FRANKLIN TELECOMMUNICATIONS CORP
Form 10-K
January 28, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2001

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

Commission file number 0-11616

FRANKLIN TELECOMMUNICATIONS CORP.
(Exact Name of Registrant as Specified in its Charter)

California	95-3733534
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

733 Lakefield Road, Westlake Village, California 91361
(Address of Principal Executive Offices) (Zip Code)
Registrant's Telephone Number, Including Area Code: (805) 373-8688

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

Title of each class	Name of each exchange
Common stock, without par value	American Stock Exchange

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

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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 [X]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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. [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant at DECEMBER 31, 2001 was $1,940,461 based on the closing sale price of $.05, on November 14, 2001, the most recent trading date.

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of the latest practicable date:

TITLE OF EACH CLASS OF COMMON STOCK	OUTSTANDING AT December 31, 2001
Common Stock, no par value	43,809,231

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Part I.

Item 1. Business

Certain statements constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance or achievements, expressed or implied by such forward-looking statements.

OVERVIEW

Franklin has substantially reduced operations due to a lack of cash, and is functioning with minimal staff while it seeks acquisition opportunities or financing that would allow it to resume normal operations. The following discussion describes the state of the industry in general, and Franklin's business and products. It should be read in light of Franklin's current situation.

Today's telecommunications company can trace both the challenges it faces and the potential for growth it holds to the deregulation of the industry in 1996. One of the most visible results of this deregulation was the emergence of Competitive Local-Exchange Carriers (CLECs). Almost immediately, CLECs became the darlings of Wall Street, winning record amounts of financing to build out facility based networks. This expansion, while a competitive necessity, was not without danger. For all too many of these CLECs, the powerful upward spike in value was matched by an equally dramatic downward plunge, as the realities of establishing a sustainable business while paying off venture capital debt became evident.

The dot.com's followed an almost identical profile--rapid expansion followed closely by collapse and confusion. One example of cause and effect in this debacle was the complete misreading of what to expect from fiber optics: fortunes were made and lost on the myth of an imminent shortage of bandwidth to support growing IP demands. The reality proved to be bandwidth to spare.

After the tumultuous year in 2001 for telecommunications companies, should we despair for the industry? No! Telecommunications has taken a beating, and Franklin has suffered with the rest of the sector. Franklin's problems were further exacerbated by a shortage of working capital suffered before its product line was adequately established in the marketplace. This inevitably resulted in inadequate sales.

But after acknowledging the challenges, it is fair to examine the very real potential that still permeates the telecommunications industry . . . including Franklin . We are looking for a solid, continuous pattern of growth over several years, once we have obtained sufficient financing. The consensus is that most small businesses and enterprises alike will move toward a converged data/voice network, but they will take a phased approach. Most organizations will deploy a solution over a several years. This is what we hope to see--and where we believe Franklin Telecom can find a niche.

Opportunity involves risk. In a year that has seen several of our larger competitors quit business, Franklin survives, but barely. It has only been through massive cuts in personnel and overhead that Franklin has been able to escape bankruptcy, and Franklin continues to operate at a loss. We are committed to focusing resources on finding a market for our line of VoIP products. For example, we believe that our SoftSwitch 2000 still offers a competitive edge over hardware solutions that lack this product's unique ability to authenticate, route and bill for VoIP calls.

Franklin needs to rebuild its sales and marketing capabilities. We also continue to seek alliances, partnerships and mergers with other businesses that could bolster development of additional products and services. All of this involves enormous risk, especially considering current economic circumstances that make working capital hard to find, and we may be unable to attract other businesses for such alliances or relationships.

Still, unlike many of our competitors, Franklin has been in business for more than twenty years. The Company has a history of well-designed, dependable products and services. We expect Franklin to find its place in a stable, long-term growth cycle within the telecommunications industry.

FRANKLIN OWNS ALL THE VOIP TECHNOLOGY USED IN ITS PRODUCTS. IF THIS SEGMENT OF THE TELECOMMUNICATIONS INDUSTRY IS TO GROW, WE HOPE THAT ONE OR MORE OF THE REMAINING COMPANIES IN THE INDUSTRY (SUCH AS CISCO, NORTEL & LUCENT) WHO LACK

CERTAIN OF THESE TECHNOLOGY ASSETS WILL BECOME CUSTOMERS OR MERGER CANDIDATES. However, to date we have been unable to develop significant relationships with these companies, and we may never be able to establish any such relationships.

Our business has been the design, manufacture and sale of Internet Telephony equipment, also called "Voice Over Internet Protocol" (VoIP) equipment and other high speed communications products and subsystems. Our products have been marketed through Original Equipment Manufacturers ("OEMs") and distributors, as well as directly to end users. In addition, through our majority-owned subsidiary, FNet Corp. ("FNet"), we continue to provide traditional switched network and Internet Protocol telephony services, and Internet access to businesses and individuals. Our customers are located throughout the world in a wide range of industries including financial services, government, telephone services and manufacturing.

We offer a suite of Internet Telephony solutions that enable business communications (voice) over data networks. From the small office home office (SOHO) to the branch office and headquarters operations of medium to large scale corporations, we offer a cost-effective call handling solution. From the enterprise to the carrier market, we offer converged network solutions; managing the connectivity and integration of voice, data, fax and video. Where ever possible, the Company offers a turnkey solution that can be "owned" by its customers. Our products and services are designed to enable connectivity and e-commerce.

The Company is both an equipment supplier and a service provider, offering turn-key business communications solutions to both the carrier and enterprise segments of the Internet Telephony market. The Company has produced gateways, gatekeepers and edge servers that provide advanced packet switching solutions that significantly reduce the infrastructure costs associated with communications networks. We have designed, developed and manufactured our own products..

In addition to manufactured solutions, the Company maintains a Network Operations Center that provides both "on -net" and "off-net" connectivity for the Company's equipment customers. The Network Operations Center interconnects the Company's customers on a global basis. The Network Operations Center includes Internet access facilities and a Class 4 circuit switch.

The Company is also able to provide additional assistance to its customers by offering design, installation and network management services. The Company believes that this strategy of combining network operations and equipment design is a significant product differentiation strategy, uniquely positioning the Company. Many of the Company's customers have elected to interconnect with the Network Operations center.

The Company's FNet division, through a joint venture, has provided a combination of satellite solutions to enable telephone communications for NATO forces throughout the Bosnia and Kosovo region. As of May 2001 the Company modified the agreement with its joint venture partner, MegaBurst, located in Washington D.C., to provide that Megaburst will assume responsibility for the project. Some 21 earth station transponders are connected to "telephone calling booths" linked via satellite to the U.S., where they are interconnected to the Public Switched Telephone Network (PSTN). NATO soldiers, using FNet calling cards, are able to make calls throughout the world through FNet facilities. FNet was incurring a net loss on operations of this service and hence has curtailed all costs connected with this operation. The contract change consisted of MegaBurst taking over all costs of providing the service and FNet transfering the fixed assets, consisting principally of the ground stations, to MegaBurst. The Company will receive a 50% share of any joint venture profit.

INDUSTRY BACKGROUND--VOIP PRODUCTS

The telecommunications industry has historically followed a path of development based on the belief that voice and data require separate technologies and network resources. Traditional telephone systems were, and are still, built around an architecture that requires a dedicated connection, or circuit, in order for a voice call to be completed. This technology requires the circuit to remain dedicated between calling parties for the entire duration of a call.

Much data today is transmitted over Internet Protocol-based networks (IP). These networks are more efficient because they do not require a dedicated circuit for the entire path of the call. In a network using Internet Protocol, the voice, fax, video or data is compressed and divided into packets that are simultaneously sent to a final destination where they are reassembled back to their original form. In this type of network, multiple types of information including voice, fax and different forms of data can travel through the network at the same time. The improvements in the technologies used in data networks have led to an increase in use of this type of network to transmit both voice and data. The IP telephony market emerged from these technological advances. Recent developments in IP telephony technology have significantly bridged the voice quality gap between the traditional telephone system, commonly referred to as a circuit-switched system, and IP based systems. Consequently, the circuit-switched system now finds itself in direct competition with IP telephony systems.

A telephone call transmits signals that direct a series of switches to open a dedicated path (circuit) to a second telephone. The dedicated circuit carries the electronic signals through the line. The phones convert the signals back into speech. Unlike the traditional circuit switched phone call, which travels on a dedicated circuit, the electronic signals go to a data voice gateway, which converts them into small packets of compressed digital information. The packets may take different routes to their destination. After traveling through the IP network, the packets are converted back into electronic signals by another data voice gateway and put back on the phone network.

Today a voice call placed over an IP telephony network can sound virtually indistinguishable from the same call made over the traditional telephone system. What distinguishes IP telephony technology, however, is that it allows service providers to simultaneously send voice, fax and data transmissions over their networks and enables them to quickly add and use additional features and services without the need for costly network upgrades. In contrast, changes to the traditional telephone system are costly and difficult. For example, based on estimates from the International Engineering Consortium, the recent integration of such basic services as caller ID and call return services into the traditional telephone system took over a decade and hundreds of millions of dollars to implement in the United States alone.

The added flexibility and cost-effectiveness of IP telephony networks are particularly important in an increasingly deregulated and competitive market environment. Deregulation acts as a catalyst for the rapid deployment of these services by allowing new service providers to quickly enter formerly regulated markets and by forcing existing service providers to rapidly respond to the challenge of competition.

We believe a significant market opportunity still exists for the makers of IP telephony systems. Very few of our competitors have developed a comprehensive solution that incorporates the functionality that service providers require to provide end-to-end service. Some vendors have developed products that embed the instructions on where to route the IP telephony call in the same equipment that

provides the IP telephony technology. This approach limits service providers' flexibility to make modifications to their networks, because any modification must be made at several different points throughout the network.

In December 2001, Manoj Menon, Director of the Technology Practice group at Frost & Sullivan, stated that the market is undergoing a strategic inflection point. "We will soon witness the emergence of total solutions providers and the rise of new companies which could overtake the giants in the field." He was referring to the evolution of IBM from a PC company to that of becoming a system integrator, and the genesis of Dell and HP into the computing markets in the early 1980s as a historical example for a potential telecom shakeout.

Many vendors only provide limited billing and network management data. This data is gathered and formatted in a simplistic fashion, limiting the ability of service providers to manage sophisticated networks or to bill using any pricing structure they desire. Also, these simplistic billing systems make it difficult to connect service providers' networks to the networks of other service providers.

Some router, switch and IP telephony companies have formed partnerships with billing and network management technology providers in order to provide even the most basic operational support solution to service providers. A router is a device that routes packets over the Internet or other Internet Protocol networks. A switch is a device that takes multiple incoming calls and places these calls onto fewer lines. This partnering necessitates integration, which can be technologically difficult, time consuming and expensive.

Many IP telephony vendors require dedicated ports for voice, fax or data. A port is the connection between the traditional telephone system and the IP telephony system. Each port handles a single call. Systems that use dedicated ports are inefficient and more costly because more ports are needed to handle the different types of transmissions anticipated. In addition, many vendors do not have the technical capability to integrate these ports with the traditional telephone system so that the ports can correctly interpret busy signals, dial tones and disconnects. This means that service providers cannot accurately bill for the call. Furthermore, the inability to integrate well with the traditional telephone system makes it more difficult for end-users to gain the benefits of this technology because they have to dial separate phone numbers or use multi-step dialing processes.

Industry Background--Telephone Services

The international long distance industry segment of the global telecommunications market (consisting of the transmission of voice and data between countries) is undergoing a period of fundamental change that has resulted, and is expected to continue to result, in significant growth in usage of international telecommunications services. The dynamics of present day life have caused individuals to seek more sophisticated communications solutions, driving service providers to bundle applications to capitalize on the wide range of consumer needs.

New analysis from Frost & Sullivan (December 7, 2001) U.S. Market for Enhanced IP-Based Voice Services, reveals that this industry generated revenues of $520 million in 2001 and is projected to reach $31.8 billion by 2007.

Furthermore, a separate analysis from Frost & Sullivan (November 28, 2001) reveals that WORLD VOIP EQUIPMENT MARKETS generated more than $1 billion in revenues in 2000 and will exceed $14 billion by 2006.

By the end of 2004, 4% of American phone company revenues ($3 billion) will shift to IP telephony -- $1 billion going to consumers in cost savings, and $2 billion going to the IP telephony industry (Forrester Research, Mar. 2000).

Franklin believes that informed studies and research like those cited here confirm expectations for a positive market for VoIP Equipment sales and the expansion of VoIP services, both of which this Company can supply.

The Company believes that growth in international long distance services is being driven by a number of factors including:

- the globalization of the world's economies and the worldwide trend toward deregulation of the telecommunications sector;
- declining prices arising from increased competition generated by privatization and deregulation;
- increased worldwide telephone density (tele-density) and accessibility arising from technological advances and greater investment in telecommunications infrastructure, including the deployment of wireless networks;
- a wider selection of products and services; and
- the growth in the transmission of data traffic via internal company networks and the Internet.

The Company believes that growth of traffic originated in markets outside the U.S. will be higher than growth in traffic originated within the U.S. due to recent deregulation in many foreign markets, relative economic growth rates and increasing access to telecommunications facilities in emerging markets.

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REGULATORY AND COMPETITIVE ENVIRONMENT

Consumer demand and competitive initiatives have acted as catalysts for government deregulation, especially in developed countries. Deregulation accelerated in the U.S. in 1984 with the divestiture by AT&T of the Regional Bell Operating Companies ("RBOCs"). Today, there are more than 500 U.S. long distance companies, most of which are small or medium-sized companies. In order to be successful, these small and medium-sized companies typically offer their customers a full range of services, including international long distance. However, most of these carriers do not have the critical mass of customers to receive volume discounts on international traffic from larger facilities-based carriers such as AT&T and MCI WorldCom. In addition, these companies have only a limited ability to invest in international facilities. Emerging multinational carriers have capitalized on this demand for less expensive international transmission facilities. These alternative international carriers are able to take advantage of larger traffic volumes in order to obtain volume discounts on international routes (resale traffic) and/or invest in facilities when the volume of particular routes justifies such investments. As these emerging international carriers have become established, they have also begun to carry overflow traffic from the larger long distance providers that own overseas transmission facilities.

Deregulation in the U.K. began in 1981 when Mercury, a subsidiary of Cable &Wireless plc, was granted a license to operate a facilities-based network and compete with British Telecommunications plc. In 1990, deregulation spread to

other European countries with the adoption of the "Directive on Competition in the Markets for Telecommunication Services." A series of subsequent European Union ("EU") directives, reports and actions are expected to result in substantial deregulation of the telecommunications industries in most EU member states by the end of the decade. Further deregulation of the EU telecommunications market will occur in 2000 upon the implementation of the EU's Amending Directive to the Interconnection Directive, which mandates the introduction of equal access and carrier pre-selection by 2000. A similar movement toward deregulation has already taken place in Australia and New Zealand, and is also taking place in Japan, Mexico, Hong Kong and other markets. Other governments have begun to allow competition for value-added and other selected telecommunications services and features, including data and facsimile services and certain restricted voice services.

On February 15, 1997, the United States and 67 other countries signed the WTO Agreement and agreed to open their telecommunications markets to competition and foreign ownership starting in February 1998.

These 68 countries represent approximately 95% of worldwide telecommunications traffic. The Company believes that the WTO Agreement will provide the Company with significant opportunities to compete in international markets and provide end-to-end facilities-based services to and from these countries. The FCC recently released an order that significantly changes U.S. regulation of international services in order to implement the U.S. open market commitments under the WTO Agreement. This order is expected to increase opportunities for foreign carriers to compete in the U.S. communications market, while increasing opportunities for U.S. carriers to enter foreign markets and to develop alternative termination arrangements with non-dominant carriers in other countries.

COMPETITIVE OPPORTUNITIES AND ADVANCES IN TELECOMMUNICATIONS TECHNOLOGY

As a result of deregulation and other competitive pressures in the global telecommunications industry, prices for telecommunications services generally have fallen, releasing pent-up consumer demand and creating the impetus for improved quality of service. New technologies, including fiber optic cable and improvements in digital compression, have played an important role in this process by, among other things, improving the quality and speed of transmission capacity while lowering costs. The growth of the Internet as a communications medium, as well as advances in packet switching technology and Internet telephony, are expected to have an increasing impact on the international telecommunications market.

Advances in technology have created a variety of ways for telecommunications carriers to provide customer access to their networks and services. These include customer-paid local access, international and domestic toll-free access, direct digital access through a dedicated line, equal access through automated routing from the PSTN (Public Switched Telephone Network), call re-origination and Internet telephony. The type of access offered depends on the proximity of switching facilities to the customer, the needs of the customer and the regulatory environment in which the carrier competes. Overall, these changes have resulted in a trend towards bypassing traditional international long distance operating agreements as companies seek to operate more efficiently.

As countries deregulate, the demand for alternative access methods typically decreases because carriers are permitted to offer a wider range of facilities-based services on a transparent basis. In a deregulated country such as the United States, carriers can establish switching facilities, own or lease

fiber optic cable, enter into operating agreements with foreign carriers and, accordingly, provide direct access service. In countries where deregulation has commenced, but is not yet complete, carriers are permitted to offer facilities-based data and facsimile services, as well as limited voice services, although for the most part they are not yet permitted to offer full voice telephony. In less developed markets, international long distance carriers have used advances in technology to develop innovative alternative access methods, such as call re-origination.

DEVELOPMENTS IN THE INTERNET INDUSTRY

The rate at which Internet-related companies are shutting down or declaring bankruptcy is slowing, and the worst is over, according to Tim Miller, founder of Webmergers.com. During 2001, he found, 537 Internet companies collapsed, more than twice the number that met that fate in 2000. "Shutdowns followed on the heels of the stock-market downturn as venture investors, watching their exit opportunities dissolve, abruptly shut their doors on cash-hungry startups," Miller wrote. He said that the slowdown is not due to the fact there are so few dot-coms left. Webmergers.com estimates between 7,000 and 10,000 Internet companies received some sort of funding. "At most, then, 10 percent have shut down," he said. "It may be safer to say that the Darwinian process has left many fewer weak Internet companies."

Reliance on the Internet for the transmission of data, applications and electronic commerce is growing among organizations and corporations. As the volume of information available on organizations' computer systems has increased, and the use of data communications has grown as a preferred means of day-to-day communications, these organizations are increasingly seeking a number of geographically dispersed access points to their own networks and to the networks of other organizations. The number of interconnections that businesses desire to establish with networks, customers, suppliers and affiliates generally has made the development of proprietary access systems on a case-by-case basis costly and time consuming.

INTERNET TELEPHONY

The Internet telephony industry began in 1995, when experienced Internet users began to transfer voice messages from one PC to another. In 1995, VocalTec Communications, Ltd. ("VocalTec") introduced software that allowed PC users to place international calls via the Internet to other PC users for the price of a local call. In its early months, the growth of Internet telephony was constrained due to the poor sound quality of the calls and because calls were mainly limited to those placed from one PC to another (known as PC to PC VoIP) The poor sound quality of Internet telephony was due to the fact that the Internet was not created to provide for simultaneous voice traffic. Unlike conventional voice communication circuits, in which the entire circuit is reserved for a call, Internet telephony uses packet switching technology in which voice data is divided into discrete packets that are transmitted over the Internet. These packets must travel through several routers in order to reach their destination, which may cause misrouting, and delays in transmission and reception. The limited capacity of the Internet also restrained the growth rate of Internet telephony. There is also PC to Phone and Phone to Phone. IDC pioneered the PC (or Net to Phone) and the Company was the first to introduce Phone to Phone in October 1997 and later added full Billing function.

New software algorithms have substantially reduced delays and the use of private networks or intranets to transmit calls as an alternative to the public Internet has alleviated capacity problems. The introduction of gateway servers connecting packet-switched data networks such as the Internet to circuit-switched public telephone networks has also improved overall transmission quality.

A significant attribute of Internet telephony is the ability to reduce overall

transmission costs versus traditional circuit switched networks. Packet switched networks are substantially less expensive to operate than circuit-switched networks because carriers can compress voice traffic and place more calls on a single line. In addition, packet switching avoids international settlement rates which only apply to interconnection between circuit switched networks. The total cost of an Internet telephone call, for example, is based on the local calls to and from the gateways of the respective ISPs, thereby bypassing the international settlement process. IDC estimates that by the year 2002, IP telephony could account for 11% of U.S. and international long distance voice traffic alone. According to Probe Research, the market for IP telephony is expected to grow from an estimated $309 million in 1998 to approximately $4.4 billion in 2002, a 93.8% compound annual growth rate. Probe Research also estimates that the volume of voice and fax traffic over IP networks will increase from 31 million minutes in 1997 to approximately 55.2 million minutes of use in 2002, for a compounded annual growth rate of 346.8%. The growth in IP services far outpaces growth expected in the circuit switched market, currently estimated to be growing at a compounded annual growth rate of 8.3%.

INDUSTRY BACKGROUND--INTERNET SERVICES

The Internet is a collection of computer networks linking millions of public and private computers around the world. Historically, the Internet was used by government agencies and academic institutions to exchange information, publish research and transfer e-mail. A number of factors, including the proliferation of communication-enabled personal computers, the availability of intuitive graphical user interface software and the wide accessibility of an increasingly robust network infrastructure, have combined to allow users to easily access the Internet and, in turn, have produced rapid growth in the number of Internet users.

The emergence of the World Wide Web, the graphical, multimedia environment of the Internet, has resulted in the development of the Internet as a new mass communications medium. The ease and speed of publishing, distributing and communicating text, graphics, audio and video over the Internet has led to a proliferation of Internet-based services, including chat, online magazines, news feeds, interactive games and a wealth of educational and entertainment information, as well as to the development of online communities. In addition, the reduced cost of executing transactions over the Internet provides individuals and organizations with a new means to conduct business.

THE COMPANY'S PRODUCTS AND SERVICES

Unlike many of its competitors, the Company produces its own hardware solutions. Designed from the motherboard up, including DSP technology, voice compressors (called VOCODERS), telephone line interfaces and system software, all Company products are the result of internal engineering. Although the products represent the Company's proprietary engineering, the Company plans to comply wth industry standards, such as SIP, to assure interoperability and connectivity with products manufactured by other vendors.

The Company has produced a family of Internet Telephony solutions that range from small 2 port solutions to meet the access requirements of branch office and geographically distributed work groups; to Carrier type solutions with thousands of ports of voice, fax, data and video connectivity. The Company also produces "back office" software solutions that facilitate the integration, interoperability and management of VOIP networks. These software solutions include the Company's Gatekeeper; an Authentication Mapping and Billing Server (Softswitch 2000) and "Click to Speak" a push to talk solution to voice enable a website or e-mail. The Company's philosophy is to use the robust, real time,

fault tolerant operating system Linux for mission critical hardware operations and Microsoft NT for back office applications.

The Company's data voice "gateway" products are named for tropical storms: the Tempest(R), the Typhoon(TM)and the Breeze(TM):

The Breeze(TM) is a branch office access solution that enables two telephone devices such as phones or fax machines to be interconnected to the Internet or a managed private data network. It provides full T.38 relay fax and a wide range of voice compression options. It contains a Wide Area Network interface with internal router and is the most cost effective VOIP solution in the market.

The Tempest(R) has been the Company's primary data voice gateway since its introduction in 1997. The Tempest is a PC based platform that supports 24 analog ports per node or from 1-4 digital spans (T1/E1) per node. Using T1 Primary Rate ISDN lines, for example, the Tempest is able to support 96 ports. The product integrates with the Company's billing and Gatekeeper products. It is also used to support the CTS products and is often selected as an enterprise solution by medium to large-scale vendors.

The Typhoon(TM) will be the Company's Carrier Class product line and it represents our next generation of VOIP solutions. It features 24 analog ports or 96 digital ports in a 2U high (3.5"), rack mounted configuration that is less than half the size and power consumption of the Tempest product line. The Typhoon will support true SS7 carrier class connectivity and will enable over 1300 ports per POP co-location rack. Typhoon interconnects with the Softswitch 2000 gatekeeper and the Franklin family of SNMP software. The Company plans to release the Typhoon in late 2000.

Softswitch 2000 (AMAS) - is an "Authentication Mapping and Billing Server" and is the core of the Company's "back office" telephone company solutions. It is designed to manage the best route (i.e. least cost route) through a network, determine who is authorized to use the network, and bill customers, either by invoice or debit card. When a customer puts the Tempest/Typhoon together with a Softswitch 2000, it gets a "phone company in a box" solution that enables next generation telephone companies a turn-key solution for VOIP global networking.

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GateKeeper - The Gatekeeper plays the role of enabling data voice gateways of different manufacturers to "talk to each other", or "interoperate", enabling computer to phone, website to phone and computer to computer communications. There are several contending standards for interoperability in the market. They are called H.323; MGCP and SIP. The Company plans to support all three protocols, enabling us to reach the widest cross section of interoperability options in the market.

The Company also provides a variety of Internet sevices through its subsidiary FNet, including dial up, ADSL, ISDN, frame relay, Web page hosting and various other Internet related services. This segment of the business has played a minor role in the Company's revenue and is not expected to contribute a significant amount to future growth.

MARKETING AND DISTRIBUTION OF PRODUCTS AND SERVICES

The Company intends to rebuild a direct sales force for the marketing of its VOIP and data communications products, once it is able to secure adequate financing or business partners. It maintains a home page on the World Wide Web and a headquarters-based sales and service office. It also markets its products through Original Equipment Manufacturers (OEM), and distributors.

The growth of the Internet has spawned new industries consisting of the building of infrastructure for next generation telephone companies that utilize VOIP and Internet Service Providers, both offering connections to corporate America as well as private individuals. The Company designs and manufactures products which are basic to the operation of both Next Geneation Telephone Companies and Internet Service Providers. In addition, these same products are required in the expansion of corporate based private Intranets. Sales to large corporate clients, next generation telephone companies and Internet Service Providers are handled through telemarketing with in person follow-up sales calls.

MARKETING OF TELEPHONE SERVICES

The Company maintains a Network Operations Center that provides "off-net" connectivity for the Company's equipment customers. The Network Operations Center interconnects the Company's customers on a global basis. Telephone off net delivery is offered to all customers that would like to connect their networks to FNet, so that calls can be completed anywhere in the world. This allows a customer to become a world wide telephone company, even though their own network only directly covers a certain regional area. The Network operations center includes Internet access facilities and a Class 4 circuit switch. The center interconnects with three International Record Carriers and is capable of completing a voice call to any phone in the world. The Company's equipment customer is offered the opportunity to access the circuit switched facilities and to interconnect with each other, using the Company to enable "settlement" between the networks.

MARKETING OF INTERNET SERVICES

The market for Internet products and services is varied, including both hardware and software products and related services. Most companies in the industry provide either hardware, software or services. FNet offers both hardware and software specifically designed to provide enhanced Internet accessibility and usage.

Internet users generally fall into one of two specific market segments, the individual user and the business user. Management of the Company believes that the individual user segment will continue to show rapid growth, with the principal uses being information services, on-line shopping and personal communications. The advent and increasing popularity of home shopping via television programming may also extend to the Internet. The Internet can provide consumers with vastly wider choices from a much greater base of vendors. Many catalogue and mail order companies now utilize electronic catalogues accessible through the Internet.

The other significant market is the business user. At present, electronic mail Is the most common application, utilizing computer-based LAN or WAN communication. The trend for companies with multiple, remote site locations is to link existing WANs utilizing the Internet, in order to minimize direct telephone company charges; this market segment is usually referred to as the Intranet. Internet access provides a fast, inexpensive method of achieving this connectivity. Although currently available technology provides some limited ability for voice communication over the Internet, the quality is poor and

communication is generally possible only if users at both ends have PCs with modems and identical software. It is possible that Intranet applications could eventually eliminate the need for resident operating software and massive on-site storage facilities for many businesses. Under this scenario, a PC with resident software will no longer be necessary, with access to any desired program available through an inexpensive workstation connected to the Internet.

Also, data storage could be centralized in a secure database accessible through the Internet.

The Company currently markets its Internet services through press releases, direct mail and its home page on the World Wide Web, and other targeted marketing strategies.

COMPETITION - VOIP PRODUCTS

We compete in a new, rapidly evolving and highly competitive and fragmented market. We expect competition to intensify in the future. We believe that the main competitive factors in our market are product quality, features, cost and customer relationships. We believe a critical component to success in this market is the ability to establish and maintain strong customer relationships with a wide variety of international service providers and to facilitate relationships between those service providers to increase the geographic coverage of their services.

Our current principal competitors include large networking equipment manufacturers, such as 3Com Corporation and Cisco Systems, Inc., large telecommunications equipment manufacturers, such as Lucent Technologies Inc. and Nortel Networks Corporation, and IP telephony technology companies, such as VocalTec Communications, Ltd. and Clarent Corporation. We also expected new competitors to emerge, although there has been very little movement in new companies entering this field in 2001. Many of our competitors are substantially larger than we are and have significantly greater financial, sales and marketing, technical, manufacturing and other resources and more established distribution channels and stronger relationships with service providers. These competitors may be able to respond more rapidly to new or emerging technologies and changes in customer requirements or devote greater resources to the development, promotion and sale of their products than we can. These competitors may enter our existing or future markets with solutions that may be less expensive, provide higher performance or additional features or be introduced earlier than our solutions. Given the market opportunity, we also expect that other companies may enter our market with better products and technologies. If any technology that is competing with ours is more reliable, faster, less expensive or has other advantages over our technology, then the demand for our products and services could decrease.

We expect our competitors to continue to improve the performance of their current products and introduce new products or new technologies. Successful new product introductions or enhancements by our competitors could reduce the sales or market acceptance of our products and services, perpetuate intense price competition or make our products obsolete. To be competitive, we must continue to invest significant resources in research and development, sales and marketing and customer support. We cannot be sure that we will have sufficient resources to make these investments or that we will be able to make the technological advances necessary to be competitive.

Increased competition is likely to result in price reductions, reduced gross margins and loss of market share. Our failure to compete successfully against current or future competitors could seriously harm our business, financial condition and results of operations.

COMPETITION - INTERNET SERVICES

The Internet services market in which FNet operates is extremely competitive, and the Company expects competition in this market to intensify in the future. The Company's current and prospective competitors include many large companies that have substantially greater market presence and financial, technical, marketing and other resources than the Company. The Company competes (or in the future is expected to compete) directly or indirectly with the following

categories of companies: (i) national and regional Internet Service Providers, such as Earthlink, IDT, MindSpring, and UUNET; (ii) established online services such as America Online, CompuServe, Prodigy and the Microsoft Network; (iii) computer software and technology companies such as Microsoft; (iv) national telecommunications companies, such as AT&T, MCI and Sprint; (v) the Regional Bell Operating Companies ("RBOCs"); (vi) cable operators, such as Comcast, TCI and Time Warner; and (vii) nonprofit or educational ISPs.

The entry of new participants from these categories and the potential entry of competitors from other categories (such as computer hardware manufacturers) would result in substantially greater competition for the Company. The ability of these competitors or others to bundle services and products with Internet connectivity services could place the Company at a significant competitive disadvantage. In addition, competitors in the telecommunications industry may be able to provide customers with reduced communications costs in connection with their Internet access services, reducing the overall cost of Internet access and significantly increasing pricing pressures on the Company. Moreover, certain of the Company's online competitors, including America Online, the Microsoft Network and Prodigy, offer unlimited access to the Internet and their proprietary content at flat rates that are generally equivalent to the Company's flat rate, and do not require a set-up fee. Certain of the RBOCs have also introduced competitive flat-rate pricing for unlimited access (without a set-up fee) for at least some period of time. As a result, competition for active users of Internet services has intensified. There can be no assurance that the Company will be able to offset the adverse effect on revenues of any necessary price reductions resulting from competitive pricing pressures by increasing the number of its customers, by generating higher revenue from enhanced services, by reducing costs or otherwise.

The Company believes that its ability to compete successfully in the Internet services market depends on a number of factors, including market presence; the adequacy of the Company's customer and technical support services; the capacity, reliability and security of its network infrastructure; the ease of access to and navigation of the Internet provided by the Company's services; the pricing policies of the Company, its competitors and its suppliers; the timing of introductions of new services by the Company and its competitors; the Company's ability to support existing and emerging industry standards; and industry and general economic trends. There can be no assurance that the Company will have the financial resources, technical expertise or marketing and support capabilities to compete successfully. Also, the Company believes that it has a competitive advantage over most Internet Service Providers because it manufactures much of the equipment necessary to operate an Internet Service Provider, and is able to react quickly to technological changes in the industry.

ASSEMBLY AND MANUFACTURING OPERATIONS

The Company's facilities are located in Westlake Village, California. Assembly of the Company's products has ordinarily been contracted out to local circuit board assembly contractors, with final systems tests completed at the Company's facility. At the time the Company was involved in significant manufacturing operations, these operations consisted primarily of procurement, inspection and testing of components, final assembly of subsystems, and extensive testing of finished products. The Company procured substantially all of its parts from outside suppliers.

EMPLOYEES

As of December 15, 2001, The Company had 6 full time and 2 part time employees. The Company's employees are not represented by any collective bargaining

organization and the Company has never experienced a work stoppage. The Company believes that its relations with its employees are good.

Item 2. Properties

The Company has reduced the total rented facilities from three leased facilities, two in Westlake Village, California, and one in Scottsdale, Arizona, to one in Westlake Village. The Company now occupies a leased facility in Westlake Village, California. The Westlake Village facility houses sales, software engineering, administrative, telephone and Internet services. The facility is 4,900 square feet, with a lease rate of $4,981 per month, on a month to month bassis. The total result of these moves has been a reduction in rent from about $20,000 per month to $4,900 per month.

Item 3. Legal Proceedings

During June 2000, two shareholders who acquired their shares in a private placement in March 2000 filed a lawsuit against Franklin and officers and directors Frank W. Peters and Thomas L. Russell. The lawsuit sought to postpone the June 28, 2000 annual stockholders meeting, based upon alleged deficiencies in the proxy materials pertaining to the meeting. At a hearing held on June 28, 2000, the Court declined to enjoin the meeting as requested by plaintiffs, and the meeting went forward. Thereafter, the plaintiffs amended the lawsuit several times and ultimately added new claims pertaining to the private placement and alleging securities law violations. The Company settled the action without any admission of liability.

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In August 2001, Nexbell filed a lawsuit against FNet alleging breach of a carrier contract for circuits. This dispute has been settled for $25,000 paid at the rate of $1,048 per month plus 240,000 shares of the Company's common stock.

In September 2001, a former employee filed an action against the Company for wrongful termination. The dispute was settled for $12,500.

In November 2001, NEC filed a lawsuit against the Company alleging breach of contract for $40,000 still due on a lease for a PBX. This action is still pending.

In November 2001, two former employees filed a claim with the California labor board, claiming certain vacation and overtime was not paid to them. In January 2002, the labor board issued a judgment in the amount of $79,115.. The Company has appealed the ruling and intends to contest it vigorously.

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

Not applicable .

PART II.

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The Company's Common Stock is listed on the American Stock Exchange ("AMEX") under the symbol FCM. The following table sets forth the range of high and low bid quotation per share for the Common Stock as reported by AMEX for the calendar years of 2001 and 2000, and the OTC Bulletin Board during the third and fourth calendar quarters of 1999. The bid price reflects inter-dealer prices and does not include retail mark-up, markdown, or commission..

CALENDAR	HIGH	LOW
1999		
Third Quarter	3.69	1.38
Fourth Quarter	4.00	1.94
2000		
First Quarter	2.94	1.87
Second Quarter	2.00	.69
Third Quarter	1.69	.69
Fourth Quarter	.81	.31
2001		
First Quarter	.62	.09
Second Quarter	.12	.07
Third Quarter	.06	.04
Fourth Quarter	.05	.04

The Company has never declared or paid a cash dividend on its Common Stock and does not expect to pay any cash dividends in the foreseeable future. On November 14, 2001 AMEX halted trading due to a delay in filing the Form 10K.

As of June 30, 2001, the Company had approximately 900 shareholders of record.

Recent sales of unregistered securities

During the year ended June 30, 2001, the Company completed the following common stock transactions of previously unissued common shares:

- Issued 10,000 shares in connection with the exercise of stock options for cash of $4,000.

- In connection with a private placement in August 2000, the Company issued 4,994,600 shares of common stock and 5,105,711 warrants for gross proceeds of $2,497,000, less fees and commissions of $13,000. The warrants had an exercise price of $3, vested immediately, and expire three years from the date of issuance. The Company allocates the proceeds received from debt, convertible debt, convertible preferred stock, or common

stock with detachable warrants using the relative fair value of the individual elements at the time of issuance. The amount allocated to the warrants of $478,000 was calculated using the Black-Scholes option pricing model. As of June 30, 2001, no warrants had been exercised.

- Issued 295,858 shares of common stock to its chief financial officer in connection with a cashless exercise of options that were processed by the Company. No expense was recorded in connection with the transaction because the chief financial officer had owned the shares that were used to pay for the cashless exercise for more than six months prior to the transaction.

- Issued 477,324 shares of common stock for services valued at $318,000.

- In connection with a private placement in March 2000, the Company issued warrants to the investors that were designed to

protect the investors against short-term declines in the value of the Company's common stock during the period between the date of the issuance of the shares and the effective date of a Registration Statement covering the shares issued. The warrants vest if the market price of the Company's common stock is below $1.50 on the effective date. The registration statement for the shares became effective in November 2000, at which time the market price of the Company's common stock was below $1.50. As a result, warrants for 2,011,329 shares became exercisable at an exercise price of $0.01 per share. During the year ended June 30, 2001, the Company issued 1,927,797 net shares of common stock in connection with a cashless exercise of said warrants, and 50,000 shares of common stock were issued for cash of $500.

- In connection with a private placement in March 2000, the Company was obligated to effect the registration of the shares sold within a specified time period, with penalties due to the investors if the deadline was not met. As the deadline was not met, the Company became obligated to pay the penalties in either cash or shares of common stock. The Company opted to pay the penalties in shares of common stock and issued 503,538 shares to these investors in November 2000 and recognized an expense of $430,000 in the consolidated statement of operations for the year ended June 30, 2001.

- Issued 111,111 shares of the Company's common stock for 6,667 shares of FNet common stock in a stock-for-stock transaction. The shares of FNet's common stock had been issued during the year ended June 30, 1999.

Item 6. Selected Consolidated Financial Data

The selected financial data set forth below for the fiscal years ended June 30, 1999, 2000 and 2001 have been derived from the Company's consolidated financial statements, audited by Singer Lewak Greenbaum & Goldstein LLP and should be read in conjunction with those consolidated financial statements (including the notes thereto). The selected financial data set forth below for the fiscal years ended June 30, 1997 and 1998 have been derived from the Company's audited financial statements not included in this Form 10-K.

CONSOLIDATED STATEMENT OF OPERATIONS DATA (IN THOUSANDS, EXCEPT PER SHARE DATA):

	YEARS ENDED JUNE 30,			
	1997	1998	1999	2000
SALES	$ 1,735	$ 1,377	$ 10,631	$ 3,20
COST OF SALES	990	834	5,641	4,77
GROSS PROFIT (LOSS)	745	543	4,990	(1,56
OPERATING EXPENSES:				
RESEARCH AND DEVELOPMENT EXPENSES	480	1,612	1,870	1,83

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	1,766	3,304	5,602	7,51
IMPAIRMENT OF LONG-LIVED ASSETS	1,584	591	--	224
TOTAL OPERATING EXPENSES	3,830	5,507	7,472	9,57
LOSS FROM OPERATIONS	(3,085)	(4,964)	(2,482)	(11,14
OTHER INCOME (EXPENSE):				
INTEREST INCOME	--	250	148	6
INTEREST EXPENSE	(41)	(43)	(27)	(10
ABANDONMENT OF PROPERTY AND EQUIPMENT	--	--	--	(367)
OTHER	(6)	26	(43)	(5
TOTAL OTHER INCOME (EXPENSE)	(47)	233	78	(46
LOSS BEFORE MINORITY INTEREST,INCOME TAXES AND EXTRAORDINARY ITMES	(3,132)	(4,731)	(2,404)	(11,60
MINORITY INTEREST IN LOSS OF SUBSIDIARY	--	--	--	-
LOSS BEFORE INCOME TAXES AND EXTRAORDINARY ITEM	(3,132)	(4,731)	(2,404)	(11,60
PROVISION FOR INCOME TAXES	2	3	7	
LOSS BEFORE EXTRAORDINARY ITEM	(3,134)	(4,734)	(2,411)	(11,61
EXTRAORDINARY ITEM:GAIN (LOSS) ON EXTINGUISHMENT OF DEBT, NET	310	227	(2)	6
NET LOSS	(2,824)	(4,507)	(2,413)	(11,55
BASIC (LOSS) PER SHARE:				
LOSS BEFORE EXTRAORDINARY GAIN	(0.26)	(0.30)	(0.11)	(0.3
EXTRAORDINARY GAIN	0.03	0.01	--	-
NET LOSS PER COMMON SHARE	(.23)	(.29)	(0.11)	(0.3
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	12,267,991	15,524,556	22,596,694	29,797,49

BALANCE SHEET DATA (IN THOUSANDS):

	YEARS ENDED JUNE 30,			
	1997	1998	1999	2000

CASH	$ 1,464	$ 5,750	$ 1,637	$ 1,27
WORKING CAPITAL (DEFICIT)	809	5,963	3,355	2,79
TOTAL ASSETS	3,514	8,892	9,435	7,15
LONG-TERM DEBT	360	404	762	78
OTHER LIABILITIES	183	--	--	-
STOCKHOLDER'S EQUITY (DEFICIT)	1,575	7,036	5,739	4,90

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

RESULTS OF OPERATIONS

FISCAL YEAR ENDED JUNE 30, 2001 COMPARED TO FISCAL YEAR ENDED JUNE 30, 2000

NET SALES. Net sales decreased by $1,962,000 or 61%, from $3,207,000 in the year ended June 30, 2000 to $1,245,000 in the year ended June 30, 2001. The overall decrease is attributable to a continued reduction in sales of the main product line for the year ended June 30, 2001. The revenue mix for the year ended June 30, 2001 consisted of 34% DVG and other hardware and software products, and 66% Telephone and Internet services.

During the fiscal year, potential enterprise customers that the Company had pursued held back on major commitments. A commonly cited reason for a delay in purchasing VoIP hardware was concern for the immediate stability of the marketplace. However, a survey released in August 2001 of IT professionals from 132 small to medium organizations and 136 enterprise operations indicates that thus far, 13% of small businesses and 19% of enterprise operations have deployed some form of VoIP, and that 49% of small businesses and 55% or enterprises intend to implement VoIP within the year. The general consensus within the industry is that most small businesses and enterprises alike will move toward a converged data/voice network, but they will take a phased approach. Most organizations will deploy a solution over several years. We see this as promising for long term sales and deployment of our hardware and software solutions.

Franklin Telecom survived a very challenging time, both as a company and as part of the telecommunications industry. The Company plans to return to a growth mode in the near future, although this is subject to a number of unknown factors and contingencies. As a small company, Franklin believes itself to enjoy an advantage over some of the giants among its competitors who have experienced comparable difficulties over the last two years in that it usually requires less time and fewer resources to turn around a smaller, less cumbersome operation.

GROSS PROFIT (LOSS). Gross profit decreased as a percentage of net sales to a loss of (336)% for the year ended June 30, 2001, from a gross loss of (49)% of net sales for the corresponding period of 2000. The gross profit percentage decrease can be attributed to a combination of carrier termination costs exceeding revenues for telephone services and fixed manufacturing overhead costs assigned to a hardware sales base which contracted. A large portion of the gross

loss is based on unresolved disputes with common carriers regarding invoicing for cancelled circuits. A favorable resolution could substantially improve the percentage of loss reported herein.

FNet is involved in a dispute with several telephone and satellite common carriers. One of these is PanAmSat, which was contracted to carry telephone traffic from our Bosnia NATO project. FNet claims that the service was a failure and was canceled after two months. PanAmSat claims that FNet owes it approximately $1 million for the remaining unpaid balance of the contract . FNet is vigorously contesting the claim.

Most of the current loss occurred in the first half of the fiscal year. Franklin has cut personnel and operations cost from $500,000 per month in February to an estimated $40,000 per month currently, thereby realizing a monthly savings of $460,000. In addition, from January 2001 forward, the Company's two top executives have drawn no cash salary. The difficulty in this extreme reduction in space and work force is maintaining the functionality of the Company. Remaining personnel have had to execute three job functions and cross train in others.

OPERATING EXPENSES. Operating expenses decreased by $2,864,000 or 30%, from $9,576,000 in the year ended June 30, 2000 to $6,712,000 in the year ended June 30, 2001. The decrease is attributable to decreased sales and marketing efforts, accounting charges and costs in cutting back the general and administrative infrastructure. This also includes a $1.2M inpairment of long lived fixed assets. The Company has also completed a consolidation of its physical plant, by closing the Arizona office and contracting the Westlake Village office thereby substantially reducing overhead.

OTHER INCOME (EXPENSE). Interest income decreased by $49,000 or 72% in the year ended June 30, 2001 to $27,000 from $68,000 in the year ended June 30, 2001, due to the reduction in cash and cash equivalents available for interest bearing investments. Interest expense increased by $194,000 or 178% in the year ended June 30, 2001 to $303,000 from $109,000 in the year ended June 30, 2000, due primarily to the recording of imputed interest on a prior period note from the Company's chairman. This is an non cash calculation required by Generally Accepted Accounting Principles. Other expense decreased from $56,000 in the year ended June 30, 2000 to $30,000 year ended June 30, 2001 due to various non operating items.

FISCAL YEAR ENDED JUNE 30, 2000 COMPARED TO FISCAL YEAR ENDED JUNE 30, 1999

NET SALES. Net sales decreased by $7,424,000, or 70%, from $10,631,000 in the year ended June 30, 1999 to $3,207,000 in the year ended June 30, 2000. The overall decrease is attributable to the loss of a single customer that constituted 76% of total sales for the year ended June 30, 1999. The revenue mix for the year ended June 30, 2000 consisted of 35% DVG and other hardware and software products, and 65% Telephone and Internet services.

GROSS PROFIT (LOSS). Gross profit decreased as a percentage of net sales to a loss of (49)% for the year ended June 30, 2000, from a gross profit of 47% of net sales for the corresponding period of 1999. The gross profit percentage decrease can be attributed to a combination of carrier termination costs exceeding flat rate revenues for telephone services and fixed manufacturing overhead costs exceeding the margins produced by a smaller hardware sales base.

OPERATING EXPENSES. Operating expenses increased by $2,104,000, or 28%, from $7,472,000 in the year ended June 30, 1999 to $9,576,000 in the year ended June

30, 2000. The increase is attributable to increased sales and marketing efforts, accounting charges associated with cashless exercise of employee stock options, and costs in enhancing the general and administrative infrastructure.

OTHER INCOME (EXPENSE). Interest income decreased by $80,000, or 54%, from $148,000 in the year ended June 30, 1999 to $68,000 in the year ended June 30, 2000, due to a reduction in the availability of equity funds for investment in interest bearing accounts. Interest expense increased by $82,000, or 304% from $27,000 in the year ended June 30, 1999 to $109,000 in the year ended June 30, 2000, due to the $2,500,000 in convertible notes issued by the Company during the year ended June 30, 2000. The convertible notes, including accrued interest, were subsequently repaid in May, 2000. Other expense increased from $43,000 in the year ended June 30, 1999 to $56,000 in the year ended June 30, 2000, due to various non-operating items. During the year ended June 30, 2000, the Company took a charge of $367,000 for equipment located at previous joint venture partner locations, which was deemed to be not recoverable.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents and net working capital deficit totaled $49,000 and $(2,672,000), respectively, as of June 30, 2001. The sources of cash were provided primarily by issuance of equity securities, and to a lesser extent, collections of sales revenues. The Company has relied on sales of new shares and the exercise of warrants and options to supplement the funding of operations for an extended period of time. The Company received $1,011,000, $10,589,000 and $2,485,000 in equity financing, for the years ended June 30, 1999, 2000, and 2001, respectively. Its subsidiary, FNet, received $110,000, $53,000 and $-0- in equity financing for the years ended June 30, 1999, 2000 and 2001, respectively.

Both Franklin Telecom and FNet have continued to experience losses. The Company has not currently been able to raise sufficient capital from sales of additional shares. Audit opinions on the Company's financial statements for the past two fiscal years have advised that the Company may not be able to continue as a going concern.

The Company is currently in a survival mode. As of December 31, 2001 it held $33,500 of cash or cash equivalents. Current monthly cash consumption is approximately $25,000. Sales from FTC and the FNet division are approximately $30,000 per month. Management is currently deferring salary or taking options in lieu of salary. Recent non-operating cash funding has been contributed by the Company's chairman in the form of convertible debt.

The Company believes that existing cash and cash equivalents and cash flow from operations will not be sufficient to meet the Company's presently anticipated working capital needs during the next twelve months and the foreseeable future. Although the Company continues the effort to raise cash through sales of existing inventory and anticipates future private placements of its securities, there is no assurance that this effort will be successful.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk generally represents the risk that losses may occur in the values of financial instruments as a result of movements in interest rates, foreign currency exchange rates and commodity prices. The Company is exposed to changes in financial market conditions in the normal course of its business due to its use of certain financial instruments as well as transacting in various foreign currencies.

INTEREST RATE RISK. At June 30, 2001 and 2000, the Company's cash equivalents and short-term investments totalled approximately $49,000 and $1,275,000, respectively. Since the Company typically does not purchase fixed-income securities, its cash and cash equivalents are not subject to significant interest rate risk. The Company places substantially all of its interest bearing investments with major financial institutions and by policy limits the amount of credit exposure to any one financial institution. Additionally, the Company does not hold or issue financial instruments for trading, profit or speculative purposes.

EQUITY PRICE RISK The Company does not invest in available-for-sale equity securities, and is not subject to significant equity price risk.

FOREIGN EXCHANGE RATE RISK The Company operates internationally and sometimes receives payments in local currencies. This can expose the Company to market risk from changes in foreign exchange rates to the extent that transactions are not denominated in the U.S. dollar. As a result the Company faces the risk that the foreign currencies may decline in value as compared to the U.S. dollar, resulting in a foreign currency translation loss.

Item 8. Financial Statements and Supplementary Data

See Part IV, Item 14

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure None

Part III.

Item 10. Directors and Executive Officers of the Registrant

The directors and executive officers of the Company are as follows:

NAME	AGE	POSITION
Frank W. Peters	63	Chairman of the Board of Directors
Martin S. Albert	70	Acting Chief Executive Officer & Director
Gary S. Rogers	46	Director

Mr. Peters has been the Chairman of the Board of Directors since its organization in 1981 and served as its Chief Executive Officer until September 2000. Between 1975 and 1984 he was also President of Franklin Data Systems and Franklin Systems Corporation, predecessors to the Company. From 1973 to 1975, he was Vice President of Jacquard Systems Corporation, a computer hardware and word processing software development marketer. Between 1965 and 1973 he held various marketing and sales positions with IBM. He holds an BA degree in Physics from the State University of California at Los Angeles.

Mr. Albert has been a director since March 2001 and has been Acting Chief Executive Officer of the Company since December 1, 2001. Before joining Franklin Telecom, Mr. Albert was co-founder and Managing Partner of the AmerScan Group. He has held executive marketing and general management positions at CBS, Raytheon, Photo Circuits, Kollmorgen Corp., and Infotech before embarking on an entrepreneurial career in 1970. He has worked in the venture capital industry for nearly 15 years. Mr. Albert has also been a guest speaker at many universities and conferences including UCLA and the MIT Venture Forums and has been adjunct professor in entrepreneurship at California State University at Northridge and California Lutheran University. He holds an BA degree in Physics from the City College of New York.

Mr. Rogers has been a director since April 2001. He is currently serving as V.P. Operations for AML Communications, a manufacturer of Broadband RF/microwave for

a high-speed digital world. His current responsibilities are Manufacturing, Planning and Purchasing for the wireless and custom products divisions. His previous assignment was as VP Operations at Neopoint Inc. a startup designer and manufacturer of Smart phones based on CDMA technology in San Diego. He had responsibility for establishing and maintaining, Planning and Procurement, Logistics, Customer Service, Facilitates, IS, and Product Test departments. From 1996 to 1998 Gary served as the V.P. Operations for Tandon Associates, a leading

international manufacturer of components for hard disk drives. He was responsible for the factory completion and ramp up to volume production in the Far East manufacturing operations. Prior to this assignment (1993 to 1995) he was Director of Quality for Reveal Computer Products, a manufacturer/distributor of computer peripherals targeting mass merchandisers and OEM's. From 1990 to 1993 he was Director of Worldwide Quality Tandon Computer Corporation. Mr. Rogers has a BS degree in Business Administration, operations management from California State University Northridge.

Item 11. Executive Compensation

The following table sets forth certain compensation paid or accrued by the Company during the years ended June 30, 1999, 2000 and 2001 to its Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer, Vice President of Marketing, Engineering and Chief Operating Officer of FNet. (the "Named Executive Officers").

	ANNUAL COMPENSATION			
NAME AND PRINCIPAL POSITION	YEAR	SALARY	BONUS	ALL OTHE COMPENSAT
Frank W. Peters, Chairman & CEO, FTC & FNet (3)	1999	$ 350,000	-0-	-0-
(January 1980 to Present)	2000	$ 371,000 (1)	-0-	-0-
	2001	$ 150,000 (2)	-0-	-0-
Philip Ericson, President and COO, FTC	1999	-0-	-0-	-0-
(January to September 2000)	2000	$ 100,962	-0-	-0-
	2001	$ 150,000	-0-	-0-
Thomas Russell, Chief Financial Officer, FTC & FNet	1999	$ 137,016	-0-	-0-
(January 1996 to May 2001)	2000	$ 154,327	-0-	-0-
	2001	$ 60,000	-0-	-0-
Stephen Lee, Vice President Marketing, FTC	1999	--	--	--
(January to September 2000)	2000	$ 150,000	-0-	-0-
	2001	$ 75,000	-0-	-0-
Sean Quine, Vice President Engineering, FTC	1999	$ 140,000	-0-	-0-
(October 1997 to February 2001)	2000	$ 180,000	-0-	-0-
	2001	22,000	-0-	-0-
John Saltwick, Vise President Engineering, FTC	1999	$ 110,000	-0-	-0-
(April 1998 to May 2001)	2000	$ 121,000	-0-	-0-
	2001	$ 15,000	-0-	-0-
Michael C. Peters, COO, FNet	1999	$ 127,000	-0-	-0-

(January 1, 1994 to Present)	2000	$ 148,432 (4)	-0-	-0-
(COO of FNet Corp. efective May 2000)	2001	$ 189,000 (2)	-0-	-0-

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(1) $96,667 of these amounts were deferred.
(2) All of this was deferred.
(3) Frank Peters was succeeded by Mr. Robert Stewart as CEO on September 15, 2000. Then in January 2001, Mr. Stewart resigned and Mr. Frank Peters stepped in as acting CEO.
(4) Of these amounts, $22,432 was deferred.

Except as disclosed above, no compensation characterized as long-term compensation, including or long-term incentive plan payouts, were paid by the Company during the years ended June 30, 1999, 2000 and 2001 to any of the Named Executive Officers.

Employment Arrangements. The Company's Chairman is employed pursuant to a six year Employment Agreement, effective January 1, 1998. The Employment Agreement provides for compensation at the rate of $27,000 per month, with annual increases of 6%. Beginning in June 2000, the Company's Chairman temporarily reduced his salary to $12,500 per month until certain goals are achieved by the Company. As of January 1, 2001 the Chairman ceased drawing any cash salary and has deferred his new salary of $150,000 per year without interest.

OPTION GRANTS DURING THE YEAR ENDED JUNE 30, 2001.

The following table sets forth certain information as of June 30, 2001 with respect to options held by the Named Executive Officers. The Company has no outstanding stock appreciation rights, either freestanding or in tandem with options.

NAME	SHARES ACQUIRED ON EXERCISE (#)	VALUE REALIZED ($)	NUMBER OF UNEXERCISED OPTIONS AT JUNE 30, 2001 EXERCISABLE/UNEXERCISABLE	VALUE OF UN IN-THE-MONEY JUNE 30, EXERCISABLE/UN
Frank W. Peters.......	N/A	-0-	1,550,000/ 0	-0- /
Philip Ericson........	N/A	-0-	-0- /-0-	-0- /
Thomas Russell........	295,858	$369,823	-0-/-0-	-0- /

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(1) Assumes that a share of Common Stock was valued at $0.10 per share on June 30, 2001. Amounts reflected are based on this assumed price minus the exercise price and do not indicate that shares were sold.

REPORT OF THE COMPENSATION COMMITTEE. The Company's executive compensation program is designed to help attract, retain, and motivate the highly qualified personnel needed to manage the Company's business and affairs. To meet these goals, the Company has implemented a compensation program with the following components:

o base salaries that reflect the scope and responsibilities of the position, as well as the skills, knowledge, experience, abilities, and contributions of each individual executive.

- short-term incentives that are based on the financial performance of the Company.

- long-term incentives that balance the executive officer's short- and long-term perspectives and provide rewards consistent with shareholder returns.

Compensation decisions are made following an assessment of the individual's contributions to the Company's success, any significant changes in the individual's role or responsibility, and internal equity of the Company's compensation relationships.

The competitiveness of the Company's total compensation program-incorporating base salaries, short-term incentives and long-term incentives is regularly reviewed by the Compensation Committee. Based on such reviews, the Company concluded that the compensation paid to its executives was fair and reasonable. In general, the Company believes that the overall compensation levels for the executive group should reflect competitive levels of compensation for comparable positions in similarly sized companies over the long term.

The Company believes that it is essential to link executive compensation and Company performance. To meet this objective, the Company maintains stock option programs which provide option grants on a regular, though not necessarily annual, basis to provide participants with an opportunity to share in the Company's performance. Stock option grants reflect the past contributions of the individual, the individual's ability to affect Company profitability, the scope of the individual's responsibilities, the need to retain the individual's services over time and management's assessments and recommendations. All executive officers, including the chief executive officer, are eligible to participate in this program.

The Company's policy of awarding cash bonuses is designed to specifically relate executive pay to Company and individual performance. As a pay-for-performance program, cash bonuses provide financial rewards for achievement of substantive Company and personal objectives. Actual awards paid are based primarily on actual Company performance.

Performance Graph

The following graph summarized cumulative total shareholder return data (assuming reinvestment of dividends) for the five-year period beginning June 30, 1996. The graph assumes that $100 was invested on June 30, 1996: (i) in the Common Stock of Franklin Telecommunications Corp, (ii) in the AMEX Composite Index (where the Company's Common Stock is traded), and (iii) a peer group comprised of Vodavi Technology, Inc. (VTEK) and VocalTec Communications Ltd. (TOCL).

TOTAL RETURN TO STOCKHOLDERS
(assumes $100 investment on 6/30/96)

[Performance Graph Here]

TOTAL RETURN ANALYSIS	06/30/1996	06/30/1997	06/30/1998	06/30/1999	06/30/2000	0

Franklin Telecom.	(x)	$ 100.00	$ 197.14	$ 215.78	$ 221.04	$ 78.94
Peer Group	(+)	$ 100.00	$ 67.14	$ 82.42	$ 88.35	$ 146.04
AMEX Composite	(o)	$ 100.00	$ 107.94	$ 125.05	$ 138.34	$ 162.26

COMPLIANCE WITH INTERNAL REVENUE CODE SECTION 162(m). The Company analyzes its executive compensation practices and plans on an ongoing basis with respect to Section 162(m) of the Internal Revenue Code. Where it deems advisable, the Company will take appropriate action to maintain the tax deductibility of its executive compensation.

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Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Stock as of June 30, 2001 by each director and executive officer of the Company, each person known to the Company to be the beneficial owner of more than 5% of the outstanding Common Stock, and all directors and executive officers of the Company as a group. Except as otherwise indicated below, each person has sole voting and investment power with respect to the shares owned, subject to applicable community property laws.

	SHARES BENEFICIALLY OWNED (INCLUDES EXERCISABLE OPTIONS)	
NAME AND ADDRESS	NUMBER	PERCENT
Frank W. Peters (1)........................ 733 Lakefield Road Westlake Village, CA 91361	11,048,835	22.0%
Marty S. Albert 733 Lakefield Road Westlake Village, CA 91361	1,000,000	2
Gary S. Rogers 733 Lakefield Road Westlake Village, CA 91361	1,000,000	2
All directors and executive officers of the Company as a group (3 persons)...........	13,048,835	26.0%

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(1) Includes options to purchase 1,550,000 shares and rights to convert notes to 3,304,166 shares all which could be exercised in 60 days.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In September 2000, the Company's Chief Financial Officer exercised options to purchase 400,000 shares of common stock at an exercise price of $.44 per share. The exercise was done on a net basis, so that the actual number of shares issued was 295,858.

In March 2001, the Company's Chairman loaned the Company $100,000 convertible to stock at $0.12 per share bearing interest at 6% due in one year.

In June 2001, the Company's Chairman loaned the Company $20,000 convertible to stock at $0.08 per share bearing interest at 6% due in one year.

In July 2001, the Company's Chairman loaned the Company $19,000 convertible to stock at $0.05 per share bearing interest at 6% due in one year.

In September 2001, the Company granted options to purchase 1,000,000 shares of common stock at an exercise price of $0.05 per share, the fair value of the underlying shares, to each of two members of the board. The options were granted outside of the Company's stock option plans, vest 10% per month over the next 10 months, and expire three years from the date of grant.

In November 2001, the Company's Chairman loaned the Company $50,000 convertible to stock at $0.05 per share bearing interest at 6% due in one year.

In November 2001, the Company granted options to purchase 2,400,000 and 2,500,000 shares of common stock at an exercise price of $0.05 per share, the fair value of the underlying shares, to its chief executive officer/chairman and chief operating officer, respectively. These options were granted for payment of deferred salaries from January to October 2001 valued at $118,000 and $128,000, respectively. The options were granted outside of the Company's stock option plans and may be exercised any time after issuance and for a period of three years from the date of grant.

Part IV.

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) Exhibits

3.1	Restated Articles of Incorporation of Franklin Telecommunications Corp.(1)
3.2	Bylaws of Franklin Telecommunications Corp.(2)
10.1	Employment Agreement, dated March 1, 1993 between Franklin Telecommunications Corp. and Frank W. Peters. (1)
23.1	Consent of Singer Lewak Greenbaum & Goldstein LLP

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(1) Incorporated by reference from Registrant's Registration Statement on Form S-1 (No. 333-24791), filed with the Commission on April 9, 1997.

(2) Incorporated by reference from Amendment No. 2 to Registrant's Registration Statement on Form S-3 (No. 333-35834), filed with the Commission on July 31, 2000.

(b) Financial Statements

(c) Reports on From 8-K

None.

SIGNATURES

Pursuant to the requirements of Section 13 of 15(d) of the Securities Exchange Act of 1934, Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Franklin Telecommunications Corp.

By: /s/ Frank W. Peters
Frank W. Peters
Chairman of the Board

Dated: January 12, 2002

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
(1) Principal Executive Officer		
/s/ Martin S. Albert Martin S. Albert	Acting Chief Executive Officer	January 22, 200
(2) Principal Financial and Accounting Officer		
/s/ FRANK W. PETERS Frank W. Peters	Acting Principle Accounting Officer and a Director	January 22, 200
(3) Directors		
/s/ FRANK W. PETERS Frank W. Peters	Chairman of the Board of Directors	January 22, 200
/s/ Martin S. Albert Martin S. Albert	Director	January 22, 200
/s/ GARY S. ROGERS Gary S. Rogers	Director	January 22, 200

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION

3.1	RESTATED ARTICLES OF INCORPORATION OF FRANKLIN TELECOMMUNICATIONS CORP.(1)
3.2	BYLAWS OF FRANKLIN TELECOMMUNICATIONS CORP.(2)
10.1	EMPLOYMENT AGREEMENT, DATED MARCH 1, 1993 BETWEEN FRANKLIN TELECOMMUNICATIONS CORP. AND FRANK W. PETERS.(1)
23.1	CONSENT OF SINGER LEWAK GREENBAUM & GOLDSTEIN LLP

(1) INCORPORATED BY REFERENCE FROM REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1 (NO. 333-24791), FILED WITH THE COMMISSION ON APRIL 9, 1997.

(2) INCORPORATED BY REFERENCE FROM AMENDMENT NO. 2 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-3 (NO. 333-35834), FILED WITH THE COMMISSION ON JULY 31, 2000.

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
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JUNE 30, 2001

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Shareholders of
Franklin Telecommunications Corp.

We have audited the accompanying consolidated balance sheets of Franklin Telecommunications Corp. and subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of operations, shareholders' equity (deficit), and cash flows for each of the three years in the period ending June 30, 2001. 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial

statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Franklin Telecommunications Corp. and subsidiaries as of June 30, 2001 and 2000, and the results of their consolidated operations and their consolidated cash flows for each of the three years in the period ended June 30, 2001 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, during the year ended June 30, 2001, the Company incurred a net loss of $10,820,000 and it had negative cash flows from operations of $3,748,000. These factors, among others, as discussed in Note 2 to the consolidated financial statements, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

SINGER LEWAK GREENBAUM & GOLDSTEIN LLP

Los Angeles, California
November 30, 2001

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
JUNE 30,

ASSETS

	2001	2000
CURRENT ASSETS		
Cash and cash equivalents	$ 49,000	$1,275,000
Accounts receivable, less allowance for doubtful accounts of $122,000 and $50,000	21,000	136,000
Other receivables	1,000	8,000
Note receivable - related party	--	64,000
Inventories, less allowance for obsolescence of $2,377,000 and $134,000	325,000	2,698,000
Prepaid expenses	15,000	80,000
Total current assets	411,000	4,261,000
PROPERTY AND EQUIPMENT, net	589,000	2,158,000

LICENSES	391,000	695,000
OTHER ASSETS	44,000	43,000
TOTAL ASSETS	$1,435,000	$7,157,000

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
JUNE 30,

LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)

	2001	2000
CURRENT LIABILITIES		
Convertible promissory notes payable (majority due to a related party)	$ 122,000	$ --
Current portion of capital lease obligations	28,000	34,000
Accounts payable	1,554,000	407,000
Accrued liabilities	1,379,000	1,028,000
Total current liabilities	3,083,000	1,469,000
NOTE PAYABLE - RELATED PARTY	686,000	762,000
CAPITAL LEASE OBLIGATIONS, net of current portion	--	20,000
Total liabilities	3,769,000	2,251,000
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY (DEFICIT)		
Series C convertible preferred stock, no par value 10,000,000 shares authorized 0 and 0 shares issued and outstanding	--	--
Common stock, no par value 90,000,000 shares authorized 42,617,241 and 34,247,013 shares issued and outstanding	35,850,000	32,270,000
Common stock committed, no par value 74,716 and 74,716 shares committed but not yet issued	82,000	82,000
Accumulated deficit	(38,266,000)	(27,446,000)
Total shareholders' equity (deficit)	(2,334,000)	4,906,000

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)	$ 1,435,000	$ 7,157,000

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED JUNE 30,

	2001	2000	1999
SALES			
Product	$ 421,000	$ 1,109,000	$ 8,767,000
Telephone and Internet services	824,000	2,098,000	1,864,000
Total sales	1,245,000	3,207,000	10,631,000
COST OF SALES			
Product	2,772,000	1,115,000	4,475,000
Telephone and Internet services	2,659,000	3,660,000	1,166,000
Total cost of sales	5,431,000	4,775,000	5,641,000
GROSS PROFIT (LOSS)	(4,186,000)	(1,568,000)	4,990,000
OPERATING EXPENSES			
Research and development expenses	1,152,000	1,834,000	1,870,000
Selling, general, and administrative expenses	4,351,000	7,518,000	5,602,000
Impairment of long-lived assets	1,209,000	224,000	--
Total operating expenses	6,712,000	9,576,000	7,472,000
LOSS FROM OPERATIONS	(10,898,000)	(11,144,000)	(2,482,000)
OTHER INCOME (EXPENSE)			
Interest income	19,000	68,000	148,000
Other income	8,000	--	--
Interest expense	(303,000)	(109,000)	(27,000)
Other expense	(30,000)	(56,000)	(43,000)
Abandonment of property and equipment	--	(367,000)	--

Total other income (expense)	(306,000)	(464,000)	78,000
LOSS BEFORE PROVISION FOR INCOME TAXES AND EXTRAORDINARY ITEM	(11,204,000)	(11,608,000)	(2,404,000)
PROVISION FOR INCOME TAXES	3,000	3,000	7,000

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED JUNE 30,

	2001	2000	1999
LOSS BEFORE EXTRAORDINARY ITEM	$(11,207,000)	$(11,611,000)	$ (2,411,000)
EXTRAORDINARY ITEM			
Gain on extinguishment of debt, net of taxes of $0, $0, and $0	387,000	60,000	(2,000)
NET LOSS	$(10,820,000)	$(11,551,000)	$ (2,413,000)
BASIC AND DILUTED LOSS PER SHARE ATTRIBUTABLE TO COMMON SHAREHOLDERS			
Loss before extraordinary gain (loss)	$ (0.28)	$ (0.39)	$ (0.11)
Extraordinary gain (loss)	0.01	--	--
NET LOSS PER COMMON SHARE	$ (0.27)	$ (0.39)	$ (0.11)
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING	40,113,816	29,797,493	22,596,694

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP
AND SUBSIDIARIE
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT
FOR THE YEARS ENDED JUNE 30

	Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amoun
BALANCE, JUNE 30, 1998	548	$ 4,856,000	18,344,178	$ 15,571
COMMON STOCK ISSUED FOR				
Cash			444,725	474
Notes receivable			807,536	
Conversion of preferred stock	(548)	(4,856,000)	5,543,468	4,856
Issuance of committed shares			67,336	85
Services rendered			121,356	64
Stock options/warrants			468,127	468
COMMON STOCK OF SUBSIDIARY ISSUED FOR				
Cash				60
Stock options				50
NET LOSS				
BALANCE, JUNE 30, 1999	--	--	25,796,726	21,628
SHARES OF COMMON STOCK COMMITTED FOR ACCRUED COMPENSATION				
EXPIRATION OF COMMITTED SHARES				
COMMON STOCK ISSUED FOR				
Cash			6,955,957	8,056
Services rendered			21,694	48
Stock options/warrants			261,603	179
Cashless exercise of options			1,211,033	717

	Common Stock Committed		Accumulated	
	Shares	Amount	Deficit	T
BALANCE, JUNE 30, 1998	77,336	$ 91,000	$(13,482,000)	$ 7,
COMMON STOCK ISSUED FOR				
Cash				
Notes receivable				
Conversion of preferred stock				
Issuance of committed shares	(67,336)	(85,000)		
Services rendered				
Stock options/warrants				
COMMON STOCK OF SUBSIDIARY ISSUED FOR				
Cash				
Stock options				
NET LOSS			(2,413,000)	(2,
BALANCE, JUNE 30, 1999	10,000	6,000	(15,895,000)	5,
SHARES OF COMMON STOCK COMMITTED FOR ACCRUED COMPENSATION	74,716	82,000		

EXPIRATION OF COMMITTED SHARES		(10,000)	(6,000)	
COMMON STOCK ISSUED FOR				
Cash				8,
Services rendered				
Stock options/warrants				
Cashless exercise of options				

The accompanying notes are an integral part of these financial statements.

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FRANKLIN TELECOMMUNICATIONS CORP
AND SUBSIDIARIE
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT
FOR THE YEARS ENDED JUNE 30

	Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amoun
WARRANTS ISSUED FOR				
services rendered		$		$ 60
private placement				2,039
financing costs				110
Offering costs				(620
COMMON STOCK OF SUBSIDIARY ISSUED FOR CASH				53
NET LOSS				
BALANCE, JUNE 30, 2000	-	-	34,247,013	32,270
COMMON STOCK ISSUED FOR				
Cash			5,105,711	2,029
Services rendered			477,324	318
Stock options/warrants			10,000	4
Cashless exercise of options			295,858	
Cashless exercise of protective warrants			1,977,797	
Late registration filing			503,538	430
Offering costs				(13
WARRANTS ISSUED FOR PRIVATE PLACEMENT				478
IMPUTED INTEREST ON RELATED PARTY NOTE PAYABLE				344
COMMON STOCK OF SUBSIDIARY EXCHANGED FOR COMMON STOCK OF PARENT				(10
NET LOSS				
BALANCE, JUNE 30, 2001	-	$ -	42,617,241	$ 35,850

	Common Stock Committed		Accumulated	
	Shares	Amount	Deficit	T
WARRANTS ISSUED FOR				
services rendered		$	$	$
private placement				2,
financing costs				
Offering costs				(
COMMON STOCK OF SUBSIDIARY ISSUED FOR CASH				
NET LOSS			(11,551,000)	(11,
BALANCE, JUNE 30, 2000	74,716	82,000	(27,446,000)	4,
COMMON STOCK ISSUED FOR				
Cash				2,
Services rendered				
Stock options/warrants				
Cashless exercise of options				
Cashless exercise of protective warrants				
Late registration filing				
Offering costs				
WARRANTS ISSUED FOR PRIVATE PLACEMENT				
IMPUTED INTEREST ON RELATED PARTY NOTE PAYABLE				
COMMON STOCK OF SUBSIDIARY EXCHANGED FOR COMMON STOCK OF PARENT				
NET LOSS			(10,820,000)	(10,
BALANCE, JUNE 30, 2001	74,716	$ 82,000	$(38,266,000)	$ (2,

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS
AND SUBSIDI
CONSOLIDATED STATEMENTS OF CASH
FOR THE YEARS ENDED JUN

	2001	2000	199
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$(10,820,000)	$(11,551,000)	$ (2,413
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation and amortization	699,000	642,000	434
Stock issued for late filing of registration statement	430,000	-	

Stock issued for services rendered	256,000	48,000	50
Warrants issued for services rendered	-	60,000	
Cashless exercise of stock options and warrants	-	717,000	
Warrants issued for financing costs	-	110,000	
Loss on abandonment of property and equipment	-	367,000	
Extraordinary gain on disposal of property and equipment	(9,000)	-	
Impairment of long-lived assets	1,209,000	224,000	
Gain on write-off of debt	(387,000)	(60,000)	
Provision for doubtful accounts	72,000	(56,000)	98
Write-off of accounts receivable	-	1,411,000	
Imputed interest on related party note payable	267,000	-	
Reserve for inventory obsolescence	2,243,000	-	
(Increase) decrease in			
Accounts receivable	43,000	251,000	(2,617
Other receivables	7,000	65,000	25
Inventories	130,000	(156,000)	(1,003
Prepaid expenses	65,000	1,000	(26
Other assets	-	(10,000)	
Increase (decrease) in			
Accounts payable	1,534,000	(620,000)	854
Accrued liabilities	513,000	(743,000)	747
Net cash used in operating activities	(3,748,000)	(9,300,000)	(3,851
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property and equipment	(63,000)	(720,000)	(1,275
Proceeds from notes receivable	-	-	207
Other assets	-	(49,000)	(260
Other liabilities	-	-	
Net cash used in investing activities	(63,000)	(769,000)	(1,328

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30,

	2001	2000	1999
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from convertible notes payable	$ 122,000	$ 2,500,000	$ -
Payments on convertible notes payable	-	(2,500,000)	-
Proceeds from sale of common stock and warrants	2,485,000	9,475,000	1,011,000
Proceeds from sale of minority stock in consolidated subsidiary	-	53,000	55,000

Proceeds from exercise of options	4,000	179,000	-
Payments on capital lease obligation	(26,000)	-	-
Net cash provided by financing activities	2,585,000	9,707,000	1,066,000
Net decrease in cash and cash equivalents	(1,226,000)	(362,000)	(4,113,000)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,275,000	1,637,000	5,750,000
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 49,000	$ 1,275,000	$ 1,637,000
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
INCOME TAXES PAID	$ -	$ -	$ -

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES During the year ended June 30, 2001, the Company completed the following:

- Discounted non-interest-bearing related party notes payable in the amount of $76,000, using a discount rate of 10%.
- Issued stock for services rendered during the year ended June 30, 2000. Said services were valued at $62,000.

During the year ended June 30, 2000, the Company completed the following:

- Repossessed equipment from a customer who was in arrears on payment for said equipment at a cost of $868,000.
- Equipment with a net book value of $150,000 was transferred to the Company in exchange for payment of a long-term note receivable.

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30,

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES (CONTINUED)

- Committed to issue 74,716 shares of common stock valued at $82,000 as payment for accrued compensation to an employee.
- Issued 275,625 warrants to purchase common stock for services valued at $60,000.
- Purchased equipment under a capital lease in the amount of $54,000.

During the year ended June 30, 1999, the Company completed the following:

- Equipment valued at $500,000 that was prepaid at June 30, 1998 was delivered to the Company.

- 5,543,468 shares of common stock were issued upon the conversion of 548 shares of its Series C preferred stock.

- Equipment with a net book value of $16,000 and the trade name "Malibu Internet Services" were sold to an individual in exchange for a note receivable of $55,000.

- The current portion of a note payable to a related party for $228,000 plus accrued interest of $130,000 was converted into a long-term note payable to the same related party.

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP.
AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2001

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NOTE 1 - BUSINESS AND ORGANIZATION

Franklin Telecommunications Corp. ("Franklin") and its subsidiaries (collectively, the "Company") design, build, and sell Internet Telephony equipment, also called Voice Over Internet Protocol equipment ("VOIP"), and other high speed communications products and subsystems. The Company's products are marketed through Original Equipment Manufacturers ("OEMs") and distributors, as well as directly to end users. In addition, through its majority owned subsidiary, FNet Corp. ("FNet"), the Company provides traditional switched network and Internet Protocol telephony services and Internet access to businesses and individuals. The Company's customers are located primarily in the United States, Canada, South America, Asia, and parts of Europe in a wide range of industries including financial services, government, telephone services, and manufacturing.

The Company offers a suite of Internet Telephony solutions that enable business communications over the Internet. From the small office home office ("SOHO") to the branch office and headquarters operations of medium to large scale corporate America, the Company offers a cost-effective call handling solution. From the enterprise to the carrier market, the Company can deal with "convergence," managing the connectivity and integration of voice, data, and fax. Wherever possible, the Company offers a turnkey solution that can be "owned" by its customers. When equipment sales are not in the best interest of a particular customer's business communications solution, the Company plans to provide that solution as a "service" that can be leased. The Company is a leading edge supplier of Internet Telephony solutions as a result of its flexibility in providing business communication solutions as equipment or services on a global basis. The Company's products and services enable connectivity and e-commerce.

The Company is both an equipment supplier and a service provider, offering turnkey business communications solutions to both the carrier and enterprise segments of the Internet Telephony market. The Company

produces gateways, gatekeepers, and edge servers that provide advanced packet switching solutions that significantly reduce the infrastructure costs associated with communications networks. The Company's products are designed, developed, and manufactured by the Company.

NOTE 2 - GOING CONCERN MATTERS

The accompanying consolidated 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 incurred a net loss of $9,948,000 during the year ended June 30, 2001 and it had negative cash flows from operations of $3,748,000. These factors raise substantial doubt about the Company's ability to continue as a going concern.

Recovery of the Company's assets is dependent upon future events, the outcome of which is indeterminable. The Company's attainment of profitable operations is dependent upon its obtaining adequate debt and equity financing and achieving a level of sales adequate to support the Company's cost structure. In addition, realization of a major portion of the assets in the accompanying balance sheet is dependent upon the Company's ability to meet its financing requirements and the success of its plans to sell its products. 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.

Management plans to raise additional equity capital, continue to develop its products, and look for merger or acquisition candidates.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Franklin and its wholly owned or majority owned subsidiaries, FNet Corp., FNet/Curacao, FNet-Bosnia, IDM, Internet Passport, Lan Performance, TCI, and FTC 800. All inter-company balances and transactions have been eliminated.

Revenue Recognition

Revenues from product sales are recognized upon shipment of the product to customers. The Company does not allow the right of return on product sales. Revenue from telephone and Internet services are recognized over the period services are provided and consist primarily of fees charged for the Company's billable network and Internet access services.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Comprehensive Income

The Company utilizes Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income." This statement establishes standards for reporting comprehensive income and its components in a financial statement. Comprehensive income as defined includes all changes in equity (net assets) during a period from non-owner sources. Examples of items to be included in comprehensive income, which are excluded from net income, include foreign currency translation adjustments and unrealized gains and losses on available-for-sale securities. Comprehensive income is not presented in the Company's financial statements since the Company did not have any of the items of comprehensive income in any period presented.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Inventories

Inventories are stated at the lower of cost or market (estimated net realizable value). Cost is determined using the average cost method, which approximates the first-in, first-out ("FIFO") method. Net realizable value is based on forecasts for sales of the Company's products in the ensuing years. The industry in which the Company operates is characterized by rapid technological advancement and change. Should demand for the Company's products prove to be significantly less than anticipated, the ultimate realizable value of the Company's inventories could be substantially less than the amount shown on the accompanying consolidated balance sheets.

Property and Equipment

Property and equipment are stated at cost. The Company provides for depreciation using the straight-line method over the estimated useful lives as follows:

Computers and software	5 years
Machinery and equipment	7 years
Furniture and fixtures	7 years

Expenditures for maintenance and repairs are charged to operations as incurred while renewals and betterments are capitalized. Gains or losses on the sale of property and equipment are reflected in the statements of operations.

Licenses

Licenses are stated at cost and are amortized using the straight-line method over the license periods of five years.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future net cash flows expected to be generated by the assets. If the assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount exceeds the fair value of the assets.

Warranties

The Company provides limited warranties of one year from the date of purchase of its products. A minimal accrual has been made for warranty liabilities because they are not expected to be significant.

Fair Value of Financial Instruments

The Company measures its financial assets and liabilities in accordance with generally accepted accounting principles. For certain of the Company's financial instruments including cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, the carrying amounts approximate fair value due to their short maturities. The amounts shown for note receivable - related party, convertible promissory notes payable, note payable - related party, and capital lease obligations also approximate fair value because current interest rates and terms offered by and to the Company for similar notes and lease agreements are substantially the same.

Minority Interest

Minority interest represents the minority shareholders' proportionate share of the equity of FNet.

During the year ended June 30, 1999, FNet sold approximately 60,000 shares of its stock to outside investors at $1 per share. It also issued 50,000 shares upon the exercise of 50,000 stock options. The shares sold to investors were issued under a private offering circular pursuant to the exemption from registration under the Securities Act of 1933 provided in Rule 505 of Regulation D. After the issuance of these shares, Franklin's ownership percentage remained at 71% as of June 30, 1999.

During the year ended June 30, 2000, FNet sold approximately 26,250 shares of its stock to outside investors at $2 per share. The shares sold to investors were issued under a private offering circular pursuant to the exemption from registration under the Securities Act of 1933 provided in Rule 505 of Regulation D. After the issuance of these shares, Franklin's ownership percentage remained at 71% as of June 30, 2001 and 2000.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Minority Interest (Continued)

FNet, on a stand-alone basis, had a shareholders' deficit. As a result, Franklin's investment in FNet had a negative carrying value. The increase in capitalization of FNet resulting from the sale of shares of common stock to outside investors benefited Franklin in that it reduced the negative carrying value of Franklin's investment in FNet. Accordingly, Franklin has accounted for the change in its proportionate share of FNet's equity resulting from the issuance of stock to outside investors as an increase in shareholders' equity and a reduction in minority interest liability in the consolidated financial statements.

The accompanying consolidated balance sheets do not reflect a minority interest liability as of June 30, 2001 and 2000 as FNet, on a stand-alone basis, had a shareholders' deficit as of such dates. The accompanying consolidated statements of operations for the years ended June 30, 2001, 2000, and 1999 do not reflect the minority interest's share of FNet's losses for said years as the related accrual would result in the Company's recordation of a minority interest receivable.

Stock Options and Warrants

SFAS No. 123, "Accounting for Stock-Based Compensation," defines a fair value based method of accounting for stock-based compensation. However, SFAS No. 123 allows an entity to continue to measure compensation cost related to stock and stock options issued to employees using the intrinsic method of accounting prescribed by Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees." Entities electing to remain with the accounting method of APB 25 must make pro forma disclosures of net income and earnings per share as if the fair value method of accounting defined in SFAS No. 123 had been applied. The Company has elected to account for its stock-based compensation to employees under APB 25.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $83,000, $393,000, and $204,000 for the years ended June 30, 2001, 2000, and 1999 respectively.

Research and Development Costs

Research and development costs are expensed as incurred.

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NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes

The Company accounts for income taxes under the asset and liability method of accounting. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is required when it is less likely than not that the Company will be able to realize all or a portion of its deferred tax assets.

Loss per Share

The Company utilizes SFAS No. 128, "Earnings per Share." Basic loss per share is computed by dividing loss available to common shareholders by the weighted-average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Because the Company has incurred net losses, basic and diluted loss per share are the same.

The following potential common shares have been excluded from the computation of diluted net loss per share for all periods presented because the effect would have been anti-dilutive:

	2001
Options outstanding inside the Company's stock option plans	1,531,000
Options outstanding outside the Company's stock option plans	1,441,451
Convertible notes payable	1,104,033
Warrants issued in conjunction with convertible notes payable	1,000,000
Warrants issued in conjunction with various private placements	8,856,888
Warrants issued as offering costs for convertible notes payable	100,000
Warrants issued for services rendered	420,000
FNet warrants issued in conjunction with various private placements	30,000
FNet warrants issued in conjunction with Series C preferred stock	668,104

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Concentrations of Credit Risk

The Company sells its products throughout the United States, Canada, Australia, and parts of Europe and South America and extends credit to its customers and performs ongoing credit evaluations of such customers. The Company evaluates its accounts receivable on a regular basis for collectability and provides for an allowance for potential credit losses as deemed necessary.

For the years ended June 30, 2001 and 2000, no customers accounted for more than 5% of the Company's product sales. One customer accounted for 76% of the Company's product sales for the year ended June 30, 1999.

Export sales, primarily to Canada, Australia, Europe, and South America, represented 0%, 2%, and 9% of net sales for the years ended June 30, 2001, 2000, and 1999, respectively.

Recently Issued Accounting Pronouncements

In September 2000, the FASB issued SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125." This statement is not applicable to the Company.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations." This statement addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, "Business Combinations," and SFAS No. 38, "Accounting for Pre-Acquisition Contingencies of Purchased Enterprises." All business combinations in the scope of this statement are to be accounted for using one method, the purchase method. The provisions of this statement apply to all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method for those business combinations is prohibited. This statement also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001 or later. The Company does not expect adoption of SFAS No. 141 to have a material impact, if any, on its financial position or results of operations.

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NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recently Issued Accounting Pronouncements (Continued)

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, "Intangible Assets." It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. It is effective for fiscal years beginning after December 15, 2001. Early application is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not been issued previously. The Company does not expect adoption of SFAS No. 142 to have a material impact, if any, on its financial position or results of operations.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This statement applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or the normal operation of long-lived assets, except for certain obligations of lessees. This statement is not applicable to the Company.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," the accounting and reporting provisions of APB No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual, and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business, and amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation for a subsidiary for which control is likely to be temporary. The Company does not expect adoption of SFAS No. 144 to have a material impact, if any, on its financial position or results of operations.

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NOTE 4 - CASH AND CASH EQUIVALENTS

The Company maintains cash deposits at banks located in California. Deposits at each bank are insured by the Federal Deposit Insurance Corporation up to $100,000. At times, the Company holds cash with these banks in excess of amounts insured by federal agencies. Excess cash is invested in money market accounts, certificates of deposit, and United

States Government agency notes. As of June 30, 2001 and 2000, the uninsured portions of these balances held at the banks aggregated to $0 and $1,116,000, respectively.

Income from these investments consists entirely of interest income in the amount of $19,000, $68,000, and $148,000 for the years ended June 30, 2001, 2000, and 1999, respectively. The aggregate carrying amount of cash and short-term investments by major types at June 30 was as follows:

	2001	2000
Cash	$ 41,000	$ 519,000
Money market accounts	8,000	756,000
TOTAL	$ 49,000	$ 1,275,000

NOTE 5 - INVENTORIES

Inventories at June 30 consisted of the following:

	2001	2000
Raw materials	$ 1,360,000	$ 1,314,000
Work in process	201,000	222,000
Finished goods	1,141,000	1,296,000
Reserve for obsolescence	(2,377,000)	(134,000)
TOTAL	$ 325,000	$ 2,698,000

During the year ended June 30, 2001, the Company did not realize sufficient sales from Internet telephony equipment to support it capital structure. Therefore, management revised its forecasts and projections for the Company. These revised sales forecasts indicated that future expected cash flows from sales of Internet telephony equipment were less than the carrying value of their inventories. The carrying value of the Company's inventories was $2,702,000, but based on recent comparable sales of other telephony equipment, management determined the fair value of inventories to be approximately $325,000. As a result, the Company recorded an additional reserve for obsolescence of $2,243,000.

NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment at June 30 consisted of the following:

	2001	2000
Computers and software	$ 1,230,000	$ 1,607,000

Machinery and equipment	882,000	1,562,000
Furniture and fixtures	223,000	280,000
	2,335,000	3,449,000
Less accumulated depreciation	1,746,000	1,291,000
TOTAL	$ 589,000	$ 2,158,000

During the year ended June 30, 2001, the Company did not realize sufficient sales from Internet telephony equipment and services to support its capital structure. Therefore, management revised its forecasts and projections for Franklin and FNet. These revised sales forecasts indicated that future expected cash flows from these business units were less than the carrying value of their long-lived assets. The carrying value of the Company's long-lived assets was $2,125,000, but based on recent comparable sales of other telephony equipment, management determined the fair value of the long-lived assets to be approximately $980,000. As a result, the Company recognized an impairment charge of $1,145,000. The charge included $104,000 for licenses and $1,041,000 of tenant improvements, property and equipment, software and supporting technologies, and infrastructure, which are included in the consolidated statement of operations for the year ended June 30, 2001. Of this impairment charge, $365,000 is related to Franklin, and the remaining $780,000 is related to FNet.

During the year ended June 30, 2000, the Company was unable to take possession of certain property and equipment and therefore recognized an expense of $367,000 for the abandonment of these assets.

NOTE 7 - NOTE RECEIVABLE - RELATED PARTY

Note receivable - related party at June 30 consisted of the following:

	2001	2000
Note receivable from a former director, bearing interest at 6% per annum, secured by certain shares of Franklin's common stock, and was due in July 2000, but was mutually extended for one year.	$ -	$ 64,0
Less current portion	-	64,0
LONG-TERM PORTION	$ -	$

During the year ended June 30, 2001, the Company determined that the

note receivable from its director was uncollectible and wrote off the entire balance. The Company recorded a loss on impairment on the note receivable of $64,000.

NOTE 8 - ACCRUED LIABILITIES

Accrued liabilities at June 30 consisted of the following:

	2001	2000
Salaries and related expenses	$ 249,000	$ 372,0
Salaries and related expenses due to officers	776,000	318,0
Accrued legal settlement (Note 12)	165,000	
Other accrued liabilities	189,000	338,0
TOTAL	$ 1,379,000	$ 1,028,0

NOTE 9 - CONVERTIBLE NOTES PAYABLE

Convertible notes payable at June 30 consisted of the following:

	2001	2000
6% convertible promissory note, due March 20, 2002	$ 100,000	$
6% convertible promissory note, due May 29, 2002	2,000	
6% convertible promissory note, due June 28, 2002	20,000	
	122,000	
Less current portion	122,000	
LONG-TERM PORTION	$ -	$

On March 20, 2001 and June 28, 2001, the Company issued convertible promissory notes to its chief executive officer/chairman in the amounts of $100,000 and $20,000, respectively. The notes are convertible upon issuance at the option of the holder into the Company's common stock at a conversion price equal to the fair value of the Company's common stock on the date of issuance, or $0.12 and $0.08, respectively. The notes incur interest at 6% per annum, the interest is payable annually, and the notes mature one year from the date of issuance. None of the

notes were converted into common stock during the year ended June 30, 2001. No expense was recorded in connection with the issuance of the convertible notes since the conversion price was equal to the fair value of the Company's common stock at the date of issuance.

On May 29, 2001, the Company issued a convertible promissory note to an investor in the amount of $2,000. The note is convertible upon issuance at the option of the holder into the Company's common stock at a conversion price equal to the fair value of the Company's common stock on the date of issuance, or $0.10. The note incurs interest at 6% per annum, the interest is payable annually, and the note matures one year from the date of issuance. The note was not converted into common stock during the year ended June 30, 2001. No expense was recorded in connection with the issuance of the convertible note since the conversion price was equal to the fair value of the Company's common stock at the date of issuance.

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NOTE 10 - NOTE PAYABLE - RELATED PARTY

The $762,000 due to the Company's chief executive officer/chairman represents three separate notes that were consolidated into one non-interest-bearing promissory note on December 31, 1998. The promissory note contains a set repayment plan with payments through June 30, 2000. If the Company violates the plan, the note is due on demand. As of June 30, 2000, the Company had violated the plan, but the Company's chief executive officer/chairman has signed a waiver, deferring all payments due until the earlier of July 1, 2002 or upon an acquisition of the Company. As of June 30, 2001, no acquisition offers had been made.

In accordance with generally accepted accounting principles, all non-interest-bearing notes must be discounted using the Company's average borrowing rate. This discount is amortized on a straight-line basis over the term of the note. As of June 30, 2001 the discount on the related party note payable was $76,000, using a discount rate of 10%.

NOTE 11 - NOTE PAYABLE

During the year ended June 30, 2000, the conversion feature of certain notes payable to former vendors expired. The Company wrote off the notes payable and recognized an extraordinary gain on the extinguishment of debt in the amount of $60,000, which represents $24,000 in principal and $36,000 in accrued interest.

In December 1999, the Company issued five convertible notes payable for $500,000 each and 1,000,000 warrants to purchase shares of the Company's common stock at an exercise price of $1.65 per share to an investment company. The notes bore interest at 10% per annum, were unsecured, required quarterly interest payments on the unconverted balance, and were scheduled to mature on December 3, 2002. The notes were repaid in May 2000. The notes were convertible into shares of the Company's common stock if the Company elected not to pay the aggregate

principal amount outstanding and accrued interest by May 3, 2000.

The warrants vest upon issuance and expire three years from the date of the private placement. At June 30, 2001, none of the warrants had been exercised.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

Operating Leases and Capital Lease Obligations

The Company leases its production, warehouse, and administrative facilities under various non-cancelable operating leases that expire through March 2003. In addition to the minimum annual rental commitments, the leases provide for periodic cost of living increases in the base rent and payment by the Company of common area costs. All leases have various renewal features. Rent expense related to the operating leases was $222,000, $218,000, and $170,000 for the years ended June 30, 2001, 2000, and 1999, respectively.

The Company leased two condominiums from a related party on a month-to-month basis for business travel and employee relocation. Rent expense related to these operating leases was $19,000, $53,100, and $49,000 for the years ended June 30, 2001, 2000, and 1999, respectively.

The Company also leases certain telephone equipment under a capital lease. The lease has an initial term of two years and requires fixed monthly payments.

Future minimum lease payments under capital and operating leases at June 30, 2001 were as follows:

Year Ending June 30	Operating Lease	Capital Lease
2002	$ 122,000	$ 32,000
2003	85,000	-
	$ 207,000	32,000
Less amount representing interest		4,000
		28,000
Less current portion		28,000
LONG TERM PORTION		$ -

Leased capital assets as of June 30 consisted of the following:

	2001	2000
Telephone equipment	$ 60,000	$ 60,000
Less accumulated depreciation	17,000	5,000
TOTAL	$ 43,000	$ 55,000

NOTE 12 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Operating Leases and Capital Lease Obligations (Continued)

For the years ended June 30, 2001, 2000, and 1999, depreciation expense related to capital leases amounted to $12,000, $5,000, and $0, respectively.

Litigation

During June 2000, two shareholders who acquired their shares in a private placement in March 2000 filed a lawsuit against Franklin and two of the Company's officers/directors. The lawsuit sought to postpone the June 28, 2000 annual shareholders meeting, based upon alleged deficiencies in the proxy materials pertaining to the meeting. At a court hearing held on June 28, 2000, the court declined to enjoin the meeting as requested by the plaintiffs.

Thereafter, the plaintiffs amended the lawsuit several times and ultimately added new claims pertaining to the private placement and alleging securities law violations. During October 2000, the lawsuit was abandoned by the plaintiffs, and both parties mutually agreed to dismiss the suit without financial restitution.

During April 2000, Nexbell, a long distance service provider, filed suit against FNet, alleging that FNet defaulted under the terms and conditions of FNet's service agreement when FNet failed to pay for services rendered valued at $165,000. FNet has engaged in ongoing settlement discussions in order to end the expense of the litigation and believes that a settlement in the amount of $165,000 is probable. As such, the Company has recorded an accrual for $165,000 as of June 30, 2001 (see Note 18).

In addition, the Company is involved in certain legal proceedings and claims which arise in the normal course of business. Management does not believe that the outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations.

Software License Agreements

During November 1997, the Company entered into a contract for software development and a worldwide license agreement with a software development company. The license agreement provides for a three-year term and may be extended on a year-to-year basis thereafter. In addition to the fixed fee of $426,000, there is a royalty of $0.75 per port for each personal computer board sold containing the licensed software. Amounts paid under the license agreement totaled $0, $4,500, and $103,000 during the years ended June 30, 2001, 2000, and 1999 respectively.

NOTE 12 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Software License Agreements (Continued)

During March 1998, the Company entered into a five-year, worldwide license agreement with a company to use certain software of this company to create software for sale to third parties. The Company must pay a license fee of $35,000, a royalty of $10 per port, and a one-time, active maintenance and support services fee of $10,000. Amounts paid under this license agreement totaled $0, $0, $0 during the years ended June 30, 2001, 2000, and 1999, respectively. During the year ended June 30, 2000, the Company recognized an impairment of the license of $28,000, which represented the unamortized purchase price of the license.

During May 1999, the Company entered into a license agreement with TEK DigiTel ("TEK") in which TEK granted the Company a license to manufacture and sell certain hardware and software which were developed by TEK. In addition to the fixed fee of $250,000, there is a royalty of $35 per unit for each product sold containing the licensed software and hardware. Amounts paid under this license agreement totaled $0, $0, and $150,000 during the years ended June 30, 2001, 2000, and 1999, respectively. During the year ended June 30, 2001, the Company recognized an impairment of the license of $104,000, which represents the unamortized purchase price of the license.

Private Placement Exemptions

The Company and FNet's private placements of securities have been issued in transactions intended to be exempt from registration under the Securities Act of 1933 pursuant to the provisions of Regulation D promulgated thereunder. These rules include factors pursuant to which one or more private placement transactions may be integrated as part of other offerings and include rules that limit the dollar amount that can be raised and the number of non-accredited investors that can participate

In the event any of the Company's private placement transactions, including private placement transactions undertaken by the Company since the transactions referred to above, were deemed to be integrated, it is possible that the exemption from the registration requirements of the Securities Act of 1933 would not be available for one or more of those offerings. In the event that one or more of such transactions are

determined not to have been exempt from such registration requirements, the purchasers may have the right to seek rescission of the sales and/or seek money damages against the Company. Management believes that each of the Company's private offerings were exempt from the registration requirements of the Securities Act of 1933.

NOTE 12 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Employment Agreements

On September 2, 1997, the Company entered into a six-year employment agreement with its chief executive officer/chairman. The annual salary for the officer is $324,000. The officer may at his option convert up to 50% of his compensation into options to purchase the Company's common stock. The exercise price will equal 50% of the fair market value of the Company's common stock at the date of grant. During the year ended June 30, 2000, the Company reduced the annual salary to $150,000 per year.

Service Agreement

In September 2000, FNet entered into a five-year, non-cancelable service agreement with a satellite service provider to operate uplink and downlink earth stations between the United States and the Balkan region. The estimated fee for the project was $1,236,000. As of June 30, 2001, the Company had violated certain terms and conditions of the service agreement. As such, the agreement stipulates that the Company must immediately pay the remaining fee for the project of approximately $1,058,000. The Company is in the process of negotiating a settlement with the service provider and has included this balance in accounts payable on the accompanying balance sheet.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT)

Stock Option Plans

The Company adopted an Incentive Stock Option Plan ("Plan A") and Nonqualified Stock Option Plan ("Plan B") (the "1986 Plans"). Plan A provides for the granting of options to purchase shares of common stock that are intended to qualify as incentive stock options within the meaning of Section 422A of the Internal Revenue Code, and Plan B provides for the granting of options to purchase shares of common stock that are not intended to qualify. The 1986 Plans provide for the issuance of up to 700,000 shares in the aggregate at the fair market value of the Company's stock at the date of grant.

During the year ended June 30, 1989, the Company adopted the 1988 Stock Option Plan (the "1988 Plan"). Under the terms of the plan, options to purchase 300,000 shares of the Company's common stock are available for issuance to employees, officers, and directors. Options granted may be either incentive stock options or non-statutory options. The exercise price of the incentive stock options and non-statutory options may not be greater or less than 110% and 85%, respectively, of the fair market

value of the Company's common stock at the date of grant.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

During the year ended June 30, 1994, the Company adopted the 1993 Stock Option Plan (the "1993 Plan"). The 1993 Plan provides for the granting of options to purchase up to 600,000 shares of common stock.

During the year ended June 30, 1995, the Company adopted the 1994 Stock Option Plan (the "1994 Plan"). The 1994 Plan provides for the granting of options to purchase up to 1,400,000 shares of common stock. Such options will be non-statutory.

During the year ended June 30, 1998, the Company adopted the 1998 Stock Option Plan (the "1998 Plan"). The 1998 Plan provides for the granting of options to purchase up to 2,000,000 shares of common stock that are intended to qualify as incentive stock options within the meaning of Section 422A of the Internal Revenue Code.

Options granted under all of the aforementioned plans vest in accordance with the terms established by the Company's stock option committee. All such options granted to date were issued to employees, have vesting periods of between two to four years, and generally terminate at the earlier of one year beyond the end of the option period or upon termination of employment.

In October 1998, certain outstanding options granted to employees in prior years were repriced. Per SFAS No. 123, the Company should incur additional compensation cost for the excess of the fair value of the modified options issued over the value of the original options at the date of the exchange. The Company thus added that incremental amount to the remaining unrecognized compensation cost for the original options at the June 30, 1999 pro forma disclosure and recognized the total amount over the remaining years of the remaining life of the options. The remaining expected life of the options is three years at June 30, 2001.

In October 1999, the Company re-priced an aggregate of 547,000 options issued to 14 employees under the 1998 Plan and outside of the Plan. In relation to this re-pricing, the Company did not record any compensation expense for the years ended June 30, 2001 and 2000 since the fair market value of the Company's stock price was less than the re-priced exercise price at those dates.

In March 2000, the FASB issued an interpretation of SFAS No. 40, "Accounting for Certain Transactions involving Stock Compensation." In accordance with the interpretation, employee stock option awards that are re-priced will be accounted for as variable awards from the date of the re-pricing to the date the options are exercised, forfeited, or expire. The interpretation of this FASB is effective for all re-pricings subsequent to December 15, 1998.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

Activity for the 1986 Plans, the 1988 Plan, the 1993 Plan, the 1994 Plan, and the 1998 Plan is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding, June 30, 1998	2,165,250	$ 1.14
Granted	1,452,000	$ 0.63
Exercised	(281,750)	$ 0.42
Canceled	(268,750)	$ 2.60
Outstanding, June 30, 1999	3,066,750	$ 0.83
Granted	322,000	$ 0.67
Exercised	(691,000)	$ 0.41
Canceled	(347,500)	$ 0.58
Outstanding, June 30, 2000	2,350,250	$ 0.37
Granted	10,000	$ 0.75
Exercised	(25,000)	$ 0.44
Canceled	(804,250)	$ 0.51
OUTSTANDING, JUNE 30, 2001	1,531,000	$ 0.30
EXERCISABLE AT JUNE 30, 2001	1,389,500	$ 0.27

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

During the year ended June 30, 1999, the Company granted options to purchase 2,615,000 shares of common stock to key management employees,

which vest over a period of zero to four years. The option exercise price was set at $0.44 per share, the fair value of the underlying shares.

During the year ended June 30, 2000, the Company granted options to purchase 1,095,000 shares of common stock to key management employees, which vest over a period of two to four years. The option exercise price was set at $0.69 per share, the fair value of the underlying shares.

During the year ended June 30, 2001, the Company granted options to purchase 3,246,451 shares of common stock to employees, which vest over a period of zero to four years. The option price of such options range from $0.08 to $1.25 per share, which represented the fair value of the underlying shares at the date of grant. During the year ended June 30, 2001, 2,660,000 of the options granted during that year were also canceled.

Activity for options outside of the Plan is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding, June 30, 1998	1,325,000	$ 1.77
Granted	2,615,000	$ 0.44
Exercised	(82,500)	$ 0.44
Expired/canceled	(1,315,000)	$ 1.78
Outstanding, June 30, 1999	2,542,500	$ 0.44
Granted	1,095,000	$ 0.69
Exercised	(605,000)	$ 0.45
Expired/canceled	(755,000)	$ 0.45
Outstanding, June 30, 2000	2,277,500	$ 0.56
Granted	3,246,451	$ 0.59
Exercised	(382,500)	$ 0.44
Canceled	(3,700,000)	$ 0.68
OUTSTANDING, JUNE 30, 2001	1,441,451	$ 0.38
EXERCISABLE AT JUNE 30, 2001	1,286,451	$ 0.34

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

The exercise prices for the options outstanding at June 30, 2001 inside and outside of the Plan ranged from $0.01 to $3.66. The weighted-average remaining contractual life of the options outstanding at June 30, 2001 is 2.57 years, and the information relating to these options is as follows:

Range of Exercise Prices	Stock Options Outstanding	Stock Options Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price of Options Outstanding	Weighted-Average Exercise Price of Options Exercisable
$ 0.01 - 0.10	441,451	441,451	3.40 years	$ 0.09	$ 0.09
$ 0.11 - 1.00	2,454,000	2,182,500	1.85 years	$ 0.45	$ 0.42
$ 1.01 - 3.66	77,000	52,000	5.64 years	$ 2.40	$ 2.36
	2,972,451	2,675,951			

The Company's majority owned subsidiary, FNet, established a 1996 stock option plan (the "FNet Plan") which was amended in 1998. The FNet Plan, as amended, provides for the granting of options to purchase up to 7,000,000 shares of FNet common stock that are intended to qualify as incentive stock options within the meaning of Section 422A of the Internal Revenue Code. Such options will become exercisable in accordance with the terms established by FNet's stock option committee. All options granted to date vest between zero and four years and generally terminate at the earlier of the end of the option period or upon termination of employment.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

Activity for the FNet Plan is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding, June 30, 1998	5,619,000	$ 1.00
Granted	1,114,000	$ 1.00
Exercised	(12,000)	$ 1.00
Expired/canceled	(3,450,000)	$ 1.00

	Shares	Weighted-Average Exercise Price
Outstanding, June 30, 1999	3,271,000	$ 1.00
Granted	50,000	$ 2.00
Expired/canceled	(737,000)	$ 1.00
Outstanding, June 30, 2000	2,584,000	$ 1.02
Canceled	(1,218,000)	$ 1.04
OUTSTANDING, JUNE 30, 2001	1,366,000	$ 1.00
EXERCISABLE AT JUNE 30, 2001	1,220,000	$ 1.00

During the year ended June 30, 1999, the Company granted options to purchase 355,000 shares of common stock to key management employees, which vest over a period of four years. The option exercise price was set at $1 per share, the fair value of the underlying shares

During the year ended June 30, 2000, the Company granted options to purchase 2,845,000 shares of FNet's common stock to key management employees, which vest over a period of two to four years. The option exercise price was set at $2 per share, the fair value of the underlying shares.

During the year ended June 30, 2001, the Company granted options to purchase 578,750 shares of FNet's common stock to employees, which vest over a period of two to four years. The option exercise price was set at $2 per share, the fair value of the underlying shares.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

Activity for FNet options outside of the FNet Plan is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding, June 30, 1998	380,000	$ 1.00
Granted	355,000	$ 1.00
Expired/canceled	(255,000)	$ 1.00
Outstanding, June 30, 1999	480,000	$ 1.00
Granted	2,845,000	$ 2.00
Expired/canceled	(1,800,000)	$ 1.83

Outstanding, June 30, 2000	1,525,000	$	1.86
Granted	578,750	$	2.00
Canceled	(1,647,500)	$	1.95
OUTSTANDING, JUNE 30, 2001	456,250	$	1.78
EXERCISABLE AT JUNE 30, 2001	165,000	$	1.70

The exercise prices for the options outstanding at June 30, 2001 inside and outside of the FNet Plan ranged from $1 to $2. The weighted-average remaining contractual life of the options outstanding at June 30, 2001 is 5.58 years, and the information relating to these options is as follows:

Range of Exercise Prices	Stock Options Outstanding	Stock Options Exercisable	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price of Options Outstanding	Weighted-Average Exercise Price of Options Exercisable
$ 1.00	1,458,500	1,270,000	5.21 years	$ 1.00	$ 1.00
$ 2.00	363,750	115,000	7.10 years	$ 2.00	$ 2.00
	1,822,250	1,385,000			

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

The Company has adopted only the disclosure provisions of SFAS No. 123. It applies APB 25 and related interpretations in accounting for its plans and does not recognize compensation expense for its stock-based compensation options other than for restricted stock and options issued to outside third parties.

If the Company had elected to recognize compensation expense based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed by SFAS No. 123, the Company's net loss and loss per share would be reduced to the pro forma amounts indicated below:

	Year Ended June 30,		
	2001	2000	1999
Net loss			
As reported	$ (10,820,000)	$ (11,551,000)	$ (2,413,000
Pro forma	$ (11,084,000)	$ (12,154,000)	$ (3,343,268
Loss per common share			
As reported	$ (0.27)	$ (0.39)	$ (0.11
Pro forma	$ (0.27)	$ (0.41)	$ (0.15

These pro forma amounts may not be representative of future disclosures because they do not take into effect pro forma compensation expense related to grants made before June 30, 1996. The pro forma amounts take into account the pro forma compensation expense of the Franklin and FNet options. The fair value of the Franklin options issued to employees described above was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for the years ended June 30, 2001, 2000, and 1999: dividend yields of 0%, 0%, and 0%, respectively; expected volatility of 100%, 100%, and 100%, respectively; risk-free interest rates of 5.8%, 6.4%, and 5.6%, respectively; and expected lives of two, four, and four, respectively. The weighted-average fair value of options granted during the years ended June 30, 2001, 2000, and 1999 were $0.34, $1.27, and $0.34, respectively, and the weighted-average exercise price was $0.59, $0.69, and $0.63, respectively.

The fair value of the FNet options issued to employees described above was estimated at the date of grant using the minimum value method with the following weighted-average assumptions for the years ended June 30, 2001, 2000, and 1999: dividend yields of 0%, 0%, and 0%, respectively; risk-free interest rates of 6%, 6.4%, and 5.8%, respectively; and expected lives of two, four, and four years, respectively. The weighted-average fair value of options granted during the years ended June 30, 2001, 2000, and 1999 was $0.25, $0.44, and $0.20, respectively, and the weighted-average exercise price was $2, $2, and $1, respectively.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Option Plans (Continued)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion,

the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Warrants

In connection with the 1995 Private Placement, during the years ended June 30, 1996 and 1995, the Company issued 2,380,000 and 220,000 warrants, respectively, to purchase shares of the Company's common stock. The exercise price of the warrants was $0.50, as amended, if exercised on or before March 24, 1996 and $1.25 if exercised after March 24, 1996 but on or before September 30, 1998 (the expiration date). For the years ended June 30, 2001, 2000, and 1999, 0, 50,000, and 113,250 warrants, respectively, were exercised, leaving a remaining balance of 50,000 unexercised as of June 30, 2001.

In connection with convertible notes payable for $2,500,000 issued in December 1999, the Company issued to an investment banker 100,000 warrants to purchase shares of the Company's common stock at an exercise price of $1.65 per share. The warrants may be exercised any time after issuance and for a period of three years from the date of the private placement. The Company recognized a financing expense of $25,000 in connection with the issuance. As of June 30, 2001, no warrants had been exercised.

In connection with a private placement in March 2000, the Company issued to various investors 73,600 FNet warrants to purchase shares of FNet's common stock at an exercise price ranging from $0.32 to $0.35 per share. The warrants may be exercised any time after issuance and for a period of five years from the date of the private placement. There was not any expense recorded in connection with the issuance of the warrants as the exercise price approximated the fair value of FNet's common stock at the date of issuance. As of June 30, 2001, 43,600 warrants had been exercised, leaving a remaining balance of 30,000 unexercised warrants.

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NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Issuances

During the year ended June 30, 2001, the Company completed the following common stock transactions of previously unissued common shares:

- Issued 10,000 shares in connection with the exercise of stock options for cash of $4,000.

- In connection with a private placement in August 2000, the Company issued 4,994,600 shares of common stock and 5,105,711 warrants for gross proceeds of $2,497,000, less fees and commissions of $13,000. The warrants had an exercise price of $3, vested immediately, and expire three years from the date of issuance. The Company allocates the proceeds received from debt, convertible debt, convertible preferred stock, or common stock with detachable

warrants using the relative fair value of the individual elements at the time of issuance. The amount allocated to the warrants of $478,000 was calculated using the Black-Scholes option pricing model. As of June 30, 2001, no warrants had been exercised.

- Issued 295,858 shares of common stock to its chief financial officer in connection with a cashless exercise of options that were processed by the Company. No expense was recorded in connection with the transaction because the chief financial officer had owned the shares that were used to pay for the cashless exercise for more than six months prior to the transaction.

- Issued 477,324 shares of common stock for services valued at $318,000.

- In connection with a private placement in March 2000, the Company issued warrants to the investors that were designed to protect the investors against short-term declines in the value of the Company's common stock during the period between the date of the issuance of the shares and the effective date of a Registration Statement covering the shares issued. The warrants vest if the market price of the Company's common stock is below $1.50 on the effective date. The registration statement for the shares became effective in November 2000, at which time the market price of the Company's common stock was below $1.50. As a result, warrants for 2,011,329 shares became exercisable at an exercise price of $0.01 per share. During the year ended June 30, 2001, the Company issued 1,927,797 net shares of common stock in connection with a cashless exercise of said warrants, and 50,000 shares of common stock were issued for cash of $500.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Issuances (Continued)

- In connection with a private placement in March 2000, the Company was obligated to effect the registration of the shares sold within a specified time period, with penalties due to the investors if the deadline was not met. As the deadline was not met, the Company became obligated to pay the penalties in either cash or shares of common stock. The Company opted to pay the penalties in shares of common stock and issued 503,538 shares to these investors in November 2000 and recognized an expense of $430,000 in the consolidated statement of operations for the year ended June 30, 2001.

- Issued 111,111 shares of the Company's common stock for 6,667 shares of FNet common stock in a stock-for-stock transaction. The shares of FNet's common stock had been issued during the year ended June 30, 1999.

During the year ended June 30, 2000, the Company completed the following common stock transactions of previously unissued common shares:

- Issued 1,211,033 shares of common stock in connection with a cashless exercise of options and warrants that were processed by the Company. The Company recognized an expense of $717,000 related to this cashless exercise, primarily due to employees that are not officers of the Company.

- Issued 261,603 shares of common stock in connection with the exercise of stock options for cash of $179,000.

- In connection with a private placement in August 1999, the Company issued 1,932,368 shares of common stock and 400,000 warrants for gross proceeds of $2,000,000, less fees and commissions of $205,000. The warrants had an exercise price of $1.55, vested immediately, and expire five years from the date of issuance. The Company allocates the proceeds received from debt, convertible debt, convertible preferred stock, or common stock with detachable warrants using the relative fair value of the individual elements at the time of issuance. The amount allocated to the warrants of $371,000 was calculated using the Black-Scholes option pricing model. As of June 30, 2001, no warrants had been exercised.

- In connection with a private placement in February 2000, the Company sold 841,515 shares of common stock for gross proceeds of $1,500,000. The Company paid commissions and fees of $36,000 in connection with this private placement.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Issuances (Continued)

- In connection with a private placement in March 2000, the Company issued 4,022,667 shares of common stock and 1,205,667 warrants for gross proceeds of $6,040,000, less fees and commissions of $344,000. The warrants had an exercise price of $2.50, vested immediately, and expire five from the date of issuance. The Company allocates the proceeds received from debt, convertible debt, convertible preferred stock, or common stock with detachable warrants using the relative fair value of the individual elements at the time of issuance. The amount allocated to the warrants of $1,668,000 was calculated using the Black-Scholes option pricing model. As of June 30, 2001, no warrants had been exercised.

- In connection with a private placement in March 2000, the Company sold 43,600 shares of common stock for $376,000. The Company paid commissions and fees of $35,000 in connection with this private placement.

- Issued 115,807 shares of common stock at prices ranging from $0.44

to $10 for total cash of $179,000.

- Committed to issue to an employee 74,716 shares of common stock for accrued compensation of $82,187.

- Issued 21,694 shares to certain employees of common stock as compensation valued at $48,000.

During the year ended June 30, 1999, the Company completed the following common stock transactions of previously unissued common shares:

- Issued 444,725 shares of common stock at prices ranging from $0.50 to $2.27 for total cash proceeds of $474,000.

- Issued 5,543,468 shares of common stock valued at $4,856,000 upon the conversion of 548 shares of its convertible Series C preferred stock valued at $4,856,000.

- Issued 570,000 shares of common stock valued at $200,000 to the Company's chief executive officer/chairman in exchange for a note receivable.

- Issued 121,356 shares of common stock for services valued at $64,000.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Stock Issuances (Continued)

- Issued 21,524 shares of common stock in connection with the exercise of warrants, whereby the warrant holders issued notes receivable in favor of the Company for $22,000 as payment for the exercise price.

- Issued 215,514 shares of common stock in connection with the exercise of stock options, whereby the option holders issued notes receivable in favor of the Company for $216,000.

- Issued 60,625 shares of common stock in connection with the exercise of stock options for cash proceeds of $29,000.

- Issued or committed to issue 408,000 shares of common stock in connection with the exercise of warrants for cash proceeds of $467,000.

Pursuant to state laws, the Company is currently restricted, and may be restricted for the foreseeable future, from making dividends to its shareholders as a result of its accumulated deficit as of June 30, 2001.

Convertible Preferred Stock

During the year ended June 30, 1998, the Company issued 740 shares of its Series C convertible preferred stock in a private placement for $7,400,000. 20% of the shares held may be converted to common stock four months after issuance with an additional 20% eligible for conversion each month thereafter, in which the limitation on conversion ends nine months after issuance. Any unconverted shares will be automatically converted to common shares at the later of either 18 months from issuance, the Company's common stock being traded on a national exchange, or the filing of a registration statement covering the resale of the common shares issued upon conversion.

Series C shares do not pay dividends and do not have voting rights. The shares are convertible into shares of common stock at a conversion price of $4.64 per share, subject to certain adjustments relating to the market price of the underlying common stock. As of June 30, 2001, all shares of preferred stock have been converted into common stock.

NOTE 13 - SHAREHOLDERS' EQUITY (DEFICIT) (CONTINUED)

Convertible Preferred Stock (Continued)

Each preferred share was accompanied by a warrant that is exercisable to purchase shares of common stock of the Company's subsidiary, FNet, at an exercise price of $1 and which, under certain circumstances, could be exercisable to acquire shares of common stock of the Company at the exercise price of $4.64 during September 1998. On September 30, 1998, 995,510 of the warrants were converted into warrants exercisable to acquire the Company's common stock, and on September 22, 1999, 17,786 of these warrants were exercised for shares of the Company's common stock, leaving 668,104 warrants exercisable to acquire FNet's common stock. The warrants expire November 24, 2002. No warrants had been exercised during the year ended June 30, 2001.

NOTE 14 - INCOME TAXES

The tax effects of temporary differences that give rise to deferred taxes at June 30 are as follows:

	2001
Deferred tax assets	
Accounts receivable, principally due to allowance for doubtful accounts	$ 52,000
Goodwill	232,000
Compensated absences and deferred salaries, principally due to accrual for financial reporting purposes	442,000
Inventories, principally due to additional costs inventoried for tax purposes pursuant to the	

Tax Reform Act of 1986 and allowance for inventory obsolescence	1,018,000
Plant and equipment, principally due to differences in depreciation	140,000
Deferred revenue	81,000
Accrued settlement	70,000
Warrants for services	-
Accrued warranty	5,000
General business tax credit carryforwards	335,000
Net operating loss carryforwards	13,147,000
Total gross deferred tax assets	15,522,000
Less valuation allowance	14,972,000
Net deferred tax assets	550,000

FRANKLIN TELECOMMUNICATIONS CORP.
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2001

NOTE 14 - INCOME TAXES (CONTINUED)

	2001
Deferred tax liabilities	
State taxes	$ 550,000
Plant and equipment, principally due to differences in depreciation	-
NET DEFERRED TAX LIABILITY	$ -

The valuation allowance increased by $4,375,000 and $4,132,000 during the years ended June 30, 2001 and 2000, respectively. No provision for income taxes for the years ended June 30, 2001, 2000, and 1999 is required, except for minimum state taxes, since the Company incurred losses during such years.

Income tax expense differs from the amounts computed by applying the United States federal income tax rate of 34% to income taxes as a result of the following:

	2001	2000
Computed "expected" tax benefit	$ (3,679,000)	$ (3,910,000)

Increase in income taxes resulting from		
Other	282,000	8,000
Exercise of stock options	(442,000)	(230,000)
Change in the beginning-of-the-year balance of the valuation allowance for deferred tax assets allocated to income tax expense	3,839,000	4,132,000
State income taxes	3,000	3,000
TOTAL	$ 3,000	$ 3,000

As of June 30, 2001, the Company had consolidated net operating loss carryforwards of $36,000,000 and $11,600,000 for federal and state income tax reporting purposes, respectively, which expire in varying amounts through 2021. The Company also has general business tax credit carryforwards of $310,000 and $25,000 available to offset against future federal and state income taxes, respectively, which expire at various times through 2021. Should a substantial change in the Company's ownership occur, there could be an annual limitation on the amount of the net operating loss carryforwards available for use in the future.

NOTE 15 - RELATED PARTY TRANSACTIONS

In August 1999, a non-employee director of the Company received warrants to purchase 140,000 shares of common stock at an exercise price of $1.38 per share as consideration for the production of advertising materials valued at $60,000.

In October 1999, the Company's former president exercised options to purchase 262,500 shares of the Company's common stock at an exercise price of $0.44 per share. The exercise was done on a net basis so that the actual number of shares issued were 215,973.

In October 1999, the Company's chief financial officer exercised options to purchase 150,000 shares of the Company's common stock at an exercise price of $0.44 per share. The exercise was done on a net basis so that the actual number of shares issued were 103,043.

In February 2000, the Company's chief financial officer exercised options to purchase 150,000 shares of the Company's common stock at an exercise price of $0.44 per share. The exercise was done on a net basis so that the actual number of shares issued were 117,992.

In May 2000, the Company's president was granted options to purchase 400,000 shares of the Company's common stock at an exercise price of $0.69 per share. The options vest over a two-year period. During the year ended June 30, 2001, all of these options were canceled.

In September 2000, the Company chief financial officer exercised

options to purchase 400,000 shares of the Company's common stock at an exercise price of $0.44 per share. The exercise was done on a net basis so that the actual number of shares issued was 295,858.

NOTE 16 - 401(k) PLAN

The Company sponsors a 401(k) plan which includes a deferred feature under section 401(k) of the Internal Revenue Code (the "Plan"). The Plan covers all full-time employees of the Company. Contributions to the plan are at the discretion of the Company's Board of Directors, but limited to the amounts allowable for federal income tax purposes. Under the section 401(k) portion of the Plan, employees may elect to contribute up to 15% of their compensation. The Company did not make any contributions to the Plan during the years ended June 30, 2001, 2000, and 1999.

NOTE 17 - EXTINGUISHMENT OF DEBT

During the year ended June 30, 2001, a long distance service provider forgave certain payables in the amount of $387,000.

NOTE 18 - LINES OF BUSINESS

The Company operates in two major lines of business: the manufacture and distribution of data communications and connectivity products ("Franklin") and Internet services ("FNet"). Information concerning operations in these lines of business for the years ended June 30, 2001, 2000, and 1999 was as follows:

	2001	2000	
Net sales			
Franklin	$ 421,000	$ 1,109,000	$
FNet	824,000	2,098,000	
TOTAL	$ 1,245,000	$ 3,207,000	$
Operating losses			
Franklin	$ (6,492,000)	$ (6,990,000)	$
FNet	(4,406,000)	(4,154,000)	
TOTAL	$ (10,898,000)	$ (11,144,000)	$
Identifiable assets			
Franklin	$ 988,000	$ 5,198,000	$
FNet	447,000	1,959,000	

TOTAL	$ 1,435,000	$ 7,157,000	$
Capital expenditures			
Franklin	$ 44,000	$ 152,000	$
FNet	19,000	640,000	
TOTAL	$ 63,000	$ 792,000	$
Depreciation and amortization			
Franklin	$ 315,000	$ 275,000	$
FNet	384,000	367,000	
TOTAL	$ 699,000	$ 642,000	$

NOTE 19 - SUBSEQUENT EVENTS

Common Stock and Warrants

In connection with a private placement in September 2001, the Company issued 1,140,000 shares of common stock and 520,000 warrants for gross proceeds of $57,000. The exercise price of the warrants is $0.05 per share, unless the 10-day average price of the Company's common stock is less than $0.25 per share between March 15, 2002 to March 25, 2002, in which case the exercise price will be $0.001. The warrants vested immediately and expire nine months from the date of issuance. The Company allocates the proceeds received from debt, convertible debt, convertible preferred stock, or common stock with detachable warrants using the relative fair value of the individual elements at the time of issuance. The amount allocated to the warrants will be calculated using the Black-Scholes option pricing model.

Convertible Promissory Notes

In July 2001, the Company issued a convertible promissory note to its chief executive officer/chairman in the amount of $19,000. The note is convertible upon issuance at the option of the holder into the Company's common stock at a conversion price equal to the fair value of the Company's common stock on the date of issuance, or $0.05. The note incurs interest at 6% per annum, the interest is payable annually, and the note matures in July 2002. No expense was recorded in connection with the issuance of the convertible note since the conversion price was equal to the fair value of the Company's common stock at the date of issuance.

In November 2001, the Company issued a convertible promissory note (the

"November Note") to its chief executive officer/chairman in the amount of $50,000. The November Note is convertible upon issuance at the option of the holder into the Company's common stock at a conversion price equal to the fair value of the Company's common stock on the date of issuance, or $0.05. The November Note incurs interest at 6% per annum, the interest is payable annually, and the note matures in November 2002. No expense was recorded in connection with the issuance of the November Note since the conversion price was equal to the fair value of the Company's common stock at the date of issuance. Upon conversion of the November Note, the Company will also issue 250,000 warrants. The exercise price of the warrants will be $0.05 per share, unless the 10-day average price of the Company's common stock is less than $0.25 per share between March 15, 2002 to March 25, 2002, in which case the exercise price will be $0.001. All unexercised warrants expire in June 2002.

NOTE 19 - SUBSEQUENT EVENTS (CONTINUED)

Convertible Promissory Notes (Continued)

Related to the issuance of the November Note, the Company allocates the proceeds received from debt, convertible debt, or convertible preferred stock with detachable warrants using the relative fair value of the individual elements at the time of issuance. The amount allocated to the warrants as a debt discount if the November Note is converted will be calculated using the Black-Scholes option pricing model and will be recognized as interest expense over the period until the note matures.

Operating Leases

Subsequent to June 30, 2001, the Company converted an operating lease with future payments of $97,000 and $73,000 in the years ended June 30, 2002 and 2003, respectively, into a month-to-month lease.

Litigation Settlement

In July 2001, FNet settled a lawsuit with Nexbell for $25,000, which is payable at a rate of $1,040 per month beginning August 1, 2001, and 240,000 shares of the Company's common stock valued at $140,000.

Stock Options

In September 2001, the Company granted options to purchase 2,000,000 shares of common stock at an exercise price of $0.05 per share, the fair value of the underlying shares, to two members of the board. The options were granted outside of the Company's stock option plans, vest 10% per month over the next 20 months, and expire three years from the date of grant.

In October 2001, the Company granted options to purchase 1,260,000 shares of common stock at an exercise price of $0.05 per share, the fair value of the underlying shares, to various employees. These options were granted for payment of deferred salaries from February to

September 2001 valued at $20,842. The options were granted outside of the Company's stock option plans and may be exercised any time after issuance and for a period of three years from the date of grant.

In November 2001, the Company granted options to purchase 2,400,000 and 2,500,000 shares of common stock at an exercise price of $0.05 per share, the fair value of the underlying shares, to its chief executive officer/chairman and chief operating officer, respectively. These options were granted for payment of deferred salaries from January to October 2001 valued at $118,000 and $128,000, respectively. The options were granted outside of the Company's stock option plans and may be exercised any time after issuance and for a period of three years from the date of grant.

NOTE 19 - SUBSEQUENT EVENTS (CONTINUED)

Stock Options (Continued)

In December 2001, the Company granted options to purchase 100,000 shares of common stock at an exercise price of $.05 per share, the fair value of the underlying shares, to an attorney as a bonus. The options were granted outside of the Company's stock option plans and may be exercised any time after issuance and for a period of three years from the date of grant.

Litigation

In November 2001, the lessor of certain telephone equipment, which the Company had leased under a non-cancelable capital lease, filed suit against the Company. The compliant alleges that the Company defaulted under the terms and conditions of the capital lease agreement when the Company failed to make the required monthly payments. The lessor is seeking payment for the remaining balances due under the lease agreement in the amount of $28,000. The Company has accrued for such amounts as a capital lease obligation.

In November 2001, two former employees of the Company filed a claim with the California Labor Board, claiming vacation and overtime were not paid to them. In January 2002, the California Labor Board issued a judgment in the amount of $79,000. The Company has appealed the case.