

AUDITORS' REPORT

TO THE MEMBERS OF BHARAT SANCHAR NIGAM LIMITED

- A. We have audited the attached Balance Sheet of Bharat Sanchar Nigam Limited as at 31st March 2004 and the related Profit and Loss Account and Cash Flow Statement for the year ended on that date annexed thereto, which we have signed under reference to this report. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- B. We conducted our audit in accordance with the auditing standards generally accepted in India. 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 audit provides a reasonable basis for our opinion.
- C. We did not audit the financial statements of 49 units (circles, districts, regions, training institutions and factories), whose financial statements reflect total assets of Rs. 952,567,038 thousands as at 31st March, 2004 and total revenues of Rs. 317,562,843 thousands for the year ended on that date. These financial statements have been audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included in the financial statements in respect of these units, is based solely on the report of the other auditors.
- D. As required by the Companies (Auditor's Report) Order, 2003 issued by the Central Government of India in terms of sub-section (4A) of section 227 of 'The Companies Act, 1956' of India (the 'Act') and on the basis of such checks as we considered appropriate and according to the information and explanations given to us and reports of other auditors, we set out in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the said Order.
- E. Attention is drawn to the following:

Assets taken over from Department of Telecommunications ("DoT") and DoT balances

- As referred to in Notes 2.1, 5.1, 5.2, 5.6 and 5.7 on Schedule U forming part of the Accounts, net assets (including contingent liabilities) taken over from DoT as on 1st October 2000 have been verified and valued by the management based on internal calculations, and are subject to confirmation from DoT as regards their ownership and value. Consequently we are unable to comment upon whether all assets and liabilities transferred pursuant to the Memorandum of Understanding referred to in Note 2.1 on Schedule U have actually been accounted for or not.*
- As referred to in Note 7.1 on Schedule U, a net amount of Rs. 134,766 thousands recoverable on current account from DoT is subject to confirmation, reconciliation and consequential adjustments.*

License Fee, Spectrum Charges, Inter connect Usage Charges

3. *As stated in Note 12.1 on Schedule U, the Company does not have a system of identifying NLD revenue separately based on the actual usage of pulse. In the absence of such a system it is not possible to quantify the license fee on actual NLD revenue and its impact on the accounts.
Further, the Company has changed its basis for computing NLD revenue for the purpose of calculating license fee. The resultant impact of the change in accounting estimate has not been ascertained, which is not in accordance with AS- 5 "Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies".*
4. *As referred to in Note 11.2 on Schedule U, IUC Charges payable to and receivable from MTNL amounting to Rs.4,502,264 and Rs.12,169,876 thousands respectively and the adjustment to the extent of Rs.2,318,333 thousands of IUC receivable from MTNL against the amount payable to MTNL as interest accrued on bonds, are subject to confirmation, reconciliation and consequential adjustments.*
5. *As referred to in Note 11.3 on Schedule U, no provision has been made for telecom traffic charges payable to Bangladesh Telegraph and Telephone Board and Pakistan Telecom Company Limited for the years ended March 31,2003 and 2004, the quantum of which could not be ascertained. Further the net claim of Rs.1,291,214 thousands payable to Bangladesh Telegraph and Telephone Board and Pakistan Telecom Company Limited has been accounted for as recoverable from DoT, which is subject to confirmation by DoT.*

Retirement Benefits

6. *No provision has been made in these accounts for leave encashment liability in respect of unavailed leave balance as on 1st October 2000, the extent of which has not been ascertained.*
7. *As mentioned in Note 9.3 on Schedule U, no provision has been made in the financial statement for incremental pension liability for the period upto 30.09.2000 resulting from revision of pay scale as on 1st October 2000 which according to the Company's management is to be borne by DoT. However, no confirmation has been received from DoT in this regard.*
8. *No provision has been made in the accounts for gratuity for directly recruited employees. Further, as referred to in Note 9.2 on Schedule U the liability for leave encashment for absorbed employees and directly recruited employees has been provided on an estimated basis, which is not in accordance with Accounting Standard ("AS") -15 "Accounting for Retirement Benefits" issued by the Institute of Chartered Accountants of India ("ICAI") which requires retirement benefits to be provided on the basis of actuarial valuation.*

Cash Basis of Accounting

9. *As stated in Note 2.1 on Schedule T, certain items are accounted for on cash basis, instead of accrual basis, which is not in accordance with the generally accepted accounting principles in India. The impact of such accounting on the profits for the year has not been ascertained.*

Summary

10. *The resultant impact of observations stated in paragraphs 1 to 9 above on the assets, liabilities and profits has not been quantified by the management.*

Fixed Assets and Capital Work-in-Progress

11. *As stated in Note 5.9 on Schedule U, the net book value of Rs 1,508,250 thousands relating to phased out assets has not been adjusted against the carrying value of fixed assets. Consequently depreciation has been provided on such phased out assets. The fixed assets are overstated by Rs 1,508,250 thousands and net profit for the year is understated by Rs 231,215 thousands.*
12. *The observations stated in paragraphs 12.1 to 12.17 below are based on the observations made by the branch auditors in their report and which we have discussed with the management. The resultant impact arising out of these observations on the assets, liabilities and profits of the Company as a whole has not been quantified by the management. However, a few units have quantified the impact which has been included in the respective paragraphs.*

Fixed Assets and Capital Work-in-Progress

- 12.1 *As referred to in Note 5.8 on Schedule U, provision for abandoned/ old outstanding projects as identified by 3 units stood at Rs. 468,432 thousands as at March 31,2004. Pending completion of the review of such projects at other units further provision, if any, is not currently ascertainable.*
- 12.2 *Capital Work in Progress amounting to Rs. 3,037,600 thousands identified by 10 units has not been capitalized pending analysis of status, value and receipt of commissioning certificates. Other units are in the process of identifying such assets. Pending completion of capitalization, the depreciation under provided, if any, on such assets is not ascertainable.*
- 12.3 *As stated in Note 5.3 on Schedule U, the Company has provided depreciation on fixed assets taken over from DoT considering such transfer value as original cost. The Company has not computed the remaining useful life of assets and no revision in rates of depreciation has been made. The depreciation method followed is not in accordance with AS 6 – “Depreciation Accounting” issued by the ICAI and the extent of shortfall in depreciation charge for the year could not be ascertained.*
- 12.4 *As referred to in Note 5.5 on Schedule U, in the absence of information relating to cost of lease-hold land, no adjustment has been made in the accounts towards amortization of the cost of such leasehold land.*

Current assets, Loans and Advances and Current liabilities

- 12.5 *The Management is in the process of reconciling the various differences in the balances between the subsidiary records and the control accounts at the circles.*
- 12.6 *The purchase cost of inventory in certain locations, does not include all costs incurred in bringing the inventories to their present location and condition, the extent of which has not been quantified.*

- 12.7 As referred to in Note 6.2 on Schedule U, provision for obsolete items of inventory aggregating to Rs 476,458 thousands identified by 15 units has been made. *Pending completion of the review at other units, further provision required, if any, is not currently ascertainable.*
- 12.8 As stated in Note 8.1 on Schedule U, Bank Reconciliation Statements have not been prepared at several units. 7 units have reported unmatched reconciling items in the bank reconciliation statements aggregating to Rs.67,943 thousands.
- 12.9 The adequacy or otherwise of the provision for doubtful debts amounting to Rs 22,103,567 thousands as at March 31st, 2004 (including Rs 5,605,374 thousands provided during the year) could not be verified in the absence of relevant information.
- 12.10 As stated in Note 8.2 on Schedule U Cash and Bank balances include Rs 61,442 thousands representing balance in contra accounts which could not be verified by us in the absence of the relevant information.
- 12.11 There have been frauds reported by 11 circles which are under investigation by the vigilance wing of the Company against which an estimated loss of Rs. 403,243 thousands has been provided in these accounts. Pending completion of the investigation, the ultimate financial impact is not ascertainable.

Revenue

- 12.12 As referred to in Significant Accounting Policies on Schedule T, revenue from reciprocal services between the Circle, MTNL and DoT has not been accounted for.
- 12.13 The exchange wise reconciliation of outgoing metered calls and calls billed has not been done in most of the circles of the Company. Consequently the completeness of the bills raised vis-a-vis calls metered could not be verified and to that extent the correctness of the provision for revenue sharing as well as for licence fee payable could not be ascertained.

Inter/Intra circle remittance Account

- 12.14 As stated in Note 13 on Schedule U no adjustment has been made in respect of net difference of Rs 2,449,353 thousands pending reconciliation of inter/intra circle account balances.

Others

- 12.15 As stated in Note 23 (f) on Schedule U, at certain units contingent liabilities have not been ascertained.
- 12.16 In the absence of a system for identifying qualifying assets and the period of time required to get such assets ready for their intended use, the borrowing costs that may be directly attributable are not capitalized as part of the cost of the asset, which is not in accordance with AS – 16 on "Borrowing Costs" issued by ICAI.
- 12.17 As stated in Note 18 on Schedule U, in the absence of necessary details, the Company has not disclosed the cancellable and non-cancellable leases as required by AS-19 on "Leases" issued by ICAI.

Disclosure Under Schedule VI

- 13 *The Company has not made following disclosures required under Schedule VI to the Companies Act, 1956 as per references given after each item:*
- 13.1 *Bifurcation of Land as Freehold and Leasehold.*
- 13.2 *Classification of Sundry Debtors as "Secured" (to the extent of Security Deposits held by the Company).*
- 13.3 *Bifurcation of Sundry Debtors into debts outstanding for a period exceeding six months and other debts.*
- 13.4 *Classification of Cash and Bank balances into cash balances in hand and bank balances and not as balances in contra accounts.*
- 13.5 *Estimated amount of contract remaining to be executed on capital account and not provided for, to the extent not ascertained as stated in Note 25 on Schedule U.*
- 13.6 *Quantity and Value wise break up of closing stock of finished goods and consumption of raw materials*
- 13.7 *Consumption of stores and spares.*
- 13.8 *CIF Value of imports if any, in respect of (a) Raw materials (b) Components and Spare parts and (c) Capital goods.*
- 13.9 *Consumption of imported and indigenous raw materials and spares and percentage to the total consumption.*
- 13.10 *Deferred payment liabilities repayable within one year.*
- 13.11 *Loans and Advances to employees a part of which is secured by hypothecation /mortgage of motor cars and scooters and land (amount not ascertained) have been disclosed as "unsecured".*
- 13.12 *Amount due to Small Scale Industrial Undertakings(SSIs) and the names of the SSIs to whom the amounts due are outstanding for more than 30 days.*
- 13.13 *As stated in Note 6.3 on Schedule U the internal profit of Rs 23,159 thousands for the year has been netted off against administrative expenses since it is not possible to identify the individual items of stores which have been capitalized or expensed.*
- 13.14 *An Unsecured loan in perpetuity has been disclosed as a separate line item "Deferred Government Grant" in the balance sheet.*

Others

- 13.15 *Certain branch auditors have commented on the weaknesses and lacunae in the financial accounting software used by the Company.*

F. Further to our comments in the Annexure referred to in paragraph 'D' above, we report that:

- (a) *Subject to paragraphs 1 to 9 and 12 above and Notes 1 to 4 on Cash Flow Statement*, we have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit;
- (b) In our opinion, *subject to paragraphs 1,3,9 & 12 above and II (c) of the Annexure to the Auditors' Report* , proper books of account as required by law have been kept by the Company so far as appears from our examination of those books;
- (c) *Subject to paragraphs 1,3,9 & 12 above and II(c) of the Annexure to the Auditors' Report*, the Balance Sheet, Profit and Loss Account and Cash Flow Statement dealt with by this report are in agreement with the books of account;
- (d) *Subject to paragraphs 3,8,9,12.3,12.4,12.6,12.7,12.15,12.16,12.17 stated above*, in our opinion, the Balance Sheet, Profit and Loss Account and Cash Flow Statement dealt with by this report comply with the applicable accounting standards referred to in Section 211 (3C) of the Act;
- (e) On the basis of written representations received from the directors as on 31st March, 2004 and taken on record by the Board of Directors of the Company, we report that none of the directors is disqualified as on 31st March, 2004 from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- (f) In our opinion and to the best of our information and according to the explanations given to us and on consideration of the separate audit reports on individual audited financial statements of 49 units, the said financial statements together with the Notes thereon and attached thereto give in the prescribed manner *except for those stated in paragraph 13 of this report, the information required by the Act, and subject to paragraph 11 above with effect on the profit for the year being understated by Rs 231,215 thousands and the consequential effect on the net assets and subject to paragraphs 1 to 9 and 12 above the effect of which on the profit for the year and net assets could not be ascertained, also give a true and fair view in conformity with the accounting principles generally accepted in India.*
 - (i) in the case of the Balance Sheet, of the state of affairs of the Company as at 31st March, 2004;
 - (ii) in the case of the Profit and Loss Account, of the profit for the year ended on that date and
 - (iii) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Anupam Dhawan
Membership No: F084451.
Partner
For and on behalf of
Price Waterhouse
Chartered Accountants

Place : New Delhi

Date :26th August,2004.

ANNEXURE TO THE AUDITORS' REPORT

Referred to in paragraph D of our report dated :

- I.
 - a). *The records maintained by the Company in respect of its fixed assets are not considered to be proper in so far as these do not give full particulars of quantitative details and situation of fixed assets. The fixed asset register has not been updated at several units.*
 - b). It has been represented to us that the fixed assets at most of the circles have been physically verified by the management during the year and that no material discrepancies between the book records and physical inventory have been noticed. However, a number of other auditors have reported that no documentary evidence supporting such physical verification was made available to them.
 - c) No substantial part of fixed assets of the Company has been disposed of during the year.
- II.
 - a). It has been represented to us that inventory has been physically verified by the management at most of the units during the year and that no material discrepancies between the book records and physical inventory have been noticed on such verification. However, a number of other auditors have reported that no documentary evidence supporting such physical verification was made available.
 - b). *In the absence of proper documentation we are unable to comment on the reasonableness and adequacy of procedure of physical verification of inventories followed by the management.*
 - c). *On the basis of our examination of the inventory records and on the basis of the other auditors' reports, in our opinion, the Company is not maintaining proper records of inventory. Further, in the absence of any documentary evidence we are unable to comment on whether any material discrepancies were noticed on physical verification.*
- III. The Company has neither granted nor taken any loans, secured or unsecured, to/from companies, firms or other parties covered in the register maintained under Section 301 of the Act.
- IV. *On the basis of the other auditors' reports, we are of the opinion that the internal control procedure for purchase of inventory and fixed assets needs to be strengthened to make it commensurate with the size of the Company and nature of its business. However, we are unable to comment on whether there is a continuing failure to correct major weaknesses in internal control as none of the other auditors have reported in this regard.*
- V. There are no transactions that need to be entered in the register maintained in pursuance of Section 301 of the Act.
- VI. The Company has not accepted any deposits from the public.
- VII. *On the basis of the other auditors' reports, in our opinion, the Company's present internal audit system needs to be strengthened to make it commensurate with its size and nature of its business.*

- VIII. *The Company has not maintained cost records as prescribed by the Central Government under clause (d) of sub section (1) of section 209 of the Act.*
- IX. a) *Out of 49 circles, auditors of 34 circles have reported that the Company is not regular in depositing undisputed statutory dues including investor education & protection fund, employees' state insurance, income tax, wealth tax, customs duty, excise duty and other material statutory dues as applicable with the appropriate authorities in India. However, the extent of arrears of statutory dues outstanding as at March 31st 2004 for a period of more than six months from the date they became payable has been reported only by four auditors as set out in Appendix I.*
- b) *Auditors in respect of 29 circles have reported that there are dues of sales tax, income tax, customs duty, wealth tax, excise duty and cess which have not been deposited on account of dispute. However, the amounts involved and the forum where the dispute is pending have been reported only by 14 auditors as detailed in Appendix II.*
- X. The Company has not given any guarantee for loans taken by others from banks or financial institutions during the year.
- XI. Based on the review of utilization of the funds on an overall basis, in our opinion, the funds raised on short-term basis have not been used for long-term investment and vice versa.
- XII. The Company has not made any preferential allotment of shares to parties and companies covered in the register maintained under Section 301 of the Act during the year.
- XIII. The Company has not issued any debenture during the year.
- XIV. During the course of our examination of the books and records of the Company carried out in accordance with generally accepted auditing practices in India, we have not come across any instance of fraud by the Company, noticed or reported during the year. However, based on the information given by the Company and reported by certain other auditors, there were instances of fraud on the Company, the details of which are given in Appendix III.

Clauses X, XI, XIII, XIV and XX of the aforesaid order are not applicable to the Company.