

FULLNET COMMUNICATIONS INC

Form 10-Q

August 14, 2008

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2008

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

73-1473361

(State or other jurisdiction of incorporation or organization)

(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)**

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
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller 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

As of August 12, 2008, 7,425,565 shares of the registrant's common stock, \$0.00001 par value, were outstanding.

FORM 10-Q
TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Condensed Consolidated Balance Sheets June 30, 2008 (Unaudited) and December 31, 2007 (Derived from Audited Statements)</u>	3
<u>Condensed Consolidated Statements of Operations Three and six months ended June 30, 2008 and 2007 (Unaudited)</u>	4
<u>Condensed Consolidated Statement of Stockholders Deficit Six months ended June 30, 2008 (Unaudited)</u>	5
<u>Condensed Consolidated Statements of Cash Flows Six months ended June 30, 2008 and 2007 (Unaudited)</u>	6
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	19
<u>Item 4. Controls and Procedures</u>	19
<u>Item 4T. Controls and Procedures</u>	20
PART II. OTHER INFORMATION	
<u>Item 1. Legal Proceedings</u>	21
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	21
<u>Item 3. Defaults Upon Senior Securities</u>	21
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	21
<u>Item 5. Other Information</u>	21
<u>Item 6. Exhibits</u>	22
<u>Signatures</u>	26
<u>Exhibit 31.1</u>	

Exhibit 31.2

Exhibit 32.1

Exhibit 32.2

- 2 -

Table of Contents

FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS

	JUNE 30, 2008	DECEMBER 31, 2007
	(Unaudited)	(Derived from Audited Statements)
ASSETS		
CURRENT ASSETS		
Cash	\$ 11,901	\$ 15,369
Accounts receivable, net	15,657	25,968
Prepaid expenses and other current assets	27,644	62,271
Total current assets	55,202	103,608
PROPERTY AND EQUIPMENT, net	431,357	507,968
INTANGIBLE ASSETS, net	16,648	25,553
OTHER ASSETS	5,250	5,250
TOTAL	\$ 508,457	\$ 642,379
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Accounts payable trade	\$ 214,562	\$ 176,014
Accounts payable related party, current portion	5,988	5,988
Accrued and other current liabilities	1,059,245	1,017,223
Accrued interest related party, current portion	34,800	34,800
Notes payable, current portion	510,636	510,636
Notes payable related party, current portion	34,800	34,800
Deferred revenue	116,563	112,586
Total current liabilities	1,976,594	1,892,047
ACCOUNTS PAYABLE related party, less current portion	255,172	264,154
ACCRUED INTEREST related party, less current portion	176,550	181,397
NOTES PAYABLE related party, less current portion	264,900	285,200
OTHER LIABILITIES	29,454	44,452
Total liabilities	2,702,670	2,667,250

STOCKHOLDERS DEFICIT

Common stock \$.00001 par value; authorized, 10,000,000 shares; issued and outstanding, 7,355,308 and 6,670,878 shares in 2008 and 2007, respectively	75	68
Common stock issuable, 70,257 shares in 2008 and 2007	57,596	57,596
Additional paid-in capital	8,378,381	8,350,254
Accumulated deficit	(10,630,265)	(10,432,789)
Total stockholders deficit	(2,194,213)	(2,024,871)
TOTAL	\$ 508,457	\$ 642,379

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
REVENUES				
Access service revenues	\$ 136,891	\$ 163,800	\$ 280,238	\$ 325,653
Co-location and other revenues	330,821	310,329	674,658	610,447
Total revenues	467,712	474,129	954,896	936,100
OPERATING COSTS AND EXPENSES				
Cost of access service revenues	60,466	56,014	116,985	109,879
Cost of co-location and other revenues	78,237	82,653	159,761	160,781
Selling, general and administrative expenses	332,367	318,419	698,501	659,467
Depreciation and amortization	61,312	74,834	129,806	149,426
Total operating costs and expenses	532,382	531,920	1,105,053	1,079,553
LOSS FROM OPERATIONS	(64,670)	(57,791)	(150,157)	(143,453)
INTEREST EXPENSE	(23,855)	(24,362)	(47,319)	(49,024)
NET LOSS	\$ (88,525)	\$ (82,153)	\$ (197,476)	\$ (192,477)
Net loss per share basic	\$ (.01)	\$ (.01)	\$ (.03)	\$ (.03)
Net loss per share assuming dilution	\$ (.01)	\$ (.01)	\$ (.03)	\$ (.03)
Weighted average shares outstanding basic	7,425,565	6,741,135	7,147,991	6,741,135
Weighted average shares outstanding assuming dilution	7,425,565	6,741,135	7,147,991	6,741,135

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT (UNAUDITED)
Six Months Ended June 30, 2008

	Common stock Shares	Common stock Amount	Common Stock Issuable	Additional Paid In Capital	Accumulated Deficit	Total
Balance at January 1, 2008	6,670,878	\$ 68	\$ 57,596	\$ 8,350,254	\$ (10,432,789)	\$ (2,024,871)
Stock compensation expense				85		85
Options exercise	684,430	7		28,042		28,049
Net loss					(197,476)	(197,476)
Balance at June 30, 2008	7,355,308	\$ 75	\$ 57,596	\$ 8,378,381	\$ (10,630,265)	\$ (2,194,213)

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
	June 30,	
	2008	June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (197,476)	\$ (192,477)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	129,806	149,426
Stock compensation	85	77
Provision for uncollectible accounts receivable	1,477	1,768
Net (increase) decrease in		
Accounts receivable	8,834	8,790
Prepaid expenses and other current assets	34,627	2,908
Net increase (decrease) in		
Accounts payable trade	38,548	(14,940)
Accounts payable related party	(8,982)	36,530
Accrued and other liabilities	27,025	72,812
Accrued interest related party	(4,847)	15,869
Deferred revenue	3,977	9,899
Net cash provided by operating activities	33,074	90,662
 CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(44,291)	(40,842)
Acquisition of assets		(910)
Net cash used in investing activities	(44,291)	(41,752)
 CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable		(49,487)
Principal payments on borrowings under notes payable related party	(20,300)	
Proceeds from exercise of options	28,049	
Net cash provided by (used in) financing activities	7,749	(49,487)
NET DECREASE IN CASH	(3,468)	(577)
Cash at beginning of period	15,369	16,007
Cash at end of period	\$ 11,901	\$ 15,430

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid for interest	\$ 22,033	\$ 6,660
------------------------	-----------	----------

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the year ended December 31, 2007.

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. Operating results of the interim period are not necessarily indicative of the amounts that will be reported for the year ending December 31, 2008. Certain reclassifications have been made to prior period balances to conform with the presentation for the current period.

2. MANAGEMENT S PLANS

At June 30, 2008, current liabilities exceed current assets by \$1,921,392. The Company does not have a line of credit or credit facility to serve as an additional source of liquidity. Historically the Company has relied on shareholder loans as an additional source of funds. The Company is in default on various loans (see Note 9. Notes Payable). These factors raise substantial doubts about the Company's ability to continue as a going concern.

During September 2005, the Company received a back billing from AT&T (formerly SBC) of approximately \$230,000. Since then, the Company has received a number of additional back billings from AT&T that total in excess of \$7,900,000. The Company believes AT&T has no basis for these charges, has reviewed these billings with its attorneys and is vigorously disputing the charges. Therefore, the Company has not recorded any expense or liability related to these billings.

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

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

Table of Contents**3. 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.

4. LOSS PER SHARE

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

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Numerator:				
Net loss	\$ (88,525)	\$ (82,153)	\$ (197,476)	\$ (192,477)
Denominator:				
Weighted average shares outstanding basic	7,425,565	6,741,135	7,147,991	6,741,135
Effect of dilutive stock options				
Effect of dilutive warrants				
Weighted average shares outstanding assuming dilution	7,425,565	6,741,135	7,147,991	6,741,135
Net loss per share basic	\$ (.01)	\$ (.01)	\$ (.03)	\$ (.03)
Net loss per share assuming dilution	\$ (.01)	\$ (.01)	\$ (.03)	\$ (.03)

Basic and diluted losses per share were the same for the three and six months ended June 30, 2008 and 2007 because there was a net loss for each period.

5. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	June 30, 2008	December 31, 2007
Accounts receivable	\$ 204,882	\$ 213,716
Less allowance for doubtful accounts	(189,225)	(187,748)
	\$ 15,657	\$ 25,968

6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-Q

	June 30, 2008	December 31, 2007
Computers and equipment	\$ 1,464,468	\$ 1,420,177
Leasehold improvements	965,864	965,864
Software	57,337	57,337
Furniture and fixtures	28,521	28,521
	2,516,190	2,471,899
Less accumulated depreciation	(2,084,833)	(1,963,931)
	\$ 431,357	\$ 507,968

- 8 -

Table of Contents

Depreciation expense for the three months ended June 30, 2008 and 2007 was \$57,188 and \$68,915, respectively. Depreciation expense for the six months ended June 30, 2008 and 2007 was \$120,902 and \$137,197, respectively.

7. INTANGIBLE ASSETS

Intangible assets consist primarily of acquired customer bases and covenants not to compete and are carried net of accumulated amortization. Upon initial application of Statement of Financial Accounting Standard (SFAS) No. 142, *Goodwill and Intangible Assets*, as of January 1, 2002, the Company reassessed useful lives and began amortizing these intangible assets over their estimated useful lives and in direct relation to any decreases in the acquired customer bases to which they relate. Management believes that such amortization reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used.

Amortization expense for the three months ended June 30, 2008 and 2007 relating to intangible assets was \$4,124 and \$5,919, respectively. Amortization expense for the six months ended June 30, 2008 and 2007 relating to intangible assets was \$8,904 and \$12,229, respectively.

8. ACCRUED AND OTHER CURRENT LIABILITIES

Accrued and other current liabilities consist of the following:

	June 30, 2008	December 31, 2007
Accrued interest	\$ 378,390	\$ 349,561
Accrued deferred compensation	505,670	506,990
Accrued other liabilities	175,185	160,672
	\$ 1,059,245	\$ 1,017,223

9. NOTES PAYABLE

Notes payable consist of the following:

	June 30, 2008	December 31, 2007
Interim loan from a related party, interest at 10%, requires payments equal to 50% of the net proceeds received by the Company from its private placement of convertible promissory notes, matured December 2001; unsecured (1)	\$ 299,700	\$ 320,000
Convertible promissory notes; interest at 12.5% of face amount, payable quarterly; these notes are unsecured and matured at December 31, 2006 (convertible into approximately 1,003,659 shares at June 30, 2008 and December 31, 2007) (2)	510,636	510,636
	810,336	830,636
Less current portion	545,436	545,436

\$ 264,900 \$ 285,200

(1) In September 2007, the lender agreed to accept monthly payments of \$5,800 beginning December 1, 2007 to be allocated 50% to principal and 50% to interest. At June 30, 2008, the outstanding principal and interest of the interim loan was \$511,050.

Table of Contents

(2) During 2000 and 2001, the Company issued 11% convertible promissory notes or converted other notes payable or accounts payable to convertible promissory notes in an amount totaling \$2,257,624. The terms of the Notes are 36 months with limited prepayment provisions. Each of the Notes may be converted by the holder at any time at \$1.00 per common stock share and by the Company upon registration and when the closing price of the Company's common stock has been at or above \$3.00 per share for three consecutive trading days. Additionally, the Notes are accompanied by warrants exercisable for the purchase of the number of shares of

Company common stock equal to the number obtained by dividing 25% of the face amount of the Notes purchased by \$1.00. These warrants are exercisable at any time during the five years following issuance at an exercise price of \$.01 per share. Under the terms of the Notes, the Company was required to register the common stock underlying both the Notes and the detached warrants by filing a registration statement with the Securities and Exchange Commission within 45 days following the Final Expiration Date of the Offering (March 31, 2001). On May 31, 2001, the Company exchanged 2,064,528 shares of its common stock and warrants (exercisable for the purchase of 436,748 shares

of common stock at \$2.00 per share) for convertible promissory notes in the principal amount of \$1,746,988 (recorded at \$1,283,893) plus accrued interest of \$123,414. The warrants expired on May 31, 2006. This exchange was accounted for as an induced debt conversion and a debt conversion expense of \$370,308 was recorded.

Pursuant to the provisions of the convertible promissory notes, the conversion price was reduced from \$1.00 per share on January 15, 2001 to \$.49 per share on December 31, 2003 for failure to register under the Securities Act of 1933, as amended, the common stock underlying the convertible promissory notes and underlying

warrants on February 15, 2001. Reductions in conversion price are recognized at the date of reduction by an increase to additional paid-in capital and an increase in the discount on the convertible promissory notes. Furthermore, the interest rate was increased to 12.5% per annum from 11% per annum because the registration statement was not filed before March 1, 2001. At June 30, 2008, the outstanding principal and interest of the convertible promissory notes was \$889,026.

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

promissory
notes.

In November
and
December 2003
and
March 2004,
\$455,000,
\$50,000 and
\$5,636,
respectively, of
these
convertible
promissory
notes matured.
The Company
has not made
payment or
negotiated an
extension of
these notes, and
the lenders have
not made any
demands. The
Company is
currently
developing a
plan to satisfy
these notes
subject to the
approval of each
individual note
holder.

10. COMMON STOCK OPTIONS AND WARRANTS

The following table summarizes the Company's employee stock option activity for the three and six months ended June 30, 2008:

	Three Months Ended June 30, 2008	Weighted Average Exercise Price	Six Months Ended June 30, 2008	Weighted Average Exercise Price
Options outstanding, beginning of the period	2,447,704	\$.53	3,132,134	\$.42
Options granted during the period	3,000	.04	6,000	.04
Options exercised during the period			(684,430)	.04
Options cancelled during the period			(3,000)	.04

Options outstanding, end of the period	2,450,704	\$.53	2,450,704	\$.53
--	-----------	----	-----	-----------	----	-----

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), *Share-Based Payment*. SFAS 123(R) replaced SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes *Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees*. The Company adopted SFAS 123(R) on January 1, 2006 using the modified prospective method as described in the standard. Under the modified prospective method, the Company is required to record compensation cost for new and modified awards over the related vesting period of such awards prospectively and record compensation cost prospectively for the unvested portion at time of adoption, of previously issued and outstanding awards over the remaining vesting period of such awards. As of January 1, 2006, the Company had no unvested outstanding awards and as a result, the adoption of SFAS123(R) had no impact on the Company's consolidated financial statements or consolidated results of operations.

Table of Contents

The following table summarizes the Company's common stock purchase warrant and non-employee stock option activity for the three and six months ended June 30, 2008:

	Three Months Ended June 30, 2008	Weighted Average Exercise Price	Six Months Ended June 30, 2008	Weighted Average Exercise Price
Warrants and non-employee stock options outstanding, beginning of the period	591,000	\$.49	641,000	\$.45
Warrants and non-employee stock options expired during the period			(50,000)	.01
Warrants and non-employee stock options outstanding, end of the period	591,000	\$.49	591,000	\$.49

11. RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. On February 6, 2008, the FASB issued Financial Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157* . This Staff Position delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the FASB and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS 157. Management is assessing the impact of the adoption of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). This statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted the provisions of SFAS 159 on January 1, 2008.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R) which is a revision of Statement No. 141, *Business Combinations*. SFAS 141R will apply to all business combinations and will require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at full fair value at the acquisition date. SFAS 141R will also require transaction-related costs to be expensed in the period incurred, rather than capitalizing these costs as a component of the respective purchase price. SFAS 141R is effective for acquisitions completed after January 1, 2009 and early adoption is prohibited. Management is assessing the impact of the adoption of SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160), an amendment of ARB No. 51. SFAS 160 will change the accounting and reporting for minority interests which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. SFAS 160 requires

retroactive adoption of the presentation and disclosure requirements for existing minority interests. The Company is assessing the impact that SFAS 160 may have on its financial position, results of operations, and cash flows.

Table of Contents

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). This statement will require enhanced disclosures about derivative instruments and hedging activities to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Management is assessing the impact of the adoption of SFAS 161.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company is currently evaluating the impact of the adoption of FSP No. 142-3 on its consolidated financial statements.

12. RELATED PARTY TRANSACTIONS

The Company has an operating lease for certain equipment which is leased from one of its significant shareholders who also holds a \$299,700 interim loan (see Note 9 Notes Payable). The original lease was dated November 21, 2001 and the terms were \$6,088 per month for 12 months with a fair market purchase option at the end of the lease. Upon default on the lease, the Company was allowed to continue leasing the equipment on a month-to-month basis at the same monthly rate as the original lease. The Company was unable to make the month-to-month payments. In January and November 2006, the Company agreed to extend the expiration date on 425,000 and 140,000, respectively, of common stock purchase warrants for the lessor in return for a credit of \$17,960 and \$3,940, respectively, on the operating lease. In September 2007, the lessor agreed to cease the monthly lease payments effective January 1, 2007 which generated a total of \$54,795 of forgiveness of debt income. The lessor also agreed to accept payments of \$499 per month on the balance owed. At June 30, 2008 the Company had recorded \$261,160 in unpaid lease payments. The loss of this equipment would have a material adverse effect on the Company's business, financial condition and results of operations.

13. CONTINGENCIES

During September 2005, the Company received a back billing from AT&T (formerly SBC) of approximately \$230,000. Since then, the Company has received a number of additional back billings from AT&T that total in excess of \$7,900,000. The Company believes AT&T has no basis for these charges, has reviewed these billings with its attorneys and is vigorously disputing the charges. Therefore, the Company has not recorded any expense or liability related to these billings.

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.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is qualified in its entirety by the more detailed information in our Form 10-K and the financial statements contained therein, including the notes thereto, and our other periodic reports filed with the Securities and Exchange Commission since December 31, 2007 (collectively referred to as the Disclosure Documents). Certain forward-looking statements contained in this Report and in the Disclosure Documents regarding our business and prospects are based upon numerous assumptions about future conditions which may ultimately prove to be inaccurate and actual events and results may materially differ from anticipated results described in such statements. Our ability to achieve these results is subject to certain risks and uncertainties, including those inherent risks and uncertainties generally in the Internet service provider and competitive local exchange carrier industries, the impact of competition and pricing, changing market conditions, and other risks. Any forward-looking statements contained in this Report represent our judgment as of the date of this Report. We disclaim, however, any intent or obligation to update these forward-looking statements. As a result, the reader is cautioned not to place undue reliance on these forward-looking statements. References to us in this report include our subsidiaries: FullNet, Inc. (FullNet), FullTel, Inc. (FullTel) and FullWeb, Inc. (FullWeb).

Overview

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

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 and www.fulltel.com. Information contained on our Web sites is not and should not be deemed to be a part of this Report.

Company History

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

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

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

Table of Contents

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 will market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service; our business-to-business network design, connectivity, domain and Web hosting businesses; and traditional telephone services. At June 30, 2008 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.

Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended				Six Months Ended			
	June 30, 2008		June 30, 2007		June 30, 2008		June 30, 2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Revenues:								
Access service revenues	\$ 136,891	29.3%	\$ 163,800	34.5%	\$ 280,238	29.3%	\$ 325,653	34.8%
Co-location and other revenues	330,821	70.7	310,329	65.5	674,658	70.7	610,447	65.2
Total revenues	467,712	100.0	474,129	100.0	954,896	100.0	936,100	100.0
Cost of access service revenues	60,466	12.9	56,014	11.8	116,985	12.3	109,879	11.7
Cost of co-location and other revenues	78,237	16.7	82,653	17.4	159,761	16.7	160,781	17.2
Selling, general and administrative expenses	332,367	71.1	318,419	67.2	698,501	73.1	659,467	70.4
Depreciation and amortization	61,312	13.1	74,834	15.8	129,806	13.6	149,426	16.0
Total operating costs and expenses	532,382	113.8	531,920	112.2	1,105,053	115.7	1,079,553	115.3
Loss from operations	(64,670)	(13.8)	(57,791)	(12.2)	(150,157)	(15.7)	(143,453)	(15.3)
Interest expense	(23,855)	(5.1)	(24,362)	(5.1)	(47,319)	(5.0)	(49,024)	(5.2)
Net loss	\$ (88,525)	(18.9)%	\$ (82,153)	(17.3)%	\$ (197,476)	(20.7)%	\$ (192,477)	(20.5)%

Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007*Revenues*

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-Q

Access service revenues decreased \$26,909 or 16.4% to \$136,891 for the 2008 2nd Quarter from \$163,800 for the same period in 2007 primarily due to a decline in the number of customers.

Co-location and other revenues increased \$20,492 or 6.6% to \$330,821 for the 2008 2nd Quarter from \$310,329 for the same period in 2007. This increase was primarily attributable to the addition of new customers and the sale of additional services to existing customers.

- 14 -

Table of Contents*Operating Costs and Expenses*

Cost of access service revenues increased \$4,452 or 7.9% to \$60,466 for the 2008 2nd Quarter from \$56,014 for the same period in 2007. This increase was primarily due to recurring costs associated with expansion and support of our network. Cost of access service revenues as a percentage of access service revenues increased to 44.2% during the 2008 2nd Quarter, compared to 34.2% during the same period in 2007.

Cost of co-location and other revenues decreased \$4,416 or 5.3% to \$78,237 for the 2008 2nd Quarter from \$82,653 for the same period in 2007 primarily related to a decrease of \$18,265 on the discontinuance of monthly operating lease expense for certain equipment. This decrease was offset by increases to recurring costs related to increased customers on traditional phone services. Cost of co-location and other revenues as a percentage of co-location and other revenues decreased to 23.6% during the 2008 2nd Quarter, compared to 26.6% during the same period in 2007.

Selling, general and administrative expenses increased \$13,948 or 4.4% to \$332,367 for the 2008 2nd Quarter compared to \$318,419 for the same period in 2007 primarily attributable to an increase in employee costs. The employee costs increase was primarily related to annual wage increases and the addition of one employee. Selling, general and administrative expenses as a percentage of total revenues increased to 71.1% during the 2008 2nd Quarter from 67.2% during the same period in 2007.

Depreciation and amortization expense decreased \$13,522 or 18.1% to \$61,312 for the 2008 2nd Quarter compared to \$74,834 for the same period in 2007 primarily related to several assets reaching full depreciation.

Interest Expense

Interest expense remained relatively the same for the 2008 2nd Quarter compared to the same period in 2007.

Six Months Ended June 30, 2008 Compared to Six Months Ended June 30, 2007*Revenues*

Access service revenues decreased \$45,415 or 13.9% to \$280,238 for the six-month period from \$325,653 for the same period in 2007 primarily due to a decline in the number of customers.

Co-location and other revenues increased \$64,211 or 10.5% to \$674,658 for the six-month period from \$610,447 for the same period in 2007. This increase was primarily attributable to the addition of new customers and the sale of additional services to existing customers.

Operating Costs and Expenses

Cost of access service revenues increased \$7,106 or 6.5% to \$116,985 for the six-month period from \$109,879 for the same period in 2007. This increase was primarily due to recurring costs associated with expansion and support of our network. Cost of access service revenues as a percentage of access service revenues increased to 41.7% during the six-month period, compared to 33.7% during the same period in 2007.

Cost of co-location and other revenues remained relatively the same for the six-month period compared to the same period in 2007. There was a decrease of \$36,530 on the discontinuance of monthly operating lease expense for certain equipment. This decrease was offset by increases to recurring costs related to increased customers on traditional phone services. Cost of co-location and other revenues as a percentage of co-location and other revenues decreased to 23.7% during the six-month period, compared to 26.3% during the same period in 2007.

Selling, general and administrative expenses increased \$39,034 or 5.9% to \$698,501 for the six-month period compared to \$659,467 for the same period in 2007 primarily attributable to an increase in employee costs. The employee costs increase was primarily related to annual wage increases and the addition of one full-time and one part-time employee. Selling, general and administrative expenses as a percentage of total revenues increased to 73.1% during the six-month period from 70.4% during the same period in 2007.

Depreciation and amortization expense decreased \$19,620 or 13.1% to \$129,806 for the six-month period compared to \$149,426 for the same period in 2007 primarily related to several assets reaching full depreciation.

Table of Contents*Interest Expense*

Interest expense decreased \$1,705 or 3.5% to \$47,319 for the six-month period compared to \$49,024 for the same period in 2007. This decrease was primarily attributable to the lower note balances from the payment of principal on the notes.

Liquidity and Capital Resources

As of June 30, 2008, we had \$11,901 in cash and \$1,976,594 in current liabilities, including \$116,563 of deferred revenues that will not require settlement in cash.

At June 30, 2008, we had a working capital deficit of \$1,921,392, while at December 31, 2007 we had a working capital deficit of \$1,788,439. 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.

As of June 30, 2008, \$188,828 of the \$214,562 we owed to our trade creditors was past due. We have no formal agreements regarding payment of these amounts. At June 30, 2008, \$261,160 payable under a matured lease obligation to a related party was outstanding and we had outstanding principal and interest owed on matured notes totaling \$1,400,076. We have not made payment or negotiated an extension of the convertible promissory notes and the lenders have not made any payment demands. We are currently developing a plan to satisfy these notes on terms acceptable to the note holders.

During September 2005, we received a back billing from AT&T (formerly SBC) of approximately \$230,000. Since then, we have received a number of additional back billings from AT&T that total in excess of \$7,900,000. We believe AT&T has no basis for these charges, have reviewed these billings with our attorneys and are vigorously disputing the charges. Therefore, we have not recorded any expense or liability related to these billings.

	For the Periods Ended June 30,	
	2008	2007
Net cash flows provided by operations	\$ 33,074	\$ 90,662
Net cash flows used in investing activities	(44,291)	(41,752)
Net cash flows provided by (used in) financing activities	7,749	(49,487)
Cash used for the purchases of equipment was \$44,291 and \$40,842, respectively, for the six months ended June 30, 2008 and 2007.		
Cash used for principal payments on notes payable was \$20,300 and \$49,487, respectively, for the six months ended June 30, 2008 and 2007. Cash provided by the exercise of options was \$28,049 for the six months ended June 30, 2008.		

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

Table of Contents

Because our cost of developing new networks and services, funding other strategic initiatives, and operating our business depend on a variety of factors (including, among other things, the number of subscribers and the service for which they subscribe, the nature and penetration of services that may be offered by us, regulatory changes, and actions taken by competitors in response to our strategic initiatives), it is almost certain that actual costs and revenues will materially vary from expected amounts and these variations are likely to increase our future capital requirements. Our current cash balances will not be sufficient to fund our current business plan 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.

In the event that we are unable to obtain additional capital or to obtain it on acceptable terms or in sufficient amounts, we will be required to delay the further development of our network or take other actions. This could have a material adverse effect on our business, operating results and financial condition and our ability to achieve sufficient cash flows to service debt requirements.

Our ability to fund the capital expenditures and other costs contemplated by our business plan and to make scheduled payments with respect to bank 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 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.

Financing Activities

On January 5, 2001, we obtained a \$250,000 interim loan. This loan bears interest at 10% per annum and requires payments equal to 50% of the net proceeds received by us from our private placement of convertible notes payable. Subsequently, the principal balance of the loan was increased to \$320,000 and the due date was extended to December 31, 2001. Through August 2007 we had made aggregate payments of principal and interest of \$35,834 on this loan. In September 2007, the lender agreed to accept monthly payments of \$5,800 beginning December 1, 2007 to be allocated 50% to principal and 50% to interest. At June 30, 2008, the outstanding principal and interest of the loan was \$511,050.

We have an operating lease for certain equipment which is leased from one of our significant shareholders who also holds a \$299,700 interim loan (see Note 9 - Notes Payable of the financial statements appearing in this report). The original lease was dated November 21, 2001 and the terms were \$6,088 per month for 12 months with a fair market purchase option at the end of the lease. Upon default on the lease, we were allowed to continue leasing the equipment on a month-to-month basis at the same monthly rate as the original lease. We were unable to make the month-to-month payments. In January and November 2006, we agreed to extend the expiration date on 425,000 and 140,000, respectively, of common stock purchase warrants for the lessor in return for a credit of \$17,960 and \$3,940, respectively, on the operating lease. In September 2007, the lessor agreed to cease the monthly lease payments effective January 1, 2007 which generated a total of \$54,795 of forgiveness of debt income. The lessor also agreed to accept payments of \$499 per month on the balance owed. At June 30, 2008 we had recorded \$261,160 in unpaid lease payments. The loss of this equipment would have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

Pursuant to the provisions of the convertible promissory notes (see Note 9 Notes Payable), the conversion price was reduced from \$1.00 per share on January 15, 2001 to \$.49 per share on December 31, 2003 for failure to register under the Securities Act of 1933, as amended, the common stock underlying the convertible promissory notes and underlying warrants on February 15, 2001. Reductions in conversion price were recognized at the date of reduction by an increase to additional paid-in capital and an increase in the discount on the notes payable. Furthermore, the interest rate was increased to 12.5% per annum from 11% per annum because the registration statement was not filed before March 1, 2001. In November and December 2003 and March 2004, \$455,000, \$50,000 and \$5,636, respectively, of these convertible promissory notes matured. We have not made payment or negotiated an extension of these notes, and the lenders have not made any demands. At June 30, 2008, the outstanding principal and interest of the convertible promissory notes was \$889,026.

Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. On February 6, 2008, the FASB issued Financial Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157* . This Staff Position delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the FASB and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS 157. We are assessing the impact of the adoption of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). This statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We adopted the provisions of SFAS 159 on January 1, 2008.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R) which is a revision of Statement No. 141, *Business Combinations*. SFAS 141R will apply to all business combinations and will require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at full fair value at the acquisition date. SFAS 141R will also require transaction-related costs to be expensed in the period incurred, rather than capitalizing these costs as a component of the respective purchase price. SFAS 141R is effective for acquisitions completed after January 1, 2009 and early adoption is prohibited. We are assessing the impact of the adoption of SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160), an amendment of ARB No. 51. SFAS 160 will change the accounting and reporting for minority interests which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. SFAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. We are assessing the impact that SFAS 160 may have on our financial position, results of operations, and cash flows.

Table of Contents

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). This statement will require enhanced disclosures about derivative instruments and hedging activities to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We are assessing the impact of the adoption of SFAS 161.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We are currently evaluating the impact of the adoption of FSP No. 142-3 on our consolidated financial statements.

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 our accounting principles, we must often make individual estimates and assumptions regarding expected outcomes or uncertainties. As you might expect, 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.

During September 2005, we received a back billing from AT&T (formerly SBC) of approximately \$230,000. Since then, we have received a number of additional back billings from AT&T that total in excess of \$7,900,000. We believe AT&T has no basis for these charges, have reviewed these billings with our attorneys and are vigorously disputing the charges. Therefore, we have not recorded any expense or liability related to these billings.

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 such cash flows and fair value, however, could affect the calculation and result in additional impairment charges in future periods.

Item 3. 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 4. Controls and Procedures

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

Table of Contents

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

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

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

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

Our Chief Executive Officer and Chief Financial Officer, 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, 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.

Item 4(T). Controls and Procedures.

No significant deficiencies or material weaknesses in our controls and procedures were discovered and, accordingly, no corrective actions were necessary (see Item 4 Controls and Procedures, above).

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On March 13, 2008 three of our officers exercised common stock options for the purchase of 684,430 common stock shares at a weighted average price per share of \$.04 per share for proceeds to us of \$28,049. These common stock shares were issued pursuant to exemptions from registration under the Securities Act of 1933, as amended (the 1933 Act), including Rule 506 of Regulation D promulgated there under and Section 4(6) of the 1933 Act. No sales commissions or other remuneration was paid in conjunction with the exercise of the stock options and issuance of the common stock shares. The common stock shares are restricted securities as defined in Rule 501 of Regulation D and may not be resold or transferred without registration under the 1933 Act or in compliance with exemptions from that registration.

Item 3. Defaults Upon Senior Securities

We are in default on convertible promissory notes that matured in November 2003, December 2003 and March 2004. These notes bear interest at 12.5% per annum and are convertible into approximately 1,003,659 shares of our common stock. We were unable to pay these notes at maturity and are currently developing a plan to satisfy these notes on terms acceptable to the note holders. At June 30, 2008, the aggregate outstanding principal and accrued interest of the convertible promissory notes was \$889,026. We have not made payment or negotiated an extension of these notes, and the lenders have not made any demands.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the second quarter of 2008.

Item 5. Other Information

During the three months ended June 30, 2008 all events reportable on Form 8-K were reported.

Table of Contents**Item 6. Exhibits**

(a) The following exhibits are either filed as part of or are incorporated by reference in this Report:

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

- 4.9 Form of Warrant Certificate for Illinois Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.6 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference). #
- 4.10 Form of Promissory Note for Illinois Investors for Interim Financing in the amount of \$505,000 (filed as Exhibit 4.7 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference). #
- 4.11 Form of Warrant Agreement for Interim Financing in the amount of \$500,000 (filed as Exhibit 4.8 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference). #
- 4.12 Form of Warrant Certificate for Interim Financing in the amount of \$500,000 (filed as Exhibit 4.9 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference). #

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	
4.13	Form of Promissory Note for Interim Financing in the amount of \$500,000 (filed as Exhibit 4.10 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
4.14	Form of Convertible Promissory Note for September 29, 2000, private placement (filed as Exhibit 4.13 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000 and incorporated herein by reference).	#
4.15	Form of Warrant Agreement for September 29, 2000, private placement (filed as Exhibit 4.13 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000 and incorporated herein by reference).	#
4.16	Form of 2001 Exchange Warrant Agreement (filed as Exhibit 4.16 to Registrant's Form 10-QSB for the quarter ended June 30, 2001 and incorporated herein by reference).	#
4.17	Form of 2001 Exchange Warrant Certificate (filed as Exhibit 4.17 to Registrant's Form 10-QSB for the quarter ended June 30, 2001 and incorporated herein by reference).	#
10.1	Financial Advisory Services Agreement between the Company and National Securities Corporation, dated September 17, 1999 (filed as Exhibit 10.1 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.2	Lease Agreement between the Company and BOK Plaza Associates, LLC, dated December 2, 1999 (filed as Exhibit 10.2 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.3	Interconnection agreement between Registrant and Southwestern Bell dated March 19, 1999 (filed as Exhibit 6.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
10.4	Stock Purchase Agreement between the Company and Animus Communications, Inc. (filed as Exhibit 6.2 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
10.5	Registrar Accreditation Agreement effective February 8, 2000, by and between Internet Corporation for Assigned Names and Numbers and FullWeb, Inc. d/b/a FullNic f/k/a Animus Communications, Inc. (filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-Q

- 10.6 Master License Agreement For KMC Telecom V, Inc., dated June 20, 2000, by and between FullNet Communications, Inc. and KMC Telecom V, Inc. (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference). #
- 10.7 Domain Registrar Project Completion Agreement, dated May 10, 2000, by and between FullNet Communications, Inc., FullWeb, Inc. d/b/a FullNic and Think Capital (filed as Exhibit 10.2 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference). #
- 10.8 Amendment to Financial Advisory Services Agreement between Registrant and National Securities Corporation, dated April 21, 2000 (filed as Exhibit 10.3 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference). #
- 10.9 Asset Purchase Agreement dated June 2, 2000, by and between FullNet of Nowata and FullNet Communications, Inc. (filed as Exhibit 99.1 to Registrant's Form 8-K filed on June 20, 2000 and incorporated herein by reference). #
- 10.10 Asset Purchase Agreement dated February 4, 2000, by and between FullNet of Bartlesville and FullNet Communications, Inc. (filed as Exhibit 2.1 to Registrant's Form 8-K filed on February 18, 2000 and incorporated herein by reference). #

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	
10.11	Agreement and Plan of Merger Among FullNet Communications, Inc., FullNet, Inc. and Harvest Communications, Inc. dated February 29, 2000 (filed as Exhibit 2.1 to Registrant's Form 8-K filed on March 10, 2000 and incorporated herein by reference).	#
10.12	Asset Purchase Agreement dated January 25, 2000, by and between FullNet of Tahlequah, and FullNet Communications, Inc. (filed as Exhibit 2.1 to Registrant's Form 8-K filed on February 9, 2000 and incorporated herein by reference).	#
10.13	Promissory Note dated August 2, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.13 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.14	Warrant Agreement dated August 2, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.14 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.15	Warrant Certificate dated August 2, 2000 issued to Timothy J. Kilkenny (filed as Exhibit 10.15 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.16	Stock Option Agreement dated December 8, 2000, issued to Timothy J. Kilkenny (filed as Exhibit 10.16 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.17	Warrant Agreement dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.17 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.18	Warrant Agreement dated December 29, 2000, issued to Roger P. Baresel (filed as Exhibit 10.18 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.19	Stock Option Agreement dated February 29, 2000, issued to Wallace L. Walcher (filed as Exhibit 10.19 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.20	Stock Option Agreement dated February 17, 1999, issued to Timothy J. Kilkenny (filed as Exhibit 3.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
10.21	Stock Option Agreement dated October 19, 1999, issued to Wesdon C. Peacock (filed as Exhibit 10.21 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-Q

10.22	Stock Option Agreement dated April 14, 2000, issued to Jason C. Ayers (filed as Exhibit 10.22 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.23	Stock Option Agreement dated May 1, 2000, issued to B. Don Turner (filed as Exhibit 10.23 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.24	Form of Stock Option Agreement dated December 8, 2000, issued to Jason C. Ayers, Wesdon C. Peacock, B. Don Turner and Wallace L. Walcher (filed as Exhibit 10.24 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.25	Warrant Certificate Dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.25 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.26	Warrant Certificate Dated November 9, 2000, issued to Roger P. Baresel (filed as Exhibit 10.26 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.27	Warrant Certificate Dated December 29, 2000, issued to Roger P. Baresel (filed as Exhibit 10.27 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#

Table of Contents

<i>Exhibit Number</i>	<i>Exhibit</i>	
10.28	Stock Option Agreement dated October 13, 2000, issued to Roger P. Baresel (filed as Exhibit 10.28 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.29	Stock Option Agreement dated October 12, 1999, issued to Travis Lane (filed as Exhibit 10.29 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.30	Promissory Note dated January 5, 2001, issued to Generation Capital Associates (filed as Exhibit 10.30 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.31	Placement Agency Agreement dated November 8, 2000 between FullNet Communications, Inc. and National Securities Corporation (filed as Exhibit 10.31 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.32	Promissory Note dated January 25, 2000, issued to Fullnet of Tahlequah, Inc.	#
10.33	Promissory Note dated February 7, 2000, issued to David Looper	#
10.34	Promissory Note dated February 29, 2000, issued to Wallace L. Walcher	#
10.35	Promissory Note dated June 2, 2000, issued to Lary Smith	#
10.36	Promissory Note dated June 15, 2001, issued to higganbotham.com L.L.C.	#
10.37	Promissory Note dated November 19, 2001, issued to Northeast Rural Services	#
10.38	Promissory Note dated November 19, 2001, issued to Northeast Rural Services	#
10.39	Form of Convertible Promissory Note dated September 6, 2002	#
10.40	Employment Agreement with Timothy J. Kilkenny dated July 31, 2002	#
10.41	Employment Agreement with Roger P. Baresel dated July 31, 2002	#
10.42	Letter from Grant Thornton LLP to the Securities and Exchange Commission dated January 30, 2003	#
10.43	Form 8-K dated January 30, 2003 reporting the change in certifying accountant	#

Edgar Filing: FULLNET COMMUNICATIONS INC - Form 10-Q

10.44	Form 8-K dated September 20, 2005 reporting the change in certifying accountant	#
22.1	Subsidiaries of the Registrant	#
31.1	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Timothy J. Kilkenny	*
31.2	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Roger P. Baresel	*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Timothy J. Kilkenny	*
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Roger P. Baresel	*

Incorporated by reference.

* Filed herewith.

Table of Contents

SIGNATURES

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

**REGISTRANT:
FULLNET COMMUNICATIONS, INC.**

Date: August 14, 2008

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

Date: August 14, 2008

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

- 26 -

Table of Contents

EXHIBIT INDEX

<i>Exhibit Number</i>	<i>Exhibit</i>
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