Infosys Technologies Limited and subsidiaries

Consolidated balance sheets as of March 31,

	2003	2004
ASSETS		
Current Assets		
Cash and cash equivalents	$ 354,362,918	$ 444,553,465
Investment in liquid mutual fund units	–	217,604,513
Trade accounts receivable, net of allowances	109,119,856	150,102,586
Deferred tax assets	288,541	–
Prepaid expenses and other current assets	24,384,316	35,871,753
Unbilled revenue	19,702,186	23,725,119
Total current assets	507,857,817	871,857,436
Property, plant and equipment, net	157,194,190	228,419,168
Goodwill	–	7,834,269
Intangible assets, net	6,471,236	1,878,105
Deferred tax assets	7,264,885	7,381,530
Investments	4,613,833	470,420
Prepaid income taxes	4,452,678	68,963
Other assets	16,454,328	14,272,380
TOTAL ASSETS	$ 704,308,967	$ 1,132,182,271
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 426,611	$ 954,890
Client deposits	3,208,295	15,021,176
Other accrued liabilities	46,249,269	99,518,224
Deferred tax liabilities	–	210,200
Income taxes payable	–	21,626,600
Unearned revenue	13,202,115	14,711,639
Total current liabilities	63,086,290	152,042,729
Non-current liabilities		
Preferred stock of subsidiary	10,000,000	21,557,448
Other non-current liabilities	5,217,758	5,001,628
Stockholders' Equity		
Common stock, $0.16 par value		
100,000,000 equity shares authorized,		
Issued and outstanding – 66,243,078 and 66,641,056 as of		
March 31, 2003 and 2004, respectively	8,602,909	8,647,061
Additional paid-in capital	127,042,751	157,204,530
Accumulated other comprehensive income	(31,444,835)	40,084,033
Deferred stock compensation	(2,817,066)	–
Retained earnings	524,621,160	747,644,842
Total stockholders' equity	626,004,919	953,580,466
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 704,308,967	$ 1,132,182,271

See accompanying notes to the consolidated financial statements

Infosys Technologies Limited and subsidiaries

Consolidated statements of income for the years ended March 31,

	2002	2003	2004
Revenues	$ 545,051,214	$ 753,807,025	$ 1,062,584,888
Cost of revenues (including amortization of stock compensation expenses of $2,999,457, $2,818,887 and $1,653,156)	293,031,689	417,359,025	602,289,263
Gross profit	252,019,525	336,448,000	460,295,625
Operating Expenses:			
Selling and marketing expenses	27,113,122	55,649,913	76,811,466
General and administrative expenses	44,348,181	57,808,445	82,224,122
Amortization of stock compensation expenses	2,010,315	1,984,647	1,163,910
Amortization of intangible assets	–	2,360,799	6,980,074
Total operating expenses	73,471,618	117,803,804	167,179,572
Operating income	178,547,907	218,644,196	293,116,053
Other income, net	13,865,294	18,048,110	27,950,174
Income before income taxes	192,413,201	236,692,306	321,066,227
Provision for income taxes	27,946,892	41,822,265	50,775,927
Net income	$ 164,466,309	$ 194,870,041	$ 270,290,300
Earnings per equity share			
Basic	$ 2.51	$ 2.97	$ 4.11
Diluted	$ 2.49	$ 2.93	$ 4.05
Weighted equity shares used in computing earnings per equity share			
Basic	65,556,648	65,571,002	65,695,077
Diluted	66,084,874	66,479,009	66,791,559

See accompanying notes to the consolidated financial statements

Infosys Technologies Limited and subsidiaries

Consolidated statements of stockholders' equity and comprehensive income

	Common stock Shares	Par value	Additional paid-in capital	Comprehensive income	Accumulated other comprehensive income	Deferred stock compensation	Retained earnings	Total stockholders' equity
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	28,013	2,895	949,076		–	–	–	951,971
Cash dividends	–	–	–		–	–	(23,064,211)	(23,064,211)
Deferred stock compensation								
related to stock option grants	–	–	113,354		–	(113,354)	–	–
Amortization of compensation								
related to stock option grants	–	–	–		–	5,009,772	–	5,009,772
Comprehensive income								
Net income	–	–	–	$ 164,466,309	–	–	164,466,309	164,466,309
Other comprehensive income								
Translation adjustment	–	–	–	(16,776,176)	(16,776,176)	–	–	(16,776,176)
Comprehensive income				$ 147,690,133				
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	56,948	5,908	2,799,780		–	–	–	2,805,688
Cash dividends	–	–	–		–	–	(34,013,046)	(34,013,046)
Income tax benefit arising on								
exercise of stock options	–	–	1,163,023		–	–	–	1,163,023
Amortization of compensation								
related to stock option grants	–	–	–		–	4,803,534	–	4,803,534
Comprehensive income								
Net income	–	–	–	$ 194,870,041	–	–	194,870,041	194,870,041
Other comprehensive income								
Translation adjustment	–	–	–	13,996,313	13,996,313	–	–	13,996,313
Comprehensive income				$ 208,866,354				
Balance as of March 31, 2003	66,243,078	$ 8,602,909	$ 127,042,751		$ (31,444,835)	$ (2,817,066)	$ 524,621,160	$ 626,004,919
Common stock issued	397,978	44,152	27,040,385		–	–	–	27,084,537
Cash dividends	–	–	–		–	–	(47,266,618)	(47,266,618)
Income tax benefit arising on								
exercise of stock options	–	–	3,121,394		–	–	–	3,121,394
Amortization of compensation								
related to stock option grants	–	–	–		–	2,817,066	–	2,817,066
Comprehensive income								
Net income	–	–	–	$ 270,290,300	–	–	270,290,300	270,290,300
Other comprehensive income								
Unrealized gain on mutual fund								
investments, net of taxes of $ 82,186	–	–	–	146,904	146,904	–	–	146,904
Translation adjustment	–	–	–	71,381,964	71,381,964	–	–	71,381,964
Comprehensive income				$ 341,819,168				
Balance as of March 31, 2004	66,641,056	$ 8,647,061	$ 157,204,530		$ 40,084,033	–	$ 747,644,842	$ 953,580,466

See accompanying notes to the consolidated financial statements

Infosys Technologies Limited and subsidiaries

Consolidated statements of cash flows for the years ended March 31,

	2002	2003	2004
OPERATING ACTIVITIES:			
Net income	$ 164,466,309	$ 194,870,041	$ 270,290,300
Adjustments to reconcile net income to net cash provided by operating activities			
Gain on sale of property, plant and equipment	(16,754)	(2,070)	89,756
Depreciation	33,608,391	37,023,974	45,288,910
Amortization of intangible assets	–	2,360,799	6,980,074
Provision for investments	–	3,219,030	2,104,043
Deferred taxes	(1,999,471)	(2,418,210)	809,305
Amortization of stock compensation expenses	5,009,772	4,803,534	2,817,066
Changes in assets and liabilities			
Trade accounts receivable	(7,196,700)	(37,657,569)	(26,768,538)
Prepaid expenses and other current assets	1,079,574	(5,236,301)	(8,147,376)
Unbilled revenue	(3,132,295)	(15,436,197)	(656,773)
Income taxes	869,109	(3,922,235)	25,854,186
Accounts payable	(27,382)	419,750	(507,553)
Client deposits	1,075,855	919,545	10,933,375
Unearned revenue	(3,753,943)	9,491,122	(33,283)
Other accrued liabilities	1,492,616	22,756,370	44,399,069
Net cash provided by operating activities	191,475,081	211,191,583	373,452,561
INVESTING ACTIVITIES:			
Expenditure on property, plant and equipment	(68,347,644)	(43,157,754)	(93,226,060)
Expenditure on intangible assets	–	(3,551,433)	–
Proceeds from sale of property, plant and equipment	335,079	70,383	310,863
Loans to employees	(5,547,203)	(7,249,008)	3,961,650
Purchase of subsidiary, net of cash acquired	–	–	(10,383,445)
Purchase of investments	(2,200,000)	(54,378)	(205,324,508)
Net cash used in investing activities	(75,759,768)	(53,942,190)	(304,661,500)
FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	963,351	2,805,688	27,084,537
Proceeds from issuance of preferred stock by subsidiary	–	10,000,000	10,267,126
Payment of dividends	(22,902,618)	(33,913,973)	(47,183,238)
Net cash used in financing activities	(21,939,267)	(21,108,285)	(9,831,575)
Effect of exchange rate changes on cash	(7,374,351)	7,735,870	31,231,061
Net increase in cash and cash equivalents during the period	86,401,695	143,876,978	90,190,547
Cash and cash equivalents at the beginning of the period	124,084,245	210,485,940	354,362,918
Cash and cash equivalents at the end of the period	$ 210,485,940	$ 354,362,918	$ 444,553,465
Supplementary information:			
Cash paid towards taxes	$ 27,493,194	$ 45,398,138	$ 23,722,149

See accompanying notes to the consolidated financial statements

Notes to the consolidated financial statements

1 Company overview and significant accounting policies

1.1 Company overview

Infosys Technologies Limited ("Infosys") along with its majority owned and controlled subsidiaries, Progeon Limited ("Progeon"), Infosys Technologies (Australia) Pty. Limited ("Infosys Australia"), and Infosys Technologies (Shanghai) Co. Limited ("Infosys China") is a leading global information technology, or 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 consolidated financial statements include Infosys and its subsidiaries ("the company") and are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Infosys consolidates entities in which it owns or controls more than 50% of the voting shares. The results of acquired businesses are included in the consolidated financial statements from the date of acquisition. Inter-company balances and transactions are eliminated on consolidation.

1.3 Use of estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are used for, but not limited to accounting for costs and efforts expected to be incurred to complete performance under software development arrangements, allowance for uncollectible accounts receivable, future obligations under employee benefit plans, provisions for post-sales customer support, the useful lives of property, plant, equipment and intangible assets and income tax valuation allowances. Actual results could differ from those estimates. Appropriate changes in estimates are made as management become aware of changes in circumstances surrounding the estimates. Changes in estimates are reflected in the financials statements in the period in which changes are made and, if material, their effects are disclosed in the notes to the consolidated financial statements.

1.4 Revenue recognition

The company derives revenues primarily from software development and related services, licensing of software products and from business process management services. Arrangements with customers for software development and related services are either on a fixed price, fixed timeframe or on a time and material basis.

Revenue on time-and-material contracts is recognized as the related services are performed. Revenue from the end of the last billing to the balance sheet date is recognized as unbilled revenues. Revenue from fixed-price, fixed-time frame contracts is recognized as per the percentage-of-completion method. Guidance has been drawn from paragraph 95 of Statement of Position (SOP) 97-2 to account for revenue from fixed price arrangements for software development and related services in conformity with SOP 81-1. The input (efforts expended) method has been used to measure progress towards completion as there is a direct relationship between input and productivity. Provisions for estimated losses, if any, 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 are classified as unbilled revenue while billings in excess of costs and earnings are classified as unearned revenue. Maintenance revenue is recognized ratably over the term of the underlying maintenance agreement.

The company provides its clients with a fixed-period warranty for corrections of errors and telephone support on all its fixed-price, fixed-time frame contracts. Costs associated with such support services are accrued at the time related revenues are recorded and included in cost of revenues. The company estimates such costs based on historical experience and estimates are reviewed on a periodic basis for any material changes in assumptions and likelihood of occurrence.

In accordance with SOP 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. Arrangements to deliver software products generally have three elements: license, implementation and Annual Technical Services ("ATS"). The company has applied the principles in SOP 97-2 to account for revenue from these multiple element arrangements. Vendor specific objective evidence of fair value ("VSOE") has been established for ATS. VSOE is the price charged when the element is sold separately. 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. In the absence of an established VSOE for implementation, the entire arrangement fee for license and implementation is recognized as the implementation is performed. Revenue from client training, support and other services arising due to the sale of software products is recognized as the services are performed. ATS revenue is recognized ratably over the period in which the services are rendered.

Revenues from business process management and other services are recognized on both, the time-and-material and fixed-price, fixed-time frame basis. Revenue on time-and-material contracts is recognized as the related services are rendered. Revenue from fixed-price, fixed-time frame contracts is recognized as per the proportional performance method using an output measure of performance.

When the company receives advances for services and products, such amounts are reported as client deposits until all conditions for revenue recognition are met.

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 and that are readily convertible to known amounts of cash to be cash equivalents. Cash and cash equivalents comprise cash, and cash on deposit with banks, and corporations.

1.6 Investments

Investments in non-readily marketable equity securities of other entities where the company is unable to exercise significant influence and for which there are no readily determinable fair values are recorded at cost. Declines in value judged to be other than temporary are included in earnings.

Investment securities designated as "available for sale" are carried at their fair value. Fair value is based on quoted market prices. 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 earnings.

The cost of securities sold is based on the specific identification method. Interest and dividend income are recognized when earned.

1.7 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
Plant and equipment	5 years
Furniture and fixtures	5 years
Vehicles	5 years
Computer equipment	2-5 years

The cost of software purchased for internal use is accounted under SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Deposits paid towards the acquisition of these long lived assets outstanding at each balance sheet date and the cost of assets not put to use before such date are disclosed under "Capital work-in-progress". Costs of improvements that substantially extend the useful life of particular assets are capitalized. Repairs and maintenance cost are charged to earnings when incurred. The cost and related accumulated depreciation are removed from the consolidated financial statements upon sale or disposition of the asset.

The company evaluates the recoverability of these assets 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.

1.8 Business combinations

Business combinations have been accounted using the purchase method under the provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standard ("SFAS") No. 141, Business Combinations. Cash and amounts of consideration that are determinable at the date of acquisition are included in determining the cost of the acquired business.

1.9 Goodwill

Goodwill represents the cost of the acquired businesses in excess of the fair value of identifiable tangible and intangible net assets purchased. Goodwill is tested for impairment on an annual basis, relying on a number of factors including operating results, business plans and future cash flows. Recoverability of goodwill is evaluated using a two-step process. The first step involves a comparison of the fair value of a reporting unit with its carrying value. If the carrying amount of the reporting unit exceeds its fair value, the second step of the process involves a comparison of the fair value and carrying value of the goodwill of that reporting unit. If the carrying value of the goodwill of a reporting unit exceeds the fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess. Goodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount.

1.10 Intangible assets

Intangible assets are amortized over their respective individual estimated useful lives on a straight-line basis. The estimated useful life of an identifiable intangible asset is based on a number of factors including the effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, and known technological advances), and the level of maintenance expenditures required to obtain the expected future cash flows from the asset.

Intangible assets are evaluated for recoverability 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

1.11 Research and development

Research and development costs are expensed as incurred. Software product development costs are expensed as incurred until technological feasibility is achieved. Research and development costs and software development costs incurred under contractual arrangements with customers are accounted as cost of revenues.

1.12 Foreign currency

The functional currency of the company is the Indian rupee ("Rs."). The functional currency for Infosys Australia and Infosys China is the respective local currency. The consolidated financial statements are reported in U.S. dollars. 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, expense and cash-flow items using a monthly average exchange rate for the respective periods. The gains or losses resulting from such translation are included in "Other comprehensive income", a separate component of stockholders' equity. The translation of the financial statements of foreign subsidiaries from the local currency to the functional currency of the company is also performed on the same basis.

Foreign-currency denominated assets and liabilities are translated into the functional currency at exchange rates in effect at the balance sheet date. The gains or losses resulting from such translation are included in earnings. Transaction gains or losses realized upon settlement of foreign currency transactions are included in determining net income for the period in which the transaction is settled. Revenue, expense and cash-flow items denominated in foreign currencies are translated into the functional currency using the exchange rate in effect on the date of the transaction.

1.13 Earnings per share

Basic earnings per share is computed by dividing net income for the period by the weighted average number of equity shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the diluted weighted average number of equity shares outstanding during the period. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the if-converted method. Diluted earnings per share reflects the potential dilution from equity shares issuable through employee stock options and preferred stock of subsidiary.

1.14 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. 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 not more likely than not. Changes in valuation allowance from period to period are reflected in the income statement of the period of change. Deferred taxes are not provided on the undistributed earnings of subsidiaries outside India where it is expected that the earnings of the foreign subsidiary will be permanently reinvested. Tax benefits earned on exercise of employee stock options in excess of compensation charged to earnings are credited to additional paid in capital.

1.15 Fair value of financial instruments

In determining the fair value of its financial instruments, the company uses a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. The methods used to determine fair value include discounted cash flow analysis and dealer quotes. All methods of assessing fair value result in general approximation of value, and such value may never actually be realized.

1.16 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 nature, all such financial instruments involve risk, including the credit risk of non-performance by counterparties. In management's opinion, as of March 31, 2003 and March 31, 2004, 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.

1.17 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 foreign exchange forward contracts where the counter party is generally a bank. The company purchases foreign exchange forward 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 constitute hedges from an economic perspective, they do not qualify for hedge accounting under SFAS 133, as amended. Any derivative that is either not designated a hedge, or is so designated but is ineffective per SFAS 133, is marked to market and recognized in earnings immediately.

1.18 Retirement benefits to employees

1.18.1 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. The company fully contributes all ascertained liabilities to the Infosys Technologies Limited Employees' Gratuity Fund Trust (the "Trust"). In case of Progeon, contributions are made to the Progeon Employees Gratuity Fund Trust. Trustees administer contributions made to the Trust and contributions are invested in specific designated instruments as permitted by law and investments are also made in mutual funds that invest in the specific designated instruments.

1.18.2 Superannuation

Certain employees of Infosys are also participants in 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. The company has no further obligations to the Plan beyond its monthly contributions. Certain employees of Progeon are also eligible for superannuation benefit. Progeon makes monthly provisions under the superannuation plan based on a specified percentage of each covered employee's salary. Progeon has no further obligations to the superannuation plan beyond its monthly provisions which are periodically contributed to a trust fund, the corpus of which is invested with the Life Insurance Corporation of India.

1.18.3 Provident fund

Eligible employees receive benefits from a provident fund, which is a defined contribution plan. Both the employee and the company make monthly contributions to the provident fund plan equal to a specified percentage of the covered employee's salary. The company contributes a part of the contributions to the Infosys Technologies Limited Employees' Provident Fund Trust. The remaining portion is contributed to the Government administered provident fund. The company has 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 Progeon 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. Progeon has no further obligations under the provident fund plan beyond its monthly contributions.

1.19 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 stock option plans. 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.

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

	Year ended March 31, 2002	2003	2004
Net income, as reported	$ 164,466,309	$ 194,870,041	$ 270,290,300
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	5,009,772	4,803,534	2,817,066
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(64,294,987)	(62,447,389)	(49,665,156)
Pro forma net income	$ 105,181,094	$ 137,226,186	$ 223,442,210
Earnings per share:			
Basic – as reported	2.51	2.97	4.11
Basic – pro forma	1.60	2.09	3.40
Diluted – as reported	2.49	2.93	4.05
Diluted – pro forma	1.59	2.09	3.36

The fair value of each option is estimated on the date of grant using the Black-Scholes model with the following assumptions:

	Year ended March 31, 2002	2003	2004
Dividend yield %	0.2%	0.2%	0.2%
Expected life	1-5years	1-5years	1-5years
Risk free interest rate	9.5%	6.0%	5.1-5.7%
Volatility	69.0%	60-75%	60-75%

1.20 Dividends

Final dividends on common stock are recorded as a liability on the date of declaration by the stockholders and interim dividends are recorded as a liability on the date of declaration by the board of directors.

1.21 Reclassifications

Certain reclassifications have been made to conform prior period data to the current presentations.

2 Notes to the consolidated financial statements

2.1 Cash and cash equivalents

The cost and fair values for cash and cash equivalents are as follows:

	As of March 31, 2003	2004
Cost and fair values		
Cash and bank deposits	$ 283,302,326	$ 396,660,847
Deposits with corporations	71,060,592	47,892,618
	$ 354,362,918	$ 444,553,465

Cash and cash equivalents include restricted cash balances in the amount of $336,610 and $456,401 as of March 31, 2003 and 2004 respectively. The restrictions are primarily on account of unclaimed dividend.

2.2 Trade accounts receivable

Trade accounts receivable as of March 31, 2003 and 2004, net of allowance for doubtful accounts of $3,010,568 and $3,078,798 respectively, amounted to $109,119,856 and $150,102,586. The age profile of trade accounts receivable, net of allowances is given below.

In %

As of March 31,	2003	2004
Period (in days)		
0 – 30	65.8	69.7
31 – 60	29.0	21.6
61 – 90	3.9	4.7
More than 90	1.3	4.0
	100.0	100.0

2.3 Business combination

On January 2, 2004 the company acquired, for cash, 100% of the equity in Expert Information Services Pty. Limited, Australia for $14,500,243. The purchase consideration includes $3,359,738 retained in escrow for representations and warranties made by the selling shareholders. The acquired company was renamed as "Infosys Technologies (Australia) Pty. Limited". There is a further contingent consideration payable to the sellers subject to continued employment and meeting of defined operating and financial performance parameters. The contingent consideration will be accounted as compensation.

The purchase price, including transaction costs, has been allocated based on management's estimates and independent appraisals of fair values as follows:

Component	Purchase price allocated
Plant and equipment	$ 441,588
Net current assets	5,199,094
Non current liabilities	(510,563)
Customer contracts	2,045,094
Goodwill	7,464,485
Total purchase price	$ 14,639,698

The identified customer contracts intangible is being amortized over a period of two years beginning January 2004, being management's estimate of the useful life of the asset. The company believes that the acquisition resulted in recognition of goodwill primarily because of the acquired company's market position, skilled employees, management strength and potential to serve as a platform for enhancing business opportunities in Australia. The goodwill has been allocated to the Australia reporting unit.

2.4 Prepaid expenses and other current assets

Prepaid expenses and other current assets consist of the following:

	As of March 31, 2003	2004
Rent deposits	$ 2,856,226	$ 3,447,398
Security deposits with service providers	2,814,216	2,094,238
Loans to employees	12,252,004	12,995,976
Prepaid expenses	5,209,907	12,343,022
Other current assets	1,251,963	4,991,119
	$ 24,384,316	$ 35,871,753

Other current assets represent advance payments to vendors for the supply of goods and rendering of services and marked to market gains on foreign exchange forward contracts. Deposits with service providers relate principally to leased telephone lines and electricity supplies.

2.5 Property, plant and equipment – net

Property, plant and equipment consist of the following:

	As of March 31, 2003	2004
Land	$ 9,948,480	$ 20,796,805
Buildings	81,114,141	105,902,504
Furniture and fixtures	43,969,763	59,074,894
Computer equipment	77,299,299	107,248,308
Plant and equipment	47,832,904	65,425,296
Vehicles	73,995	98,321
Capital work-in-progress	16,281,831	47,937,529
	276,520,413	406,483,657
Accumulated depreciation	(119,326,223)	(178,064,489)
	$ 157,194,190	$ 228,419,168

Depreciation expense amounted to $33,608,391, $37,023,974 and $45,288,910 for fiscal 2002, 2003 and 2004 respectively. The amount of third party software expensed during fiscal 2002, 2003 and 2004 was $7,147,614, $11,607,776 and $14,194,206 respectively.

2.6 Intangible assets

During fiscal 2003, the company acquired the intellectual property rights to the Trade IQ product from IQ Financial Systems Inc., USA for its banking business unit. The consideration paid amounted to $3.5 million and was recorded as an intangible asset and amortized over two years being management's initial estimate of the useful life. In the same fiscal year, the company also entered into an agreement for transferring the intellectual property rights in a commercial software application product used in the design of high performance structural systems. The company is required to pay the committed consideration of $5.0 million within ten years of the contract date. The ownership of intellectual property in the product transfers to the company on remittance of the consideration. The committed consideration of $5.0 million was recorded as an intangible asset and was being amortized over management's estimate of the useful life, which was initially 5 years. During fiscal 2004, management revised its estimates of the remaining useful life of these intangible assets. The additional amortization for fiscal 2004 due to the revisions in the estimates of remaining useful life was $3.6 million. The recorded values of these intangible assets have been completely amortized as of March 31, 2004.

The identified customer contracts intangible arising from the purchase price allocation of Expert Information Services Pty. Limited, Australia is being amortized over a period of two years beginning January 2004, being management's estimate of the useful life of the asset. The unamortized balance as of March 31, 2004 was $1,878,105.

2.7 Investments

The carrying value of the company's investments in non-readily-marketable equity securities for which there are no readily determinable fair values are as follows:

	Carrying value
As of March 31, 2003	
M-Commerce Ventures Pte Ltd – 80 units, each unit representing 1 Ordinary Share of S$1 each at par and 900 Redeemable Preference Shares of S$1 each at par, with a premium of S$1,110 per Redeemable Preference Share	$ 453,863
CiDRA Corporation – 33,333 Series D Convertible Preferred Stock, at $90 each, fully paid, par value $0.01 each	2,999,970
Workadia Inc., USA – 880,000 Series B Preferred Stock at $2.5 each, fully paid, par value $0.0005 each	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
	$ 4,613,833
As of March 31, 2004	
M-Commerce Ventures Pte Ltd – 100 units, each unit representing 1 Ordinary Share of S$1 each at par and 684 Redeemable Preference Shares of S$1 each at par with a premium of S$1,110 per Redeemable Preference Share and 126 Redeemable Preference Shares of S$1 each at par	$ 470,420
	$ 470,420

Investments in liquid mutual fund units are designated as "available for sale".

2.8 Other assets

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

2.9 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. Loans aggregating $28,706,332 and $27,268,356 were outstanding as of March 31, 2003 and 2004.

The required repayments of employee loans outstanding as of March 31, 2004 are as detailed below.

Year	Repayment
2005	$ 12,995,976
2006	4,004,809
2007	2,902,160
2008	2,088,789
2009	2,081,803
Thereafter	3,194,819
	$ 27,268,356

The estimated fair values of related party receivables amounted to $24,422,419 and $23,934,228 as of March 31, 2003 and 2004 respectively. 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.

2.10 Other accrued liabilities

Other accrued liabilities comprise the following:

	As of March 31, 2003	2004
Accrued compensation to staff	$ 25,382,793	$ 71,320,274
Accrued dividends	336,610	456,401
Provision for post sales client support	1,015,022	1,180,440
Employee withholding taxes payable	4,964,118	9,019,477
Provision for expenses	12,196,810	15,613,679
Retainage	1,120,938	1,213,798
Others	1,232,978	714,155
	$ 46,249,269	$ 99,518,224

2.11 Employee post-retirement benefits

2.11.1 Gratuity

The following tables set out the funded status of the gratuity plans and the amounts recognized in the company's financial statements in fiscal 2002, 2003 and 2004. The measurement date used is March 31 of the relevant fiscal year.

	Year ended March 31,		
	2002	2003	2004
Change in benefit obligations			
Benefit obligations at the beginning of the year	$ 13,581,972	$ 15,851,898	$ 18,789,198
Unrecognized actuarial loss	–	(514,983)	4,728,137
Service cost	1,341,313	2,158,209	3,737,069
Interest cost	1,376,398	1,082,815	1,231,369
Benefits paid	(175,364)	(238,823)	(749,864)
Effect of exchange rate changes	(272,421)	450,082	2,279,128
Benefit obligations at the end of the year	$ 15,851,898	$ 18,789,198	$ 30,015,037
Change in plan assets			
Fair value of plan assets at the beginning of the year	$ 10,147,905	$ 12,448,532	$ 16,064,766
Effect of exchange rate changes	(524,191)	385,738	1,852,497
Actual return on plan assets	1,324,702	1,369,206	2,127,404
Employer contributions	1,675,480	2,100,113	4,526,200
Benefits paid	(175,364)	(238,823)	(749,864)
Plan assets at the end of the year	$ 12,448,532	$ 16,064,766	$ 23,821,003
Funded status	$ (3,403,366)	$ (2,724,432)	$ (6,194,034)
Excess of actual return over estimated return on plan assets	141,394	552,688	(1,263,439)
Unrecognized transitional obligation	594,784	402,646	391,966
Unrecognized actuarial loss	3,131,389	2,235,222	6,566,769
(Accrued) / prepaid benefit	$ 464,201	$ 466,124	$ (498,738)

Net gratuity cost for fiscal 2002, 2003 and 2004 comprises the following components:

	Year ended March 31,		
	2002	2003	2004
Service cost	$ 1,341,313	$ 2,158,209	$ 3,737,069
Interest cost	1,376,398	1,082,815	1,231,369
Expected return on assets	(1,183,308)	(816,518)	(863,965)
Amortization of unrecognized transitional obligation	44,535	43,980	46,449
Amortization of unrecognized actuarial loss	105,330	129,701	382,516
Net gratuity cost	$ 1,684,268	$ 2,598,187	$ 4,533,438

The assumptions used in accounting for the gratuity plan in fiscal 2002, 2003 and 2004 are set out below.

	Year ended March 31,		
	2002	2003	2004
Discount rate	10.0%	7.0%	5.2%
Rate of increase in compensation levels	9.0%	5.0-7.0%	5.1%
Rate of return on plan assets	10.0%	7.0%	5.2%

The company assesses these assumptions with its projected long-term plans of growth and prevalent industry standards. Unrecognized actuarial loss is amortized over the average remaining service period of the active employees expected to receive benefits under the Plan.

The company contributes all ascertained liabilities to the Infosys Technologies Limited Employees' Gratuity Fund Trust. In case of Progeon, contributions are made to the Progeon Employees' Gratuity Fund Trust. Trustees administer contributions made to the trust and contributions are invested in specific designated instruments as permitted by Indian law and investments are also made in mutual funds that invest in the specific designated instruments. As of March 31, 2004, all of the plan assets are invested in debt securities.

The company's overall expected long-term rate-of-return-on assets has been determined based on consideration of available market information, current provisions of Indian law specifying the instruments in which investments can be made, and historical returns. Historical returns during fiscal 2002, 2003 and 2004 have not been lower than the expected rate of return on plan assets estimated for those years.

Accumulated benefits obligation was $5,989,534 and $7,477,612 as of March 31, 2003 and 2004 respectively.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid.

	Year ending March 31,
2005	$ 388,245
2006	425,740
2007	481,781
2008	529,215
2009	584,145
2010-2014	$ 2,884,595

The expected benefits are based on the same assumptions used to measure the company's benefit obligations as of March 31, 2004.

The company expects to contribute approximately $5,347,926 to the gratuity trusts during fiscal 2005.

2.11.2 Superannuation

The company contributed $1,220,716, $1,216,282 and $2,204,794 to the superannuation plan in fiscal 2002, 2003 and 2004 respectively.

2.11.3 Provident fund

The company contributed $3,146,742, $3,820,331 and $5,884,403 to the provident fund in fiscal 2002, 2003 and 2004, respectively.

2.12 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.

2.12.1 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 ADSs represent one underlying equity share.

2.12.2 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.

2.12.3 Liquidation

In the event of 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.

2.12.4 Stock options

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

2.13 Preferred stock of subsidiary

Infosys holds 100% of the equity share capital of Progeon. The equity shares have been issued to Infosys as per the terms of the stock subscription agreement signed in April 2002, between Infosys, Citicorp International Finance Corporation ("CIFC") and Progeon. 12,250,000 equity shares have been issued to Infosys in each of April 2002 and March 2004 for an aggregate consideration of $5,279,699. Pursuant to the agreement, CIFC has been issued 4,375,000 (0.0005%) cumulative convertible preference shares in each of June 30, 2002 and March 31, 2004 for an aggregate consideration of $20,267,126.

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 upon the earlier of, (i) one year prior to Progeon's initial public offering ("IPO") date, (ii) June 30, 2005, or (iii) at the holder's option, immediately upon the occurrence of any Liquidity Event.; 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. Indian law requires redemption of preference shares within a period of 20 years.

2.14 Other income, net

Other income, net, consists of the following:

	Year ended March 31,		
	2002	2003	2004
Interest income	$ 10,423,654	$ 16,701,515	$ 18,450,458
Income from mutual fund investments	–	–	3,922,426
Exchange gains, net	2,749,162	4,157,373	7,536,326
Provision for investments	–	(3,219,030)	(2,104,043)
Others	692,478	408,252	145,007
	$ 13,865,294	$ 18,048,110	$ 27,950,174

In fiscal 2003, the company provided for write-downs to investments in the aggregate amount of approximately $3.2 million. These included approximately $1.5 million for Asia Net Media BVI Limited, $0.2 million for JASDIC Park Company, $1.5 million for Workadia Inc., and other miscellaneous investments. The provisions during fiscal 2004 include write-downs to investments in CiDRA Corporation of $1.5 million, $0.4 million towards investment in Stratify Inc and other miscellaneous investments. These write-downs were required due to the non-temporary impact of adverse market conditions on these entities' business models and contemporary transactions on the securities of the entities which have been indicative of their current fair value.

2.15 Operating leases

The company has various operating leases, mainly for office buildings, that are renewable on a periodic basis. Rental expenses for operating leases in fiscal 2002, 2003 and 2004 were $5,109,690, $6,141,298 and $8,575,314 respectively.

The schedule of future minimum rental payments in respect of non-cancellable operating leases is set out below.

	Year ending March 31,
2005	$ 6,220,905
2006	5,147,125
2007	3,724,398
2008	3,390,281
2009	1,889,522
Thereafter	1,110,460
Total	$ 21,482,691

2.16 Research and development

General and administrative expenses in the accompanying statements of income include research and development expenses of $3,083,994, $2,950,949 and $9,405,854 for fiscal 2002, 2003 and 2004 respectively.

2.17 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 $5,009,772, $4,803,534 and $2,817,066 for fiscal 2002, 2003, and 2004 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 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 ADSs. The 1998 Plan is administered by a Compensation Committee comprising four 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 four 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 exercisable for equity shares.

The options under the 1998 Plan and 1999 Plan vest over a period of one through four years and expire 5 years from the date of completion of vesting.

Progeon's 2002 Plan provides for the grant of stock options to its employees and was approved by its board of directors and stockholders in June 2002. All options under the 2002 Plan are exercisable for equity shares. The 2002 Plan is administered by a Compensation Committee comprising three members, all of whom are directors of the company. The 2002 Plan provides for the issue of 5,250,000 equity shares to employees, at an exercise price, which shall not be less than the FMV. 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 general meeting. The options issued under the 2002 Plan vest in periods ranging between one through six years, although accelerated vesting based on performance conditions is provided in certain instances. All options granted have been accounted for as a fixed plan.

The activity in the warrants/equity shares of the 1994, 1998 and 1999 ESOP in fiscal 2002, 2003 and 2004 are set out below.

Year ended March 31,

	2002		2003		2004	
	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	330,000	–	321,400	–	318,200	
Granted	–	–	–	–	–	
Forfeited	(8,600)	$ 1.15	(3,200)	$ 1.15	(1,600)	$ 1.15
Exercised	–	–	–	–		
Outstanding at the end of the period	321,400		318,200		316,600	
1998 Option plan:						
Outstanding at the beginning of the period	782,753	–	1,131,247		1,251,703	
Granted	454,250	$ 98	290,100	$ 124	47,950	$ 95
Forfeited	(77,773)	$ 241	(124,874)	$ 92	(202,466)	$ 150
Exercised	(27,983)	$ 44	(44,770)	$ 47	(129,435)	$ 59
Outstanding at the end of the period	1,131,247		1,251,703		967,752	
Exercisable at the end of the period	164,527	–	315,002	–	385,876	
Weighted-average fair value of options granted during the period	–	$ 31	–	$ 32	–	$ 24
1999 Option plan:						
Outstanding at the beginning of the period	2,793,980	–	4,668,815	–	5,061,171	
Granted	2,050,500	$ 65	616,850	$ 78	192,800	$ 66
Forfeited	(175,635)	$ 119	(212,316)	$ 97	(394,898)	$ 99
Exercised	(30)	$ 85	(12,178)	$ 56	(268,543)	$ 73
Outstanding at the end of the period	4,668,815		5,061,171		4,590,530	
Exercisable at the end of the period	448,530	–	1,222,639	–	2,112,120	
Weighted-average fair value of options granted during the period	–	$ 32	–	$ 35		$ 29

The following table summarizes information about stock options outstanding as of March 31, 2004

	Options Outstanding			Options Exercisable	
Range of exercise prices per share ($)	No. of shares arising out of options	Weighted average remaining contractual life in years	Weighted average exercise price	No. of shares arising out of options	Weighted average exercise price
1994 Plan					
1.15	316,600	0.25	$ 1.15	–	–
1998 Plan					
34-50	21,150	2.94	$ 34	21,150	$ 34
51-100	218,113	5.92	$ 84	30,678	$ 87
101-150	295,060	6.24	$ 125	42,675	$ 127
151-200	305,039	4.68	$ 190	204,963	$ 190
201-300	59,590	4.63	$ 240	35,790	$ 240
301-400	54,550	4.09	$ 325	38,010	$ 326
401-660	14,250	3.91	$ 518	12,610	$ 526
	967,752			385,876	
1999 Plan					
51-100	2,897,459	5.30	$ 75	1,128,950	$ 83
101-150	1,315,751	4.74	$ 125	750,510	$ 127
151-200	358,920	4.46	$ 166	216,180	$ 166
201-275	18,400	3.91	$ 208	16,480	$ 207
	4,590,530			2,112,120	

Options to purchase 1,401,150 shares of Progeon, with a weighted average exercise price of $1.39 and fair value $0.60 have been granted during fiscal 2004. Options to purchase 77,700 shares with a weighted average exercise price of $0.79 were forfeited during the period. Options to purchase 3,124,625 shares were outstanding as of March 31, 2004 with a weighted average remaining contractual life of 4.81 years and weighted average exercise price of $1.00. Options to purchase 443,641 shares were exercisable as of March 31, 2004 with a weighted average exercise price of $0.69.

Options to purchase 1,801,175 shares of Progeon, with a weighted average exercise price of $0.69 and fair value $0.30 have been granted during fiscal 2003 and were outstanding as of March 31, 2003. There were no forfeitures or exercises on these grants. The outstanding options as of March 31, 2003 had a weighted average remaining contractual life of 4.33 years and weighted average exercise price of $0.69. No options were exercisable as of March 31, 2003.

2.18 Income taxes

The provision for income taxes in the income statement comprises:

	Year ended March 31,		
	2002	2003	2004
Current taxes			
Domestic taxes	$ 6,483,255	$ 18,717,241	$ 10,488,985
Foreign taxes	23,463,108	25,523,234	39,477,637
	29,946,363	44,240,475	49,966,622
Deferred taxes			
Domestic taxes	27,126	(1,122,604)	1,189,074
Foreign taxes	(2,026,597)	(1,295,606)	(379,769)
	(1,999,471)	(2,418,210)	809,305
Aggregate taxes	$ 27,946,892	$ 41,822,265	$ 50,775,927

All components of the aggregate taxes of $27,946,892, $41,822,265 and $50,775,927 for fiscal 2002, 2003 and 2004 are allocated to the continuing operations of the company. Deferred tax expense of $82,186 is included in stockholders' equity as of March 31, 2004, being tax on unrealized gain on mutual fund investments. Tax benefits of $1,163,023 and $3,121,394 earned on exercise of employee stock options are credited to additional paid in capital during fiscal 2003 and fiscal 2004.

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:

	As of March 31,	
	2003	2004
Deferred tax assets:		
Property, plant and equipment	$ 4,719,124	$ 6,251,836
Allowances on trade accounts receivable	1,093,701	770,471
Investments	2,545,761	3,211,257
Accrual for compensated absences	–	687,379
Others	–	256,786
	8,358,586	11,177,729
Less: Valuation allowance	(614,004)	(1,967,903)
	7,744,582	9,209,826
Deferred tax liabilities		
Gains on foreign exchange forward contracts	(191,156)	(1,392,879)
Intangible assets	–	(563,431)
Unrealized gain on mutual fund investments	–	(82,186)
	(191,156)	(2,038,496)
Net deferred tax assets	$ 7,553,426	$ 7,171,330

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 reversals of deferred tax liabilities, 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 allowance at March 31, 2004. The valuation allowance relates to provision for doubtful debts and investments. 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.

At April 2001, the valuation allowance was $1,587,629. The valuation allowance decreased by $913,329 during the year ended March 31, 2002. The valuation allowance further decreased by $60,296 in the year ended March 31, 2003. The valuation allowance increased by $1,353,899 during the year ended March 31, 2004.

A reconciliation of the income tax provision to the amount computed by applying the statutory income tax rate to the income before provision for income taxes is summarized below.

	Year ended March 31,		
	2002	2003	2004
Net income before taxes	$ 192,413,201	$ 236,692,306	$ 321,066,227
Enacted tax rates in India	35.70%	36.75%	35.875%
Computed expected tax expense	68,691,513	86,984,422	115,182,509
Tax effect due to non-taxable income for Indian tax purposes	(48,690,954)	(50,569,115)	(78,299,551)
Effect of enacted tax rate change	142,565	(56,018)	67,754
Effect of differential foreign tax rates	2,788,938	2,944,982	7,202,637
Others	5,014,830	2,517,994	6,622,578
Aggregate taxes	$ 27,946,892	$ 41,822,265	$ 50,775,927

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 ten consecutive years, beginning from the financial year when the unit started producing computer software or April 1, 1999, whichever is earlier. The Finance Act 2002 provided that the exempt income from an export oriented undertaking, for fiscal 2003 be restricted to 90% of its export income. However, this restriction is not applicable from fiscal 2004. Additionally, the Export Deduction is being phased out equally over a period of five years starting from fiscal 2000.

The company is subject to a 15% Branch Profit Tax (BPT) in the U.S. to the extent its U.S. branch's net profit during the year is greater than the increase in the net assets of the company's U.S. branch during the fiscal year, computed in accordance with the Internal Revenue Code. At March 31, 2004, the company's US branch net assets amounted to approximately $127.5 million. The company has not triggered the BPT and intends to maintain the current level of its net assets in the US, as it is consistent with its business plan. Accordingly, a BPT provision has not been recorded.

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.

2.19 Earnings per share

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

	Year ended March 31,		
	2002	2003	2004
Basic earnings per equity share – weighted average number of common shares outstanding excluding unallocated shares of ESOP	65,556,648	65,571,002	65,695,077
Effect of dilutive common equivalent shares – stock options outstanding	528,226	908,007	1,096,482
Diluted earnings per equity share – weighted average number of common shares and common equivalent shares outstanding	66,084,874	66,479,009	66,791,559

Options to purchase 635,800 shares under the 1998 Plan and 2,521,757 shares under the 1999 Plan were not considered for calculating diluted earnings per share for fiscal 2004 as their effect was anti-dilutive.

2.20 Derivative financial instruments

The company enters into foreign exchange forward 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 $88,000,000 and $149,000,000 as of March 31, 2003 and 2004, respectively. The foreign exchange forward contracts mature between one to 12 months.

2.21 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. 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.

Geographic segmentation is based on business sourced from that geographic region and delivered from both on-site and off-shore. 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.

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. Allocated expenses of the geographic segments include expenses incurred for rendering services from the company's offshore software development centers and on-site expenses. 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.

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.

2.21.1 Industry segments

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, net						13,865,294
Income before income taxes						192,413,201
Provision for income taxes						27,946,892
Net income						$164,466,309

2.21.1 Industry segments (contd.)

Year ended March 31, 2003

	Financial services	Manufacturing	Telecom	Retail	Others	Total
Revenues	$ 283,305,475	$ 123,755,305	$ 114,309,356	$ 85,841,812	$ 146,595,077	$ 753,807,025
Identifiable operating expenses	113,522,995	50,493,841	38,470,934	27,432,075	54,817,856	284,737,701
Allocated expenses	81,032,424	32,793,395	31,096,470	22,779,164	39,122,548	206,824,001
Segmental operating income	88,750,056	40,468,069	44,741,952	35,630,573	52,654,673	262,245,323
Unallocable expenses						43,601,127
Operating income						218,644,196
Other income, net						18,048,110
Income before income taxes						236,692,306
Provision for income taxes						41,822,265
Net income						$ 194,870,041

Year ended March 31, 2004

	Financial services	Manufacturing	Telecom	Retail	Others	Total
Revenues	$ 389,295,510	$ 156,817,111	$ 175,944,313	$ 123,789,209	$ 216,738,745	$ 1,062,584,888
Identifiable operating expenses	163,735,082	68,091,130	72,990,651	46,018,191	90,679,001	441,514,055
Allocated expenses	102,561,509	38,821,686	45,490,446	31,230,109	54,674,462	272,778,212
Segmental operating income	122,998,919	49,904,295	57,463,216	46,540,909	71,385,282	348,292,621
Unallocable expenses						55,176,568
Operating income						293,116,053
Other income, net						27,950,174
Income before income taxes						321,066,227
Provision for income taxes						50,775,927
Net income						$270,290,300

2.21.2 Geographic segments

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, net					13,865,294
Income before income taxes					192,413,201
Provision for income taxes					27,946,892
Net income					$ 164,466,309

Year ended March 31, 2003

	North America	Europe	India	Rest of the World	Total
Revenues	$ 550,075,653	$ 133,236,361	$ 16,132,922	$ 54,362,089	$ 753,807,025
Identifiable operating expenses	218,257,001	46,559,987	4,084,049	15,836,664	284,737,701
Allocated expenses	149,621,377	35,920,484	5,823,309	15,458,831	206,824,001
Segmental operating income	182,197,275	50,755,890	6,225,564	23,066,594	262,245,323
Unallocable expenses					43,601,127
Operating income					218,644,196
Other income, net					18,048,110
Income before income taxes					236,692,306
Provision for income taxes					41,822,265
Net income					$ 194,870,041

Year ended March 31, 2004

	North America	Europe	India	Rest of the World	Total
Revenues	$ 756,812,858	$ 204,350,661	$ 14,426,782	$ 86,994,587	$ 1,062,584,888
Identifiable operating expenses	317,978,761	82,552,540	3,949,627	37,033,127	441,514,055
Allocated expenses	193,007,959	51,844,725	3,590,587	24,425,457	272,868,728
Segmental operating income	245,826,138	69,953,396	6,886,568	25,536,003	348,202,105
Unallocable expenses					55,086,052
Operating income					293,116,053
Other income, net					27,950,174
Income before income taxes					321,066,227
Provision for income taxes					50,775,927
Net income					$ 270,290,300

2.21.3 Significant clients

No client individually accounted for more than 10% of the revenues in fiscal 2002, 2003 and 2004.

2.22 Litigation

The company is subject to legal proceedings and claims, which have arisen, in the ordinary course of its business. Legal actions, when ultimately concluded and determined, will not, in the opinion of management, have a material effect on the results of operations or the financial position of the company.

Ms. Jennifer Griffith, a former employee, has filed a lawsuit against the company and its former director, Mr. Phaneesh Murthy. The lawsuit has been served on the company. Management is reviewing the allegations. Based on its present knowledge of facts, management estimates that the lawsuit will not have material impact on the result of operation or financial position of the company.

2.23 Commitments and contingencies

The company has outstanding performance guarantees for various statutory purposes totaling $1,681,044 and $2,066,820 as of March 31, 2003 and 2004, respectively. These guarantees are generally provided to governmental agencies.

2.24 Subsequent event

The Board of Directors in its meeting on April 13, 2004, approved a 3:1 bonus issue subject to approval by the shareholders at the Annual General Meeting to be held on June 12, 2004. The Board also approved a stock dividend of 1 for 1 for ADS holders (i.e. 1 ADS for each ADS held). This will also result in the change in ratio of domestic shares to ADS from 1:2 to 1:1. Subject to the approval of the members in the Annual General Meeting on June 12, 2004, the record date for the bonus issue would be July 2, 2004. Share and per share information in the consolidated financial statements do not reflect the effect of these proposals. If approved, the proposals will require retroactive presentation of such information in subsequently issued consolidated financial statements.

Financial Statement Schedule – II

(Schedule II of Reg. §210.5-04(c) of Regulation S-X-17 of the Securities Act of 1933 and Securities Exchange Act of 1934)

Valuation and qualifying accounts

Allowance for doubtful accounts on trade accounts receivable

Description	Balance at beginning of period	Charged to cost and expenses	Write offs	Balance at end of period
Fiscal 2003	$ 3,941,245	$ 150,864	$ (1,081,541)	$ 3,010,568
Fiscal 2004	$ 3,010,568	$ 3,432,034	$ (3,363,804)	$ 3,078,798