Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Infosys Technologies Limited

We have audited the accompanying consolidated balance sheets of Infosys Technologies Limited and subsidiaries as of March 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended March 31, 2005. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule II. These consolidated financial statements and the financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Infosys Technologies Limited and subsidiaries as of March 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG

Bangalore, India

April 14, 2005 except for Note 2.23, as to which the date is April 22, 2005

INFOSYS TECHNOLOGIES LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF MARCH 31,

(Dollars in millions except share data)

	2004	2005
ASSETS		
Current Assets		
Cash and cash equivalents	$ 445	$ 410
Investments in liquid mutual fund units	218	278
Trade accounts receivable, net of allowances	150	303
Deferred tax assets	—	2
Prepaid expenses and other current assets	36	35
Unbilled revenue	24	32
Total current assets	873	1,060
Property, plant and equipment, net	228	352
Goodwill	8	8
Intangible assets, net	2	—
Deferred tax assets	7	8
Other assets	14	26
Total Assets	**$1,132**	**$1,454**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 1	$ 1
Client deposits	15	7
Other accrued liabilities	99	124
Income taxes payable	22	23
Unearned revenue	15	20
Total current liabilities	152	175
Non-current liabilities		
Preferred stock of subsidiary	22	21
Other non-current liabilities	5	5
Stockholders' Equity		
Common stock, $0.16 par value 300,000,000 equity shares authorized, Issued and outstanding –266,564,224 and 270,570,549 as of March 31, 2004 and 2005, respectively (See Note 2.11)	9	31
Additional paid-in capital	157	266
Accumulated other comprehensive income	39	33
Retained earnings	748	923
Total stockholders' equity	953	1,253
Total Liabilities And Stockholders' Equity	**$1,132**	**$1,454**

See accompanying notes to the consolidated financial statements

INFOSYS TECHNOLOGIES LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME FOR THE YEARS ENDED MARCH 31,

(Dollars in millions except share and per share data)

	2003	2004	2005
Revenues	**$ 754**	**$ 1,063**	**$ 1,592**
Cost of revenues (including amortization of stock compensation expenses of $3 million and $2 million for fiscal 2003 and 2004)	417	603	904
Gross profit	**337**	**460**	**688**
Operating Expenses:			
Selling and marketing expenses	56	77	103
General and administrative expenses	58	82	127
Amortization of stock compensation expenses	2	1	—
Amortization of intangible assets	2	7	2
Total operating expenses	118	167	232
Operating income	**219**	**293**	**456**
Gain on sale of long term investment	—	—	11
Other income, net	18	28	24
Income before income taxes	**237**	**321**	**491**
Provision for income taxes	42	51	72
Net income	**$ 195**	**$ 270**	**$ 419**
Earnings per equity share			
Basic	$ 0.74	$ 1.03	$ 1.57
Diluted	$ 0.73	$ 1.01	$ 1.52
Weighted average equity shares used in computing earnings per equity share			
(See Note 2.11)			
Basic	262,284,008	262,780,308	266,901,033
Diluted	265,916,036	267,166,236	273,590,413

See accompanying notes to the consolidated financial statements

INFOSYS TECHNOLOGIES LIMITED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(Dollars in millions)

	Common stock							
	Shares (See Note 2.11)	**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, 2002	**264,744,520**	**$ 9**	**$123**		**$ (46)**	**$ (8)**	**$ 364**	**$ 442**
Common stock issued	227,792		3		—	—	—	3
Cash dividends	—	—	—		—	—	(34)	(34)
Income tax benefit arising on exercise of stock options	—	—	1		—	—	—	1
Amortization of compensation related to stock option grants	—	—	—		—	5	—	5
Comprehensive income								
Net income	—	—	—	$195	—	—	195	195
Other comprehensive income								
Translation adjustment	—	—	—	14	14	—	—	14
Comprehensive income				$209				
Balance as of March 31, 2003	**264,972,312**	**$ 9**	**$127**		**$ (32)**	**$ (3)**	**$ 525**	**$ 626**
Common stock issued	1,591,912	—	27		—	—	—	27
Cash dividends	—	—	—		—	—	(47)	(47)
Income tax benefit arising on exercise of stock options	—	—	3		—	—	—	3
Amortization of compensation related to stock option grants	—	—	—		—	3	—	3
Comprehensive income								
Net income	—	—	—	$270	—	—	270	270
Other comprehensive income								
Translation adjustment	—	—	—	71	71	—	—	71
Comprehensive income				$341				
Balance as of March 31, 2004	**266,564,224**	**$ 9**	**$157**		**$ 39**	**—**	**$ 748**	**$ 953**
Common stock issued	4,006,325	—	99		—	—	—	99
Cash dividends	—	—	—		—	—	(222)	(222)
Income tax benefit arising on exercise of stock options	—	—	10		—	—	—	10
Stock split effected in the form of a stock dividend (See Note 2.11)	—	22			—	—	(22)	—
Comprehensive income								
Net income	—	—	—	$419	—	—	419	419
Other comprehensive income								
Translation adjustment	—	—	—	(6)	(6)	—	—	(6)
Comprehensive income				$413				
Balance as of March 31, 2005	**270,570,549**	**$ 31**	**$266**		**$ 33**	**—**	**$ 923**	**$1,253**

See accompanying notes to the consolidated financial statement

INFOSYS TECHNOLOGIES LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED MARCH 31,

(Dollars in millions)

	2003	2004	2005
OPERATING ACTIVITIES:			
Net income	**$195**	**$ 270**	**$ 419**
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	37	45	64
Amortization of intangible assets	2	7	2
Provision for investments	3	2	—
Gain on sale of long term investment	—	—	(11)
Deferred taxes	(2)	1	(3)
Amortization of stock compensation expenses	5	3	—
Changes in assets and liabilities			
Trade accounts receivable	(38)	(27)	(150)
Prepaid expenses and other current assets	(5)	(8)	2
Unbilled revenue	(15)	(1)	(9)
Income taxes	(4)	26	8
Accounts payable	—	(1)	—
Client deposits	1	11	(8)
Unearned revenue	9	—	6
Other accrued liabilities	23	44	24
Net cash provided by operating activities	**211**	**372**	**344**
Investing Activities:			
Expenditure on property, plant and equipment	(43)	(93)	(186)
Expenditure on intangible assets	(4)	—	—
Loans to employees	(7)	4	2
Purchase of subsidiary, net of cash acquired	—	(10)	—
Investments in liquid mutual fund units	—	(205)	(100)
Redemption of liquid mutual fund units	—	—	40
Non-current deposits with corporations	—	—	(15)
Proceeds from sale of long term investment	—	—	11
Net cash used in investing activities	**(54)**	**(304)**	**(248)**
Financing Activities:			
Proceeds from issuance of common stock	3	27	99
Proceeds from issuance of preferred stock by subsidiary	10	10	—
Payment of dividends	(34)	(47)	(222)
Net cash used in financing activities	**(21)**	**(10)**	**(123)**
Effect of exchange rate changes on cash	8	33	(8)
Net increase in cash and cash equivalents during the period	144	91	(35)
Cash and cash equivalents at the beginning of the period	210	354	445
Cash and cash equivalents at the end of the period	**$354**	**$ 445**	**$ 410**
Supplementary information:			
Cash paid towards taxes	$ 45	$ 24	$ 66
Stock split effected in the form of a stock dividend (see Note 2.11)			

See accompanying 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 subsidiary, Progeon Limited (Progeon), and wholly-owned subsidiaries Infosys Technologies (Australia) Pty. Limited (Infosys Australia), Infosys Technologies (Shanghai) Co. Limited (Infosys China) and Infosys Consulting Inc. (Infosys Consulting) is a leading global technology services firm. 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 and revenue from the end of the last billing to the balance sheet date is recognized as unbilled revenues. Revenue from fixed-price, fixed-timeframe contracts is recognized as per the percentage-of-completion method. Guidance has been drawn from paragraph 95 of Statement of Position (SOP) 97-2, Software Revenue Recognition, 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-timeframe 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, 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-timeframe basis. 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 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	Vehicles	5 years
Plant and equipment	5 years	Computer equipment	2-5 years
Furniture and fixtures	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 is 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, Infosys China and Infosys Consulting 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. Diluted earnings per share reflects the potential dilution from equity shares issuable through employee stock options and preferred stock of subsidiary. The dilutive effect of employee stock options is reflected in diluted earnings per share by application of the treasury stock method. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the if-converted method. If securities have been issued by a subsidiary that enable their holders to obtain the subsidiary's common stock, the earnings of the subsidiary shall be included in the consolidated diluted earnings per share computations based on the consolidated group's holding of the subsidiary's securities.

If the number of common shares outstanding increases as a result of a stock dividend or stock split or decreases as a result of a reverse stock split, the computations of basic and diluted earnings per share are adjusted retroactively for all periods presented to reflect that change in capital structure. If such changes occur after the close of the reporting period but before issuance of the financial statements, the per-share computations for that period and any prior-period financial statements presented are based on the new number of shares.

1.14 Income taxes

Income taxes are accounted 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 of deductions 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, 2004 and 2005 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. Limits 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

The company enters into foreign exchange forward contracts where the counterparty 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 the company believes that 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 of Infosys 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 pension fund. The rate at which the annual interest is payable to the beneficiaries by the trust is being administered by the government. The company has an obligation to fund any shortfall on the yield of the trust's investments over the administered interest rates.

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.

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 exceeds 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 No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

(Dollars in millions except share and per share data)	Year ended March 31,		
	2003	2004	2005
Net income, as reported	$ 195	$ 270	$ 419
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	5	3	—
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(62)	(50)	(26)
Pro forma net income	$ 138	$ 223	$ 393
Earnings per share: (See Note 2.11)			
Basic – as reported	$0.74	$1.03	$1.57
Basic – pro forma	$0.52	$0.85	$1.47
Diluted – as reported	$0.73	$1.01	$1.52
Diluted – pro forma	$0.52	$0.84	$1.43

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,		
	2003	2004	2005
Dividend yield %	0.2%	0.2%	—
Expected life	1-5 years	1-5 years	—
Risk free interest rate	6.0%	5.1-5.7%	—
Volatility	60-75%	60-75%	—

There have been no grants of stock options by Infosys Technologies Limited during fiscal 2005.

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 Recent Accounting Pronouncement

In December 2004, the Financial Accounting Standards Board issued FASB Statement No. 123 (revised 2004), Share-Based Payment requiring companies to change their accounting policies to record the fair value of stock options issued to employees as an expense. Currently, the company does not deduct the expense of employee stock option grants from its income based on the fair value method as it has adopted the pro forma disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation. The revised Statement eliminates the alternative to use APB Opinion 25's intrinsic value method of accounting that was provided in Statement 123 as originally issued. The unamortized stock compensation expense as of March 31, 2005, determined under the fair value method is approximately $15 million. Pursuant to the Securities and Exchange Commission Release No. 33-8568, the company is required to adopt SFAS 123R from April 1, 2006.

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:

(Dollars in millions)

	As of March 31, 2004	As of March 31, 2005
Cost and fair values		
Cash and bank deposits	$397	$361
Deposits with corporations	48	49
	$445	$410

2.2 Trade accounts receivable

Trade accounts receivable as of March 31, 2004 and 2005, net of allowance for doubtful accounts of $3 million and $4 million, amounted to $150 million and $303 million. The age profile of trade accounts receivable, net of allowances is given below.

In %

As of March 31,	2004	2005
Period (in days)		
0 – 30	69.7	55.2
31 – 60	21.6	32.2
61 – 90	4.7	4.6
More than 90	4.0	8.0
	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 approximately $14 million. The purchase consideration includes approximately $3 million 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:

(Dollars in millions)

Component	Purchase price allocated
Plant and equipment	$ 1
Net current assets	5
Non current liabilities	(1)
Customer contracts	2
Goodwill	7
Total purchase price	$14

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:

(Dollars in millions)

	As of March 31,	
	2004	2005
Rent deposits	$ 3	$ 4
Security deposits with service providers	2	4
Loans to employees	13	15
Prepaid expenses	13	11
Other current assets	5	1
	$36	$35

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:

(Dollars in millions)

	As of March 31,	
	2004	2005
Land	$ 21	$ 27
Buildings	106	168
Furniture and fixtures	59	79
Computer equipment	107	141
Plant and equipment	65	91
Capital work-in-progress	48	73
	406	579
Accumulated depreciation	(178)	(227)
	$ 228	$ 352

Depreciation expense amounted to $37 million, $45 million and $64 million for fiscal 2003, 2004 and 2005. The amount of third party software amortized during fiscal 2003, 2004 and 2005 was $12 million, $14 million and $26 million.

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 $4 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 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 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 $4 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.

2.7 Other assets

Other assets consist of the following:

(Dollars in millions)

	As of March 31,	
	2004	**2005**
Non-current portion of loans to employees	$ 14	$10
Non-current deposits with corporations	—	15
Others	—	1
	$ 14	$26

2.8 Related parties

The company provides loans to eligible employees in accordance with policy. No loans have been made to employees in connection with equity issues. The employee 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%. Loans aggregating $27 million and $25 million were outstanding as of March 31, 2004 and 2005.

The required repayments of employee loans outstanding as of March 31, 2005 are as detailed below.

(Dollars in millions)

Fiscal year of repayment	Repayment
2006	$15
2007	4
2008	2
2009	3
2010	1
	$25

The estimated fair values of related party receivables amounted to $24 million and $21 million as of March 31, 2004 and 2005. 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:

	(Dollars in millions) As of March 31,	
	2004	2005
Accrued compensation to staff	$71	$ 66
Provision for post sales client support	1	7
Withholding taxes payable	9	14
Provision for expenses	16	32
Retainage	1	3
Others	1	2
	$99	$124

2.10 Employee post-retirement benefits

2.10.1 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 2003, 2004 and 2005. The measurement date used is March 31 of the relevant fiscal year.

	(Dollars in millions) Year ended March 31,		
	2003	2004	2005
Change in benefit obligations			
Benefit obligations at the beginning of the year	$ 16	$ 19	$ 30
Unrecognized actuarial loss	—	5	(2)
Service cost	2	4	5
Interest cost	1	1	2
Benefits paid	—	(1)	(1)
Effect of exchange rate changes	—	2	—
Benefit obligations at the end of the year	$ 19	$ 30	$ 34
Change in plan assets			
Fair value of plan assets at the beginning of the year	$ 13	$ 16	$ 24
Effect of exchange rate changes	—	2	—
Actual return on plan assets	1	2	2
Employer contributions	2	5	6
Benefits paid	—	(1)	(1)
Plan assets at the end of the year	$ 16	$ 24	$ 31
Funded status	$ (3)	$ (6)	$ (3)
Excess of actual return over estimated return on plan assets	1	(1)	(1)
Unrecognized actuarial loss	2	7	4
(Accrued) / prepaid benefit	$—	$—	$—

Net gratuity cost for fiscal 2003, 2004 and 2005 comprises the following components:

	Year ended March 31,		
	2003	2004	2005
Service cost	$ 2	$ 4	$ 5
Interest cost	1	1	2
Expected return on assets	—	(1)	(1)
Net gratuity cost	$ 3	$ 4	$ 6

The assumptions used in accounting for the gratuity plan in fiscal 2003, 2004 and 2005 are set out below.

	Year ended March 31, 2003	2004	2005
Discount rate	7.0%	5.2%	6.7%
Rate of increase in compensation levels	5.0-7.0%	5.1%	5.1%
Rate of return on plan assets	7.0%	5.2%	6.7%

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, 2005, 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 2003, 2004 and 2005 have not been lower than the expected rate of return on plan assets estimated for those years.

Accumulated benefits obligation was $7 million and $10 million as of March 31, 2004 and 2005.

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

(Dollars in millions)

Year ending March 31,	
2006	$1
2007	$1
2008	$1
2009	$2
2010	$2
2011-2015	$8

The expected benefits are based on the same assumptions used to measure the company's benefit obligations as of March 31, 2005.

The company expects to contribute approximately $7 million to the gratuity trusts during fiscal 2006.

2.10.2 Superannuation

The company contributed $1 million, $2 million and $4 million to the superannuation plan in fiscal 2003, 2004 and 2005.

2.10.3 Provident fund

The company contributed $4 million, $6 million and $10 million to the provident fund in fiscal 2003, 2004 and 2005.

2.11 Stockholders' equity

Infosys has only one class of capital stock referred to as equity shares. On June 12, 2004, the members of the company approved a 3:1 bonus issue on the equity shares of the company. The bonus issue has the nature of a stock split effected in the form of a stock dividend with three additional shares being issued for every share held. Bonus shares have been allotted to shareholders on July 3, 2004. The computations of basic and diluted earnings per share has been adjusted retroactively for all periods presented to reflect the change in capital structure. All references in these financial statements to number of shares, per share amounts and exercise price of stock option grants 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. Each ADS represents 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 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 plans.

2.12 Preferred stock of subsidiary

Infosys holds a majority 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 approximating $5 million. 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 approximating $20 million.

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 Progeon 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 Progeon. Each preference share is convertible into one equity share of par value $0.20 each. Indian law requires redemption of preference shares within a period of 20 years.

2.13 Non-operating income

In fiscal 2005, the Company sold its investment in Yantra Corporation. The carrying value of the investment in Yantra Corporation was completely written down in fiscal 1999. Consideration received from the sale resulted in a gain of $11 million. There is a further consideration of $1 million, subject to contractual contingencies, receivable by April 2006. No gain has been recognized on the contingent portion.

Other income, net, consists of the following:

(Dollars in millions)

	Year ended March 31,		
	2003	**2004**	**2005**
Interest income	$ 17	$18	$ 17
Income from mutual fund investments	—	4	9
Exchange gains/(losses), net	4	8	(2)
Provision for investments	(3)	(2)	—
	$ 18	$28	$ 24

In fiscal 2003, the company provided for write-downs to investments in the aggregate amount of approximately $3 million. These included $1.5 million each for investments in Asia Net Media BVI Limited and Workadia Inc. The provisions during fiscal 2004 include write-downs to investments in CiDRA Corporation of $1.5 million, and $0.4 million toward investment in Stratify Inc. 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.

2.14 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 2003, 2004 and 2005 were $6 million, $9 million and $9 million.

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

(Dollars in millions)

Year ending March 31,	
2006	$ 6
2007	6
2008	6
2009	4
2010	3
Thereafter	6
Total	$31

2.15 Research and development

Research and development expenses were $3 million, $9 million and $17 million for fiscal 2003, 2004 and 2005.

2.16 Employees' Stock Offer Plans (ESOP)

In September 1994, the company established the 1994 plan, which provided for the issue of 24,000,000 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 million and $3 million for fiscal 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 5,880,000 equity shares representing 5,880,000 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 26,400,000 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 five years from the date of completion of vesting.

The activity in the warrants/equity shares of the 1994, 1998 and 1999 ESOP in fiscal 2003, 2004 and 2005 are set out below.

	2003		2004		2005	
	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	1,285,600	—	1,272,800	—	1,266,400	
Granted	—	—	—	—	—	
Forfeited	(12,800)	$ 0.3	(6,400)	$ 0.3	—	—
Exercised	—	—	—	—	(1,266,400)	$ 0.3
Outstanding at the end of the period	1,272,800		1,266,400		—	
1998 Option plan:						
Outstanding at the beginning of the period	4,524,988	—	5,006,812		3,871,008	
Granted	1,160,400	$ 31	191,800	$ 24	—	—
Forfeited	(499,496)	$ 23	(809,864)	$ 38	(230,918)	$ 42
Exercised	(179,080)	$ 12	(517,740)	$ 15	(585,800)	$ 36
Outstanding at the end of the period	5,006,812		3,871,008		3,054,290	
Exercisable at the end of the period	1,260,008		1,543,504		1,920,642	
Weighted-average fair value of options granted during the period	—	$ 8	—	$ 6	—	—
1999 Option plan:						
Outstanding at the beginning of the period	18,675,260	—	20,244,684	—	18,362,120	
Granted	2,467,400	$ 20	771,200	$ 17	—	—
Forfeited	(849,264)	$ 24	(1,579,592)	$ 25	(886,658)	$ 26
Exercised	(48,712)	$ 14	(1,074,172)	$ 18	(3,420,525)	$ 22
Outstanding at the end of the period	20,244,684		18,362,120		14,054,937	
Exercisable at the end of the period	4,890,556		8,448,480		9,579,297	
Weighted-average fair value of options granted during the period	—	$ 9	—	$ 7		—

The following table summarizes information about stock options outstanding as of March 31, 2005.

Range of exercise prices per share ($)	Options Outstanding			Options Exercisable	
	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
1998 Plan					
9-25	773,955	4.7	$ 20	338,579	$ 18
26-50	1,818,495	4.6	$ 39	1,120,223	$ 44
51-75	195,640	3.6	$ 60	195,640	$ 60
76-100	209,200	3.1	$ 81	209,200	$ 81
101-165	57,000	2.9	$130	57,000	$130
	3,054,290			1,920,642	
1999 Plan					
13-25	8,411,661	4.5	$ 19	4,181,121	$ 20
26-50	5,574,476	3.8	$ 35	5,329,376	$ 35
51-70	68,800	2.9	$ 54	68,800	$ 54
	14,054,937			9,579,297	

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 whose members are directors of Progeon. 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 Progeon 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 Progeon's 2002 Plan in fiscal 2003, 2004 and 2005 are set out below.

	2003		2004		2005	
	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
2002 Option plan:						
Outstanding at the beginning of the period	—		1,801,175		3,124,625	
Granted	1,801,175	$0.69	1,401,150	$1.39	432,900	$2.65
Forfeited	—		(77,700)	$0.79	(327,357)	$1.52
Exercised	—		—	—	(113,650)	$0.72
Outstanding at the end of the period	1,801,175	$0.69	3,124,625	$1.00	3,116,518	$1.18

The weighted average fair value of options granted by Progeon during fiscal 2003, 2004 and 2005 were $0.30, $0.60 and $1.01, respectively.

The outstanding options of Progeon as of March 31, 2005 have a weighted average remaining contractual life of 1.9 years. 662,191 options were exercisable as of March 31, 2005 with a weighted average exercise price of $0.90.

__2.17 Income taxes__

The provision for income taxes in the income statement comprises:

(Dollars in millions)

	Year ended March 31,		
	2003	**2004**	**2005**
Current taxes			
Domestic taxes	$19	$ 10	$ 20
Foreign taxes	25	40	55
	44	50	75
Deferred taxes			
Domestic taxes	(1)	1	—
Foreign taxes	(1)	—	(3)
	(2)	1	(3)
Aggregate taxes	$42	$ 51	$ 72

All components of the aggregate taxes of $42 million, $51 million and $72 million for fiscal 2003, 2004 and 2005 are allocated to the continuing operations of the company. Tax benefits of $3 million and $10 million earned on exercise of employee stock options have been credited to additional paid in capital during fiscal 2004 and fiscal 2005.

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:

(Dollars in millions)

	As of March 31,	
	2004	**2005**
Deferred tax assets:		
Property, plant and equipment	$ 6	$ 8
Allowances on trade accounts receivable	1	1
Investments	3	1
Compensated absences and other accruals	1	1
	11	11
Less: Valuation allowance	(2)	(1)
	9	10
Deferred tax liabilities		
Gains on foreign exchange forward contracts	(1)	—
Intangible assets	(1)	—
	(2)	—
Net deferred tax assets	$ 7	$ 10

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, 2005. The valuation allowance relates to 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 2002, the valuation allowance was $1 million. The valuation allowance increased by $1 million during the year ended March 31, 2004. The valuation allowance decreased by $1 million during the year ended March 31, 2005.

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

(Dollars in millions)

	Year ended March 31,		
	2003	**2004**	**2005**
Income before income taxes	$ 237	$ 321	$ 491
Enacted tax rates in India	36.75%	35.88%	36.59%
Computed expected tax expense	$ 87	$ 115	$ 180
Tax effect due to non-taxable income for Indian tax purposes	(51)	(78)	(126)
Effect of differential foreign tax rates	3	7	9
Others	3	7	9
Aggregate taxes	$ 42	$ 51	$ 72

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 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). The Government of India has 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 tax holidays on all facilities under STPs expire in stages by 2009.

Infosys 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 U.S. branch during the fiscal year, computed in accordance with the Internal Revenue Code. At March 31, 2005, Infosys’ US branch net assets amounted to approximately $187 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.

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:

	Year ended March 31, 2003	2004	2005
Basic earnings per equity share – weighted average number of common shares outstanding excluding unallocated shares of ESOP	262,284,008	262,780,308	266,901,033
Effect of dilutive common equivalent shares – stock options outstanding	3,632,028	4,385,928	6,689,380
Diluted earnings per equity share – weighted average number of common shares and common equivalent shares outstanding	265,916,036	267,166,236	273,590,413

Options to purchase 678,590 shares under the 1998 Plan and 2,107,416 shares under the 1999 Plan were not considered for calculating diluted earnings per share for fiscal 2005 as their effect was anti-dilutive.

The computation of basic and diluted earnings per share has also been adjusted retroactively for all periods presented to reflect the change in capital structure. See Note 2.11

2.19 Derivative financial instruments

The company enters into foreign exchange forward contracts where the counterparty 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 $149 million and $353 million as of March 31, 2004 and 2005, respectively. The foreign exchange forward contracts mature between one to 12 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. 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 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. 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 assets 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.

2.20.1 Industry segments

(Dollars in millions)

Year ended March 31, 2003	**Financial services**	**Manufacturing**	**Telecom**	**Retail**	**Others**	**Total**
Revenues	$283	$124	$114	$86	$147	$754
Identifiable operating expenses	114	50	38	27	55	284
Allocated expenses	81	33	31	23	39	207
Segmental operating income	88	41	45	36	53	263
Unallocable expenses						44
Operating income						219
Other income, net						18
Income before income taxes						237
Provision for income taxes						42
Net income						$195

Year ended March 31, 2004	**Financial services**	**Manufacturing**	**Telecom**	**Retail**	**Others**	**Total**
Revenues	$389	$157	$176	$124	$217	$1,063
Identifiable operating expenses	164	68	73	46	91	442
Allocated expenses	103	39	45	31	55	273
Segmental operating income	122	50	58	47	71	348
Unallocable expenses						55
Operating income						293
Other income, net						28
Income before income taxes						321
Provision for income taxes						51
Net income						$ 270

Year ended March 31, 2005	Financial services	Manufacturing	Telecom	Retail	Others	Total
Revenues	$549	$231	$295	$155	$362	$1,592
Identifiable operating expenses	232	99	122	63	142	658
Allocated expenses	147	55	71	37	102	412
Segmental operating income	170	77	102	55	118	522
Unallocable expenses						66
Operating income						456
Gain on sale of long term investment						11
Other income, net						24
Income before income taxes						491
Provision for income taxes						72
Net income						$ 419

2.20.2 Geographic segments

(Dollars in millions)

Year ended March 31, 2003	North America	Europe	India	Rest of the World	Total
Revenues	$550	$133	$16	$55	$754
Identifiable operating expenses	218	47	4	16	285
Allocated expenses	150	36	6	15	207
Segmental operating income	182	50	6	24	262
Unallocable expenses					43
Operating income					219
Other income, net					18
Income before income taxes					237
Provision for income taxes					42
Net income					$195

Year ended March 31, 2004	North America	Europe	India	Rest of the World	Total
Revenues	$757	$204	$14	$88	$1,063
Identifiable operating expenses	318	83	4	37	442
Allocated expenses	193	52	4	24	273
Segmental operating income	246	69	6	27	348
Unallocable expenses					55
Operating income					293
Other income, net					28
Income before income taxes					321
Provision for income taxes					51
Net income					$ 270

Year ended March 31, 2005	North America	Europe	India	Rest of the World	Total
Revenues	$1,038	$355	$30	$169	$1,592
Identifiable operating expenses	433	141	7	77	658
Allocated expenses	258	84	7	64	413
Segmental operating income	347	130	16	28	521
Unallocable expenses					65
Operating income					456
Gain on sale of long term investment					11
Other income, net					24
Income before income taxes					491
Provision for income taxes					72
Net income					$ 419

2.20.3 Significant clients

No client individually accounted for more than 10% of the revenues in fiscal 2003, 2004 and 2005.

2.21 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.

2.22 Commitments and contingencies

The company has outstanding performance guarantees for various statutory purposes totaling $2 million and $4 million as of March 31, 2004 and 2005. These guarantees are generally provided to governmental agencies.

2.23 Tax contingencies

On April 15, 2005, the company received a demand from the Indian tax authorities for payment of additional tax of $11 million, including interest of $3 million, upon completion of their tax review for fiscal 2002. The tax demand is mainly on account of disallowance of a portion of the deduction to its taxable income under Indian law claimed by the company under Section 10A of the Income-tax Act. Deduction under Section 10A of the Income-tax Act is determined by the ratio of “Export Turnover” to “Total Turnover”. The disallowance arose from certain expenses incurred in foreign currency being reduced from Export Turnover but not also reduced from Total Turnover.

The company intends to contest the demand and management, including its tax advisers, believes that its position will likely be upheld in the appellate process. No tax expense has been accrued in the financial statements for the tax demand raised. Management believes that the ultimate outcome of this proceeding will not have a material adverse effect on the company’s financial position and results of operations.

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

($ in millions)

Description	Balance at beginning of the period	Charged to cost and expenses	Write offs	Balance at end of the period
Fiscal 2004	$3	$3	$(3)	$3
Fiscal 2005	$3	$5	$(4)	$4