**INFOSYS TECHNOLOGIES LIMITED AND SUBSIDIARY**
**UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**
**PREPARED IN ACCORDANCE WITH U.S. GAAP**

**QUARTER AND NINE MONTHS ENDED DECEMBER 31, 2002**

## Consolidated Balance Sheets

| | As of | | |
|---|---|---|---|
| | December 31, 2002 | December 31, 2001 | March 31, 2002 |
| | (Unaudited) | (Unaudited) | (Audited) |
| **ASSETS** | | | |
| Current Assets | | | |
| Cash and cash equivalents | $308,558,738 | $179,964,266 | $210,485,940 |
| Trade accounts receivable, net of allowances | 102,408,446 | 64,505,813 | 69,017,110 |
| Deferred tax assets | 945,833 | 2,065,475 | 774,107 |
| Prepaid expenses and other current assets | 30,779,094 | 18,875,165 | 18,875,904 |
| Total current assets | 442,692,111 | 265,410,719 | 299,153,061 |
| Property, plant and equipment, net | 150,706,932 | 150,661,482 | 147,211,731 |
| Intangible assets, net | 7,428,310 | — | — |
| Deferred tax assets | 6,352,084 | 2,574,090 | 4,560,934 |
| Investments | 4,613,833 | 7,777,393 | 7,777,393 |
| Advance income taxes | 3,311,724 | 1,869,035 | — |
| Other assets | 20,293,142 | 11,127,466 | 12,458,615 |
| **Total assets** | $635,398,136 | $439,420,185 | $471,161,734 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | |
| Current Liabilities | | | |
| Accounts payable | 126,497 | 440 | — |
| Client deposits | 6,073,029 | 2,546,959 | 2,215,001 |
| Other accrued liabilities | 37,439,002 | 27,279,580 | 22,424,646 |
| Income taxes payable | — | — | 678,703 |
| Unearned revenue | 11,631,043 | 5,885,436 | 3,464,018 |
| Total current liabilities | 55,269,571 | 35,712,415 | 28,782,368 |
| Non-current liabilities | 5,000,000 | — | — |
| Preferred stock of subsidiary | | | |
| 0.0005% Cumulative Convertible Preference Shares, par value $2 each, 4,375,000 preference shares Authorized, issued and outstanding — 4,375,000 preference shares as of December 31, 2002 | 10,000,000 | — | — |
| Stockholders' Equity | | | |
| Common stock, $0.16 (Rs. 5) par value; 100,000,000 equity shares authorized, Issued and outstanding — 66,229,489, 66,169,247 and 66,186,130 as of December 31, 2002 and 2001 and March 31, 2002, respectively | 8,601,481 | 8,595,270 | 8,597,001 |
| Additional paid-in capital | 126,075,877 | 122,395,526 | 123,079,948 |
| Accumulated other comprehensive income | (37,209,073) | (39,992,215) | (45,441,148) |
| Deferred stock compensation | (3,888,756) | (8,771,464) | (7,620,600) |
| Retained earnings | 471,549,036 | 321,480,653 | 363,764,165 |
| Total stockholders' equity | $565,128,565 | $403,707,770 | $442,379,366 |
| **Total liabilities and stockholders' equity** | $635,398,136 | $439,420,185 | $471,161,734 |

See accompanying notes to the unaudited consolidated financial statements

## CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended December 31, | | Nine Months Ended December 31, | | Year Ended March 31, |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2002 | 2001 | 2002 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) | (Audited) |
| Revenues | $200,014,166 | $137,579,820 | $537,775,974 | $405,370,712 | $545,051,214 |
| Cost of revenues | 110,198,928 | 73,051,526 | 292,036,302 | 214,517,882 | 290,032,232 |
| Gross profit | 89,815,238 | 64,528,294 | 245,739,672 | 190,852,830 | 255,018,982 |
| Operating Expenses: | | | | | |
| Selling and marketing expenses | 14,952,660 | 6,840,680 | 40,734,946 | 19,752,095 | 27,113,122 |
| General and administrative expenses | 15,422,086 | 10,622,444 | 40,383,534 | 33,921,600 | 44,348,181 |
| Amortization of stock compensation expense | 1,243,948 | 1,234,472 | 3,731,844 | 3,745,554 | 5,009,772 |
| Amortization of intangible assets | 924,249 | — | 1,744,274 | — | — |
| Total operating expenses | 32,542,943 | 18,697,596 | 86,594,598 | 57,419,249 | 76,471,075 |
| Operating income | 57,272,295 | 45,830,698 | 159,145,074 | 133,433,581 | 178,547,907 |
| Other income, net | 6,907,692 | 3,106,397 | 12,538,464 | 9,072,796 | 13,865,294 |
| Income before income taxes | 64,179,987 | 48,937,095 | 171,683,538 | 142,506,377 | 192,413,201 |
| Provision for income taxes | 11,926,841 | 7,288,077 | 29,885,621 | 20,323,580 | 27,946,892 |
| Net income | $ 52,253,146 | $ 41,649,018 | $141,797,917 | $122,182,797 | $164,466,309 |
| Earnings per equity share | | | | | |
| Basic | $ 0.80 | $ 0.64 | $ 2.16 | $ 1.86 | $ 2.51 |
| Diluted | $ 0.78 | $ 0.63 | $ 2.13 | $ 1.85 | $ 2.49 |
| Weighted equity shares used in computing earnings per equity share | | | | | |
| Basic | 65,569,377 | 65,545,160 | 65,567,814 | 65,557,265 | 65,556,648 |
| Diluted | 66,667,561 | 66,114,671 | 66,405,932 | 66,205,786 | 66,084,874 |

See accompanying notes to the unaudited consolidated financial statements

# CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

| | Common Stock | | Additional Paid-in Capital | Comprehensive Income | Accumulated Other Comprehensive Income | Deferred Stock Compensation | Retained Earnings | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|
| | Shares | Par Value | | | | | | |
| Balance as of March 31, 2001 | 66,158,117 | $8,594,106 | $122,017,518 | | $(28,664,972) | $(12,517,018) | $222,362,067 | $311,791,701 |
| Common stock issued | 11,130 | 1,164 | 378,008 | | — | — | — | 379,172 |
| Cash dividends declared | — | — | — | | — | — | (23,064,211) | (23,064,211) |
| Amortization of compensation related to stock option grants | — | — | — | | — | 3,745,554 | — | 3,745,554 |
| Comprehensive income | | | | | | | | |
| Net income | — | — | — | $122,182,797 | — | — | 122,182,797 | 122,182,797 |
| Other comprehensive income | | | | | | | | |
| Translation adjustment | — | — | — | (11,327,243) | (11,327,243) | — | — | (11,327,243) |
| Comprehensive income | | | | $110,855,554 | | | | |
| Balance as of December 31, 2001 (Unaudited) | 66,169,247 | $8,595,270 | $122,395,526 | | $(39,992,215) | $ (8,771,464) | $321,480,653 | $403,707,770 |
| Common stock issued | 16,883 | 1,731 | 571,068 | | — | — | — | 572,799 |
| Amortization of compensation related to stock option grants | — | — | — | | — | 1,264,218 | — | 1,264,218 |
| Deferred stock compensation related to stock option grants | — | — | 113,354 | | — | (113,354) | — | — |
| Comprehensive income | | | | | | | | |
| Net income | — | | — | $ 42,283,512 | — | — | 42,283,512 | 42,283,512 |
| Other comprehensive income | | | | | | | | |
| Translation adjustment | — | | — | (5,448,933) | (5,448,933) | — | — | (5,448,933) |
| Comprehensive income | | | | $ 36,834,579 | | | | |
| Balance as of March 31, 2002 | 66,186,130 | $8,597,001 | $123,079,948 | | $(45,441,148) | $ (7,620,600) | $363,764,165 | $442,379,366 |
| Common stock issued | 43,359 | 4,480 | 2,191,234 | | — | — | — | 2,195,714 |
| Cash dividends paid | | | | | — | — | (34,013,046) | (34,013,046) |
| Amortization of compensation related to stock option grants | — | — | — | | — | 3,731,844 | — | 3,731,844 |
| Income tax benefit arising on exercise of stock options | — | — | 804,695 | | — | — | — | 804,695 |
| Comprehensive income | | | | | | | | |
| Net income | | — | — | $141,797,917 | — | — | 141,797,917 | 141,797,917 |
| Other comprehensive income | | | | | | | | |
| Translation adjustment | — | — | — | 8,232,075 | 8,232,075 | — | — | 8,232,075 |
| Comprehensive income | | | | $150,029,992 | | | | |
| Balance as of December 31, 2002 (Unaudited) | 66,229,489 | $8,601,481 | $126,075,877 | | $(37,209,073) | $ (3,888,756) | $471,549,036 | $565,128,565 |

See accompanying notes to the unaudited consolidated financial statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine Months Ended | | Year Ended |
|---|---|---|---|
| | December 31, 2002 | December 31, 2001 | March 31, 2002 |
| | (Unaudited) | (Unaudited) | (Audited) |
| OPERATING ACTIVITIES: | | | |
| Net income | $141,797,917 | $122,182,797 | $164,466,309 |
| Adjustments to reconcile net income to net cash provided by operating activities | | | |
| (Gain)/loss on sale of property, plant and equipment | 8,437 | (2,456) | (16,754) |
| Depreciation | 26,466,706 | 24,402,866 | 33,608,391 |
| Amortization of intangible assets | 1,744,274 | — | — |
| Provision for investments | 3,219,030 | — | — |
| Deferred tax benefit | (2,228,025) | (1,303,995) | (1,999,471) |
| Amortization of deferred stock compensation expense | 3,731,844 | 3,745,554 | 5,009,772 |
| Changes in assets and liabilities | | | |
| Trade accounts receivable | (31,876,890) | (1,720,224) | (7,196,700) |
| Prepaid expenses and other current assets | (14,584,321) | (2,273,638) | (2,052,721) |
| Income taxes | (3,159,384) | (1,729,558) | 869,109 |
| Accounts payable | 126,497 | (27,114) | (27,382) |
| Client deposits | 3,776,724 | 1,389,393 | 1,075,855 |
| Unearned revenue | 8,014,837 | (1,368,788) | (3,753,943) |
| Other accrued liabilities | 14,275,082 | 5,993,281 | 1,492,616 |
| Net cash provided by operating activities | 151,312,728 | 149,288,118 | 191,475,081 |
| INVESTING ACTIVITIES: | | | |
| Expenditure on property, plant and equipment | (26,796,968) | (59,982,936) | (68,347,644) |
| Expenditure on intangible asset | (4,078,363) | — | — |
| Proceeds from sale of property, plant and equipment | 53,222 | 236,642 | 335,079 |
| Loans to employees | (4,973,581) | (4,169,931) | (5,547,203) |
| Purchase of investments | — | (2,200,000) | (2,200,000) |
| Net cash used in investing activities | (35,795,690) | (66,116,225) | (75,759,768) |
| FINANCING ACTIVITIES: | | | |
| Proceeds from issuance of common stock | 2,195,714 | 379,172 | 963,351 |
| Proceeds from issuance of preferred stock by subsidiary | 10,000,000 | — | — |
| Payment of dividends | (34,013,046) | (23,064,211) | (22,902,618) |
| Net cash used in financing activities | (21,817,332) | (22,685,039) | (21,939,267) |
| Effect of exchange rate changes on cash | 4,373,092 | (4,606,833) | (7,374,351) |
| Net increase in cash and cash equivalents during the period | 98,072,798 | 55,880,021 | 86,401,695 |
| Cash and cash equivalents at the beginning of the period | 210,485,940 | 124,084,245 | 124,084,245 |
| Cash and cash equivalents at the end of the period | $308,558,738 | $179,964,266 | $210,485,940 |
| Supplementary information: | | | |
| Cash paid towards taxes | $ 33,014,206 | $ 22,012,502 | $ 27,493,194 |
| Non cash transaction (See Note 2.5) | $ 5,000,000 | — | — |

See accompanying notes to the unaudited consolidated financial statements

## NOTES TO UNAUDITED FINANCIAL STATEMENTS
## As of and for the Nine Months Ended December 31, 2002

### 1 Company Overview and Significant Accounting Policies

#### *1.1 Company Overview*

Infosys Technologies Limited ("Infosys" or "the Company") along with its majority owned and controlled subsidiary, Progeon Limited ("Progeon") is a leading global information technology, ("IT"), services company. The Company provides end-to-end business solutions that leverage technology thus enabling its clients to enhance business performance. The Company provides solutions that span the entire software life cycle encompassing consulting, design, development, re-engineering, maintenance, systems integration, and package evaluation and implementation. In addition, the Company offers software products for the banking industry and business process management services.

#### *1.2 Basis of Preparation of Financial Statements*

The accompanying consolidated financial statements are prepared in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). Inter-company balances and transactions are eliminated on consolidation. All amounts are stated in U.S. dollars, except as otherwise specified.

Interim information presented in the consolidated financial statements has been prepared by the management without audit and, in the opinion of management, includes all adjustments of a normal recurring nature that are necessary for the fair presentation of the financial position, results of operations, and cash flows for the periods shown, is in accordance with the generally accepted accounting principles in the United States. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's annual report on Form 20-F for the fiscal year ended March 31, 2002.

#### *1.3 Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities on the date of the financial statements and the reported amounts of revenues and expenses during the period. Examples of estimates include accounting for contract costs expected to be incurred to complete software development, allowance for uncollectible accounts receivable, future obligations under employee benefit plans, provisions for post sales customer support and the useful lives of property, plant and equipment and intangible assets. Actual results could differ from those estimates.

#### *1.4 Revenue Recognition*

The company derives revenues primarily from software services, licensing of software products and from business process management services. Revenue on time-and-material contracts is recognized as the related services are performed. Revenue from fixed-price, fixed-timeframe contracts is recognized as per the percentage-of-completion method. Provisions for estimated losses on uncompleted contracts are recorded in the period in which such losses become probable based on the current contract estimates. Costs and earnings in excess of billings is classified as unbilled revenue while billings in excess of costs and earnings is classified as unearned revenue. The company provides its clients with a fixed-period warranty for corrections of errors and telephone support on all its fixed-price, fixed-timeframe contracts. Costs associated with such support services are accrued at the time related revenues are recorded.

Revenues from business process management services are recognized on both the time-and-material and fixed-price, fixed-time frame bases. Revenue on time-and-material contracts is recognized as the related services are rendered. Revenue from fixed-price, fixed-timeframe contracts is recognized as per the proportional performance method.

In accordance with Statement of Position 97-2, *Software Revenue Recognition*, license fee revenues are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the license fee is fixed and determinable, and the collection of the fee is probable. When other services are provided in conjunction with the licensing arrangement, the revenue from such contracts are allocated to each component of the contract using the residual method, whereby revenue is deferred for the undelivered services and the residual amounts are recognized as revenue for delivered elements. When the company receives advances for software development services and products, such amounts are reported as client deposits until all conditions for revenue recognition are met. Maintenance revenue is deferred and recognized ratably over the term of the underlying maintenance agreement, generally 12 months. Revenue from client training, support and other services arising due to the sale of software products is recognized as the services are performed.

### *1.5 Cash and Cash Equivalents*

The company considers all highly liquid investments with a remaining maturity at the date of purchase/investment of three months or less to be cash equivalents. Cash and cash equivalents comprise cash, cash on deposit with banks, marketable securities and deposits with corporations.

### *1.6 Property, Plant and Equipment*

Property, plant and equipment are stated at cost less accumulated depreciation. The company depreciates property, plant and equipment over their estimated useful lives using the straight-line method. The estimated useful lives of assets are as follows:

| | |
|---|---|
| Buildings | 15 years |
| Furniture and fixtures | 5 years |
| Computer equipment | 2-5 years |
| Plant and equipment | 5 years |
| Vehicles | 5 years |

The cost of software purchased for use in software development and services is charged to the cost of revenues at the time of acquisition. Deposits paid towards the acquisition of property, plant and equipment outstanding at each balance sheet date and the cost of property, plant and equipment not put to use before such date are disclosed under *"Capital work-in-progress"*.

### *1.7 Intangible Assets*

Intangible assets are amortized over their respective individual estimated useful lives on a straight-line basis, commencing from the date the asset is available to the company for its use. Management estimates the useful lives of acquired rights in software applications to range between one through five years.

### *1.8 Impairment of Long-lived Assets*

The company evaluates the recoverability of its long-lived assets and certain identifiable intangibles, if any, whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of the assets. Assets to be disposed are reported at the lower of the carrying value or the fair value less the cost to sell.

### *1.9 Research and Development*

Research and development costs are expensed as incurred. Software product development costs are expensed as incurred until technological feasibility is achieved.

### *1.10 Foreign Currency Translation*

The accompanying financial statements are reported in U.S. dollars. The functional currency of the company is the Indian rupee ("Rs."). The translation of Rs. to U.S. dollars is performed for balance sheet accounts using the exchange rate in effect at the balance sheet date and for revenue and expense accounts using a monthly average exchange rate for the respective periods. The gains or losses resulting from such translation are reported as *"Other comprehensive income"*, a separate component of stockholders' equity. The method for translating expenses of overseas operations depends upon the funds used. If the payment is made from a rupee denominated bank account, the exchange rate prevailing on the date of the payment would apply. If the payment is made from a foreign currency, i.e., non-rupee denominated account, the translation into rupees is performed at the average monthly exchange rate.

### *1.11 Earnings Per Share*

In accordance with Statement of Financial Accounting Standards ("SFAS") 128, *Earnings Per Share*, basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period, using the treasury stock method for options and warrants, except where the result would be anti-dilutive.

### *1.12 Income Taxes*

Income taxes are accounted for using the asset and liability 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 and operating loss carry-forwards. 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 of changes in tax rates on deferred tax assets and liabilities is recognized as income in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for any tax benefits of which future realization is uncertain. The income tax provisions for the interim period is made based on the best estimate of the effective tax rate expected to be applicable for the full fiscal year.

### *1.13 Fair Value of Financial Instruments*

The carrying amounts reflected in the balance sheets for cash, cash equivalents, accounts receivable and accounts payable approximate their respective fair values due to the short maturities of these instruments.

### *1.14 Concentration of Risk*

Financial instruments that potentially subject the company to concentrations of credit risk consist principally of cash equivalents, trade accounts receivable, investment securities and hedging instruments. By their nature, all such financial instruments involve risk including the credit risk of non-performance by counterparties. In management's opinion, as of December 31, 2002 and 2001 and March 31, 2002, there was no significant risk of loss in the event of non-performance of the counterparties to these financial instruments, other than the amounts already provided for in the financial statements, if any. Exposure to credit risk is managed through credit approvals, establishing credit limits and monitoring procedures. The company's cash resources are invested with corporations, financial institutions and banks with high investment grade credit ratings. Limitations are established by the company as to the maximum amount of cash that may be invested with any such single entity.

### *1.15 Retirement Benefits to Employees*

*1.15.1 Gratuity*

In accordance with the Payment of Gratuity Act, 1972, Infosys provides for gratuity, a defined benefit retirement plan (the "Gratuity Plan") covering eligible employees. The Gratuity Plan provides a lump sum payment to vested employees at retirement, death, incapacitation or termination of employment, of an amount based on the respective employee's salary and the tenure of employment. Liabilities with regard to the Gratuity Plan are determined by actuarial valuation, based upon which, Infosys contributes to the Infosys Technologies Limited Employees' Gratuity Fund Trust (the "Trust"). Trustees administer contributions made to the Trust and invest in specific designated securities as mandated by law, which generally comprise central and state government bonds and debt instruments of government-owned corporations.

*1.15.2 Superannuation*

Apart from being covered under the Gratuity Plan described above, certain employees of Infosys are also participants of a defined contribution plan. The company makes monthly contributions under the superannuation plan (the "Plan") to the Infosys Technologies Limited Employees Superannuation Fund Trust based on a specified percentage of each covered employee's salary. Infosys has no further obligations to the Plan beyond its monthly contributions.

*1.15.3 Provident Fund*

Eligible employees also receive benefits from a provident fund, which is a defined contribution plan. Both the employee and the company make monthly contributions to this provident fund plan equal to a specified percentage of the covered employee's salary. Infosys contributes a part of the contributions to the Infosys Technologies Limited Employees Provident Fund Trust. The remainders of the contributions are made to the Government administered provident fund. There are no further obligations under the provident fund plan beyond its monthly contributions. In respect of Progeon, eligible employees receive benefits from a provident fund, which is a defined contribution plan. Both the employee and the company make monthly contributions to this provident fund plan equal to a specified percentage of the covered employee's salary. Amounts collected under the provident fund plan are deposited in a Government administered provident fund. The Company has no further obligations under the provident fund plan beyond its monthly contributions.

### *1.16 Investments*

The Company accounts by the equity method for investments between 20% and 50% or where it is otherwise able to exercise significant influence over the operating and financial policies of the investee. Investment securities in which the company controls less than 20% voting interest are currently classified as "Available-for-sale securities". Non-readily marketable equity securities for which there are no readily determinable fair values are recorded at cost.

Investment securities designated as "available-for-sale" are carried at their fair value. Fair value is based on quoted market prices. Unquoted securities are carried at cost, adjusted for declines in value judged to be other than temporary. Temporary unrealized gains and losses, net of the related tax effect are reported as a separate component of stockholders' equity until realized. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in the statements of income. The cost of securities sold is based on the specific identification method. Interest and dividend income is recognized when earned.

### *1.17 Stock-Based compensation*

The company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including FASB Interpretation No. 44, *Accounting for Certain Transactions involving Stock Compensation an interpretation of APB Opinion No. 25*, issued in March 2000, to account for its fixed plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure requirements of SFAS 148, *Accounting for Stock-Based Compensation — Transition and Disclosure, an amendment of FASB Statement No. 123*. All stock options issued to date have been accounted as a fixed stock option plan.

***1.18 Dividends***

Dividend on common stock is recorded as a liability on the date of declaration by the stockholders. For interim dividend, the liability is recognized on date of declaration by the Board of Directors.

***1.19 Derivative Financial Instruments***

On April 1, 2001, the company adopted SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* as amended, when the rules became effective for companies with fiscal years ending March 31. The company enters into forward foreign exchange contracts where the counter party is generally a bank. The company purchases forward foreign exchange contracts to mitigate the risk of changes in foreign exchange rates on accounts receivable and forecasted cash flows denominated in certain foreign currencies. Although these contracts are effective as hedges from an economic perspective, they do not qualify for hedge accounting under SFAS 133, as amended. Any derivative that is either not designated hedge, or is so designated but is ineffective per SFAS 133, is marked to market and recognized in earnings immediately.

***1.20 Reclassifications***

Certain reclassifications have been made to conform prior period data to the current presentations. These reclassifications had no effect on reported earnings.

***1.21 Recent Accounting Pronouncements***

In November 2002, the Emerging Issues Task Force reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables applicable for fiscal periods beginning after June 2003. This issue addresses when and, if so, how an arrangement involving multiple deliverables should be divided into separate units of accounting, where the deliverables (the revenue generating activities) are sufficiently separable and have standalone value to the customer. It is also necessary that there exists sufficient evidence of fair value to separately account for some or all of the deliverables. The Company believes that the adoption of the consensus will not have a material impact on the Company's revenue recognition policies as the accounting for the revenue from a significant portion of the Company's service offerings is governed by higher level GAAP literature.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of Indebtedness of Others. The adoption of the Interpretation did not have a material impact on the Company's accounting or disclosure policies.

In December 2002, the FASB issued SFAS 148, *Accounting for Stock-Based Compensation-Transition and Disclosure: An amendment of FASB Statement No. 123.* This Statement amends SFAS 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of

SFAS 148 are applicable for fiscal periods beginning after December 15, 2002. The Company continues to account for its fixed plan stock options under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. The disclosure provisions of SFAS 148 have been adopted by the Company for the quarter ended December 31, 2002.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB 51 that applies to variable interest entities created after January 31, 2003 and to variable interest entities in which our enterprise obtains an interest after that date. The Company does not expect any impact upon adoption of this interpretation.

## 2 Notes to the Unaudited Consolidated Financial Statements

### *2.1 Cash and Cash Equivalents*

The cost and fair values for cash and cash equivalents as of December 31, 2002 and 2001 and March 31, 2002, respectively are as follows:

| | As of December 31, 2002 | As of December 31, 2001 | As of March 31, 2002 |
|---|---|---|---|
| Cost and fair values | | | |
| Cash and bank deposits | $237,233,070 | $126,620,777 | $158,274,886 |
| Deposits with corporations | 71,325,668 | 53,343,489 | 52,211,054 |
| | $308,558,738 | $179,964,266 | $210,485,940 |

Cash and cash equivalents include restricted cash balances in the amount $403,632, $358,483 and $284,839 as of December 31, 2002 and 2001 and March 31, 2002 respectively.

### *2.2 Trade Accounts Receivable*

Trade accounts receivable, as of December 31, 2002 and 2001 and March 31, 2002, net of allowance for doubtful accounts of $3,092,793, $4,025,693 and $3,941,245, respectively amounted to $102,408,446, $64,505,813 and $69,017,110, respectively. The age profile of trade accounts receivable, net of allowances is given below.

| | As of December 31, 2002 | As of December 31, 2001 | As of March 31, 2002 |
|---|---|---|---|
| | | | In % |
| Period (in days) | | | |
| 0-30 | 65.1 | 68.9 | 69.0 |
| 31-60 | 23.6 | 26.5 | 30.0 |
| 61-90 | 6.6 | 4.6 | 0.5 |
| More than 90 | 4.7 | — | 0.5 |
| | 100.0 | 100.0 | 100.0 |

### *2.3 Prepaid Expenses and Other Current Assets*

Prepaid expenses and other current assets consist of the following:

| | As of December 31, | | As of March 31, |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Rent deposits | $ 3,021,132 | $ 2,071,632 | $ 2,079,155 |
| Deposits with government organizations | 1,608,790 | 1,264,146 | 1,220,401 |
| Loans to employees | 5,869,381 | 8,548,006 | 8,331,779 |
| Prepaid expenses | 4,225,787 | 5,041,519 | 2,990,523 |
| Unbilled revenues | 14,819,019 | 1,884,239 | 3,635,989 |
| Other current assets | 1,234,985 | 65,623 | 618,057 |
| | $30,779,094 | $18,875,165 | $18,875,904 |

Other current assets represent advance payments to vendors for the supply of goods and rendering of services and certain costs incurred towards purchase of software. Deposits with government organizations relate principally to leased telephone lines and electricity supplies.

### *2.4 Property, Plant and Equipment — Net*

Property, plant and equipment consist of the following:

| | As of December 31, | | As of March 31, |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Land | $ 9,851,068 | $ 9,023,385 | $ 8,955,962 |
| Buildings | 73,696,985 | 47,180,823 | 58,481,413 |
| Furniture and fixtures | 40,226,122 | 29,863,549 | 32,683,315 |
| Computer equipment | 71,789,151 | 57,407,806 | 59,006,470 |
| Plant and equipment | 44,986,312 | 32,904,434 | 37,685,337 |
| Vehicles | 73,271 | 73,058 | 72,085 |
| Capital work-in-progress | 18,007,212 | 47,039,528 | 30,881,704 |
| | 258,630,121 | 223,492,583 | 227,766,286 |
| Accumulated depreciation | (107,923,189) | (72,831,101) | (80,554,555) |
| | $ 150,706,932 | $150,661,482 | $147,211,731 |

Depreciation expense amounted to $26,466,706, $24,402,866 and $33,608,391 for the nine months ended December 31, 2002 and 2001 and fiscal 2002 respectively. The amount of third party software expensed during the nine months ended December 31, 2002 and 2001 and fiscal 2002 was $9,939,369, $5,507,313 and $7,147,614 respectively.

### *2.5 Intangible Assets*

During the nine months ended December 31, 2002, the company acquired the intellectual property rights of Trade IQ product from IQ Financial Systems Inc., USA for its banking business unit. The consideration paid amounted to US$ 3.9 million. The consideration has been recorded as an intangible asset, which is being amortized over two years representing management's estimate of the useful life of the intellectual property.

The company also entered into an agreement with the Aeronautical Development Agency, India ("ADA") for transferring the intellectual property rights in AUTOLAY, a commercial software application product used in the design of high performance structural systems. The company will pay the consideration in the form of a revenue share with a firm commitment of US$ 5 million payable within

10 years of the contract date. The ownership of intellectual property in AUTOLAY transfers to the company on remittance of the consideration to ADA. The committed consideration is recorded as an intangible asset and is being amortized over five years, which is management's estimate of the useful life. The amount payable to ADA is disclosed as a non-current liability as of December 31, 2002 and as a non-cash transaction in the consolidated statement of cash flows.

As of December 31, 2002, intangible assets (net of accumulated amortization of $1,744,274) were $7,428,310.

### *2.6 Investments*

The carrying cost and the fair values of the Company's investments are as follows:

| | Carrying Cost | Fair Value |
|---|---|---|
| As of December 31, 2002 | | |
| M-Commerce Ventures Pte Ltd — 80 units, each unit representing 1 Ordinary Share of S$1 each at par and 9 Redeemable Preference Shares of S$1 each at par, with a premium of S$1,110 per Redeemable Preference Share | $ 453,863 | $ 453,863 |
| CiDRA Corporation — 33,333 Series D Convertible Preferred Stock, at $90 each, fully paid, par value $0.01 each | 2,999,970 | 2,999,970 |
| Workadia Inc., U.S.A — 880,000 Series B Preferred Stock at $2.5 each, fully paid, par value $0.0005 each | 660,000 | 660,000 |
| Stratify, Inc. (formerly Purple Yogi Inc.) — 276,243 Series D Convertible Preferred Stock, at $1.81 each fully paid, par value $0.001 each | 500,000 | 500,000 |
| | $4,613,833 | $4,613,833 |
| As of December 31, 2001 | | |
| M-Commerce Ventures Pte Ltd — 70 units, each unit representing 1 Ordinary Share of S$1 each at par and 9 Redeemable Preference Shares of S$1 each at par, with a premium of S$1,110 per Redeemable Preference Share | $ 399,485 | $ 399,485 |
| Asia Net Media BVI Limited — 30,000,000 Ordinary Shares at $0.05 each, fully paid, par value $0.01 each | 1,500,000 | 1,500,000 |
| CiDRA Corporation — 33,333 Series D Convertible Preferred Stock, at $90 each, fully paid, par value $0.01 each | 2,999,970 | 2,999,970 |
| Workadia Inc., U.S.A — 2,200,000 Series B Convertible Preferred Stock at $1 each, fully paid, par value $0.0002 each | 2,200,000 | 2,200,000 |
| JASDIC Park Company — 480 Common Stock, at ¥50,000 each, fully paid, par value ¥50,000 each | 177,576 | 177,576 |
| Stratify, Inc. (formerly Purple Yogi Inc.) — 276,243 Series D Convertible Preferred Stock, at $1.81 each fully paid, par value $0.001 each | 500,000 | 500,000 |
| Others | 362 | 362 |
| | $7,777,393 | $7,777,393 |

| | Carrying Cost | Fair Value |
|---|---|---|
| As of March 31, 2002 | | |
| M-Commerce Ventures Pte Ltd — 70 units, each unit representing 1 Ordinary Share of S$1 each at par and 9 Redeemable Preference Shares of S$1 each at par, with a premium of S$1,110 per Redeemable Preference Share | $ 399,485 | $ 399,485 |
| Asia Net Media BVI Limited — 30,000,000 Ordinary Shares at $0.05 each, fully paid, par value $0.01 each | 1,500,000 | 1,500,000 |
| CiDRA Corporation — 33,333 Series D Convertible Preferred Stock, at $90 each, fully paid, par value $0.01 each | 2,999,970 | 2,999,970 |
| Workadia Inc., USA — 880,000 Series B Preferred Stock at $2.5 each, fully paid, par value $0.005 each | 2,200,000 | 2,200,000 |
| JASDIC Park Company — 480 Common Stock, at ¥50,000 each, fully paid, par value ¥50,000 each | 177,576 | 177,576 |
| Stratify, Inc. (formerly Purple Yogi Inc.) — 276,243 Series D Convertible Preferred Stock, at $1.81 each fully paid, par value $0.001 each | 500,000 | 500,000 |
| Others | 362 | 362 |
| | $7,777,393 | $7,777,393 |

During the nine months ended December 31, 2002, the company provided for certain investments in the amount of $3,219,030 as there was a diminution in their values that was considered other than temporary.

### *2.7 Other Assets*

Other assets represent the non-current portion of loans to employees.

### *2.8 Related Parties*

The company grants loans to employees for acquiring assets such as property and cars. Such loans are repayable over fixed periods ranging from 1 to 100 months. The annual rates of interest at which the loans have been made to employees vary between 0% through 4%. No loans have been made to employees in connection with equity issues. The loans are generally secured by the assets acquired by the employees. As of December 31, 2002 and 2001 and March 31, 2002, amounts receivable from officers amounting to $14,583, $465,973 and $473,464, respectively are included in prepaid expenses and other current assets, and other assets in the accompanying balance sheets. The required repayments of loans by employees are as detailed below.

The required repayments of loans by employees are as detailed below.

| | As of December 31, | | As of March 31, |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| 2002 | — | $ 8,548,006 | — |
| 2003 | $ 5,869,381 | 3,355,615 | $ 8,331,779 |
| 2004 | 4,262,612 | 2,267,185 | 3,755,840 |
| 2005 | 3,139,770 | 1,367,506 | 2,670,075 |
| 2006 | 2,351,568 | 1,064,996 | 1,826,748 |
| 2007 | 1,870,302 | — | 1,454,086 |
| Thereafter | 8,668,890 | 3,072,164 | 2,751,866 |
| Total | $26,162,523 | $19,675,472 | $20,790,394 |

The estimated fair values of related party receivables amounted to $17,194,669 and $14,837,206 and $17,905,507 as of December 31, 2002 and 2001 and March 31, 2002. These amounts have been determined using available market information and appropriate valuation methodologies. Considerable judgment is required to develop these estimates of fair value. Consequently, these estimates are not necessarily indicative of the amounts that the company could realize in the market.

### *2.9 Other Accrued Liabilities*

Other accrued liabilities comprise the following:

| | As of December 31, | | As of March 31, |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Accrued compensation to staff | $16,875,182 | $11,560,248 | $11,575,996 |
| Accrued dividends | 403,632 | 359,483 | 229,839 |
| Provision for post sales client support | 1,447,399 | 1,736,986 | 2,255,573 |
| Employee withholding taxes payable | 5,494,811 | 2,092,809 | 2,614,479 |
| Provision for expenses | 9,051,882 | 7,468,898 | 3,356,760 |
| Retention money | 2,251,677 | 3,305,421 | 1,918,203 |
| Others | 1,914,419 | 755,735 | 473,796 |
| | $37,439,002 | $27,279,580 | $22,424,646 |

### *2.10 Employee Post-retirement Benefits*

#### *2.10.1 Superannuation*

The company contributed $891,480, $913,808 and $1,220,716 to the superannuation plan in the nine months ended December 31, 2002 and 2001 and fiscal 2002, respectively.

#### *2.10.2 Provident Fund*

The company contributed $2,749,262, $2,337,455 and $3,146,742 to the provident fund in the nine months ended December 31, 2002 and 2001 and fiscal 2002, respectively.

### *2.11 Stockholders' equity*

Infosys has only one class of capital stock referred to as equity shares. All references in these financial statements to number of shares, per share amounts and market prices of equity shares are retroactively restated to reflect stock splits made. The rights of equity shareholders are set out below.

#### *2.11.1 Voting*

Each holder of equity shares is entitled to one vote per share. The equity shares represented by American Depositary Shares ("ADS") carry similar rights to voting and dividends as the other equity shares. Two ADS represent one underlying equity share.

#### *2.11.2 Dividends*

Should the company declare and pay dividends, such dividends will be paid in Indian Rupees. Indian law mandates that any dividend be declared out of distributable profits only after the transfer of a specified percentage of net income computed in accordance with current regulations to a general reserve. Moreover, the remittance of dividends outside India is governed by Indian law on foreign exchange and is subject to applicable taxes.

*2.11.3 Liquidation*

In the event of a liquidation of the company, the holders of common stock shall be entitled to receive any of the remaining assets of the company, after distribution of all preferential amounts. The amounts will be in proportion to the number of equity shares held by the stockholders.

*2.11.4 Stock Options*

There are no voting, dividend or liquidation rights to the holders of warrants issued under the company's stock option plan.

***2.12 Preference Shares of Subsidiary***

During the nine months ended December 31, 2002, Progeon issued 4,375,000 0.0005% cumulative convertible preference shares of par value $2.0 per share to Citicorp International Finance Corporation ("CIFC") at a issue price of $2.28 (equivalent to Rs. 112) per share, in exchange for a aggregate consideration of $10,000,000. Unless earlier converted pursuant to an agreement in this behalf between the company and CIFC, these cumulative convertible preference shares shall automatically be converted into equity shares, (i) one year prior to the Initial Public Offering ("IPO") date or (ii) September 30, 2005 or (iii) at the holder's option, immediately upon the occurrence of any Liquidity Event; whichever is earlier. The term "Liquidity Event" includes any of a decision of the Board of Directors of the company to make an IPO, merger, reconstruction, capital reorganization or other event which, in the sole opinion of the holder of the convertible preference shares, amounts to an alteration in the capital structure of the company. Each preference share is convertible into one equity share, par value $0.20 each.

Each holder of these cumulative convertible preference shares is entitled to receive notice of, and to attend, any shareholders' meeting and shall be entitled to vote together with holders of equity shares on any matters that affect their rights as preference shareholders including any resolution for winding up the company or for the repayment of reduction of the company's share capital.

In the event of any liquidation, dissolution or winding up of the company, either voluntary or involuntary, each holder of the preference shares will be paid an dollar equivalent of Rs. 112 per preference share, as adjusted for stock dividends, combinations, splits, recapitalization and the like, in preference to any distribution of any assets of the company to the holders of equity shares.

Upon the completion of the distribution described above, the remaining assets and funds of the company available for distribution to shareholders shall be distributed among all holders of preference shares and equity shares based on the number of equity shares held by each of them (assuming a full conversion of all the preference shares).

***2.13 Other Income, Net***

Other income, net, consists of the following:

| | Nine Months Ended December 31, 2002 | Nine Months Ended December 31, 2001 | Year Ended March 31, 2002 |
|---|---|---|---|
| Interest income | $11,728,239 | $7,355,707 | $10,423,654 |
| Exchange gains | 3,528,637 | 1,235,221 | 2,749,162 |
| Provision for investments | (3,219,030) | — | — |
| Others | 500,618 | 481,868 | 692,478 |
| | $12,538,464 | $9,072,796 | $13,865,294 |

### *2.14 Operating Leases*

The company has various operating leases for office buildings that are renewable on a periodic basis. Rental expense for operating leases in the nine months ended December 31, 2002 and 2001 and fiscal 2002 were $4,306,354, $3,824,111 and $5,109,690, respectively. The operating leases can be renewed or canceled at the company's option.

The company leases some of its office space under non-cancelable operating leases for periods ranging between three through ten years. The schedule of future minimum rental payments in respect of these leases is set out below.

| Year ending December 31, | |
|---|---|
| 2003 | $ 3,740,916 |
| 2004 | 3,531,052 |
| 2005 | 2,746,906 |
| 2006 | 1,321,459 |
| 2007 | 744,428 |
| Thereafter | 1,124,788 |
| | $13,209,549 |

### *2.15 Research and Development*

General and administrative expenses in the accompanying statements of income include research and development expenses of $2,159,994, $2,385,215 and $3,083,994 for the nine months ended December 31, 2002 and 2001 and fiscal 2002, respectively.

### *2.16 Employees' Stock Offer Plans ("ESOP")*

In September 1994, the company established the 1994 plan, which provided for the issue of 6,000,000 warrants, as adjusted, to eligible employees. The warrants were issued to an employee welfare trust (the "Trust"). In 1997, in anticipation of a share dividend to be declared by the company, the Trust exercised all warrants held by it and converted them into equity shares. As and when the Trust issued options/stock to eligible employees, the difference between the market price and the exercise price was accounted as deferred stock compensation expense and amortized over the vesting period. Such amortized deferred compensation expense was $3,731,844, $3,745,554 and $5,009,772 for the nine months ended December 31, 2002 and 2001 and fiscal 2002 respectively. The 1994 plan lapsed in fiscal 2000 and consequently no further shares will be issued to employees under this plan. 1998 Employees Stock Offer Plan (the "1998 Plan"). The company's 1998 Plan provides for the grant of non-statutory stock options and incentive stock options to employees of the company. The establishment of the 1998 Plan was approved by the board of directors in December 1997 and by the stockholders in January 1998. The Government of India has approved the 1998 Plan, subject to a limit of 1,470,000 equity shares representing 2,940,000 American Depositary Shares ("ADS") to be issued under the 1998 Plan. Unless terminated sooner, the 1998 Plan will terminate automatically in January 2008. All options under the 1998 Plan will be exercisable for equity shares represented by American Depositary Shares (ADSs). The 1998 Plan is administered by a Compensation Committee comprising five members, all of who are independent directors on the Board of Directors. All options under the 1998 Plan are exercisable for equity shares represented by ADSs.

1999 Stock Offer Plan (the "1999 Plan"). In fiscal 2000, the company instituted the 1999 Plan. The stockholders and the Board of Directors approved the 1999 Plan in June 1999. The 1999 Plan provides for the issue of 6,600,000 equity shares to employees. The 1999 Plan is administered by a Compensation Committee comprising five members, all of who are independent directors on the Board of Directors. Under the 1999 Plan, options will be issued to employees at an exercise price, which shall not be less than the Fair Market Value ("FMV"). Under the 1999 Plan, options may also be issued to employees at exercise prices that are less than FMV only if specifically approved by the members of the company in a general meeting. All options under the 1999 plan are exercised for equity shares.

The options under all of the above plans vest over a period of one through five years.

The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

| | Unaudited | | |
|---|---|---|---|
| | Nine Months Ended December 31, | | Year Ended March 31, |
| | 2002 | 2001 | 2002 |
| Net income, as reported | $141,797,917 | $122,182,797 | $164,466,309 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 3,731,844 | 3,745,554 | 5,009,772 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (43,311,902) | (41,779,020) | (64,294,987) |
| Pro forma net income | $102,217,859 | $ 84,149,331 | $105,181,094 |
| Earnings per share: | | | |
| Basic — as reported | $ 2.16 | $ 1.86 | $ 2.51 |
| Basic — pro forma | $ 1.56 | $ 1.28 | $ 1.60 |
| Diluted — as reported | $ 2.13 | $ 1.85 | $ 2.49 |
| Diluted — pro forma | $ 1.56 | $ 1.28 | $ 1.59 |

The activity in the warrants/equity shares of the 1994, 1998 and 1999 Employees Stock Offer Plans in the nine months ended December 31, 2002 and 2001 and fiscal 2002 are set out below.

| | Nine Months Ended | | | | Year Ended March 31, 2002 | |
|---|---|---|---|---|---|---|
| | December 31, 2002 | | December 31, 2001 | | | |
| | Shares Arising Out of Options | Weighted Average Exercise Price | Shares Arising Out of Options | Weighted Average Exercise Price | Shares Arising Out of Options | Weighted Average Exercise Price |
| 1994 Option plan: | | | | | | |
| Outstanding at the beginning of the period | 321,400 | — | 330,000 | — | 330,000 | — |
| Granted | — | | — | — | — | |
| Forfeited | (2,800) | $ 1.15 | (7,000) | $ 1.15 | (8,600) | $ 1.15 |
| Outstanding at the end of the period | 318,600 | | 323,000 | | 321,400 | — |
| Exercisable at the end of the period | — | | — | | — | |
| Weighted-average fair value of grants during the period at less than market | | — | | — | | — |
| 1998 Option plan: | | | | | | |
| Outstanding at the beginning of the period | 1,131,247 | | 782,753 | | 782,753 | — |
| Granted | 221,900 | $121.64 | 415,425 | $ 73.68 | 454,250 | $ 98.06 |
| Forfeited | (84,505) | $ 71.80 | (48,885) | $245.04 | (77,773) | $240.90 |
| Exercised | (36,887) | $ 49.64 | (11,100) | $ 60.04 | (27,983) | $ 44.32 |
| Outstanding at the end of the period | 1,231,755 | | 1,138,193 | | 1,131,247 | |
| Exercisable at the end of the period | 198,825 | | 210,130 | | 164,527 | — |
| Weighted-average fair value of grants during the period | | $121.64 | | $ 73.68 | | $ 98.06 |

| | Nine Months Ended | | | | Year Ended | |
|---|---|---|---|---|---|---|
| | December 31, 2002 | | December 31, 2001 | | March 31, 2002 | |
| | Shares Arising Out of Options | Weighted Average Exercise Price | Shares Arising Out of Options | Weighted Average Exercise Price | Shares Arising Out of Options | Weighted Average Exercise Price |
| 1999 Option plan: | | | | | | |
| Outstanding at the beginning of the period | 4,668,815 | | 2,793,980 | | 2,793,980 | |
| Granted | 478,050 | $ 74.73 | 1,979,600 | $ 95.05 | 2,050,500 | $ 64.74 |
| Forfeited | (157,961) | $ 96.49 | (133,035) | $128.69 | (175,635) | $119.23 |
| Exercised | (6,472) | $ 55.30 | (30) | $ 74.29 | (30) | $ 84.95 |
| Outstanding at the end of the period | 4,982,432 | | 4,640,515 | | 4,668,815 | |
| Exercisable at the end of the period | 1,063,051 | | 363,673 | | 448,530 | |
| Weighted-average fair value of grants during the period | | $ 74.73 | | $ 95.05 | | $ 64.74 |

### *2.17 Income Taxes*

The provision for income taxes comprises:

| | Nine Months Ended December 31, | | Year Ended March 31, |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Current taxes | | | |
| Domestic taxes | $13,553,644 | $ 4,201,904 | $ 6,483,255 |
| Foreign taxes | 18,560,002 | 16,865,008 | 23,463,108 |
| | 32,113,646 | 21,066,912 | 29,946,363 |
| Deferred taxes | | | |
| Domestic taxes | (1,296,511) | — | 27,126 |
| Foreign taxes | (931,514) | (743,332) | (2,026,597) |
| | (2,228,025) | (743,332) | (1,999,471) |
| Aggregate taxes | $29,885,621 | $20,323,580 | $27,946,892 |

The tax effects of significant temporary differences that resulted in deferred tax assets and liabilities and a description of the financial statement items that created these differences are as follows:

| | Nine Months Ended December 31, | | Year Ended March 31, |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Deferred tax assets: | | | |
| Property, plant and equipment | $3,820,125 | $2,274,931 | $2,989,348 |
| Provision for doubtful debts | 1,081,696 | 1,437,172 | 1,448,407 |
| Investments | 2,532,866 | 1,442,477 | 1,571,586 |
| | 7,434,687 | 5,154,580 | 6,009,341 |
| Less: Valuation allowance | (136,770) | (515,015) | (674,300) |
| Net deferred tax assets | $7,297,917 | $4,639,565 | $5,335,041 |

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. Management considers the scheduled reversal of the projected future taxable income, and tax planning strategies in making this assessment. Based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes that it is more likely than not the company will realize the benefits of those deductible differences, net of the existing valuation differences at December 31, 2002. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

All deferred tax expenses/(benefits) are allocated to the continuing operations of the company.

The provision for foreign taxes is due to income taxes payable overseas, principally in the United States of America. The company benefits from certain significant tax incentives provided to software firms under Indian tax laws. These incentives presently include: (i) an exemption from payment of Indian corporate income taxes for a period of ten consecutive years of operation of software development facilities designated as "Software Technology Parks" (the "STP Tax Holiday"); and (ii) a tax deduction for profits derived from exporting computer software (the "Export Deduction"). All but one of the company's software development facilities are located in designated Software Technology Parks ("STP"). The Government of India has recently amended the tax incentives available to companies set up in designated STPs. The period of the STP Tax Holiday available to such companies is restricted to 10 consecutive years beginning from the financial year when the unit started producing computer software or March 31, 2000, whichever is earlier. The Finance Act 2002 provides that the exempt income from an export oriented undertaking, for the year commencing April 1, 2002, be restricted to 90% of its aggregate income. Additionally, the export deduction will be phased out equally over a period of five years starting from fiscal 2000.

As of March 31, 2002, the accumulated undistributed earnings of the U.S. branch offices were $78.45 million. These earnings may attract a 15% tax imposed by the United States Internal Revenue Service on their repatriation to India. The Company intends to reinvest such undistributed earnings within the United States and currently has no intent to repatriate such earnings in the foreseeable future.

### *2.18 Earnings Per Share*

The following is a reconciliation of the equity shares used in the computation of basic and diluted earnings per equity share:

| | Nine Months Ended December 31, | | Year Ended March 31, |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Basic earnings per equity share — weighted average number of common shares outstanding excluding unallocated shares of ESOP | 65,567,814 | 65,557,265 | 65,556,648 |
| Effect of dilutive common equivalent shares — stock options outstanding | 838,118 | 648,521 | 528,226 |
| Diluted earnings per equity share — weighted average number of common shares and common equivalent shares outstanding | 66,405,932 | 66,205,786 | 66,084,874 |

### *2.19 Derivative Financial Instruments*

The Company enters into forward foreign exchange contracts where the counter party is generally a bank. The Company considers the risks of non-performance by the counter party as non-material. Infosys held foreign exchange forward contracts of $100,000,000, $20,000,000 and $2,000,000 as of December 31, 2002 and 2001 and March 31, 2002, respectively. The foreign forward exchange contracts mature between one to six months.

### *2.20 Segment Reporting*

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the way that public business enterprises report information about operating segments and related disclosures about products and services, geographic areas and major customers. The company's operations predominantly relate to providing IT solutions, delivered to customers located globally, across various industry segments. In the year ended March 31, 2000, the company provided segmental disclosures based on the geographical segment. However, from the fiscal year ended March 31, 2001, the Chief Operating Decision Maker evaluates the company's performance and allocates resources based on an analysis of various performance indicators by industry classes and geographic segmentation of customers. Accordingly, revenues represented along industry classes comprise the principal basis of segmental information set out in these financial statements. Secondary segmental reporting is performed on the basis of the geographical location of customers. The accounting principles consistently used in the preparation of the financial statements are consistently applied to record revenue and expenditure in individual segments and are as set out in the summary of significant accounting policies.

Industry segments for the company are primarily *financial services* comprising enterprises providing banking, finance and insurance services, *manufacturing* enterprises, enterprises in the *telecommunications ("telecom")* and *retail* industries and *others* such as utilities, transportation and logistics companies.

Revenue in relation to segments is categorized based on items that are individually identifiable to that segment, while expenditure is categorized in relation to the associated turnover of the segment. Certain expenses such as depreciation, which form a significant component of total expenses, are not specifically allocable to specific segments as the underlying services are used interchangeably. Management believes that it is not practical to provide segment disclosures relating to those costs and expenses, and accordingly these expenses are separately disclosed as "unallocated" and adjusted only against the total income of the company.

Geographic segmentation is driven based on the location of the respective client. *North America* comprises the United States of America, Canada and Mexico; *Europe* includes continental Europe (both the east and the west), Ireland and the United Kingdom, and the *Rest of the World* comprising all other places except those mentioned above and *India*.

Fixed assets used in the company's business are not identified to any of the reportable segments, as these are used interchangeably between segments. Management believes that it is currently not practicable to provide segment disclosures relating to total assets and liabilities since a meaningful segregation of the available data is onerous.

Geographical information on revenue and industry revenue information is collated based on individual customers invoiced or in relation to which the revenue is otherwise recognized.

*2.20.1 Industry Segments*

| | Nine Months Ended December 31, 2002 | | | | | |
|---|---|---|---|---|---|---|
| | Financial Services | Manufacturing | Telecom | Retail | Others | Total |
| Revenues | $203,419,872 | $91,154,337 | $79,168,194 | $61,946,100 | $102,087,471 | $537,775,974 |
| Identifiable operating expenses | 81,664,228 | 37,057,023 | 26,678,891 | 19,558,427 | 38,673,125 | 203,631,694 |
| Allocated expenses | 56,445,056 | 23,557,385 | 20,530,951 | 16,009,339 | 26,513,650 | 143,056,381 |
| Segmental operating income | $ 65,310,588 | $30,539,929 | $31,958,352 | $26,378,334 | $ 36,900,696 | 191,087,899 |
| Unallocable expenses | | | | | | 31,942,825 |
| Operating income | | | | | | 159,145,074 |
| Other income (expense), net | | | | | | 12,538,464 |
| Income before income taxes | | | | | | 171,683,538 |
| Provision for income taxes | | | | | | 29,885,621 |
| Net income | | | | | | $141,797,917 |

| | Nine Months Ended December 31, 2001 | | | | | |
|---|---|---|---|---|---|---|
| | Financial Services | Manufacturing | Telecom | Retail | Others | Total |
| Revenues | $147,615,021 | $69,386,637 | $63,617,079 | $48,997,683 | $ 75,754,292 | $405,370,712 |
| Identifiable operating expenses | 54,101,958 | 28,839,432 | 16,603,048 | 13,307,077 | 26,339,106 | 139,190,621 |
| Allocated expenses | 39,119,169 | 17,665,432 | 16,192,692 | 12,421,760 | 19,200,455 | 104,599,508 |
| Segmental operating income | $ 54,393,894 | $22,881,773 | $30,821,339 | $23,268,846 | $ 30,214,731 | 161,580,583 |
| Unallocable expenses | | | | | | 28,147,002 |
| Operating income | | | | | | 133,433,581 |
| Other income (expense), net | | | | | | 9,072,796 |
| Income before income taxes | | | | | | 142,506,377 |
| Provision for income taxes | | | | | | 20,323,580 |
| Net income | | | | | | $122,182,797 |

| | Year Ended March 31, 2002 | | | | | |
|---|---|---|---|---|---|---|
| | Financial Services | Manufacturing | Telecom | Retail | Others | Total |
| Revenues | $199,725,558 | $93,404,474 | $85,190,054 | $67,027,323 | $ 99,703,805 | $545,051,214 |
| Identifiable operating expenses | 74,364,097 | 38,112,096 | 23,873,023 | 18,696,233 | 34,831,145 | 189,876,594 |
| Allocated expenses | 51,905,935 | 23,321,898 | 21,273,366 | 16,667,939 | 24,840,829 | 138,009,967 |
| Segmental operating income | $ 73,455,526 | $31,970,480 | $40,043,665 | $31,663,151 | $ 40,031,831 | 217,164,653 |
| Unallocable expenses | | | | | | 38,616,746 |
| Operating income | | | | | | 178,547,907 |
| Other income (expense), net | | | | | | 13,865,294 |
| Income before income taxes | | | | | | 192,413,201 |
| Provision for income taxes | | | | | | 27,946,892 |
| Net income | | | | | | $164,466,309 |

*2.20.2 Geographic Segments*

| | Nine Months Ended December 31, 2002 | | | | |
|---|---|---|---|---|---|
| | North America | Europe | India | Rest of the World | Total |
| Revenues | $395,272,736 | $ 92,863,563 | $10,108,669 | $39,531,006 | $537,775,974 |
| Identifiable operating expenses | 156,416,246 | 31,914,376 | 3,536,136 | 11,764,936 | 203,631,694 |
| Allocated expenses | 104,085,331 | 24,259,358 | 3,495,073 | 11,216,619 | 143,056,381 |
| Segmental operating income | $134,771,159 | $ 36,689,829 | $ 3,077,460 | $16,549,451 | 191,087,899 |
| Unallocable expenses | | | | | 31,942,825 |
| Operating income | | | | | 159,145,074 |
| Other income (expense), net | | | | | 12,538,464 |
| Income before income taxes | | | | | 171,683,538 |
| Provision for income taxes | | | | | 29,885,621 |
| Net income | | | | | $141,797,917 |

| | Nine Months Ended December 31, 2001 | | | | |
|---|---|---|---|---|---|
| | North America | Europe | India | Rest of the World | Total |
| Revenues | $289,382,482 | $ 78,551,232 | $ 8,559,625 | $28,877,373 | $405,370,712 |
| Identifiable operating expenses | 98,476,100 | 28,315,359 | 3,048,190 | 9,350,972 | 139,190,621 |
| Allocated expenses | 74,490,566 | 20,226,600 | 2,587,309 | 7,295,033 | 104,599,508 |
| Segmental operating income | $116,415,816 | $ 30,009,273 | $ 2,924,126 | $12,231,368 | 161,580,583 |
| Unallocable expenses | | | | | 28,147,002 |
| Operating income | | | | | 133,433,581 |
| Other income (expense), net | | | | | 9,072,796 |
| Income before income taxes | | | | | 142,506,377 |
| Provision for income taxes | | | | | 20,323,580 |
| Net income | | | | | $122,182,797 |

| | Year Ended March 31, 2002 | | | | |
|---|---|---|---|---|---|
| | North America | Europe | India | Rest of the World | Total |
| Revenues | $388,168,447 | $106,103,448 | $10,735,626 | $40,043,693 | $545,051,214 |
| Identifiable operating expenses | 135,362,671 | 38,013,083 | 4,183,775 | 12,317,065 | 189,876,594 |
| Allocated expenses | 98,093,268 | 26,809,588 | 3,119,373 | 9,987,738 | 138,009,967 |
| Segmental operating income | $154,712,508 | $ 41,280,777 | $ 3,432,478 | $17,738,890 | 217,164,653 |
| Unallocable expenses | | | | | 38,616,746 |
| Operating income | | | | | 178,547,907 |
| Other income (expense), net | | | | | 13,865,294 |
| Income before income taxes | | | | | 192,413,201 |
| Provision for income taxes | | | | | 27,946,892 |
| Net income | | | | | $164,466,309 |

*2.20.3 Significant Clients*

No clients individually accounted for more than 10% of the revenues in the nine months ended December 31, 2002 and 2001 and fiscal 2002, respectively.

***2.21 Commitments and Contingencies***

The company has outstanding performance guarantees for various statutory purposes totaling $1,658,333, $3,330,910 and $3,334,700 as of December 31, 2002 and 2001 and March 31, 2002, respectively. These guarantees are generally provided to governmental agencies.

### *2.22 Litigation*

On December 17, 2001, Reka Maximovitch filed an action in the Superior Court of the State of California, Alameda County, against us and our former officer and director, Phaneesh Murthy. Ms. Maximovitch served the complaint on us in June 2002. The complaint alleges that we and Phaneesh Murthy sexually harassed her and terminated her employment in violation of public policy, specifically California's public policy against sex discrimination. The complaint also asserts claims against Phaneesh Murthy for stalking and intentional infliction of emotional distress. The complaint seeks unspecified damages, as well as punitive damages and attorneys' fees and costs. We have filed an answer denying the allegations of the complaint, and we have asserted what we believe are various meritorious defenses to the claims. The lawsuit is now in the early stages of discovery and a trial date of September 19, 2003 has been set. An unfavorable resolution of this lawsuit could adversely impact our results of operations or financial condition and reputation.

In addition, from time to time we become party to various legal proceedings arising in the ordinary course of our business. While the results of such litigation and claims cannot be predicted with certainty, we believe that the final outcome of these other matters will not seriously harm our business, operating results or financial condition.