

FULLNET COMMUNICATIONS INC
Form 10-K
March 31, 2015

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, 2014

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

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, 2014) of registrant's completed second quarter was \$157,924.

As of March 31, 2015, 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, 2014

TABLE OF CONTENTS

PART I.

<u>Item 1. Business</u>	5
<u>Item 1A. Risk Factors</u>	11
<u>Item 1B. Unresolved Staff Comments</u>	13
<u>Item 2. Properties</u>	13
<u>Item 3. Legal Proceedings</u>	13

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>	16
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	20
<u>Item 8. Financial Statements and Supplemental Data</u>	20
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	20
<u>Item 9A. Controls and Procedures</u>	20

PART III.

<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	21
<u>Item 11. Executive Compensation</u>	23
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	26
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	27
<u>Item 14. Principal Accounting Fees and Services</u>	27
<u>Item 15. Exhibits, Financial Statement Schedules</u>	28

<u>SIGNATURES</u>	30
-------------------	----

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. Known 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, there is no assurance that our expectations will prove to be correct. Our actual results could be materially different from our expectations, including the following:

- We may lose customers or fail to grow our customer base;
- We may not successfully integrate new customers 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 obtain 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, traditional telephone services as well as advanced voice and data solutions.

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.com 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.

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 data 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 as well as advanced voice and data solutions. At December 31, 2013 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.

Target Strategic Acquisitions

The goal of our acquisition strategy is to accelerate market penetration by acquiring smaller competitors in the advanced voice and data market. Additionally, we will continue to build upon our core competencies and expand our technical, customer service staff and Internet based marketing efforts. We evaluate acquisition candidates based on their compatibility with our overall business plan. When assessing an acquisition candidate, we focus on the following criteria:

- o Potential revenue and customer growth;
- o Low customer turnover or churn rates;
- o Favorable competitive environment; and
- o Favorable consolidation savings.

Generate Internal Sales Growth

We intend to expand our customer base by increasing our marketing efforts. At December 31, 2014, our sales efforts are carried out by technical engineers and our senior management. In addition, we have independent agents in certain markets. We are exploring other strategies to increase our sales, including other marketing partners and Internet based advertising programs.

Increase Rural Area Market Share

We believe that the rural areas of Oklahoma are underserved by Internet service providers, and that we can profitably serve these markets by providing reliable Internet connectivity at a reasonable cost to the residents and businesses located in these areas. 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.

Internet Access Services

We provide Internet access services to individual and small business customers 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
- 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 customers 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 200 and 400 customers at December 31, 2014 and 2013, 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

Table of Contents

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.

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, 2014, 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.

Advanced Voice and Data Solutions

Our primary advanced voice and data solution is marketed under our CallMultiplier brand name. CallMultiplier is a comprehensive cloud-based solution to consumers and businesses for automated calling, texting and voice message delivery. CallMultiplier streamlines and automates call tree management to provide efficient delivery of time sensitive voice and text messages to groups. Satisfied customers include sports teams, businesses, religious groups, schools, political campaigns, staffing companies, clubs and civic groups throughout the United States and Canada.

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. We are now focusing the majority of our efforts on Internet based advertising and marketing.

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

Table of Contents

distance and local exchange telecommunications companies, cable television, direct broadcast satellite, wireless communication

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 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 Cox Communications, 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.

We believe that our ability to attract business customers and to market value-added services is a key to our future success and profitability. 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.

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

Table of Contents

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 is 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 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

Table of Contents

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.

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

Table of Contents

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, 2014, 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.

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

At December 31, 2014, our current liabilities exceeded our current assets by \$1,067,276, our total liabilities exceeded our total assets by \$1,148,390, and we had an accumulated deficit of \$10,318,255. 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 it. 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

Table of Contents

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 commencement of 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.

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 is 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.

Table of Contents

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 regulatory and judicial 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 and judicial rulings 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, 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 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 \$16.50 per square foot. These premises are occupied pursuant to a lease that expires December 31, 2019.

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

Table of Contents

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
2014 – Calendar Quarter Ended:		
March 31	\$	\$
	.030	.030
June 30	.030	.030
September 30	.026	.026
December 31	.050	.050
2013 – Calendar Quarter Ended:		
March 31	\$.025
	.025	
June 30	.040	.040
September 30	.040	.040
December 31	.050	.030

Number of stockholders

The number of beneficial holders of record of our common stock as of the close of business on March 31, 2015 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, 2014, 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 Underlying Unexercised Options and Warrants	Weighted- Average Exercise Price of Outstanding Options and Warrants	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans
<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	3,295,382	.029	-
Warrants and certain stock options issued to non-employees	550,000	.003	-
Total	3,845,382	.026	-

Table of Contents

Recent Sales of Unregistered Securities

None.

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, traditional telephone services as well as advanced voice and data solutions.

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,

2014 and 2013:

	For the Years Ended December 31,			
	2014		2013	
	Amount	Percentage of revenues	Restated Amount	Percentage of revenues
Revenues:	\$		\$	
Access service revenues	89,689	5.1	112,613	6.9
Co-location and other revenues	1,664,562	94.9	1,514,247	93.1
Total revenues	1,754,251	100.0	1,626,860	100.0
Operating costs and expenses:				
Cost of access service revenues	99,004	5.7	109,716	6.8

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Cost of co-location and other revenues	361,872	20.6	327,296	20.1
Selling, general and administrative expenses	1,394,203	79.5	1,318,810	81.0
Depreciation and amortization	40,165	2.3	29,087	1.8
Impairment expense	11,007	0.6	-	-
Total operating costs and expenses	1,906,251	108.7	1,784,909	109.7
Loss from operations	(152,000)	(8.7)	(158,049)	(9.7)
Gain on Series A convertible preferred stock issued in exchange for indebtedness	-	-	401,004	24.6
Interest expense	(15,744)	(0.9)	(19,588)	(1.2)
	\$		\$	
Net income (loss)	(167,744)	(9.6)	223,367	13.7

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

Revenues

Access service revenues decreased \$22,924 or 20.3% to \$89,689 for the year 2014 from \$112,613 for the year 2013 primarily due to a decline in the number of customers.

Co-location and other revenues increased \$150,315 or 9.9% to \$1,664,562 for the year 2014 from \$1,514,247 for the year 2013. 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 \$10,712 or 9.8% to \$99,004 for the year 2014 from \$109,716 for the year 2013. This decrease was primarily due to reductions in costs of servicing access customers due to a reduction in the number of customers. Cost of access service revenues as a percentage of access service revenues increased to 110.4% for the year 2014 from 97.4% for the year 2013.

Cost of co-location and other revenues increased \$34,576 or 10.6% to \$361,872 for the year 2014 from \$327,296 for the year 2013 primarily related to the cost of servicing new customers and supporting the sale of additional services to existing customers. Cost of co-location and other revenues as a percentage of co-location and other revenues

increased to 21.7% for the year 2014 from 21.6% for the year 2013.

Selling, general and administrative expenses increased \$75,393 or 5.7% to \$1,394,203 for the year 2014 from \$1,318,810 for the year 2013. This increase was primarily related to increases in employee costs, advertising, rent expense, professional services, bank fees and travel and entertainment expenses of \$34,829, \$38,052, \$24,469, \$10,458, \$5,402 and \$4,781, respectively. These increases were offset by decreases in bad debt, agent commissions and property taxes expenses of \$19,308, \$10,956 and \$12,976, respectively. Selling, general and administrative expenses as a percentage of total revenues decreased to 79.5% for the year 2014 from 81.0% for the year 2013.

Depreciation and amortization expense increased \$11,078 or 38.1% to \$40,165 for the year 2014 from \$29,087 for the year 2013 primarily related to several assets reaching full depreciation.

An impairment expense of \$11,007 related to an intangible asset was incurred in 2014 and in 2013 no impairment expense was incurred.

Gain on Series A convertible preferred stock issued in exchange for indebtedness

Table of Contents

On June 3, 2013, pursuant to shareholder authorization, we issued 987,102 shares of its Series A convertible preferred stock and \$401,004 was recognized as gain on Series A convertible preferred stock issued in exchange for indebtedness for the year ended December 31, 2013. See breakdown below:

We issued 59,634 and 203,169 of its series A convertible preferred stock to settle \$55,000 of debt, \$4,634 of accrued interest and \$203,169 of accounts payable. As a result, we recognized a gain on settlement of debt and accrued interest of \$57,248 and a gain on settlement of accounts payable of \$195,042.

Members of our management and board of directors accounted for 609,507 shares of the shares issued in exchange for \$609,507 and \$46,626 of our deferred compensation and accrued payroll taxes. Participation of our management and board of directors in this exchange was approved by a majority of our shareholders.

Also, accounts payable of \$114,792 was exchanged for 114,792 of series A convertible preferred stock. We recognized \$110,200 as gain on settlement of accounts payable for the year ended December 31, 2013. An additional \$38,514 of gain netted against \$9,694 of professional fees was recognized as we wrote off additional accounts payables and deferred compensation due to the applicable Statute of Limitations.

Interest Expense

Interest expense decreased \$3,844 or 19.6% to \$15,744 for the year 2014 from \$19,588 for the year 2013 primarily related to a decrease in notes payable.

Liquidity and Capital Resources

As of December 31, 2014, we had \$14,614 in cash and \$1,103,656 in current liabilities, including \$354,967 of deferred revenues that will not require settlement in cash.

At December 31, 2014 and 2013, we had working capital deficits of \$1,067,276, and \$828,689, respectively. 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.

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

At December 31, 2014, of the \$214,917 we owed to our trade creditors \$184,045 was past due. We have no formal agreements regarding payment of these amounts.

Cash flow for the years ending December 31, 2014 and 2013 consist of the following:

	For the Years Ended December 31,	
	2014	2013
	\$	\$
Net cash flows provided by operations	78,045	55,218
Net cash flows used in investing activities	(62,188)	(11,976)
Net cash flows used in financing activities	(29,315)	(24,017)

Cash used for the purchases of equipment was \$62,188 and \$11,976, respectively, for the years ended December 31, 2014 and 2013. During the year ended December 31, 2014, \$36,532 of property and equipment was purchased on accounts.

Cash used for principal payments on notes payable was \$29,315 and \$24,017, respectively, for the years ended December 31, 2014 and 2013.

On June 3, 2013, pursuant to shareholder authorization, we issued 987,102 shares of our Series A convertible preferred stock and \$401,004 was recognized as gain on Series A convertible preferred stock issued in exchange for indebtedness for the year ended December 31, 2013. See breakdown below:

We issued 59,634 and 203,169 of our series A convertible preferred stock to settle \$55,000 of debt, \$4,634 of accrued interest and \$203,169 of accounts payable (see Note D – Convertible Notes Payable Related Party). As a result, we recognized a gain on settlement of debt and accrued interest of \$57,248 and a gain on settlement of accounts payable of \$195,042.

Members of our management and board of directors accounted for 609,507 shares of the shares issued in exchange for \$609,507 and \$46,626 of our deferred compensation and accrued payroll taxes. Participation of our management and board of directors in this exchange was approved by a majority of our shareholders.

Also, accounts payable of \$114,792 was exchanged for 114,792 of series A convertible preferred stock. We recognized \$110,200 as gain on settlement of accounts payable for the year ended December 31, 2013. An additional \$38,514 of gain netted

Table of Contents

against \$9,694 of professional fees was recognized as we wrote off additional accounts payables and deferred compensation due to the applicable Statute of Limitations.

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 customers 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, 2014, 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 and accrued interest		\$	\$	\$	\$
	305,305	46,811	93,622	140,260	24,612
Operating leases	1,108,910	221,782	443,564	443,564	-
Total contractual cash obligations		\$	\$	\$	\$
	1,414,215	268,593	537,186	583,824	24,612

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

Table of Contents

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.

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 2014 and 2013, we did not have disagreements with our principal independent accountants.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act that are designed to ensure that information required to be disclosed in our reports filed or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and that information is accumulated and communicated to our management, including our principal executive and financial officer as appropriate, to allow timely decisions regarding required disclosures.

Our principal executive officer and principal financial officer evaluated the effectiveness of disclosure controls and procedures as of December 31, 2014 pursuant to Rule 13a-15(b) under the Exchange Act. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are not effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure, due to the material weaknesses identified below.

A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Report of Management on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Our internal control system was designed to, in general, provide reasonable assurance to our management and board regarding the preparation and fair presentation of published financial statements, but because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods

Table of Contents

are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2014. The framework used by our management in making that assessment was the criteria set forth in the document entitled "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. 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. This annual report does not include an attestation report of our public accounting firm regarding internal control over financial reporting. Our management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission adopted as of September 21, 2010 that permit us to provide only our management's report in this annual report.

Changes in Internal Control over Financial Reporting

No change in our system of internal control over financial reporting occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART III.

Item 10. Directors, Executive Officers, and Corporate Governance.

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

The following information is furnished as of March 28, 2015 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 three 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	56	Chief Executive Officer and Chairman of the Board of Directors
Roger P. Baresel	59	President, Chief Financial Officer and Secretary and Director
Jason C. Ayers	40	Vice President of Operations and Director
Patricia R. Shurley	58	Vice President of Finance
Michael D. Tomas	42	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 in November 2000, and our President in October 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 Marketing Systems successfully completed two public

Table of Contents

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 became one of our directors on May 9, 2013. He has been our Vice President of Operations since December 2000 and prior to that served as President of Animus, a privately-held web hosting company which we acquired in April 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.

Audit Committee Financial Expert

Because our board of directors only consists of three 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 2013 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

Table of Contents

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.

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, Chief Financial Officer and Vice President of Operations (the “Named Executive Officers”). None of our executive officers other than the named executive officers earned annual compensation in excess of \$100,000 during 2014.

Name and Principal Position	Fiscal Year	Annual Compensation		Long-Term Compensation
		Salary	Other Compensation	Securities Underlying Options and Warrants (#) (1)
Timothy J. Kilkenny	2014	\$	(2)\$	(3)(1) -
Chairman and CEO	2013	71,388	(4)\$ 31,045	(5)(1) 457,000
	2012	77,605	(6)\$ 38,414	(7)(1) 110,000
Roger P. Baresel	2014	65,573	(8)\$ 29,425	(9)(1) -
	2013	61,116	(10)\$ 38,530	(11)(1) 1,300,848

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

	2012	\$	67,137	(12)\$	69,638	(13)(1)	90,000
			59,268		34,239		
Jason C. Ayers	2014	\$	(14)\$		(15)(1)		-
			76,537		24,947		
Vice President of Operations	2013	\$	(16)\$		(17)(1)		800,000
			73,620		50,352		
	2012	\$	(18)\$		(19)(1)		30,000
			67,142		21,633		

(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) Includes \$15,898 of deferred compensation.

Represents \$10,893 of expense reimbursement for business use of Mr. Kilkenny's automobile and parking, \$1,800 of expense reimbursement for Mr. Kilkenny's Internet connection and cell phone, \$16,666 of insurance premiums, \$1,687 of post-retirement benefits paid by us for the benefit of Mr. Kilkenny.

(4) Includes \$12,490 of deferred compensation.

(5) Represents \$10,351 of expense reimbursement for business use of Mr. Kilkenny's automobile and parking, \$1,800 of expense reimbursement for Mr. Kilkenny's Internet connection and cell phone, \$16,628 of insurance premiums, \$654 of post-retirement benefits paid by us for the benefit of Mr. Kilkenny, and \$9,080 of stock options issued to Mr. Kilkenny.

(6) Includes \$6,742 of deferred compensation.

(7) Represents \$10,351 of expense reimbursement for business use of Mr. Kilkenny's automobile and parking, \$1,800 of expense reimbursement for Mr. Kilkenny's Internet connection and cell phone, \$16,359 of insurance premiums, \$602 of post-retirement benefits paid by us for the benefit of Mr. Kilkenny, and \$313 of stock options issued to Mr. Kilkenny.

(8) Includes \$11,605 of deferred compensation.

Represents \$9,120 of expense reimbursement for business use of Mr. Baresel's automobile and parking, \$5,270 of expense reimbursement for Mr. Baresel's home office and cell phone, \$22,590 of insurance premiums, \$1,550 of post-retirement benefits paid by us for the benefit of Mr. Baresel.

(10) Includes \$9,121 of deferred compensation.

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

- (11) Represents \$9,120 of expense reimbursement for business use of Mr. Baresel's automobile and parking, \$5,265 of expense reimbursement for Mr. Baresel's home office and cell phone, \$18,913 of insurance premiums, \$614 of post-retirement benefits paid by us for the benefit of Mr. Baresel, and \$35,726 of stock options issued to Mr. Baresel.
- (12) Includes \$4,319 of deferred compensation.
- (13) Represents \$9,120 of expense reimbursement for business use of Mr. Baresel's automobile and parking, \$5,577 of expense reimbursement for Mr. Baresel's home office and cell phone, \$18,866 of insurance premiums, \$420 of post-retirement benefits paid by us for the benefit of Mr. Baresel, and \$256 of stock options issued to Mr. Baresel.
- (14) Includes \$17,105 of deferred compensation.
- (15) Represents \$2,493 of expense reimbursement for Mr. Ayer's parking, \$1,500 of expense reimbursement for Mr. Ayer's Internet connection and cell phone, \$18,975 of insurance premiums, \$1,980 of post-retirement benefits paid by us for the benefit of Mr. Ayers.
- (16) Includes \$13,205 of deferred compensation.
- (17) Represents \$540 of expense reimbursement for Mr. Ayer's parking, \$1,500 of expense reimbursement for Mr. Ayer's Internet connection and cell phone, \$19,742 of insurance premiums, \$779 of post-retirement benefits paid by us for the benefit of Mr. Ayers, and \$27,791 of stock options issued to Mr. Ayers.
- (18) Includes \$6,261 of deferred compensation.
- (19) Represents \$720 of expense reimbursement for Mr. Ayer's parking, \$1,500 of expense reimbursement for Mr. Ayer's Internet connection and cell phone, \$18,653 of insurance premiums, \$675 of post-retirement benefits paid by us for the benefit of Mr. Ayers, and \$85 of stock options issued to Mr. Ayers.

Stock Options Granted

All options granted during 2014 are nonqualified stock options. During 2014, an aggregate of 127,500 options were granted outside of a formal plan to employees. No stock options were granted to Mr. Kilkenny, Mr. Baresel and Mr. Ayers during 2014.

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.

2014 Year End Option Values

The following table sets forth information related to the exercise of stock options during 2014 and the number and value of options held by the following Named Executive Officers at December 31, 2014. During 2014, Mr. Kilkenny, Mr. Baresel and Mr. Ayers exercised no options. 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, 2014 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, 2014		Value of Unexercised In-the-Money Options at December 31, 2014 (1)	
	Exercisable	Unexercisable	Exercisable \$	Unexercisable \$
Timothy J. Kilkenny Chairman and CEO	482,000	-	14,970	-
			\$	\$
Roger P. Baresel President and CFO	530,848	600,000	10,435	6,000
			\$	\$
Jason C. Ayers Vice President of Operations	296,667	533,333	5,410	8,000

(1) Based on the closing sale price on December 31, 2014 of our common stock of \$.05 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, 2014.

Name	Outstanding Equity Awards at December 31, 2014		Option Exercise Price (1)	Stock Option Expiration Date
	Number of Common Stock Underlying Options	Awards		
	Exercisable	Unexercisable		
Timothy J. Kilkenny	30,000	-	\$.003	07/30/22
Chairman and CEO	452,000	-	\$.020	04/26/23
Roger P. Baresel	30,000	-	\$.003	07/30/22
President and CFO	200,848	-	\$.020	04/26/23
	300,000	600,000	\$.040	08/30/23
Jason C. Ayers	30,000	-	\$.003	07/30/22
Vice President of Operations	66,667	133,333	\$.020	04/26/23
	200,000	400,000	\$.040	08/30/23

(1) The closing sale price of our common stock as reported on the OTC Bulletin Board on December 31, 2014 was \$0.05

Director Compensation

During the fiscal year ended December 31, 2014, 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. At December 31, 2014 we owed, including deferred compensation, \$104,949, \$75,767 and \$88,796 to Mr. Kilkenny, Mr. Baresel and Mr. Ayers, respectively.

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

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

The following table sets forth information as of March 28, 2015, 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)	2,919,350	30.5%
Roger P. Baresel* (2)(4)	1,205,384	12.5%
Jason C. Ayers (2)(5)	880,091	9.4%
Patricia R. Shurley (2)(6)	497,239	5.5%
Michael D. Tomas (2)(7)	416,389	4.6%
All executive officers and directors as a group (5 individuals)	5,918,453	62.5%
High Capital Funding, LLC (8)		
	895,433	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 9,118,161 shares being outstanding at March 28, 2015.

- (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 240,628 shares of our Series A convertible preferred stock held by Mr. Kilkenny that are currently convertible into common stock at the rate of one share of common stock per one share of Series A convertible preferred stock and 482,000 shares of our common stock held by Mr. Kilkenny that are subject to currently exercisable stock options.
- (4) Roger P. Baresel and Judith A. Baresel, husband and wife, hold 109,350 and 427,564 shares of our common stock, respectively. The number of shares includes 137,622 shares of our Series A convertible preferred stock held by Mrs. Baresel that are currently convertible into common stock at the rate of one share of common stock per one share of Series A convertible preferred stock and 180,000 and 350,848 shares of our common stock subject to currently exercisable stock options held by Mr. and Mrs. Baresel, respectively. Amounts shown do not include options, held by Mr. Baresel, to purchase 150,000 shares of our common stock exercisable at \$.04 per share beginning August 30, 2015 and 150,000 shares of our common stock exercisable at \$.04 per share beginning August 30, 2016 and options held by Mrs. Baresel to purchase 150,000 shares of our common stock exercisable at \$.04 per share beginning August 30, 2015 and 150,000 shares of our common stock exercisable at \$.04 per share beginning August 30, 2016.
- (5) Jason C. Ayers holds 505,795 shares of our common stock. The number of shares includes 77,629 shares of our Series A convertible preferred stock that are currently convertible into common stock at the rate of one share of common stock per one share of Series A convertible preferred stock and 296,667 shares of our common stock subject to currently exercisable stock options. Amounts shown do not include options to purchase 66,667 shares of our common stock exercisable at \$.02 per share beginning April 26, 2015, 66,666 shares of our common stock exercisable at \$.02 per share beginning April 26, 2016, 200,000 shares of our common stock exercisable at \$.04 per share beginning August 30, 2015 and 200,000 shares of our common stock exercisable at \$.04 per share beginning August 30, 2016.
- (6) Patricia R. Shurley holds 342,000 shares of our common stock. The number of shares includes 70,239 shares of our Series A convertible preferred stock that are currently convertible into common stock at the rate of one share of common stock per one share of Series A convertible preferred stock and 85,000 shares of our common stock subject to currently exercisable stock options. Amounts shown do not include options to purchase 10,000 shares of our common stock exercisable at \$.02 per share beginning April 26, 2015 and 10,000 shares of our common stock exercisable at \$.02 per share beginning April 26, 2016.
- (7) Michael D. Tomas holds 295,000 shares of our common stock. The number of shares includes 83,389 shares of our Series A convertible preferred stock that are currently convertible into common stock at the rate of one share of

common stock per one share of Series A convertible preferred stock and 38,000 shares of our common stock subject to currently exercisable stock options. Amounts shown do not include options to purchase 8,000 shares of our common stock exercisable at \$.02 per share beginning April 26, 2015 and 8,000 shares of our common stock exercisable at \$.02 per share beginning April 26, 2016.

- (8) High Capital Funding, LLC, 333 Sandy Springs Circle, Suite 230, Atlanta, Georgia 30328, 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 130,669 shares of our Series A convertible preferred stock held by High Capital Funding, LLC that are currently convertible into common stock at the rate of one share of common stock per one share of Series A convertible preferred stock. Amounts shown do not include 72,500 shares of our Series A convertible preferred stock held by High Capital Funding, LLC and 815,000 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 two secured convertible promissory notes with High Capital Funding, LLC. At December 31, 2014 the outstanding principal and interest of the secured convertible promissory notes were \$198,363 and \$47,511.

Item 13. Certain Relationships and Related Transactions, and Director Independence

In 2013 we had an operating lease for certain equipment which was leased from Generation Capital Associates, one of our shareholders whose parent company, High Capital Funding, LLC also one of our shareholders, held a \$225,189 secured convertible promissory note (see Note D - Convertible Notes Payable Related Party of the financial statements appearing elsewhere in this Report). On May 31, 2013, we issued a \$50,000 secured convertible promissory note and on June 3, 2013, issued 203,169 shares of our Series A convertible preferred stock (see Note H - Series A Convertible Preferred Stock of the financial statements appearing elsewhere in this Report), in complete satisfaction of the balance due on the operating lease in the amount of \$253,169. We recognized \$195,042 as gain on settlement of accounts payable for the year ended December 31, 2013.

We were unable to make all of the required payments pursuant to the terms of the September 2007 agreement. This secured convertible promissory note is secured by the equipment leased by us pursuant to the aforementioned operating lease. Upon payment of the balance due on this secured convertible promissory note title of the equipment will be transferred to us free and clear of all liens and encumbrances.

The note holder has the right to convert the note, in its entirety or in part, into our common stock at the rate of \$1.00 per share.

We had a secured promissory note with the parent company that matured on December 30, 2011. We continued to make monthly principal and interest payments. At May 31, 2013, the outstanding principal and accrued interest of the secured promissory note was \$239,504.

On May 31, 2013, we issued a secured convertible promissory note in exchange for the existing secured promissory note with a balance due, including accrued interest, of \$239,504, which had matured on December 30, 2011. The secured convertible promissory note extended the maturity date to May 31, 2018 and increased the interest rate. The note holder has the right to convert the note, in its entirety or in part, into our common stock at the rate of \$1.00 per share.

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, 2014 and 2013 by our principal accountant.

	2014	2013
Audit Fees – Malone Bailey LLP	\$33,000	\$15,000
Audit Fees – Hood & Associates, CPAs, PC	-	2,000
Tax Fees – Hood & Associates, CPAs, PC	2,045	2,031
All Other Fees – Hood & Associates, CPAs, PC	135	384

Table of Contents

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 three 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.

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)	#
3.3	Amended and Restated Certificate of Incorporation of FullNet Communications, Inc.	
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	Certificate of Designation, Preferences, and Rights of Series A Convertible Preferred Stock of FullNet Communications, Inc.	#
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).	#

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

- 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 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). #
- 10.5 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). #
- 10.6 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). #

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	
10.7	Employment Agreement with Timothy J. Kilkenny dated July 31, 2002	#
10.8	Employment Agreement with Roger P. Baresel dated July 31, 2002	#
10.9	Secured Promissory Note and Security Agreement dated December 30, 2009, issued to High Capital Funding, LLC	#
10.10	Employment Agreement with Jason Ayers dated January 1, 2011	#
10.11	Employment Agreement with Timothy J. Kilkenny dated July 6, 2011	#
10.12	Employment Agreement with Roger P. Baresel dated July 6, 2011	#
10.13	Employment Agreement with Jason Ayers dated July 6, 2011	#
10.14	Form of Exchange Offer Acceptance Agreement	#
10.15	Secured Exchange Promissory Note and Security Agreement dated May 31, 2013, issued to High Capital Funding, LLC	#
10.16	Secured Exchange Promissory Note and Security Agreement dated May 31, 2013, issued to High Capital Funding, LLC	#
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	*
101.INS	XBRL Instance Document	**
101.SCH	XBRL Taxonomy Extension Schema Document	**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	**

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

**

Incorporated by reference.

* Filed herewith.

** In accordance with Rule 406T of Regulation S-T, the XBRL (Extensible Business Reporting Language) related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except to the extent expressly set forth by specific reference in such filing.

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 31, 2015

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

Date: March 31, 2015

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 31, 2015

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

Date: March 31, 2015

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

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

FullNet Communications, Inc. and Subsidiaries

Oklahoma City, Oklahoma

We have audited the accompanying consolidated balance sheets of FullNet Communications, Inc. and Subsidiaries (collectively, the “Company”) as of December 31, 2014 and 2013, and the related consolidated statements of operations, stockholders’ deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting 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 misstatements. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of FullNet Communications, Inc. and Subsidiaries as of December 31, 2014 and 2013, and the related results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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

/s/ MaloneBailey, LLP

www.malone-bailey.com

Houston, Texas

March 31, 2015

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

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	2014	2013
ASSETS		
CURRENT ASSETS	\$	\$
Cash	14,614	30,072
Accounts receivable, net	12,389	17,540
Prepaid expenses and other current assets	9,377	8,728
Total current assets	36,380	56,340
PROPERTY AND EQUIPMENT, net	109,288	44,635
OTHER ASSETS AND INTANGIBLE ASSETS	8,661	10,948
	\$	\$
TOTAL ASSETS	154,329	111,923
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES	\$	\$
Accounts payable	214,917	127,077
Accrued and other liabilities	486,961	410,763
Convertible notes payable, related party - current portion	46,811	45,060
Deferred revenue	345,967	302,129
Total current liabilities	1,103,656	885,029
CONVERTIBLE NOTES PAYABLE, related party - less current portion	199,063	230,129
Total liabilities	1,302,719	1,115,158
STOCKHOLDERS' DEFICIT		

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Preferred stock — \$.001 par value; authorized, 10,000,000 shares; Series A convertible; issued and outstanding, 987,102 shares in 2014 and 2013	490,905	430,382
Common stock — \$.00001 par value; authorized, 40,000,000 shares; issued and outstanding, 9,118,161 shares in 2014 and 2013	91	91
Additional paid-in capital	8,678,869	8,716,803
Accumulated deficit	(10,318,255)	(10,150,511)
Total stockholders' deficit	(1,148,390)	(1,003,235)
	\$	\$
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	154,329	111,923

See accompanying notes to consolidated financial statements.

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

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended December 31,	
	2014	2013
REVENUES	\$	\$
Access service revenues	89,689	112,613
Co-location and other revenues	1,664,562	1,514,247
Total revenues	1,754,251	1,626,860
OPERATING COSTS AND EXPENSES		
Cost of access service revenues	99,004	109,716
Cost of co-location and other revenues	361,872	327,296
Selling, general and administrative expenses	1,394,203	1,318,810
Depreciation and amortization	40,165	29,087
Impairment expense	11,007	-
Total operating costs and expenses	1,906,251	1,784,909
LOSS FROM OPERATIONS	(152,000)	(158,049)
GAIN ON SERIES A CONVERTIBLE PREFERRED STOCK ISSUED IN EXCHANGE FOR INDEBTEDNESS	-	401,004
INTEREST EXPENSE	(15,744)	(19,588)
	\$	\$
NET INCOME (LOSS)	(167,744)	223,367
Preferred stock dividends	(60,523)	(67,247)
	\$	\$
Net income (loss) available to common stockholders	(228,267)	156,120
Net income (loss) per share		

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

	\$	\$
Basic	(.03)	.02
	\$	\$
Assuming dilution	(.03)	.01
Weighted average shares outstanding		
Basic	9,118,161	9,118,161
Assuming dilution	9,118,161	11,698,069

See accompanying notes to consolidated financial statements.

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT

Years ended December 31, 2014 and 2013

	Common stock		Preferred stock		Additional paid-in capital	Accumulated deficit	Total
	Shares	Amount \$	Shares	Amount \$			
Balance at January 1, 2013	9,118,161	91	-	-	8,417,050	(10,373,878)	(1,956,737)
Stock options compensation	-	-	-	-	51,481	-	51,481
Series A convertible preferred stock issued in settlement of liabilities	-	-	987,102	672,472	-	-	672,472
Increasing dividend rate preferred stock discount	-	-	-	(309,337)	309,337	-	-
Amortization of increasing dividend rate preferred stock discount	-	-	-	67,247	(67,247)	-	-
Stock warrants issued for services	-	-	-	-	6,182	-	6,182
Net income	-	-	-	-	-	223,367	223,367
		\$		\$	\$	\$	\$
Balance at December 31, 2013	9,118,161	91	987,102	430,382	8,716,803	(10,150,511)	(1,003,235)
	-	-	-	-	22,589	-	22,589

Stock options
compensation

Amortization of
increasing dividend
rate preferred stock
discount

Net loss

Balance at December
31, 2014

	-	-	-	60,523	(60,523)	-	-
	-	-	-	-	-	(167,744)	(167,744)
		\$		\$	\$	\$	\$
	9,118,161	91	987,102	490,905	8,678,869	(10,318,255)	(1,148,390)

See accompanying notes to consolidated financial statements.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
	\$	\$
Net income (loss)	(167,744)	223,367
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	40,165	29,087
Stock options compensation	22,589	51,481
Stock warrants issued for services	-	6,182
Impairment expense	11,007	-
Provision (recovery) for uncollectible accounts receivable	(5,665)	13,643
(Gain) on Series A convertible preferred stock issued in exchange for indebtedness	-	(401,004)
Net (increase) decrease in		
Accounts receivable	10,816	(15,512)
Prepaid expenses and other current assets	(649)	(2,325)
Net increase (decrease) in		
Accounts payable	51,308	35,134
Accrued and other liabilities	67,461	11,873
Deferred revenue	48,757	103,292
Net cash provided by operating activities	78,045	55,218
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for property and equipment	(62,188)	(11,976)
Cash paid for intangible asset	(2,000)	-
Net cash used in investing activities	(64,188)	(11,976)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable – related party	(29,315)	(24,017)
Net cash used in financing activities	(29,315)	(24,017)
NET INCREASE (DECREASE) IN CASH	(15,458)	19,225
Cash at beginning of period	30,072	10,847
Cash at end of period	\$	\$

	14,614	30,072
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
	\$	\$
Cash paid for interest	15,744	19,075
NON-CASH INVESTING AND FINANCING ACTIVITIES		
	\$	\$
Property and equipment assets purchased on accounts	36,532	-
	\$	\$
Series A convertible preferred stock issued for settlement of debt and accrued interest	-	59,634
	\$	\$
Series A convertible preferred stock issued for settlement of accounts payable	-	317,961
	\$	\$
Series A convertible preferred stock issued for settlement of deferred compensation	-	656,133
	\$	\$
Increasing dividend rate preferred stock discount	-	(309,337)
	\$	\$
Amortization of increasing dividend rate preferred stock discount	60,523	67,247
	\$	\$
Reclassification of accounts payable to convertible debt – related party	-	50,000

See accompanying notes to consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2014 and 2013

NOTE A — SUMMARY OF ACCOUNTING POLICIES AND NATURE OF OPERATIONS

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

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;
- Advanced voice and data solutions; and

- Traditional telephone services.

Consolidation

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

-

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.

Cash Equivalents

Cash equivalents are represented by operating accounts or money market accounts maintained with insured financial institutions which consist of highly liquid investments that mature in three months or less from date of purchase.

Accounts Receivable

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.

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 collectability as follows:

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

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

In addition, if the Company becomes aware of a specific customer's inability to meet its financial obligations, a specific reserve is recoded against amounts due to reduce the net recognized receivable to the amount reasonably expected to be collected. There was a net reduction in bad debt expense and direct write-off for the year ended December 31, 2014 of \$5,665.

Total bad debt expense and direct write-off for the year ended December 31, 2013 was \$13,643.

Accounts receivable consist of the following at December 31:

	Schedule of Accounts Receivable	
	2014	2013
	\$	\$
Accounts receivable	216,475	261,510
Less allowance for doubtful accounts	(204,086)	(243,970)
	\$	\$
	12,389	17,540

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

Property and equipment consist of the following at December 31:

	2014	2013
--	------	------

	\$	\$
Computers and equipment	1,542,699	1,536,744
Leasehold improvements	1,083,453	994,152
Software	58,041	57,337
Furniture and fixtures	34,581	31,821
	2,718,774	2,620,054
Less accumulated depreciation	(2,609,486)	(2,575,419)
	\$	\$
	109,288	44,635

Depreciation expense for the years ended December 31, 2014 and 2013 was \$34,067 and \$23,177, respectively.

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. In accordance with ASC 360-10-35 "Impairment or Disposal of Long-lived Assets", 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. During the year ended December 31, 2014, \$2,000 was paid for intangible assets. The Company incurred an impairment expense of \$11,007 in 2014 and no impairment expense was incurred in 2013. Amortization expense for the years ended December 31, 2014 and 2013 was \$6,098 and \$5,910, respectively.

Revenue Recognition

Table of Contents

Revenues are reported on a monthly basis as services are provided, price is fixed and determinable, persuasive evidence of an arrangement exists and collectability of the resulting receivable is reasonably assured. 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. Revenues are presented net of taxes and fees billed to customers and remitted to governmental authorities.

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, 2014 and 2013 was \$99,805 and \$61,753, respectively.

Income Taxes

The Company accounts for income taxes utilizing ASC 740, "Income Taxes" (SFAS No. 109). ASC 740 requires the measurement of deferred tax assets for deductible temporary differences and operating loss carry forwards, and of deferred tax liabilities for taxable temporary differences. Measurement of current and deferred tax liabilities and assets is based on provisions of enacted tax law. The effects of future changes in tax laws or rates are not included in the measurement. The Company recognizes the amount of taxes payable or refundable for the current year and recognizes deferred tax liabilities and assets for the expected future tax consequences of events and transactions that have been recognized in the Company's financial statements or tax returns. The Company currently has substantial net operating loss carry forwards. The Company has recorded a 100% valuation allowance against net deferred tax assets due to uncertainty of their ultimate realization. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to 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, 2014. The Company files income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions.

Income Per Share

Income (loss) 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.

	2014	2013
Numerator:		
	\$	\$
Net income (loss) available to common shareholders	(228,267)	156,120
Denominator:		
Weighted average shares and share equivalents outstanding – basic	9,118,161	9,118,161
Effect of dilutive preferred stock	-	987,102
Effect of dilutive stock options	-	871,361
Effect of dilutive warrants	-	721,445
Weighted average shares and share equivalents outstanding – assuming dilution	9,118,161	11,698,069
	\$	\$
Net income (loss) per share — basic	(.03)	.02
	\$	\$
Net income (loss) per share — assuming dilution	(.03)	.01
Anti-dilutive securities excluded (1)	-	1,885,389

(1)

Anti-dilutive securities consist of stock options, warrants and convertible promissory notes that were not included in the computation of diluted earnings per share because the exercise price was greater than the average market price of the common stock.

Basic and diluted loss per share were the same for the year ended December 31, 2014 because there was a net loss for the year.

Table of Contents

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 2014 and 2013 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).

The fair values of the granted options are estimated at the date of grant using the Black-Scholes option pricing model. See Note G – Common Stock and Stock-Based Compensation for further information on stock-based compensation.

Beneficial Conversion Features

The intrinsic value of a beneficial conversion feature inherent to a convertible note payable, which is not bifurcated and accounted for separately from the convertible note payable and may not be settled in cash upon conversion, is treated as a discount to the convertible note payable. This discount is amortized over the period from the date of issuance to the date the note is due using the effective interest method. If the note payable is retired prior to the end of its contractual term, the unamortized discount is expensed in the period of retirement to interest expense. In general, the beneficial conversion feature is measured by comparing the effective conversion price, after considering the relative fair value of detachable instruments included in the financing transaction, if any, to the fair value of the common shares at the commitment date to be received upon conversion.

Related Parties

A party is considered to be related to the Company if the party directly or indirectly or through one or more intermediaries, controls, is controlled by, or is under common control with the Company. Related parties also include principal owners of the Company, its management, members of the immediate families of principal owners of the Company and its management and other parties with which the Company may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

Fair Value Measurements

The Company measures its financial assets and liabilities in accordance with the requirements of FASB ASC 820, “Fair Value Measurements and Disclosures”. ASC 820 clarifies the definition of fair value, prescribes methods for measuring fair value, and establishes a fair value hierarchy to classify the inputs used in measuring fair value as follows:

Level 1 –

Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, marketable securities and listed equities.

Level 2 -

Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reported date and includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category generally include non-exchange-traded derivatives such as commodity swaps, interest rate swaps, options and collars.

Level 3 –

Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value.

Table of Contents

Recent Accounting Pronouncements

There have been no recent accounting pronouncements that would impact our financial statements.

NOTE B — GOING CONCERN

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, 2014 and 2013 current liabilities exceeded current assets by \$1,067,276 and \$828,689, respectively. These factors raise substantial doubt about the Company's ability to continue as a going concern.

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 through mergers and acquisitions and the development of its web hosting, co-location, traditional telephone services and advanced voice and data solutions. 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 C — CONVERTIBLE NOTES PAYABLE RELATED PARTY

Notes payable consist of the following:

Schedule of Notes Payable
December 31, 2014

December 31, 2013

Secured convertible promissory note from a shareholder; interest rate of 6% through December 31, 2014, 7% through December 31, 2015, 8% through December 31, 2016, 8.5% through December 31, 2017, and 9% through May 31, 2018, with fixed monthly payments of \$3,301 through the Maturity Date, at which time the remaining balance of principal and all accrued interest shall be due and payable; matures May 31, 2018; secured by all tangible and intangible assets of the Company (1)

\$

\$

198,363

225,189

Secured convertible promissory note; interest at 6%, requires monthly installments of interest only through May 31, 2014, then requires monthly installments of \$600 including principal and interest; matures May 31, 2023; secured by certain equipment of the Company (2)

47,511

50,000

245,874

275,189

Less current portion

46,811

45,060

Convertible notes payable, related party - less current portion

\$

\$

199,063

230,129

(1)

On May 31, 2013, the Company issued this secured convertible promissory note in exchange for the existing secured promissory note with a balance due, including accrued interest, of \$239,504, which had matured on December 30, 2011. During the year of 2013, the Company continued to make principal and interest payments of \$9,702 and \$6,801, respectively, on the secured promissory note. The secured convertible promissory note extended the maturity date to May 31, 2018 and increased the interest rate as noted above. The note holder has the right to convert the note, in its entirety or in part, into common stock of the Company at the rate of \$1.00 per share. During the years 2014 and 2013, the Company made principal payments of \$26,826 and \$14,315, respectively. The secured convertible promissory note had a balance of \$198,363 at December 31, 2014.

Table of Contents

The Company analyzed the modification of the term under ASC 470-60 “Trouble Debt Restructurings” and ASC 470-50 “Extinguishment of Debt”. The Company determined the creditor has not granted a concession and the modification of the embedded conversion options does not fall in the scope of ASC 470-50.

The Company analyzed the conversion option for derivative accounting and beneficial conversion features consideration under ASC 815-15 “Derivatives and Hedging” and ASC 470-20 “Convertible Securities with Beneficial Conversion Features” and noted none.

(2)

On May 31, 2013, the Company issued this secured convertible promissory note and on June 3, 2013, issued 203,169 shares of its Series A convertible preferred stock, in complete satisfaction of the balance due in the amount of \$253,169 on an operating lease for certain equipment which was leased from one of its shareholders whose parent company holds the \$198,363 secured convertible promissory note. The Company recognized \$195,042 as gain on settlement of accounts payable for the year ended December 31, 2013 (see Note H – Series A Convertible Preferred Stock). During the years 2014, the Company made principal payments of \$2,489. The secured convertible promissory had a balance of \$47,511 at December 31, 2014.

The Company had been unable to make all of the required payments pursuant to the terms of the September 2007 agreement. This secured convertible promissory note is secured by the equipment leased by the Company pursuant to the aforementioned operating lease. Upon payment of the balance due on this secured convertible promissory note title of the equipment will be transferred to the Company free and clear of all liens and encumbrances.

The note holder has the right to convert the note, in its entirety or in part, into common stock of the Company at the rate of \$1.00 per share.

The Company analyzed the conversion option for derivative accounting and beneficial conversion features consideration under ASC 815-15 “Derivatives and Hedging” and ASC 470-20 “Convertible Securities with Beneficial Conversion Features” and noted none.

Aggregate future maturities of notes payable and accrued interest at December 31, 2014 are as follows:

	\$	
2015		46,811
2016		46,811
2017		46,811

2018	133,057
2019	7,203
Thereafter	24,612
	\$
	305,305

NOTE D – COMMITMENTS AND CONTINGENCIES

COMMITMENTS

Operating Leases

The Company leases its executive office space under a non-cancelable operating lease, at an effective annual rental rate of \$16.50 per square foot, which will expire December 31, 2019. Future minimum lease payments required at December 31, 2014 under non-cancelable operating leases that have initial lease terms exceeding one year are presented in the following table:

Year ending December 31	\$
2015	221,782
2016	221,782
2017	221,782
2018	221,782
2019	221,782
	\$
	1,108,910

Rental expense for all operating leases for the years ended December 31, 2014 and 2013 was approximately \$309,949 and \$278,275, respectively.

Table of Contents

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 \$32,615 at December 31, 2014, which is reflected in Accrued and Other 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 E — INCOME TAXES

The Company uses the liability method, where deferred tax assets and liabilities are determined based on the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial and income tax reporting purposes.

The Company has historically incurred losses from operations and therefore had no tax liability. The net deferred asset generated by the loss carry-forward has been fully reserved. The cumulative net operating loss carry-forward is approximately \$2,824,227 and \$2,689,176 for 2014 and 2013, respectively and will begin expiring in 2023.

Deferred tax assets consist of the tax effect of NOL carry-forwards. The Company has provided a full valuation allowance on the deferred tax assets because of the uncertainty regarding its realizability. Deferred tax assets consist of the following:

	December 31, 2014	December 31, 2013
Net operating loss carry-forwards	\$	\$
	960,237	914,320
Valuation allowance	(960,237)	(914,320)
	\$	\$
	-	-

NOTE F — COMMON STOCK AND STOCK-BASED COMPENSATION

COMMON STOCK

On June 3, 2013, holders of a majority of the outstanding common stock of the Company executed a Shareholder Consent to Action in Lieu of a Meeting and approved the amendment and restatement of the Company's Articles of Incorporation to increase the number of authorized shares of the Company's common stock from 10,000,000 to 40,000,000 shares, \$.00001 par value per share.

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 2014 and 2013 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).

The following table summarizes the Company's employee stock option activity for the years ended December 31, 2014 and 2013:

Schedule of Employee Stock Option Activity			
Options	Weighted average	Weighted average remaining	Aggregate intrinsic value

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

		exercise price	contractual life (yrs)	
Options outstanding, December 31, 2012	1,404,550	\$	3.06	
			.034	
Options exercisable, December 31, 2012	1,249,550	\$	2.27	\$
			.037	4,920
Options granted during the year	2,793,348		.031	
Options cancelled during the year	(827,848)		.040	
Options forfeited during the year	(57,000)		.027	
Options expired during the year	(110,168)		.040	
Options outstanding, December 31, 2013	3,202,882	\$	9.10	
			.030	
Options exercisable, December 31, 2013	1,755,882	\$	8.75	\$
			.027	42,261
Options granted during the year	127,500		.027	
Options forfeited during the year	(20,000)		.025	
Options expired during the year	(15,000)		.050	
Options outstanding, December 31, 2014	3,295,382	\$	8.20	
			.029	
Options exercisable, December 31, 2014	1,933,549	\$	7.84	\$
			.025	50,788

The following table summarizes the Company's non-vested employee stock option activity for years ended December 31, 2014 and 2013:

	2014	2013
Non-vested options outstanding, beginning of year	1,447,000	155,000

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-K

Options granted during the year	127,500	2,793,348
Options vested during the year	(192,667)	(1,444,348)
Options forfeited during the year	(20,000)	(57,000)
Non-vested options outstanding, end of year	1,361,833	1,447,000

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:

	2014	2013
Risk free interest rate	1.41% – 1.70%	0.72%-1.66%
Expected lives (in years)	5	5
Expected volatility	222%-234%	186%-243%
Dividend yield	0%	0%

The following table shows total stock options compensation expense included in the Consolidated Statements of Operations and

Table of Contents

the effect on basic and diluted earnings per share for the years ended December 31:

	2014	2013
	\$	\$
Stock options compensation	22,589	51,481
Impact on income per share:		
	\$	\$
Basic	-	-
	\$	\$
Assuming dilution	-	-

During the year 2014, 127,500 employee stock options were granted which will vest one-third on each annual anniversary of the grant date resulting in \$276 of stock options compensation. Stock options compensation of \$22,313 recorded in the year 2014 was related to options that were granted in prior years. During the year 2014, 3,000 employee stock options were granted and forfeited in the same year. Additionally, 17,000 employee stock options were forfeited that related to options granted in prior years. At December 31, 2014 there was \$17,584 of unrecognized stock options compensation that is expected to be recognized as an expense over a weighted-average period of 5.2 years.

Also during the year 2014, 15,000 of employee stock options were expired.

During the year 2013, 827,848 employee stock options were granted which were fully vested at grant date and 1,911,500 employee stock options were granted which were one-third vested at grant date resulting in \$16,448 and \$30,608 of stock options compensation, respectively. Stock options compensation of \$4,425 recorded in the year 2013 was related to options that vested in prior years. During the year 2013, 54,000 employee stock options were granted and forfeited in the same year. Additionally, 3,000 employee stock options were forfeited that related to options granted in prior years. At December 31, 2013 there was \$37,308 of unrecognized stock options compensation that is expected to be recognized as an expense over a weighted-average period of 5.1 years.

Also during the year 2013, 110,168 and 827,848 of employee stock options were expired and cancelled, respectively.

Common Stock Purchase Warrants – A summary of common stock purchase warrant activity for the years ended December 31, 2014 and 2013 follows:

Outstanding common stock purchase warrants issued to non-employees outstanding at December 31, 2014 and 2013 are as follows:

Number of shares	Exercise price	Expiration year
140,000	\$.010	2015
425,000	\$.003	2015
250,000	\$.003	2023
815,000		

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

	2014	Weighted Average Exercise Price	2013	Weighted Average Exercise Price
		\$		\$
Warrants and non-employee stock options outstanding, beginning of year	815,000	.004	565,000	.005
Warrants and non-employee stock options granted during the year	-	-	250,000	.003
Warrants and non-employee stock options expired during the year	-	-	-	-
		\$		\$
Warrants and non-employee stock options outstanding, end of year	815,000	.004	815,000	.004

Table of Contents

Of the 815,000 warrants and non-employee stock options outstanding at December 31, 2014, 550,000 were issued as equity compensation for consulting services and 265,000 were issued for interim financing.

During the year ended December 31, 2013, 250,000 warrants were issued for consulting services. The fair value of the granted warrants are estimated at the date of grant using the Black-Scholes option pricing model and the total value of \$6,182 of warrants expense was recognized for the year ended December 31, 2013.

The Black-Scholes option pricing model was used with the following weighted-average assumptions for warrants granted during the year ended December 31, 2013. No warrants were granted during the year ended December 31, 2014.

	2013
Risk free interest rate	1.36%
Expected lives (in years)	3
Expected volatility	243%
Dividend yield	0%

NOTE G — SERIES A CONVERTIBLE PREFERRED STOCK

On June 3, 2013, pursuant to shareholder authorization, the Company issued 987,102 shares of its Series A convertible preferred stock and \$401,004 was recognized as gain on Series A convertible preferred stock issued in exchange for indebtedness for the year ended December 31, 2013. See breakdown below:

The Company issued 59,634 and 203,169 of its series A convertible preferred stock to settle \$55,000 of debt, \$4,634 of accrued interest and \$203,169 of accounts payable (see Note D – Convertible Notes Payable Related Party). As a result, the Company recognized a gain on settlement of debt and accrued interest of \$57,248 and a gain on settlement of accounts payable of \$195,042.

Members of the Company’s management and board of directors accounted for 609,507 shares of the shares issued in exchange for \$609,507 and \$46,626 of the Company’s deferred compensation and accrued payroll taxes. Participation of the Company’s management and board of directors in this exchange was approved by a majority of the Company’s shareholders.

Also, accounts payable of \$114,792 was exchanged for 114,792 of series A convertible preferred stock. The Company recognized \$110,200 as gain on settlement of accounts payable for the year ended December 31, 2013. An additional \$38,514 of gain netted against \$9,694 of professional fees was recognized as the Company wrote off additional accounts payables and deferred compensation due to the applicable Statute of Limitations.

The shares of Series A convertible preferred stock are convertible into common shares of the Company at the rate of one share of common stock per share of Series A convertible preferred stock.

The holders of shares of the Series A convertible preferred stock are entitled to receive, when and as declared by the Company's board of directors, dividends in cash in the amount of one cent per share per annum through December 31, 2016, five cents per share per annum through December 31, 2017, six cents per share per annum through December 31, 2018, seven cents per share per annum through December 31, 2019, eight cents per share per annum through December 31, 2020, nine cents per share per annum through December 31, 2021, ten cents per share per annum through December 31, 2022, eleven cents per share per annum through December 31, 2023, and twelve cents per share per annum thereafter, payable within 90 days following the 31st day of December each year on such date as determined by the board of directors. The dividends are cumulative and beginning January 1, 2017, the board of directors of the Company may elect to make any required dividend payment with the Company's unregistered common stock in lieu of cash.

Due to the unstated dividend cost arising from the gradually increasing dividends on the Series A convertible preferred stock, the Company calculated a discount on the Series A convertible preferred stock at the time of issuance as the present value of the difference between (i) the dividends that are payable in the periods preceding commencement of the perpetual twelve cents per share per annum dividend; and (ii) the perpetual twelve cents per share per annum dividend for a corresponding number of periods; discounted at a market rate of 12% totaling \$309,337. The Series A convertible preferred stock was valued at the market price on the respective date of issuance for a total value of \$672,472. The discount will be amortized over the periods preceding commencement of the perpetual dividend, by charging imputed dividend cost against retained earnings and increasing the carrying amount of the Series A convertible preferred stock by a corresponding amount. The discount amortization for the years ended December 31, 2014 and 2013 was \$60,523 and \$67,247, respectively.

The Series A convertible preferred stock is non-voting except that in the event that the Company fails, for any reason, to make a dividend payment as set forth above, then each share of Series A convertible preferred stock shall thereafter be entitled to two votes upon any matter that the holders of the common stock of the Company are entitled to vote upon.

Table of Contents

The Series A convertible preferred stock may be redeemed at the option of the Company's board of directors for one dollar per share plus all accrued and unpaid dividends thereon at the date of redemption. In addition, at any time after a change of control of the Company, the holders of the Series A convertible preferred stock shall have the right, at the election of a majority of the holders, to require the Company to redeem all of the Series A convertible preferred stock for one dollar per share plus all accrued and unpaid dividends thereon at the date of redemption.

The Series A convertible preferred stock has a liquidation preference of one dollar per share plus all accrued and unpaid dividends thereon in the event of liquidation, dissolution or winding up of the Company.

The Company analyzed the embedded conversion option for derivative accounting consideration under ASC 815-15 "Derivatives and Hedging" and determined that the conversion option should be classified as equity.

The Company analyzed the conversion option for beneficial conversion features consideration under ASC 470-20 "Convertible Securities with Beneficial Conversion Features" and noted none.

NOTE H – RELATED PARTY

In 2013, the Company had an operating lease for certain equipment which was leased from Generation Capital Associates, one of its shareholders whose parent company, High Capital Funding, LLC also one of its shareholders, held a \$225,189 secured convertible promissory note (see Note C - Convertible Notes Payable Related Party). On May 31, 2013, the Company issued a \$50,000 secured convertible promissory note and on June 3, 2013, issued 203,169 shares of its Series A convertible preferred stock (see Note G – Series A Convertible Preferred Stock), in complete satisfaction of the balance due on the operating lease in the amount of \$253,169. The Company recognized \$195,042 as gain on settlement of accounts payable for the year ended December 31, 2013.

The Company had been unable to make all of the required payments pursuant to the terms of the September 2007 agreement. This secured convertible promissory note is secured by the equipment leased by the Company pursuant to the aforementioned operating lease. Upon payment of the balance due on this secured convertible promissory note title of the equipment will be transferred to the Company free and clear of all liens and encumbrances.

The note holder has the right to convert the note, in its entirety or in part, into common stock of the Company at the rate of \$1.00 per share.

NOTE I – PROPERTY AND EQUIPMENT

During the year ended December 31, 2014, \$62,188 was paid for property and equipment and \$36,532 was purchased on accounts.

During the year ended December 31, 2013, \$11,976 was paid for property and equipment.

NOTE J – SUBSEQUENT EVENT

In February 2015, the Company granted 150,000 employee stock options to one employee with an exercise price of \$.04. The stock options shall vest annually based upon the commissions earned by the employee at the rate of one share of Stock for each dollar in commissions earned and shall expire on February 3, 2025.

In March 2015, the Company granted 3,000 employee stock options to one employee with an exercise price of \$.04. The stock options shall vest one-third each year starting from March 16, 2016, and shall expire on March 16, 2025.

Table of Contents

EXHIBIT 31.1

CERTIFICATIONS

I, Timothy J. Kilkenny, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2014 of FullNet Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the year covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the years presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the year in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the

effectiveness of the disclosure controls and procedures, as of the end of the year covered by this report based on such evaluation; and

- (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2015

/s/ Timothy J. Kilkenny

Timothy J. Kilkenny

Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS

I, Roger P. Baresel, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2014 of FullNet Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the year covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the years presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the year in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the year covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2015

/s/ Roger P. Baresel

Roger P. Baresel

President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350 (as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002), I, the undersigned Chief Executive Officer of FullNet Communications, Inc. (the “Company”), hereby certify that, to the best of my knowledge, the Annual Report on Form 10-K of the Company for the year ended December 31, 2014 (the “Report”) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 31, 2015

/s/ Timothy J. Kilkenny
Timothy J. Kilkenny
Chief Executive Officer

Table of Contents

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350 (as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002), I, the undersigned President and Chief Financial and Accounting Officer of FullNet Communications, Inc. (the “Company”), hereby certify that, to the best of my knowledge, the Annual Report on Form 10-K of the Company for the year ended December 31, 2014 (the “Report”) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 31, 2015

/s/ Roger P. Baresel
Roger P. Baresel
President and Chief Financial and
Accounting Officer