection agreements and reciprocal compensation arrangements. The FCC order has been appealed. In addition, there is a risk that state public utility commissions that have previously considered this issue and ordered the payment of reciprocal compensation by the ILECs to the CLECs may be asked by the ILECs to revisit their determinations, or may revisit their determinations on their own motion. To date, at least one ILEC has filed suit seeking a refund from a carrier of reciprocal compensation that the ILEC had paid to that carrier. There can be no

assurance that any future court, state regulatory or FCC decision on this matter will favor our position. An unfavorable result may have an adverse impact on our potential future revenues as a CLEC. Reciprocal compensation is unlikely to be a significant or a long-term revenue source for us.

As we become a competitor in local exchange markets, we will become subject to state requirements regarding provision of intrastate services. This may include the filing of tariffs containing rates and conditions. As a new entrant, without market power, we expect to face a relatively flexible regulatory environment. Nevertheless, it is possible that some states could require us to obtain the approval of the public utilities commission for the issuance of debt or equity or other transactions that would result in a lien on our property used to provide intrastate services.

Employees

As of December 31, 2011, we had 14 employees employed in engineering, sales, marketing, customer support and related activities and general and administrative functions. None of our employees are represented by a labor union, and we consider our relations with our employees to be good. We also engage consultants from time to time with respect to various aspects of our business.

Item 1A. Risk Factors.

This Report includes forward looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Although we believe that our plans, intentions and expectations reflected in such forward looking statements are reasonable, we can give no assurance that such plans, intentions or expectations will be achieved. Important factors that could cause actual results to differ materially from our forward looking statements are set forth below and elsewhere in this Report. All forward looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth below.

Table of Contents

Necessity of Successfully Overcoming Numerous Financial and Operational Challenges in Order to Continue as a Going Concern.

At December 31, 2011, our current liabilities exceeded our current assets by \$1,801,314, our total liabilities exceeded our total assets by \$1,740,745, and we had an accumulated deficit of \$10,150,780. In addition, as set forth below, we face a number of operational challenges which we must successfully meet. Our ability to continue as a going concern is dependent upon our continued operations that in turn are dependent upon our ability to meet our financing requirements on a continuing basis, to maintain present financing, to achieve the objectives of our business plan and to succeed in our future operations. Our business plan includes, among other things, expansion of our Internet access services through mergers and acquisitions and the development of our web hosting, co-location and traditional telephone services. Execution of our business plan will require significant capital to fund capital expenditures, working capital needs and debt service. Current cash balances will not be sufficient to fund our current business plan beyond the next few months. As a consequence, we are currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. We continue to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund our liquidity. There can be no assurance that we will be able to obtain additional capital on satisfactory terms, or at all, or on terms that will not dilute our shareholders' interests. Consequently we might be unsuccessful in overcoming the numerous financial and operational challenges required to continue as a going concern.

Necessity of Obtaining an Acceptable Successor Interconnection Agreement.

We are dependent upon obtaining certain services from AT&T (formerly SBC) pursuant to our interconnection agreement with them. We along with many other telecommunications companies in Oklahoma are currently a party to one or more proceedings before the Oklahoma Corporation Commission (the OCC) relating to the terms of our interconnection agreements with AT&T and an anticipated successor to these interconnection agreements. Consequently we might be unsuccessful in obtaining an acceptable successor interconnection agreement which would have a material adverse effect on our business prospects, financial condition and results of operation.

Necessity of Additional Financing.

In order for us to have any opportunity for significant commercial success and profitability, we must successfully obtain additional financing, either through borrowings, additional private placements or a public offering, or some combination thereof. Although we are actively pursuing a variety of funding sources, there can be no assurance that we will be successful in obtaining additional financing which would have a material adverse effect on our business prospects, financial condition and results of operation.

Limited Marketing Experience.

We have limited experience in developing and commercializing new services based on innovative technologies, and there is limited information available concerning the potential performance of our hardware or market acceptance of our proposed services. There can be no assurance that unanticipated expenses, problems or technical difficulties will not occur which would result in material delays in product commercialization or that our efforts will result in successful product commercialization. Consequently our limited marketing experience could have a material adverse effect on our business prospects, financial condition and results of operation.

Uncertainty of Products/Services Development.

Although considerable time and financial resources were expended in the development of our services and products, there can be absolutely no assurance that problems will not develop which would have a material adverse effect on us. We will be required to commit considerable time, effort and resources to finalize our product/service development and adapt our products and services to satisfy specific requirements of potential customers. Continued system refinement, enhancement and development efforts are subject to all of the risks inherent in the development of new products/services and technologies, including unanticipated delays, expenses, technical problems or difficulties, as well as the possible insufficiency of funds to satisfactorily complete development, which could result in abandonment or substantial change in commercialization. There can be no assurance that development efforts will be successfully completed on a timely basis, or at all, that we will be able to successfully adapt our hardware or software to satisfy specific requirements of potential customers, or that unanticipated events will not occur which would result in increased costs or material delays in development or commercialization. In addition, the complex technologies planned to be incorporated into our products and services may contain errors that become apparent subsequent to commercial use. Remedying these errors could delay our plans and cause us to incur substantial additional costs. Consequently the uncertainty of our products/services development could have a material adverse effect on our business prospects, financial condition and results of operation.

Table of Contents

Competition; Technological Obsolescence.

The markets for our products and services are characterized by intense competition and an increasing number of potential new market entrants who have developed or are developing potentially competitive products and services. We will face competition from numerous sources, certain of which may have substantially greater financial, technical, marketing, distribution, personnel and other resources than us, permitting such companies to implement extensive marketing campaigns, both generally and in response to efforts by additional competitors to enter into new markets and market new products and services. In addition, our product and service markets are characterized by rapidly changing technology and evolving industry standards that could result in product obsolescence and short product life cycles. Accordingly, our ability to compete will be dependent upon our ability to complete the development of our products and to introduce our products and/or services into the marketplace in a timely manner, to continually enhance and improve our software and to successfully develop and market new products. There can be no assurance that we will be able to compete successfully, that competitors will not develop technologies or products that render our products and/or services obsolete or less marketable or that we will be able to successfully enhance our products or develop new products and/or services. Consequently our failure to successfully respond to the demands of competition and technological obsolescence could have a material adverse effect on our business prospects, financial condition and results of operation.

Risks Relating to the Internet.

Businesses reliant on the Internet may be at risk due to inadequate development of the necessary infrastructure, including reliable network backbones or complementary services, high-speed modems and security procedures. The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and amount of traffic. There can be no assurance that the Internet infrastructure will continue to be able to support the demands placed on it by sustained growth. In addition, there may be delays in the development and adoption of new standards and protocols, the inability to handle increased levels of Internet activity or due to increased government regulation. If the necessary Internet infrastructure or complementary services are not developed to effectively support growth that may occur, our business, results of operations and financial condition would be materially adversely affected.

Potential Government Regulations.

We are subject to state commission, Federal Communications Commission and court decisions as they relate to the interpretation and implementation of the Telecommunications Act, the interpretation of Competitive Local Exchange Carrier or CLEC interconnection agreements in general and our interconnection agreements in particular. In some

cases, we may become bound by the results of ongoing proceedings of these bodies or the legal outcomes of other contested interconnection agreements that are similar to agreements to which we are a party. Consequently potential government regulations could have a material adverse effect on our business, prospects, financial condition and results of operations.

Dependence on Key Personnel.

Our success depends in large part upon the continued successful performance of our current executive officers and key employees, Messrs. Timothy J. Kilkenny, Roger P. Baresel and Jason C. Ayers, for our continued research, development, marketing and operation. Although we have employed, and will employ in the future, additional qualified employees as well as retaining consultants having significant experience, if Messrs. Kilkenny, Baresel or Ayers fail to perform any of their duties for any reason whatsoever, our ability to market, operate and support our products/services will be adversely affected. While we are located in areas where the available pool of people is substantial, there is also significant competition for qualified personnel. Consequently our dependence on these key personnel could have a material adverse effect on our business prospects, financial condition and results of operation.

Limited Public Market.

During February 2000, our common stock began trading on the OTC Bulletin Board under the symbol FULO. While our common stock continues to trade on the OTC Bulletin Board, there can be no assurance that our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile. Consequently the limited public market for our common stock could have a material adverse effect on our business prospects, financial condition and results of operation.

Penny Stock Regulation.

Broker-dealer practices in connection with transactions in penny stocks are regulated by certain penny stock rules adopted by the SEC. Penny stocks generally are equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the NASDAQ system). The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide

Table of Contents

the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and, if the broker dealer is the sole market-maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, broker-dealers who sell these securities to persons other than established customers and accredited investors (generally, those persons with assets in excess of \$1,000,000 or annual income exceeding \$200,000 or \$300,000 together with their spouse), must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. Consequently, these requirements may have the effect of reducing the level of trading activity, if any, in the secondary market for a security that is or becomes subject to the penny stock rules. Our common stock is subject to the penny stock rules at the present time, and consequently our stockholders will find it more difficult to sell their shares. Consequently the Penny Stock regulations could have a material adverse effect on our business prospects, financial condition and results of operation.

Item 1B. Unresolved Staff Comments.

We do not have any unresolved staff comments to report.

Item 2. Properties

We maintain our executive office in approximately 13,000 square feet at 201 Robert S. Kerr Avenue, Suite 210 in Oklahoma City, at an effective annual rental rate of \$14.40 per square foot. These premises are occupied pursuant to a five-year lease that expires December 31, 2014.

Item 3. Legal Proceedings

As a provider of telecommunications, we are affected by regulatory proceedings in the ordinary course of our business at the state and federal levels. These include proceedings before both the Federal Communications Commission and the Oklahoma Corporation Commission (OCC). In addition, in our operations we rely on obtaining many of our underlying telecommunications services and/or facilities from incumbent local exchange carriers or other carriers pursuant to interconnection or other agreements or arrangements. In January 2007, we concluded a regulatory proceeding pursuant to the Federal Telecommunications Act of 1996 before the OCC relating to the terms of our interconnection agreement with Southwestern Bell Telephone, L.P. d/b/a AT&T, which succeeds a prior interconnection agreement. The OCC approved this agreement in May 2007. This agreement may be affected by regulatory proceedings at the federal and state levels, with possible adverse impacts on us. We are unable to accurately predict the outcomes of such regulatory proceedings at this time, but an unfavorable outcome could have a

material adverse effect on our business, financial condition or results of operations.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is traded in the over-the-counter market and is quoted on the OTC Bulletin Board under the symbol FULO. The closing sale prices reflect inter-dealer prices without adjustment for retail markups, markdowns or commissions and may not reflect actual transactions. The following table sets forth the high and low closing sale prices of our common stock during the calendar quarters presented as reported by the OTC Bulletin Board.

	Common Stock Closing Sale Prices	
	High	Low
2011 Calendar Quarter Ended:		
March 31	\$.050	\$.020
June 30	.050	.050
September 30	.003	.003
December 31	.003	.003
2010 Calendar Quarter Ended:		
March 31	\$.02	\$.01
June 30	.01	.01
September 30	.01	.01
December 31	.03	.01

Number of stockholders

The number of beneficial holders of record of our common stock as of the close of business on March 26, 2012 was approximately 117.

Dividend Policy

To date, we have declared no cash dividends on our common stock, and do not expect to pay cash dividends in the near term. We intend to retain future earnings, if any, to provide funds for operations and the continued expansion of our business.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth as of December 31, 2011, information related to each category of equity compensation plan approved or not approved by our shareholders, including individual compensation arrangements with our non-employee directors. We do not have any equity compensation plans that have been approved by our shareholders. All of our outstanding stock option grants and warrants were pursuant to individual compensation arrangements and exercisable for the purchase of our common stock shares.

Plan Category	Number of Shares	Weighted- Average Exercise Price	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans
	Underlying Unexercised Options and Warrants	of Outstanding Options and Warrants	
<i>Equity compensation plans approved by our shareholders:</i>			
None	Not Applicable	Not Applicable	Not Applicable
<i>Equity compensation plans not approved by our shareholders:</i>			
Stock option grants to non-employee directors		\$	
Stock options granted to employees	1,462,783	\$.04	
Warrants and certain stock options issued to non-employees	326,000	\$.01	
Total	1,788,783	\$.03	

Recent Sales of Unregistered Securities

Employee stock options for 725,697 and 400,000 shares of our common stock were exercised in May 2011 for \$7,256 and December 2011 for \$1,200, respectively.

In December 2009 we agreed to issue additional shares of stock to the holder of a secured promissory note in the event that any additional shares are issued at less than \$.50 per share, excluding employee stock options, prior to the payment in full of the secured promissory note (see Note D – Notes Payable of the financial statements appearing elsewhere in this report).

These common stock shares were offered and sold pursuant to Rule 506 of Regulation D of the Securities Act, and no commissions and fees were paid. With respect to the foregoing common stock transactions, we relied on Sections 4(2) and 3(b) of the Securities Act of 1933 and applicable registration exemptions of Rules 504 and 506 of Regulation D and applicable state securities laws.

Item 6. Selected Financial Data.

As a smaller reporting company, we are not required and have not elected to report any information under this item (see Item 8. Financial Statements and Supplementary Data.).

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our Consolidated Financial Statements and notes thereto included in Part II, Item 8 of this Report. The results shown herein are not necessarily indicative of the results to be expected in any future periods. This discussion contains forward-looking statements based on current expectations that involve risks and uncertainties. Actual results and the timing of events could differ materially from the forward-looking statements as a result of a number of factors. For a discussion of the factors that could cause actual results to differ materially from the forward-looking statements, see Item 1A. Risk Factors and our other periodic reports and documents filed with the Securities and Exchange Commission.

Overview

We are an integrated communications provider offering integrated communications and Internet connectivity to individuals, businesses, organizations, educational institutions and government agencies. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, Web hosting, equipment co-location, and traditional telephone service.

Our overall strategy is to become a successful integrated communications provider for residents and small to medium-sized businesses in Oklahoma. We believe that the rural areas of Oklahoma are underserved by Internet service providers, and that significant profitable growth can be achieved in serving these markets by providing reliable

Internet connectivity and value-added services at a reasonable cost to the residents and businesses located in these areas. We believe we can obtain a significant Internet service provider and business-to-business market share in Oklahoma. Our wholly-owned subsidiary, FullTel, is a licensed competitive local exchange carrier or CLEC and provides local telephone numbers for Internet access.

The market for Internet connectivity and related services is extremely competitive. We anticipate that competition will continue to intensify. The tremendous growth and potential market size of the Internet access market has attracted many new start-ups as well as existing businesses from a variety of industries. We believe that a reliable network, knowledgeable sales people and the quality of technical support currently are the primary competitive factors in our targeted market and that price is usually secondary to these factors.

As a provider of telecommunications, we are affected by regulatory proceedings in the ordinary course of our business at the state and federal levels. These include proceedings before both the Federal Communications Commission and the Oklahoma Corporation Commission (OCC). In addition, in our operations we rely on obtaining many of our underlying telecommunications services and/or facilities from incumbent local exchange carriers or other carriers pursuant to interconnection or other agreements or arrangements. In January 2007, we concluded a regulatory proceeding pursuant to the Federal Telecommunications Act of 1996 before the OCC relating to the terms of our interconnection agreement with Southwestern Bell Telephone, L.P. d/b/a AT&T, which succeeds a prior interconnection agreement. The OCC approved this agreement in May 2007. This agreement may be affected by regulatory proceedings at the federal and state levels, with possible adverse impacts on us. We are unable to accurately predict the outcomes of these regulatory proceedings at this time, but an unfavorable outcome could have a material adverse effect on our business, financial condition or results of operations.

Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the years ended December 31, 2011 and 2010:

	For the Years Ended December 31,			
	2011		2010	
	Amount	Percentage of revenues	Amount	Percentage of revenues
Revenues:				
Access service revenues	\$ 233,895	12.5%	\$ 287,773	17.0%
Co-location and other revenues	1,639,979	87.5	1,400,172	83.0
Total revenues	1,873,874	100.0	1,687,945	100.0

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Operating costs and expenses:				
Cost of access service revenues	172,938	9.2	183,435	10.9
Cost of co-location and other revenues	365,926	19.5	389,576	23.1
Selling, general and administrative expenses	1,228,533	65.6	1,381,572	81.8
Depreciation and amortization	54,267	2.9	62,317	3.7
Total operating costs and expenses	1,821,664	97.2	2,016,900	119.5
Income (loss) from operations	52,210	2.8	(328,955)	(19.5)
Other income	37,268	2.0	1,198,510	71.0
Interest expense	(24,148)	(1.3)	(81,675)	(4.8)
Income before income taxes	65,330	3.5	787,880	46.7
Income tax expense	-	-	-	-
Net income	\$ 65,330	3.5%	\$ 787,880	46.7%

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Revenues

Access service revenues decreased \$53,878 or 18.7% to \$233,895 for the year 2011 from \$287,773 for the year 2010 primarily due to a decline in the number of customers.

Co-location and other revenues increased \$239,807 or 17.1% to \$1,639,979 for the year 2011 from \$1,400,172 for the year 2010. This increase was primarily attributable to the net addition of new customers and the sale of additional services to existing customers.

Operating Costs and Expenses

Cost of access service revenues decreased \$10,497 or 5.7% to \$172,938 for the year 2011 from \$183,435 for the year 2010. This decrease was primarily due to reductions in recurring costs associated with our network. Cost of access service revenues as a percentage of access service revenues increased to 73.9% for the year 2011 from 63.7% for the year 2010.

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Cost of co-location and other revenues decreased \$23,650 or 6.1% to \$365,926 for the year 2011 from \$389,576 for the year 2010. This decrease was primarily related to a non-recurring cost in the 2010 Period of \$14,011 in addition to reductions in equipment maintenance costs of \$20,699 and costs of servicing our traditional phone service customers of \$3,024 due to a reduction in the number of customers utilizing that service. These decreases were primarily offset by an increase in recurring rental costs of \$13,885 and an increase in usage of long distance by our traditional phone service customers of \$7,027. Cost of co-location and other revenues as a percentage of co-location and other revenues decreased to 22.3% for the year 2011 from 27.8% for the year 2010.

Selling, general and administrative expenses decreased \$153,039 or 11.1% to \$1,228,533 for the year 2011 from \$1,381,572 for the year 2010. This decrease was primarily related to a voluntary reduction in compensation and the associated payroll tax expense for the top five executive officers in the amount of approximately \$16,787 per month, effective January 1, 2011 resulting in a reduction of \$201,444 for the 2011 Period compared to the 2010 Period. There were also decreases in professional services, supplies and agent commission expenses of \$14,948, \$3,857 and \$2,542, respectively. These decreases were offset primarily by increases in rent, employee costs, advertising, repair and maintenance, miscellaneous, taxes, bad debt and utilities expenses of \$10,003, \$36,085, \$10,461, \$2,842, \$3,159, \$2,982, \$2,018, and \$2,005, respectively. The increase in employee costs of \$36,085 was primarily related to the hiring of an additional employee in 2011. Selling, general and administrative expenses as a percentage of total revenues decreased to 65.6% for the year 2011 from 81.8% for the year 2010.

Depreciation and amortization expense decreased \$8,050 or 12.9% to \$54,267 for the year 2011 from \$62,317 for the year 2010 primarily related to several assets reaching full depreciation.

Other Income

The year 2011 includes \$37,268, representing certain excess telecommunication taxes and fees for which we have filed refund requests with the appropriate state agencies.

During the fourth quarter of 2010, management reviewed all of our outstanding liabilities to determine their enforceability and collectability in light of the applicable statute of limitations. Based upon this review, management concluded that by operation of law \$1,198,510 of our outstanding liabilities were no longer collectable and should be written-off. These uncollectable liabilities consisting of \$455,636 notes payable, \$520,581 accrued interest, \$164,697 accounts payable and \$57,596 common stock issuable were written-off during the fourth quarter to other income.

Interest Expense

Interest expense decreased \$57,527 or 70.4% to \$24,148 for the year 2011 from \$81,675 for the year 2010 primarily related to a decrease in notes payable.

Liquidity and Capital Resources

As of December 31, 2011, we had \$10,987 in cash and \$1,906,132 in current liabilities, including \$173,954 of deferred revenues that will not require settlement in cash.

At December 31, 2011, we had a working capital deficit of \$1,801,314, while at December 31, 2010 we had a deficit working capital of \$1,616,442. We do not have a line of credit or credit facility to serve as an additional source of liquidity. Historically we have relied on shareholder loans as an additional source of funds.

At December 31, 2011, of the \$138,758 we owed to our trade creditors \$36,090 was past due. We have no formal agreements regarding payment of these amounts. At December 31, 2011, \$256,443 payable under a matured lease obligation was outstanding. The lessor has not made any formal demands for payment or instituted collection action; however we are in discussions with the lessor to restructure this liability. At December 31, 2011, we had outstanding principal and interest owed on a matured convertible promissory note totaling \$56,733. We have been making quarterly interest payments on this note and the lender has not made any demands for payment of the principal amount of this note. At December 30, 2011 a secured promissory note matured. We have been making monthly principal and interest payments on this note and the lender has not made any demands for payment of the outstanding principal balance of this note. At December 31, 2011 the outstanding principal and interest owed on this secured promissory note was \$273,796.

In addition, during the years ended December 31, 2011 and 2010, we had one customer that comprised approximately 17% and 14% of total revenues, respectively.

During the fourth quarter of 2010, management reviewed all of our outstanding liabilities to determine their enforceability and collectability in light of the applicable statute of limitations. Based upon this review, management concluded that by operation of law \$1,198,510 of our outstanding liabilities were no longer collectable and should be written-off. These uncollectable liabilities consisting of \$455,636 notes payable, \$520,581 accrued interest, \$164,697 accounts payable and \$57,596 common stock issuable were written-off during the fourth quarter to other income.

Cash flow for the years ending December 31, 2011 and 2010 consist of the following:

	For the Years Ended December 31,	
	2011	2010
Net cash flows provided by operations	\$ 61,751	\$ 25,429
Net cash flows used in investing activities	(46,967)	(26,478)
Net cash flows used in financing activities	(14,653)	-

Cash used for the purchases of equipment was \$36,911 and \$26,478, respectively, for the years ended December 31, 2011 and 2010. Cash used for the acquisition of a business was \$10,056 for the year ended December 31, 2011.

Cash used for principal payments on notes payable was \$23,109 for the year ended December 31, 2011. Cash provided by the exercise of stock options was \$8,456 for the year ended December 31, 2011.

The planned expansion of our business will require significant capital to fund capital expenditures, working capital needs, and debt service. Our principal capital expenditure requirements will include:

- mergers and acquisitions and

- further development of operations support systems and other automated back office systems.

Because our cost of developing new networks and services, funding other strategic initiatives, and operating our business depend on a variety of factors (including, among other things, the number of subscribers and the service for which they subscribe, the nature and penetration of services that may be offered by us, regulatory changes, and actions taken by competitors in response to our strategic initiatives), it is almost certain that actual costs and revenues will materially vary from expected amounts and these variations are likely to increase our future capital requirements. Our

current cash balances will not be sufficient to fund our current business operations beyond a few months. As a consequence, we are currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. We continue to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund our liquidity needs. There is no assurance that we will be able to obtain additional capital on satisfactory terms or at all or on terms that will not dilute our shareholders interests.

Until we obtain sufficient additional capital, the further development of our network will be delayed or we will be required to take other actions. Our inability to obtain additional capital resources has had and will continue to have a material adverse effect on our business, operating results and financial condition.

Our ability to fund the capital expenditures and other costs contemplated by our business plan and to make scheduled payments with respect to borrowings will depend upon, among other things, our ability to seek and obtain additional financing in the near term. Capital will be needed in order to implement our business plan, deploy our network, expand our operations and obtain and retain a significant number of customers in our target markets. Each of these factors is, to a large extent, subject to economic, financial, competitive, political, regulatory, and other factors, many of which are beyond our control.

There is no assurance that we will be successful in developing and maintaining a level of cash flows from operations sufficient to permit payment of our outstanding indebtedness. If we are unable to generate sufficient cash flows from operations to service our indebtedness, we will be required to modify or abandon our growth plans, limit our capital expenditures, restructure or refinance our indebtedness or seek additional capital or liquidate our assets. There is no assurance that (i) any of these strategies could be effectuated on satisfactory terms, if at all, or on a timely basis or (ii) any of these strategies will yield sufficient proceeds to service our debt or otherwise adequately fund operations.

As of December 31, 2011, our material contractual obligations and commitments were:

	Total	Payments Due By Period			
		Less than 1 Year	1 3 Years	3 5 Years	More than 5 Years
Long-term debt (a)	\$ 328,078	\$ 328,078	\$	\$	\$
Interest on fixed rate debt (a)	2,451	2,451			
Operating leases	587,070	189,167	397,903		
Other agreements (b)	256,443	256,443			
Total contractual cash obligations	\$ 1,174,042	\$ 776,139	\$ 397,903	\$	\$

- (a) Included in this item is payment under a \$273,078 secured promissory note payable that matured on December 30, 2011. Also included is payment under a convertible promissory note of \$55,000 that was matured at December 31, 2011. These notes are included in the Less than One Year total. We continue to make monthly principal and interest payments on the secured promissory note. The lender has not made any demands for payment of the outstanding principal balance of this note. We have been making quarterly interest payments on the convertible promissory note. We have not negotiated an extension of the convertible promissory note and the lender has not made any demands for payment of the principal amount of this note.
- (b) This item represents a matured lease obligation. The lessor has not made any formal demands for payment or instituted collection action; however we are in discussions with the lessor to restructure this liability.

Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect certain reported amounts and disclosures. In applying these accounting principles, we must often make individual estimates and assumptions regarding expected outcomes or uncertainties. As might be expected, the actual results or outcomes are generally different than the estimated or assumed amounts. These differences are usually minor and are included in our consolidated financial statements as soon as they are known. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

We periodically review the carrying value of our intangible assets when events and circumstances warrant such a review. One of the methods used for this review is performed using estimates of future cash flows. If the carrying value of our intangible assets is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the intangible assets exceeds its fair value. We believe that the estimates of future cash flows and fair value are reasonable. Changes in estimates of these cash flows and fair value, however, could affect the calculation and result in additional impairment charges in future periods.

We periodically review the carrying value of our property and equipment whenever business conditions or events indicate that those assets may be impaired. If the estimated future undiscounted cash flows to be generated by the property and equipment are less than the carrying value of the assets, the assets are written down to fair market value and a charge is recorded to current operations. Significant and unanticipated changes in circumstances, including significant adverse changes in business climate, adverse actions by regulators, unanticipated competition, loss of key customers and/or changes in technology or markets, could require a provision for impairment in a future period.

We review loss contingencies and evaluate the events and circumstances related to these contingencies. We disclose material loss contingencies that are possible or probable, but cannot be estimated. For loss contingencies that are both

estimable and probable the loss contingency is accrued and expense is recognized in the financial statements.

Access service revenues are recognized on a monthly basis over the life of each contract as services are provided. Contract periods range from monthly to yearly. Carrier-neutral telecommunications co-location revenues and traditional telephone services are recognized on a monthly basis over the life of the contract as services are provided. Revenue that is received in advance of the services provided is deferred until the services are provided by us. Revenue related to set up charges is also deferred and amortized over the life of the contract. We classify certain taxes and fees billed to customers and remitted to governmental authorities on a net basis in revenue.

We began billing AT&T (formerly SBC) reciprocal compensation (fees for terminating AT&T customer's local calls onto our network) during 2004, and have billed for the periods of March 2003 through June 2006. AT&T failed to pay and is disputing approximately \$183,700. We are pursuing AT&T for all balances due, however there is significant uncertainty as to whether or not we will be successful. Upon the ultimate resolution of AT&T's challenge, we will recognize the associated revenue, if any. We do not expect reciprocal compensation to be a significant or a long-term revenue source.

Certain Accounting Matters

Fair Value Measurements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). This pronouncement was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This pronouncement is effective for reporting periods beginning on or after December 15, 2011, with early adoption prohibited. The new guidance will require prospective application. The adoption of this updated authoritative guidance is not expected to have a significant impact on our Consolidated Financial Statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

As a smaller reporting company, we are not required and have not elected to report any information under this item.

Item 8. Financial Statements and Supplemental Data.

Our financial statements, prepared in accordance with Regulation S-K, are set forth in this Report beginning on page F-1.

Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure.

During 2011 and 2010, we did not have disagreements with our principal independent accountants.

Item 9A. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer are responsible primarily for establishing and maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the U.S. Securities and Exchange Commission. These controls and procedures are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Furthermore, our Chief Executive Officer and Chief Financial Officer are responsible for the design and supervision of our internal controls over financial reporting that are then effected by and through our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. These policies and procedures

pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Our Executive Officer and Chief Financial Officer conducted their evaluation using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Based upon their evaluation of the effectiveness of our disclosure controls and procedures and the internal controls over financial reporting as of the last day of the period covered by this Report, they concluded that our disclosure controls and procedures and internal controls over financial reporting were fully effective during and as of the last day of the period covered by this Report and reported to our auditors and the audit committee of our board of directors that no change in our disclosure controls and procedures and internal control over financial reporting occurred during the period covered by this Report that would have materially affected or is reasonably likely to materially affect our disclosure controls and procedures or internal control over financial reporting. In conducting their evaluation of our disclosure controls and procedures and internal controls over financial reporting, these executive officers did not discover any fraud that involved management or other employees who have a significant role in our disclosure controls and procedures and internal controls over financial reporting. Furthermore, there were no significant changes in our disclosure controls and procedures, internal controls over financial reporting, or other factors that could significantly affect our disclosure controls and procedures or internal controls over financial reporting subsequent to the date of their evaluation. Because no significant deficiencies or material weaknesses were discovered, no corrective actions were necessary or taken to correct significant deficiencies and material weaknesses in our internal controls and disclosure controls and procedures.

Table of Contents**PART III.****Item 10. Directors, Executive Officers, and Corporate Governance.**

The following information is furnished as of March 26, 2012 for each person who serves on our Board of Directors or serves as one of our executive officers. Our Board of Directors currently consists of two members, although we intend to increase the size of the Board in the future. The directors serve one-year terms until their successors are elected. Our executive officers are elected annually by our Board. The executive officers serve terms of one year or until their death, resignation or removal by our Board. There are no family relationships between our directors and executive officers. In addition, there was no arrangement or understanding between any executive officer and any other person pursuant to which any person was selected as an executive officer.

Name	Age	Position
Timothy J. Kilkenny	53	Chairman of the Board of Directors and Chief Executive Officer
Roger P. Baresel	56	Director, President, Chief Financial Officer and Secretary
Jason C. Ayers	37	Vice President of Operations
Patricia R. Shurley	55	Vice President of Finance
Michael D. Tomas	39	Vice President of Technology

Timothy J. Kilkenny has served as our Chief Executive Officer and Chairman of the Board of Directors since our inception in May 1995. Prior to that time, he spent 14 years in the financial planning business as a manager for both MetLife and Prudential. Mr. Kilkenny is a graduate of Central Bible College in Springfield, Missouri.

Roger P. Baresel became one of our directors and our Chief Financial Officer on November 9, 2000, and our President on October 13, 2003. In addition, Mr. Baresel served as the Chief Financial Officer of Labock Technologies, Inc., an unrelated privately held corporation active in the defense contracting sector, from January 2007 to March 2008 and as their Chief Operating Officer from Mar 2007 to March 2008. He also served as the Chief Financial Officer of Advanced Blast Protection, Inc. (ABP), an unrelated privately held corporation active in the defense contracting sector, from January 2008 to November 30, 2009. ABP filed for protection under Chapter 11 of the U.S. Bankruptcy code on November 2, 2009. Mr. Baresel is an accomplished senior executive and consultant who has served at a variety of companies. While serving as President and CFO of Advantage Marketing Systems, Inc., a publicly-held company engaged in the multi-level marketing of healthcare and dietary supplements, from June 1995 to May 2000, annual sales increased from \$2.5 million to in excess of \$22.4 million and annual earnings increased from \$80,000 to

more than \$1.2 million. Also, during this period Advantage successfully completed two public offerings, four major acquisitions and its stock moved from the over the counter bulletin board to the American Stock Exchange. Mr. Baresel has the following degrees from Central State University in Edmond, Oklahoma: BA Psychology, BS Accounting and MBA Finance, in which he graduated Summa Cum Laude. Mr. Baresel is also a certified public accountant.

Jason C. Ayers has been our Vice President of Operations since December 8, 2000 and prior to that served as President of Animus, a privately-held web hosting company which we acquired on April 1, 1998. Mr. Ayers received a BS degree from Southern Nazarene University in Bethany, Oklahoma in May 1996 with a triple major in Computer Science, Math and Physics. Upon graduating, he was a co-founder of Animus.

Patricia R. Shurley has been our Vice President of Finance since May 2001. Prior to that, she served for three years as the Controller for Advantage Marketing Systems, Inc., a publicly-held company engaged in the multi-level marketing of healthcare and dietary supplements. Prior to that she was self-employed and owned an accounting practice. She graduated from the University of Central Oklahoma in Edmond, Oklahoma with a BS degree in Accounting and is a certified public accountant.

Michael D. Tomas has been our Vice President of Technology since September 2003. Prior to that, he was our Information Systems Manager since June 1999 and our employee since July 1996. Mr. Tomas has formal training with Cisco, Win 3.1, Win95/98, and Windows NT 4.0 as well as LAN/WAN setup, including experience with wireless networking and is Lucent certified.

Table of Contents

Audit Committee Financial Expert

Because our board of directors only consists of two directors, each of whom does not qualify as an independent director; our board performs the functions of an audit committee. Our board of directors has determined that Roger P. Baresel, our President and Chief Financial Officer qualifies as a financial expert. This determination was based upon Mr. Baresel's

- understanding of generally accepted accounting principles and financial statements;

- ability to assess the general application of generally accepted accounting principles in connection with the accounting for estimates, accruals and reserves;

- experience preparing, auditing, analyzing or evaluating financial statements that present the breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by our financial statements, or experience actively supervising one or more persons engaged in such activities;

- understanding of internal controls and procedures for financial reporting; and

- understanding of audit committee functions.

Mr. Baresel's experience and qualification as a financial expert were acquired through the active supervision of a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions and overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements.

Mr. Baresel is not an independent director. We have been unable to attract a person to serve as one of our directors and that would qualify both as an independent director and as a financial expert because of inability to compensate our directors and provide liability insurance protection.

Compliance with Section 16(a) of the Exchange Act, Beneficial Ownership Reporting Requirements

Section 16(a) of the Securities and Exchange Act of 1934, as amended, requires our directors and executive officers and any persons who own more than 10% of a registered class of our equity securities to file with the Securities and Exchange Commission (SEC) and each exchange on which our securities are listed, reports of ownership and subsequent changes in ownership of our common stock and our other securities. Officers, directors and greater than 10% stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file. Based solely on review of the copies of such reports furnished to us or written representations that no other reports were required, we believe that during 2011 all filing requirements applicable to our officers, directors and greater than 10% beneficial owners were met.

Code of Ethics

On March 25, 2003, our board of directors adopted our code of ethics that applies to all of our employees and directors, including our principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions. Our code of ethics may be found on our website at www.fullnet.net. We will describe the nature of amendments to the code on our website, except that we may not describe amendments that are purely a technical, administrative, or otherwise non-substantive. We will also disclose on our website any waivers from any provision of the code that we may grant. We will also disclose on our website any violation of the code by our principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions. Information about amendments and waivers to the code will be available on our website for at least 12 months, and thereafter, the information will be available upon request for five years.

Table of Contents**Item 11. Executive Compensation**

The following table sets forth, for the last three fiscal years, the cash compensation paid by us to our Chairman and Chief Executive Officer and Chief Financial Officer (the Named Executive Officers). None of our executive officers earned annual compensation in excess of \$100,000 during 2011.

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation Securities Underlying Options and Warrants (#) (1)
		Salary		Other Compensation	
Timothy J. Kilkenney Chairman and CEO	2011	\$ 61,658		\$ 30,570 (2)(1)	332,000
	2010	\$ 108,620	(3)	\$ 30,106 (4)	
	2009	\$ 108,902	(5)	\$ 28,936 (6)	
Roger P. Baresel President and CFO	2011	\$ 51,006		\$ 35,457 (7)(1)	361,197
	2010	\$ 101,604	(8)	\$ 31,221 (9)	
	2009	\$ 81,504	(10)	\$ 32,053 (11)	

(1) Options are granted with an exercise price equal to the fair market value of our common stock on the date of the grant and are valued based on the Black-Scholes option pricing model.

(2) Represents \$10,351 of expense reimbursement for business use of Mr. Kilkenney's automobile and parking, \$1,800 of expense reimbursement for Mr. Kilkenney's Internet connection and cell phone, \$15,339 of insurance premiums, \$633 of post retirement benefits paid by us for the benefit of Mr. Kilkenney, and \$2,447 of stock options issued to Mr. Kilkenney.

(3) Includes \$42,868 of deferred compensation.

(4) Represents \$8,400 of expense reimbursement for business use of Mr. Kilkenney's automobile, \$1,800 of expense reimbursement for Mr. Kilkenney's Internet connection and cell phone, \$17,893 of insurance premiums, and \$2,013 of post retirement benefits paid by us for the benefit of Mr. Kilkenney.

- (5) Includes \$40,121 of deferred compensation.
- (6) Represents \$8,400 of expense reimbursement for business use of Mr. Kilkenny's automobile, \$1,800 of expense reimbursement for Mr. Kilkenny's Internet connection and cell phone, \$16,614 of insurance premiums, and \$2,122 of post retirement benefits paid by us for the benefit of Mr. Kilkenny.
- (7) Represents \$9,120 of expense reimbursement for business use of Mr. Baresel's automobile and parking, \$5,221 of expense reimbursement for Mr. Baresel's home office and cell phone, \$18,397 of insurance premiums, and \$2,719 of stock options issued to Mr. Baresel.
- (8) Includes \$53,479 of deferred compensation.
- (9) Represents \$9,120 of expense reimbursement for business use of Mr. Baresel's automobile and parking, \$4,560 of expense reimbursement for Mr. Baresel's home office and cell phone, and \$17,541 of insurance premiums
- (10) Includes \$32,254 of deferred compensation.
- (11) Represents \$8,400 of expense reimbursement for business use of Mr. Baresel's automobile, \$4,560 of expense reimbursement for Mr. Baresel's home office and cell phone, \$17,422 of insurance premiums, and \$1,671 of post retirement benefits paid by us for the benefit of Mr. Baresel.

Stock Options Granted

All options granted during 2011 are nonqualified stock options. During 2011, an aggregate of 1,321,697 options were granted outside of a formal plan to employees. This included stock options exercisable for the purchase of 332,000 and 361,197 shares of our common stock granted to Mr. Kilkenny and Mr. Baresel, respectively, during 2011.

Options granted generally become exercisable in part after one year from the date of grant and generally have a term of ten years following the date of grant, unless sooner terminated in accordance with the terms of the stock option agreement.

2011 Year End Option Values

The following table sets forth information related to the exercise of stock options during 2011 and the number and value of options held by the following Named Executive Officers at December 31, 2011. During 2011, Mr. Kilkenny and Mr. Baresel exercised 332,000 and 361,197 options, respectively, and 82,000 and 161,197 of their options expired, respectively. We did not reprice any outstanding options. For the purposes of this table, the value of an option is the difference between the estimated fair market value at December 31, 2011 of the shares of common stock subject to the option and the aggregate exercise price of such option.

Name	Number of Unexercised Options at December 31, 2011		Value of Unexercised In-the-Money Options at December 31, 2011 (1)	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Timothy J. Kilkenny Chairman and CEO	532,000		\$	\$
Roger P. Baresel President and CFO	240,848		\$	\$

(1) Based on the closing sale price on December 28, 2011 of our common stock of \$.003 per share.

Table of Contents

Aggregate Stock Option Exercise

The following table sets forth information related to the number of stock options held by the named executive officers at December 31, 2011. During 2011, Mr. Kilkenny and Mr. Baresel exercised 332,000 and 361,197 options, respectively, and 82,000 and 161,197 of their options expired, respectively.

Outstanding Equity Awards at December 31, 2011

Name	Stock Option Awards		Option Exercise Price(1)	Option Expiration Date
	Number of Common Stock Underlying Options Exercisable	Unexercisable		
Timothy J. Kilkenny	452,000		\$.04	10/09/13
Chairman and CEO	80,000		\$.05	03/18/12
Roger P. Baresel	200,848		\$.04	10/09/13
President and CFO	40,000		\$.05	03/18/12

(1) The closing sale price of our common stock as reported on the OTC Bulletin Board on December 31, 2011 was \$0.003

Director Compensation

During the fiscal year ended December 31, 2011, our directors did not receive any compensation for serving in such capacities.

Employment Agreements and Lack of Keyman Insurance

On July 6, 2011, we entered into employment agreements with Timothy J. Kilkenny, Roger P. Baresel and Jason Ayers. Each agreement is effective July 1, 2011 and continues through December 31, 2016; however, the term is automatically extended for additional three-year terms, unless we or the employee gives a six-month advance notice of termination. These agreements provide, among other things, (i) an annual base salary of at least \$61,656 for Mr. Kilkenny, \$45,012 for Mr. Baresel and \$68,436 for Mr. Ayers, (ii) bonuses at the discretion of the Board of Directors, (iii) entitlement to fringe benefits including medical and insurance benefits as may be provided to our other senior officers; and (iv) eligibility to participate in our incentive, bonus, benefit or similar plans. These agreements require the employee to devote the required time and attention to our business and affairs necessary to carry out his responsibilities and duties. These agreements may be terminated under certain circumstances and upon termination provide for (i) the employee to be released from personal liability for our debts and obligations, and (ii) the payment of any amounts we owe the employee.

We do not maintain any keyman insurance covering the death or disability of our executive officers.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The following table sets forth information as of March 28, 2012, concerning the beneficial ownership of our Common Stock by each of our directors, each executive officer named in the table under the heading Item 10. Directors and Executive Officers, and Corporate Governance and all of our directors and executive officers as a group, as well as each person who is known by us to own more than 5% of the outstanding shares of our Common Stock. The non-employee beneficial owner information is based on Schedules 13D or 13G filed by the applicable beneficial owner with the Securities and Exchange Commission or other information provided to us by the beneficial owner or our stock transfer agent. Unless otherwise indicated, the beneficial owner has sole voting and investment power with respect to such stock.

Beneficial Owner (1)	Common Stock Beneficially Owned	
	Number of Shares	Percent of Class (1)
Timothy J. Kilkenny* (2)(3)	2,648,722	27.7%
Roger P. Baresel* (2)(4)	695,362	7.5%
Jason C. Ayers (2)(5)	505,795	5.6%
Patricia R. Shurley (6)	342,000	3.8%
Michael D. Tomas (7)	295,000	3.3%
All executive officers and directors as a group (5 individuals)	4,486,879	47.9%
High Capital Funding, LLC (8)		
333 Sandy Springs Circle, Suite 230, Atlanta, Georgia 30328	907,664	9.9%

* Director

(1) Percent of class for any stockholder listed is calculated without regard to shares of common stock issuable to others upon exercise of outstanding stock options. Any shares a stockholder is deemed to own by having the right to acquire by exercise of an option or warrant are considered to be outstanding

solely for the purpose of calculating that stockholder's ownership percentage. We computed the percentage ownership amounts in accordance with the provisions of Rule 13d-3(d), which includes as beneficially owned all shares of common stock which the person or group has the right to acquire within the next 60 days, based upon 8,978,161 shares being outstanding at March 28, 2012.

- (2) Address is c/o 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102.
- (3) Timothy J. Kilkenny and Barbara J. Kilkenny, husband and wife, hold 1,881,722 and 315,000 shares of our common stock, respectively. The number of shares includes 452,000 shares of our common stock that are subject to currently exercisable stock options held by Mr. Kilkenny.
- (4) Roger P. Baresel and Judith A. Baresel, husband and wife, hold 109,350 and 385,164 shares of our common stock, respectively. The number of shares includes 200,848 shares of our common stock subject to currently exercisable stock options held by Mrs. Baresel.
- (5) Jason C. Ayers holds 505,795 shares of our common stock.
- (6) Patricia R. Shurley holds 342,000 shares of our common stock.
- (7) Michael D. Tomas holds 295,000 shares of our common stock.
- (8) High Capital Funding, LLC, the parent company of Generation Capital Associates, holds 497,156 shares of our common stock. Generation Capital Associates holds 267,608 shares of our common stock. The number of shares includes 142,900 shares of our common stock that are subject to currently exercisable common stock purchase warrants held by Generation Capital Associates. Amounts shown do not include 422,100 shares of our common stock that are subject to common stock purchase warrants that are not currently exercisable because they contain a provision prohibiting their exercise to the extent that they would increase Generation Capital Associates percentage ownership beyond 9.9% of our outstanding shares of common stock. We have a secured promissory note with High Capital Funding, LLC and an operating lease with Generation Capital Associates. At December 31, 2011 the outstanding principal and interest of the secured promissory note was \$273,796 and we had recorded \$256,443 in unpaid lease payments.

Table of Contents**Item 13. Certain Relationships and Related Transactions, and Director Independence**

We have an operating lease for certain equipment which is leased from Generation Capital Associates, one of our greater than 5% shareholders. The terms of the original lease, dated November 21, 2001, required rental payments of \$6,088 per month for 12 months with a fair market purchase option at the end of the lease. Upon default on the lease, we were allowed to continue leasing the equipment on a month-to-month basis at the same monthly rate as the original lease. We were unable to make the month-to-month payments. In January and November 2006, we agreed to extend the expiration date on 425,000 and 140,000, respectively, of common stock purchase warrants for the lessor in return for a credit of \$17,960 and \$3,940, respectively, on the operating lease. In September 2007, the lessor agreed to cease the monthly lease payments effective January 1, 2007 which generated a total of \$54,795 of forgiveness of debt income. The lessor also agreed to accept payments of \$499 per month on the balance owed. In January and December 2009, we agreed to extend the expiration date on 425,000 and 140,000, respectively, of common stock purchase warrants for the lessor in return for a credit of \$3,445 and \$773, respectively, on the operating lease. At December 31, 2011 we had recorded \$256,443 in unpaid lease payments. The loss of this equipment would have a material adverse effect on our business, financial condition and results of operations. We have been unable to make all of the required payments pursuant to the terms of the September 2007 agreement. The lessor has not made any formal demands for payment or instituted collection action; however we are in discussions with the lessor to restructure this liability.

We also had an interim loan with the above shareholder which required payments equal to 50% of the net proceeds received by us from our private placement of convertible promissory notes. This interim loan matured in December 2001. In September 2007, the lender agreed to accept monthly payments of \$5,800 beginning in December 2007 to be allocated 50% to principal and 50% to interest. We were unable to make all of the required payments pursuant to the terms of the September 2007 agreement. Beginning in June 2009, the lender agreed to accept temporary reduced monthly payments of \$1,000 until such time as our financial position significantly improves. We were unable to make all of the reduced monthly payments. In October 2009 the lender assigned the interim loan to its parent company. In December 2009 the parent company agreed to convert \$248,578 of accrued interest on the interim loan into 497,156 restricted shares of our common stock valued at \$.50 per share (the Conversion). These shares were issuable at December 31, 2009, were equal to approximately 6.8% of the total number of shares outstanding and were issued in January 2010. This transaction was accounted for as a troubled debt restructuring and a gain on debt forgiveness of \$235,663 was recorded. In December 2009 the parent company further agreed to make a new loan to us in the amount of \$297,300. This loan is secured by all our tangible and intangible assets. The terms of this secured promissory note requires monthly installments of interest only for the first year then monthly installments of \$3,301 including principal and interest. The proceeds from this secured promissory note were used to repay the remaining principal amount of the interim loan of \$292,300. In connection with the Conversion, we also agreed to issue additional shares of stock to the parent company in the event that any additional shares are issued at less than \$.50 per share, excluding employee stock options, prior to the payment in full of the secured promissory note. In December 2011, we agreed to extend the expiration date on 150,000 and 275,000 common stock purchase warrants with exercise prices of \$.01 and \$1.00, respectively, from January 2, 2012 to January 2, 2015 and adjusted the exercise prices to \$.003 in return for a credit of \$1,113 on the outstanding principal balance of the secured promissory note.

This secured promissory note matured on December 30, 2011. We continue to make monthly principal and interest payments. The lender has not made any demands for payment of the outstanding principal balance of this note. At December 31, 2011, the outstanding principal and accrued interest of the secured promissory note was \$273,796.

Item 14. Principal Accounting Fees and Services

The following table sets forth the aggregate fees, including expenses, billed to us for the years ended December 31, 2011 and 2010 by our principal accountant.

	2011	2010
Audit Fees Hood & Associates, CPAs, PC	\$ 32,000	\$ 2,000
Tax Fees	2,000	
All Other Fees	2,034	

The audit fees include services rendered by our principal accountant for the audit of our financial statements, review of financial statements included in our quarterly reports and other fees that are normally provided by the accountant in connection with statutory and regulatory filings or engagements. Because our Board of Directors only consists of two directors, each of whom does not qualify as an independent director; our Board of Directors performs the functions of an audit committee. It is our policy that the Board of Directors pre-approve all audit, tax and related services. All of the services described above in this Item 14 were approved in advance by our Board of Directors. No items were approved by the Board of Directors pursuant to paragraph (c)(7)(ii)(C) of Rule 2-01 of Regulation S-X.

Table of Contents**Item 15. Exhibits, Financial Statement Schedules.**

(a) The following exhibits are filed as part of this Report:

<i>Exhibit Number</i>	<i>Exhibit</i>	
3.1	Certificate of Incorporation, as amended (filed as Exhibit 2.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
3.2	Bylaws (filed as Exhibit 2.2 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference)	#
4.1	Specimen Certificate of Registrant's Common Stock (filed as Exhibit 4.1 to the Company's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
4.2	Certificate of Correction to the Amended Certificate of Incorporation and the Ninth Section of the Certificate of Incorporation (filed as Exhibit 2.1 to Registrant's Registration Statement on form 10-SB, file number 000-27031 and incorporated by reference).	#
4.3	Certificate of Correction to Articles II and V of Registrant's Bylaws (filed as Exhibit 2.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
4.4	Form of Warrant Agreement for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.1 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.5	Form of Warrant Certificate for Florida Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.2 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.6	Form of Promissory Note for Florida Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.3 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.7	Form of Warrant Certificate for Georgia Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.4 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.8	Form of Promissory Note for Georgia Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.5 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000	#

and incorporated herein by reference).

- 4.9 Form of Warrant Certificate for Illinois Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.6 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference). #
- 4.10 Form of Promissory Note for Illinois Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.7 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference). #

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	
4.11	Form of Warrant Agreement for Interim Financing in the amount of \$500,000 (filed as Exhibit 4.8 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.12	Form of Warrant Certificate for Interim Financing in the amount of \$500,000 (filed as Exhibit 4.9 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.13	Form of Promissory Note for Interim Financing in the amount of \$500,000 (filed as Exhibit 4.10 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.14	Form of Convertible Promissory Note for September 29, 2000, private placement (filed as Exhibit 4.13 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000 and incorporated herein by reference).	#
4.15	Form of Warrant Agreement for September 29, 2000, private placement (filed as Exhibit 4.13 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000 and incorporated herein by reference).	#
4.16	Form of 2001 Exchange Warrant Agreement (filed as Exhibit 4.16 to Registrant's Form 10-QSB for the quarter ended June 30, 2001 and incorporated herein by reference)	#
4.17	Form of 2001 Exchange Warrant Certificate (filed as Exhibit 4.17 to Registrant's Form 10-QSB for the quarter ended June 30, 2001 and incorporated herein by reference)	#
10.1	Financial Advisory Services Agreement between the Company and National Securities Corporation, dated September 17, 1999 (filed as Exhibit 10.1 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.2	Lease Agreement between the Company and BOK Plaza Associates, LLC, dated December 2, 1999 (filed as Exhibit 10.2 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.3	Interconnection agreement between Registrant and Southwestern Bell dated March 19, 1999 (filed as Exhibit 6.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
10.4	Stock Purchase Agreement between the Company and Animus Communications, Inc. (filed as Exhibit 6.2 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#

- 10.5 Registrar Accreditation Agreement effective February 8, 2000, by and between Internet Corporation for Assigned Names and Numbers and FullWeb, Inc. d/b/a FullNic f/k/a Animus Communications, Inc. (filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference). #
- 10.6 Master License Agreement For KMC Telecom V, Inc., dated June 20, 2000, by and between FullNet Communications, Inc. and KMC Telecom V, Inc. (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference). #
- 10.7 Domain Registrar Project Completion Agreement, dated May 10, 2000, by and between FullNet Communications, Inc., FullWeb, Inc. d/b/a FullNic and Think Capital (filed as Exhibit 10.2 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference). #

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	<i>#</i>
10.8	Amendment to Financial Advisory Services Agreement between Registrant and National Securities Corporation, dated April 21, 2000 (filed as Exhibit 10.3 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference).	#
10.9	Asset Purchase Agreement dated June 2, 2000, by and between FullNet of Nowata and FullNet Communications, Inc. (filed as Exhibit 99.1 to Registrant's Form 8-K filed on June 20, 2000 and incorporated herein by reference).	#
10.10	Asset Purchase Agreement dated February 4, 2000, by and between FullNet of Bartlesville and FullNet Communications, Inc. (filed as Exhibit 2.1 to Registrant's Form 8-K filed on February 18, 2000 and incorporated herein by reference).	#
10.11	Agreement and Plan of Merger Among FullNet Communications, Inc., FullNet, Inc. and Harvest Communications, Inc. dated February 29, 2000 (filed as Exhibit 2.1 to Registrant's Form 8-K filed on March 10, 2000 and incorporated herein by reference).	#
10.12	Asset Purchase Agreement dated January 25, 2000, by and between FullNet of Tahlequah, and FullNet Communications, Inc. (filed as Exhibit 2.1 to Registrant's Form 8-K filed on February 9, 2000 and incorporated herein by reference).	#
10.13	Promissory Note dated August 2, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.13 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.14	Warrant Agreement dated August 2, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.14 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.15	Warrant Certificate dated August 2, 2000 issued to Timothy J. Kilkenny (filed as Exhibit 10.15 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.16	Stock Option Agreement dated December 8, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.16 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.17	Warrant Agreement dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.17 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.18	Warrant Agreement dated December 29, 2000, issued to Roger P. Baresel (filed as Exhibit 10.18 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.19	Stock Option Agreement dated February 29, 2000, issued to Wallace L Walcher (filed as Exhibit 10.19 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.20	Stock Option Agreement dated February 17, 1999, issued to Timothy J. Kilkenny (filed as Exhibit 3.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and	#

incorporated herein by reference).

- 10.21 Stock Option Agreement dated October 19, 1999, issued to Wesdon C. Peacock (filed as Exhibit 10.21 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000). #
- 10.22 Stock Option Agreement dated April 14, 2000, issued to Jason C. Ayers (filed as Exhibit 10.22 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000). #
- 10.23 Stock Option Agreement dated May 1, 2000, issued to B. Don Turner (filed as Exhibit 10.23 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000). #

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	<i>#</i>
10.24	Form of Stock Option Agreement dated December 8, 2000, issued to Jason C. Ayers, Wesdon C. Peacock, B. Don Turner and Wallace L. Walcher (filed as Exhibit 10.24 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.25	Warrant Certificate Dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.25 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.26	Warrant Certificate Dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.26 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.27	Warrant Certificate Dated December 29, 2000, issued to Roger P. Baresel (filed as Exhibit 10.27 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.28	Stock Option Agreement dated October 13, 2000, issued to Roger P. Baresel (filed as Exhibit 10.28 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.29	Stock Option Agreement dated October 12, 1999, issued to Travis Lane (filed as Exhibit 10.29 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.30	Promissory Note dated January 5, 2001, issued to Generation Capital Associates (filed as Exhibit 10.30 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.31	Placement Agency Agreement dated November 8, 2000 between FullNet Communications, Inc. and National Securities Corporation (filed as Exhibit 10.31 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.32	Promissory Note dated January 25, 2000, issued to Fullnet of Tahlequah, Inc.	#
10.33	Promissory Note dated February 7, 2000, issued to David Looper	#
10.34	Promissory Note dated February 29, 2000, issued to Wallace L. Walcher	#
10.35	Promissory Note dated June 2, 2000, issued to Lary Smith	#
10.36	Promissory Note dated June 15, 2001, issued to higganbotham.com L.L.C.	#
10.37	Promissory Note dated November 19, 2001, issued to Northeast Rural Services	#
10.38	Promissory Note dated November 19, 2001, issued to Northeast Rural Services	#
10.39	Form of Convertible Promissory Note dated September 6, 2002	#

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	
10.40	Employment Agreement with Timothy J. Kilkenny dated July 31, 2002	#
10.41	Employment Agreement with Roger P. Baresel dated July 31, 2002	#
10.42	Secured Promissory Note and Security Agreement dated December 30, 2009, issued to High Capital Funding, LLC	#
10.43	Form 8-K dated January 30, 2003 reporting the change in certifying accountant.	#
10.44	Form 8-K dated September 20, 2005 reporting the change in certifying accountant.	#
10.45	Secured Promissory Note and Security Agreement dated December 30, 2009, issued to High Capital Funding, LLC	#
10.46	Employment Agreement with Jason Ayers dated January 1, 2011	#
10.47	Employment Agreement with Timothy J. Kilkenny dated July 6, 2011	#
10.48	Employment Agreement with Roger P. Baresel dated July 6, 2011	#
10.49	Employment Agreement with Jason Ayers dated July 6, 2011	#
21.1	Subsidiaries of the Registrant	#
31.1	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Timothy J. Kilkenny	*
31.2	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Roger P. Baresel	*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Timothy J. Kilkenny	*
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Roger P. Baresel	*

Incorporated by reference.

* Filed herewith.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Exchange Act, the Registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

REGISTRANT:

FULLNET COMMUNICATIONS, INC.

Date: March 29, 2012

By: /s/ TIMOTHY J. KILKENNY
Timothy J. Kilkenny
Chief Executive Officer

Date: March 29, 2012

By: /s/ ROGER P. BARESEL
Roger P. Baresel
President and Chief Financial and
Accounting Officer

Pursuant to the requirements of the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date: March 29, 2012

By: /s/ TIMOTHY J. KILKENNY
Timothy J. Kilkenny
Chairman of the Board and Director

Date: March 29, 2012

By: /s/ ROGER P. BARESEL
Roger P. Baresel
Director

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee

FullNet Communications, Inc

Oklahoma City, Oklahoma

We have audited the accompanying consolidated balance sheets of FullNet Communications, Inc. for the year ended December 31, 2011 and 2010 and the related statements of operations, shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards of the Public Company Oversight Board (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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FullNet Communications, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note A to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency, which raises substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note A. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Hood & Associates CPAs, P.C.

Hood & Associates CPAs, P.C.

Certified Public Accountants

March 29, 2012

Tulsa, Oklahoma

Table of Contents**FullNet Communications, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2011	2010
ASSETS		
CURRENT ASSETS		
Cash	\$ 10,987	\$ 10,856
Accounts receivable, net	79,537	16,119
Prepaid expenses and other current assets	14,294	6,092
Total current assets	104,818	33,067
PROPERTY AND EQUIPMENT, net	78,141	86,065
OTHER ASSETS	5,912	5,288
TOTAL	\$ 188,871	\$ 124,420
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$ 395,201	\$ 399,882
Accrued and other liabilities, current portion	1,008,899	1,038,311
Notes payable, current portion	328,078	77,452
Deferred revenue	173,954	133,864
Total current liabilities	1,906,132	1,649,509
ACCRUED AND OTHER LIABILITIES, less current portion	23,484	18,265
NOTES PAYABLE, less current portion	-	274,848
Total liabilities	1,929,616	1,942,622
STOCKHOLDERS DEFICIT		
Common stock \$.00001 par value; authorized, 10,000,000 shares; issued and outstanding, 8,978,161 and 7,852,464 in 2011 and 2010, respectively	90	79

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Additional paid-in capital	8,409,945	8,397,829
Accumulated deficit	(10,150,780)	(10,216,110)
Total stockholders' deficit	(1,740,745)	(1,818,202)
TOTAL	\$ 188,871	\$ 124,420

See accompanying notes to financial statements.

Table of Contents**FullNet Communications, Inc. and Subsidiaries**

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended December 31,	
	2011	2010
REVENUES		
Access service revenues	\$ 233,895	\$ 287,773
Co-location and other revenues	1,639,979	1,400,172
Total revenues	1,873,874	1,687,945
OPERATING COSTS AND EXPENSES		
Cost of access service revenues	172,938	183,435
Cost of co-location and other revenues	365,926	389,576
Selling, general and administrative expenses	1,228,533	1,381,572
Depreciation and amortization	54,267	62,317
Total operating costs and expenses	1,821,664	2,016,900
INCOME (LOSS) FROM OPERATIONS	52,210	(328,955)
OTHER INCOME	37,268	1,198,510
INTEREST EXPENSE	(24,148)	(81,675)
INCOME before income taxes	65,330	787,880
Income tax expense	-	-
NET INCOME	\$ 65,330	\$ 787,880
Net income per common share		
Basic	\$.01	\$.10
Assuming dilution	\$.01	\$.10
Weighted average number of common shares outstanding		
Basic	8,316,517	7,922,721
Assuming dilution	9,265,291	8,048,044

See accompanying notes to financial statements.

Table of Contents**FullNet Communications, Inc. and Subsidiaries**

CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT

Years ended December 31, 2011 and 2010

	Common stock		Common stock	Additional	Accumulated	Total
	Shares	Amount	issuable	paid-in capital	deficit	
Balance at January 1, 2010	7,355,308	\$ 74	\$ 57,601	\$ 8,397,733	\$ (11,003,990)	\$ (2,548,582)
Issuance of common stock issuable at 12/31/09	497,156	5	(5)			
Stock compensation				96		96
Statute of limitation write-off			(57,596)			(57,596)
Net income					787,880	787,880
Balance at December 31, 2010	7,852,464	\$ 79	\$	\$ 8,397,829	\$ (10,216,110)	\$ (1,818,202)
Stock compensation				2,558		2,558
Stock options exercise	1,125,697	11		8,445		8,456

Warrant extension granted in settlement of liabilities				1,113				1,113
Net income							65,330	65,330
Balance at December 31, 2011	8,978,161	\$	90	\$	8,409,945	\$	(10,150,780)	\$ (1,740,745)

See accompanying notes to financial statements.

Table of Contents**FullNet Communications, Inc. and Subsidiaries**

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 65,330	\$ 787,880
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	54,267	62,317
Stock compensation	2,558	96
Other income	(37,268)	(1,198,510)
Provision for uncollectible accounts receivable	3,079	7,898
Net (increase) decrease in		
Accounts receivable	(29,229)	(8,974)
Prepaid expenses and other current assets	(8,202)	5,613
Net increase (decrease) in		
Accounts payable	(4,681)	72,046
Accrued and other liabilities	(24,193)	259,265
Deferred revenue	40,090	37,798
Net cash provided by operating activities	61,751	25,429
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(36,911)	(26,478)
Acquisition of business	(10,056)	-
Net cash used in investing activities	(46,967)	(26,478)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable	(23,109)	-
Proceeds from exercise of stock options	8,456	-
Net cash used in financing activities	(14,653)	-
NET INCREASE (DECREASE) IN CASH	131	(1,049)

Cash at beginning of year		10,856		11,905
Cash at end of year	\$	10,987	\$	10,856

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid for interest	\$	21,698	\$	19,570
Warrant extension granted in settlement of liabilities		1,113		-

See accompanying notes to financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

NOTE A ORGANIZATION AND NATURE OF OPERATIONS

FullNet Communications, Inc. and Subsidiaries (the Company) is an integrated communications provider (ICP) offering integrated communications, Internet connectivity and data storage to individuals, businesses, organizations, educational institutions and governmental agencies. Through its subsidiaries, FullNet, Inc., FullTel, Inc. and FullWeb, Inc., the Company provides high quality, reliable and scalable Internet solutions designed to meet customer needs. Services offered include:

Dial-up and direct high-speed connectivity to the Internet through the FullNet brand name;

Backbone services to private label Internet services providers (ISPs) and businesses;

Carrier-neutral telecommunications premise co-location;

Web page hosting;

Equipment co-location; and

Traditional telephone services.

The Company operates and grants credit, on an uncollateralized basis. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the Company's customer base and their dispersion across different industries.

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, which contemplate continuation of the Company as a going concern. However, the Company has sustained substantial net losses. At December 31, 2011 and 2010 current liabilities exceeded current assets by \$1,552,118 and \$1,616,442, respectively.

In view of the matters described in the preceding paragraph, the ability of the Company to continue as a going concern is dependent upon continued operations of the Company that in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain present financing, to achieve the objectives of its business plan and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

The Company's business plan includes, among other things, expansion of its Internet access services through mergers and acquisitions and the development of its web hosting, co-location and traditional telephone services. Execution of the Company's business plan will require significant capital to fund capital expenditures, working capital needs and debt service. Current cash balances will not be sufficient to fund the Company's current business plan beyond the next few months. As a consequence, the Company is currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. The Company continues to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund the Company's liquidity. There can be no assurance that the Company will be able to obtain additional capital on satisfactory terms, or at all, or on terms that will not dilute the shareholders' interests.

NOTE B SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

1. Consolidation

The consolidated financial statements include the accounts of FullNet Communications, Inc. and its wholly owned subsidiaries. All material inter-company accounts and transactions have been eliminated.

2. Revenue Recognition

Access service revenues are recognized on a monthly basis over the life of each contract as services are provided. Contract periods range from monthly to yearly. Carrier-neutral telecommunications co-location revenues and traditional telephone services are recognized on a monthly basis over the life of the contract as services are provided. Revenue that is received in advance of the services provided is deferred until the services are provided by the Company. Revenue related to set up charges is also deferred and amortized over the life of the contract.

The Company classifies certain taxes and fees billed to customers and remitted to governmental authorities on a net basis in revenue.

The Company began billing AT&T (formerly SBC) reciprocal compensation (fees for terminating AT&T customer's local calls onto the Company's network) during 2004, and has billed for the periods of March 2003 through June 2006. AT&T failed to pay and is disputing approximately \$183,700. The Company is pursuing AT&T for all balances due, however there is significant uncertainty as to whether or not the Company will be successful. Upon the ultimate resolution of AT&T's challenge, the Company will recognize the associated revenue, if any. The Company does not expect reciprocal compensation to be a significant or a long-term revenue source.

During the fourth quarter of 2010, the Company reviewed all of its outstanding liabilities to determine their enforceability and collectability in light of the applicable statute of limitations. Based upon this review, the Company concluded that by operation of law approximately \$1.2 million of its outstanding liabilities are no longer collectable and should be written-off. These uncollectable liabilities consisting of approximately \$456,000 notes payable, \$521,000 accrued interest, \$165,000 accounts payable and \$58,000 common stock issuable were written-off during the fourth quarter resulting in an increase to other revenue.

3. Accounts Receivable

Accounts receivable consist of the following at December 31:

	2011		2010
Accounts receivable	\$ 281,094	\$	214,596
Less allowance for doubtful accounts	(201,557)		(198,477)
	\$ 79,537	\$	16,119

Accounts receivable, other than certain large customer accounts which are evaluated individually, are considered past due for purposes of determining the allowance for doubtful accounts based on past experience of collectibility as follows:

1 - 29 days	1.5%
30 - 59 days	30%
60 - 89 days	50%
> 90 days	100%

In addition, if the Company becomes aware of a specific customer's inability to meet its financial obligations, a specific reserve is recorded against amounts due to reduce the net recognized receivable to the amount reasonably expected to be collected.

4. Property and Equipment

Property and equipment are stated at cost. Depreciation is computed primarily using the straight-line method over the estimated useful lives of the related assets as follows:

Software	3 years
Computers and equipment	5 years
Furniture and fixtures	7 years
Leasehold improvements	Shorter of estimated life of improvement or the lease term

5. Long-Lived Assets

All long-lived assets held and used by the Company, including intangible assets, are reviewed to determine whether any events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The Company bases its evaluation on such impairment indicators as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable the Company determines whether impairment has occurred through the use of an undiscounted cash flows analysis of the asset. If impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the estimated value of the asset. The Company recorded no impairments during the years ended December 31, 2011 and 2010.

6. Accrued and Other Liabilities

Accrued and other liabilities consist of the following at December 31:

	2011		2010
Accrued interest	\$ 2,451	\$	-
Accrued deferred compensation	832,897		867,582
Accrued unused vacation and sick leave	110,044		102,718
Accrued other liabilities	88,425		86,276
	1,032,383		1,056,576
Less current portion	1,008,899		1,038,311
	\$ 23,484	\$	18,265

Accrued net deferred compensation consists of the following as of December 31, 2011:

Net accrued (used) in:		
2011	\$	(34,685)
2010		167,425
2009		132,852
2000-2008		567,305
	\$	832,897

All of the Company's executive officers have voluntarily agreed to defer a portion of their compensation. This compensation is vested. The Company's top three executive officers have employment agreements which contain a Change in Control provision which provides for the immediate lump sum payment of their accrued deferred compensation in the event of a qualifying event. Accrued deferred compensation subject to this provision totaled approximately \$609,691 and \$639,042 at December 31, 2011 and 2010, respectively.

7. Income Taxes

The Company follows the liability method of accounting for income taxes. Under the liability method, deferred income taxes are provided on temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements and carry forwards that will result in taxable or deductible amounts in future years. Deferred income tax assets or liabilities are determined by applying the presently enacted tax rates and laws. Additionally, the Company provides a valuation allowance on deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense and does not believe it has any material unrealized tax benefits at December 31, 2011. The Company files income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions.

Table of Contents8. Income Per Share

Income per share basic is calculated by dividing net income by the weighted average number of shares of stock outstanding during the year, including shares issuable without additional consideration. Income per share assuming dilution is calculated by dividing net income by the weighted average number of shares outstanding during the year adjusted for the effect of dilutive potential shares calculated using the treasury stock method.

	2011	2010
Numerator:		
Net income	\$ 65,330	\$ 787,880
Denominator:		
Weighted average shares and share equivalents outstanding basic	8,316,517	7,922,721
Effect of dilutive stock options	129,658	1,686
Effect of dilutive warrants	819,116	123,637
Effect of dilutive convertible promissory notes		
Weighted average shares and share equivalents outstanding assuming dilution	9,265,291	8,048,044
Net income per share basic	\$.01	\$.10
Net income per share assuming dilution	\$.01	\$.10

Stock options exercisable for the purchase of 1,263,783 common stock shares at exercise prices ranging from \$.04 to \$.14 per share and 1,801,584 common stock shares at exercise prices ranging from \$.04 to \$1.00 per share, respectively, were outstanding for the years ended December 31, 2011 and 2010, but were not included in the calculation of income per share assuming dilution because the options were not dilutive.

Warrants exercisable for the purchase of 96,000 common stock shares at exercise prices ranging from \$.08 to \$.13 per share and 371,000 common stock shares at exercise prices ranging from \$.08 to \$1.00 per share, respectively, were outstanding for the years ended December 31, 2011 and 2010, but were not included in the calculation of income per share assuming dilution because the warrants were not dilutive.

A convertible promissory note convertible into 107,843 common stock shares at a conversion price of \$.51 per share (see Note D - Notes Payable) was outstanding for the years ended December 31, 2011 and 2010, but was not included in the calculation of income per share assuming dilution because the convertible note was not dilutive.

9. Stock Options and Warrants

The Company does not have a written employee stock option plan. The Company has historically granted only employee stock options with an exercise price equal to the market price of the Company's stock at the date of grant, a contractual term of ten years, and a vesting period of three years ratably on the first, second and third anniversaries of the date of grant (with limited exceptions).

All employee stock options granted during 2011 were nonqualified stock options. No employee stock options were granted during 2010. Stock-based compensation is measured at the grant date, based on the calculated fair value of the option, and is recognized as an expense on a straight-line basis over the requisite employee service period (generally the vesting period of the grant).

The fair values of the granted options are estimated at the date of grant using the Black-Scholes option pricing model. See Note N for further information on stock-based compensation.

The following table summarizes the Company's employee stock option activity for year ended December 31, 2011:

	Weighted	Weighted	Aggregate
		average	

	2011	average exercise price	remaining contractual life (yrs)	intristic value
Options outstanding, beginning of year	1,804,584	.50		
Options granted during the year	1,321,697	.01.		
Options exercised during the year	(1,125,697)	.01		
Options expired during the year	(537,801)	.62		
Options outstanding, end of year	1,462,783	\$.04	1.60	\$ 0
Options exercisable at end of year	1,342,883	\$.04	2.38	\$ 0

The following table summarizes the Company's non-vested employee stock option activity for year ended December 31, 2011:

	2011	Weighted average grant date fair value
Non-vested options outstanding, beginning of year	38,400	\$ 1,316
Options granted during the year	1,321,697	9,531
Options vested during the year	(1,240,197)	(9,242)
Non-vested options outstanding, end of year	119,900	\$ 1,605

The weighted-average grant date fair value of stock options granted was \$.01 in 2011. There were no stock options granted in 2010. The fair value of stock options vested was \$9,242 in 2011 and \$138 in 2010.

Common Stock Purchase Warrants A summary of common stock purchase warrant activity for the years ended December 31, 2011 and 2010 follows:

In December 2011, the Company agreed to extend the expiration date on 150,000 and 275,000 common stock purchase warrants with exercise prices of \$.01 and \$1.00, respectively, from January 2, 2012 to January 2, 2015 and adjusted the exercise prices to \$.003 in return for a credit of \$1,113 on the outstanding principal balance of a secured promissory note (see Note D - Notes Payable).

Outstanding common stock purchase warrants issued to non-employees outstanding at December 31, 2011 are as follows:

Number of shares	Exercise price	Expiration year
70,000	.13	2012
14,000	.10	2012
12,000	.08	2012
70,000	.01	2012
425,000	.003	2015
591,000		

The following table summarizes the Company's common stock purchase warrant activity for the years ended December 31, 2011 and 2010:

	2011	Weighted Average Exercise Price	2010	Weighted Average Exercise Price
Warrants outstanding beginning of year	591,000	\$.490	591,000	\$.49
Warrants outstanding end of year	591,000	\$.023	591,000	\$.49

10. Advertising

The Company expenses advertising production costs as they are incurred and advertising communication costs the first time the advertising takes place. Advertising expense for the years ended December 31, 2011 and 2010 was \$21,904 and \$11,443, respectively.

11. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures; accordingly, actual results could differ from those estimates.

12. Recently Issued Accounting Standards

Fair Value Measurements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). This pronouncement was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This pronouncement is effective for reporting periods beginning on or after December 15, 2011, with early adoption prohibited. The new guidance will require prospective application. The adoption of this updated authoritative guidance is not expected to have a significant impact on the Company's Consolidated Financial Statements.

NOTE C PROPERTY AND EQUIPMENT

Property and equipment consist of the following at December 31:

	2011		2010
Computers and equipment	\$ 1,516,280	\$	1,500,229
Leasehold improvements	991,749		970,890
Software	57,337		57,337
Furniture and fixtures	28,521		28,521
	2,593,887		2,556,977
Less accumulated depreciation	(2,515,746)		(2,470,912)
	\$ 78,141	\$	86,065

Depreciation expense for the years ended December 31, 2011 and 2010 was \$44,835 and \$210,058, respectively.

NOTE D NOTES PAYABLE

Notes payable consist of the following:

	December 31, 2011	December 31, 2010
Convertible promissory note; interest at 12.5% of face amount, payable quarterly; this note is unsecured and matured in November 2003 (convertible into approximately 107,843 shares at December 31, 2011 and 2010) (1)	\$ 55,000	\$ 55,000
Secured promissory note from a shareholder; interest at 6%, required monthly installments of interest only through December 30, 2010, then requires monthly installments of \$3,301 including principal and interest; matured at December 30, 2011; secured by all tangible and intangible assets of the Company (2)	273,078	297,300
	328,078	352,300
Less current portion	328,078	77,452
	\$ -	\$ 274,848

(1)

REMAINING CONVERTIBLE PROMISSORY NOTE - This \$55,000 convertible promissory note matured in November 2003. The Company has been unable to pay this note and has been making quarterly interest payments. The Company has not negotiated an extension of this note and the lender has not made any demands for payment of the principal amount of this note. The Company is currently developing a plan to satisfy this note. At December 31, 2011, the outstanding principal and accrued interest of the convertible promissory note was \$56,733.

CONVERTIBLE PROMISSORY NOTES written off during 2010 - During 2000 and 2001, the Company issued 11% convertible promissory notes or converted other notes payable or accounts payable to convertible promissory notes in an amount totaling \$2,257,624. The terms of the Notes were 36 months with limited prepayment provisions. Each of the Notes may be converted by the holder at any time at \$1.00 per common stock share and by the Company upon registration and when the closing price of the Company's common stock has been at or above \$3.00 per share for three consecutive trading days. Additionally, the Notes were accompanied by warrants exercisable for the purchase of the number of shares of Company's common stock equal to the number obtained by dividing 25% of the face amount of the Notes purchased by \$1.00. These warrants were exercisable at any time during the five years following issuance at an exercise price of \$.01 per share. Under the terms of the Notes, the Company was required to register the common

stock underlying both the Notes and the detached warrants by filing a registration statement with the Securities and Exchange Commission within 45 days following the Final Expiration Date of the Offering (March 31, 2001). On May 31, 2001, the Company exchanged 2,064,528 shares of its common stock and warrants (exercisable for the purchase of 436,748 shares of common stock at \$2.00 per share) for convertible promissory notes in the principal amount of \$1,746,988 (recorded at \$1,283,893) plus accrued interest of \$123,414. The warrants expired on May 31, 2006. This exchange was accounted for as an induced debt conversion and a debt conversion expense of \$370,308 was recorded.

Table of Contents

Pursuant to the provisions of the convertible promissory notes, the conversion price was reduced from \$1.00 per share on January 15, 2001 to \$.49 per share on December 31, 2003 for failure to register under the Securities Act of 1933, as amended, the common stock underlying the convertible promissory notes and underlying warrants on February 15, 2001. Reductions in conversion price were recognized at the date of reduction by an increase to additional paid-in capital and an increase in the discount on the convertible promissory notes. Furthermore, the interest rate was increased to 12.5% per annum from 11% per annum because the registration statement was not filed before March 1, 2001.

On January 1, 2002, the Company recorded 11,815 shares of common stock issuable in payment of \$11,815 accrued interest on a portion of the Company's convertible promissory notes.

In November and December 2003 and March 2004, \$455,000, \$50,000 and \$5,636, respectively, of these convertible promissory notes matured.

During the fourth quarter of 2010, the Company reviewed all of its outstanding liabilities to determine their enforceability and collectability in light of the applicable statute of limitations (see Note L - Statute of Limitations Write-off). Based upon this review, the Company concluded that by operation of law \$455,636 of these convertible promissory notes and \$520,581 of accrued interest on these notes were no longer collectable and should be written-off. These uncollectable notes were written-off during the fourth quarter resulting in an increase to other revenue.

(2)

The Company agreed to issue additional shares of stock to the shareholder in the event that any additional shares are issued at less than \$.50 per share, excluding employee stock options, prior to the payment in full of the secured promissory note.

In December 2011, the Company agreed to extend the expiration date on 150,000 and 275,000 common stock purchase warrants with exercise prices of \$.01 and \$1.00, respectively, from January 2, 2012 to January 2, 2015 and adjusted the exercise prices to \$.003 in return for a credit of \$1,113 on the outstanding principal balance of the secured promissory note.

This secured promissory note matured on December 30, 2011. The Company continues to make monthly principal and interest payments. The lender has not made any demands for payment of the outstanding principal balance of this note. At December 31, 2011, the outstanding principal and accrued interest of the secured promissory note was \$273,796.

Aggregate future maturities of notes payable at December 31, 2011 are as follows:

2012	\$	328,078
	\$	328,078

NOTE E COMMITMENTS AND CONTINGENCIES

COMMITMENTS

Operating Leases

The Company leases certain office facilities used in its operations under non-cancelable operating leases which will expire in 2014. Future minimum lease payments required at December 31, 2011 under non-cancelable operating leases that have initial lease terms exceeding one year are presented in the following table:

Year ending December 31		
2012		189,167
2013		195,690
2014		202,213
	\$	587,070

Rental expense for all operating leases for the years ended December 31, 2011 and 2010 was approximately \$247,942 and \$226,692, respectively.

The Company's long-term non-cancelable operating lease includes scheduled base rental increases over the term of the lease. The total amount of the base rental payments is charged to expense on the straight-line method over the term of the lease. The Company had recorded a deferred credit of \$23,484 at December 31, 2011, which is reflected in Other Long-term Liabilities on the Balance Sheet to reflect the net excess of rental expense over cash payments since inception of the lease. In addition to the base rent payments the Company pays a monthly allocation of the building's operating expenses.

CONTINGENCIES

As a provider of telecommunications, the Company is affected by regulatory proceedings in the ordinary course of its business at the state and federal levels. These include proceedings before both the Federal Communications Commission and the Oklahoma Corporation Commission (OCC). In addition, in its operations the Company relies on obtaining many of its underlying telecommunications services and/or facilities from incumbent local exchange carriers or other carriers pursuant to interconnection or other agreements or arrangements. In January 2007, the Company concluded a regulatory proceeding pursuant to the Federal Telecommunications Act of 1996 before the OCC relating to the terms of its interconnection agreement with Southwestern Bell Telephone, L.P. d/b/a AT&T, which succeeds a prior interconnection agreement. The OCC approved this agreement in May 2007. This agreement may be affected by regulatory proceedings at the federal and state levels, with possible adverse impacts on the Company. The Company is unable to accurately predict the outcomes of such regulatory proceedings at this time, but an unfavorable outcome could have a material adverse effect on the Company's business, financial condition or results of operations.

NOTE F INCOME TAXES

The Company's effective income tax rate on net loss differed from the federal statutory rate of 34% as follows at December 31:

	2011		2010
Income taxes benefit at federal statutory rate	\$ 22,000	\$	268,000
Tax effect of state income taxes benefit	3,000		34,000
Change in valuation allowance	(378,000)		(311,000)
Nondeductible expenses	2,000		2,000
Other	351,000		7,000
Total tax expense	\$	\$	

The components of deferred income tax assets were as follows at December 31:

	2011		2010
Deferred income tax assets			
Basis difference in property and equipment and intangible assets	\$ 311,000	\$	368,000
Deferred revenue	67,000		51,000
Net operating loss	945,000		898,000
Deferred compensation and other	(9,000)		375,000
Valuation allowance	(1,314,000)		(1,692,000)
Net deferred income tax asset			

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Change in valuation allowance	\$	(378,000)	\$	(311,000)
-------------------------------	----	-----------	----	-----------

A valuation allowance is provided for deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. At December 31, 2011, the Company has a net operating loss carry forward of approximately \$912,000 that will expire at various dates through 2031. Because this carry forward can only be used to offset future taxable income of the Company, management has provided a valuation allowance until it is more likely than not that taxable income will be generated.

The Company has adopted the provisions of FASB Accounting Standards Codification Topic ASC 740-10 (previously Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes), on January 1, 2007. The implementation of this standard had no impact on the financial statements. As of the date of adoption and as of December 31, 2011 and 2010, the unrecognized tax benefit accrual was zero.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense and does not believe it has any material unrealized tax benefits at December 31, 2011. The Company files income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions and is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2005.

NOTE G COMMON STOCK

Employee stock options for 725,697 and 400,000 shares of the Company's common stock were exercised in May 2011 for \$7,256 and December 2011 for \$1,200, respectively.

On December 29, 2009 the Company converted \$248,578 of accrued interest on an interim loan from a shareholder into 497,156 restricted shares of the Company's common stock valued at \$.50 per share. These shares were issuable at December 31, 2009, were equal to approximately 6.8% of the total number of shares outstanding and were issued on January 20, 2010. This transaction was accounted for as a troubled debt restructuring and a gain on debt forgiveness of \$235,663 was recorded. In connection with the conversion, the Company also agreed to issue additional shares of stock to the holder of a secured promissory note in the event that any additional shares are issued at less than \$.50 per share, excluding employee stock options, prior to the payment in full of the secured promissory note (see Note D Notes Payable). No shares other than employee stock options shares were issued by the Company at less than \$.50 per share during 2011 and 2010.

NOTE H FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC 820-10 requires that an entity disclose the fair value of financial instruments for which it is practicable to estimate the value. The Company considers the carrying value of certain financial instruments on the balance sheets, including cash, accounts receivable, and other assets to be reasonable estimates of fair value. At December 31, 2011 and 2010, the carrying amount of the Company's liabilities for corporate borrowings and other obligations was \$1,929,616 and \$1,942,622, respectively, and the fair value was estimated to be approximately \$189,000 and \$124,000, respectively. These amounts are based on the present value of estimated future cash outflows which is discounted based on the risk of nonperformance due to the uncertainty of the Company's ability to continue as a going concern.

NOTE I CERTAIN RELATIONSHIPS

The Company has an operating lease for certain equipment which is leased from Generation Capital Associates, one of its greater than 5% shareholders whose parent company holds a \$273,078 secured promissory note (see Note D Notes Payable). The original lease was dated November 21, 2001 and the terms were \$6,088 per month for 12 months with a fair market purchase option at the end of the lease. Upon default on the lease, the Company was allowed to continue leasing the equipment on a month-to-month basis at the same monthly rate as the original lease. The Company has been unable to make the month-to-month payments. In January and November 2006, the Company agreed to extend the expiration date on 425,000 and 140,000, respectively, of common stock purchase warrants for the lessor in return for a credit of \$17,960 and \$3,940, respectively, on the operating lease. In September 2007, the lessor agreed to cease the monthly lease payments effective January 1, 2007 which generated a total of \$54,795 of forgiveness of debt income. The lessor also agreed to accept payments of \$499 per month on the balance owed. In January and December 2009, the Company agreed to extend the expiration date on 425,000 and 140,000, respectively, of common stock purchase warrants for the lessor in return for a credit of \$3,445 and \$773, respectively, on the operating lease. At December 31, 2011 and 2010 the Company had recorded \$256,443 in unpaid lease payments. The loss of this equipment would have a material adverse effect on our business, financial condition and results of operations. The Company has been unable to make all of the required payments pursuant to the terms of the September 2007 agreement. The lessor has not made any formal demands for payment or instituted collection action; however the Company is in discussions with the lessor to restructure this liability.

NOTE J CONCENTRATIONS

During the years ended December 31, 2011 and 2010, the Company had one customer that comprised approximately 17% and 14% of total revenues, respectively.

NOTE K OTHER INCOME

The year 2011 includes \$37,268, representing certain excess telecommunication taxes and fees for which the Company has filed refund requests with the appropriate state agencies.

During the fourth quarter of 2010, the Company reviewed all of its outstanding liabilities to determine their enforceability and collectability in light of the applicable statute of limitations. Based upon this review, the Company concluded that by operation of law approximately \$1.2 million of its outstanding liabilities are no longer collectable and should be written-off. These uncollectable liabilities consisting of approximately \$456,000 notes payable, \$521,000 accrued interest, \$165,000 accounts payable and \$58,000 common stock issuable were written-off during the fourth quarter to other income. The basic and diluted per share amount of the write-off was \$.15.

NOTE L EMPLOYEE BENEFIT PLANS

The Company offers a SIMPLE IRA plan for all eligible employees. Employees meeting certain eligibility requirements can participate in the plan. Under the plan, the Company matches employee contributions to the plan up to 3% of the employee's salary. The Company made matching contributions of 1% totaling \$3,374 and 3% totaling \$11,376, respectively, during the years ended December 31, 2011 and 2010.

STOCK BASED COMPENSATION

The Company does not have a written employee stock option plan. The Company has historically granted only employee stock options with an exercise price equal to the market price of the Company's stock at the date of grant, a contractual term of ten years, and a vesting period of three years ratably on the first, second and third anniversaries of the date of grant (with limited exceptions).

All employee stock options granted during 2011 were nonqualified stock options. Stock-based compensation is measured at the grant date, based on the calculated fair value of the option, and is recognized as an expense on a straight-line basis over the requisite employee service period (generally the vesting period of the grant). No employee options were granted during 2010.

The fair values of the granted options are estimated at the date of grant using the Black-Scholes option pricing model. In addition to the exercise and grant date prices of the options, certain weighted average assumptions that were used to estimate the fair value of stock option grants in the respective periods are listed in the table below: