INFOSYS TECHNOLOGIES LTD
Form 6-K
July 28, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington , D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of the Securities Exchange Act of 1934

For the quarter ended June 30, 2006
Commission File Number: 000-25383

INFOSYS TECHNOLOGIES LIMITED
(Exact name of Registrant as specified in its charter)

Not Applicable
(Translation of Registrant's name into English)

Bangalore , Karnataka, India
(Jurisdiction of incorporation or organization)

Electronics City, Hosur Road, Bangalore, Karnataka, India 560 100. 80-2852-0261
(Address of principal executive offices)

Indicate by check mark registrant files or will file annual reports under cover Form 20-F or Form 40-F.
Form 20-F ý & Form 40-F o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g 3-2(b) under the Securities Exchange Act of 1934
Yes o No ý

If "Yes" is marked, indicate below the file number assigned to registrant in connection with Rule 12g 3-2(b).
Not Applicable

Currency of Presentation and Certain Defined Terms

In this Quarterly Report, references to " U.S." or " United States" are to the United States of America, its territories and its possessions. References to "India" are to the Republic of India. References to "$" or "dollars" or "U.S. dollars" are to the legal currency of the United States and references to "Rs." or "rupees" or "Indian rupees" are to the legal currency of India. Our financial statements are presented in Indian rupees and translated into U.S. dollars and are prepared in accordance with United States Generally Accepted Accounting Principles, or U.S. GAAP. References to "Indian GAAP" are to Indian Generally Accepted Accounting Principles. References to a particular "fiscal" year are to our fiscal year ended March 31 of such year.

All references to "we," "us," "our," "Infosys" or the "Company" shall mean Infosys Technologies Limited, and, unless specifically indicated otherwise or the context indicates otherwise, our consolidated subsidiaries. "Infosys" is a registered trademark of Infosys Technologies Limited in the United States and India. All other trademarks or tradenames used in this Quarterly Report are the property of their respective owners.

Except as otherwise stated in this Quarterly Report, all translations from Indian Rupees to U.S. dollars are based on the noon buying rate in the City of New York on June 30, 2006, for cable transfers in Indian rupees as certified for customs purposes by the Federal Reserve Bank of New York which was Rs.45.87 per $1.00. June 30, 2006 was the last day of the quarter ended June 30, 2006 for which the noon buying rate is available. No representation is made that the Indian rupee amounts have been, could have been or could be converted into U.S. dollars at such a rate or any other rate. Any discrepancies in any table between totals and sums of the amounts listed are due to rounding. Information contained in our website, www.infosys.com, is not part of this Quarterly Report.

Cautionary Note Regarding Forward-Looking Statements

In addition to historical information, this Quarterly Report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The forward-looking statements contained herein are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in the forward-looking statements. Factors that might cause such differences include but are not limited to, those discussed in the section entitled "Risk Factors " and elsewhere in this Quarterly Report as well as the section entitled "Risk Factors" in our Annual Report on Form 20-F for the fiscal year ended March 31, 2006. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Quarterly Report. In addition, readers should carefully review the other information in this Quarterly Report and in the Company's periodic reports and other documents filed with the Securities and Exchange Commission ("SEC") from time to time.

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Part I - Financial Information

Item 1. Financial Statements

Infosys Technologies Limited and subsidiaries

Consolidated Balance Sheets

	(Dollars in millions except per share data)	
	As of	
	March 31, 2006 (1)	**June 30, 2006 (Unaudited)**
ASSETS		
Current Assets		
Cash and cash equivalents	$889	$392
Investments in liquid mutual fund units	170	358
Trade accounts receivable, net of allowances	361	408
Unbilled revenue	48	57
Prepaid expenses and other current assets	40	51
Deferred tax assets	1	2
Total current assets	1,509	1,268
Property, plant and equipment, net	491	496
Goodwill	8	91
Intangible assets, net	-	19
Deferred tax assets	13	12
Advance income taxes	18	19
Other assets	27	33
Total Assets	$**2,066**	**$1,938**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$3	$2
Income taxes payable	-	1
Client deposits	2	2
Unearned revenue	44	54
Other accrued liabilities	160	147
Total current liabilities	209	206
Non-current liabilities		
Other non-current liabilities	5	5
Minority interests	15	2
Stockholders' Equity		
Common stock, $0.16 par value 600,000,000 equity shares authorized, Issued and outstanding - 551,109,960 and 553,686,352 as of March 31, 2006 and June 30, 2006, respectively (See Note 2.11)	31	61
Additional paid-in capital	410	444
Accumulated other comprehensive income	9	(46)
Retained earnings	1,387	1,266
Total stockholders' equity	1,837	1,725
Total Liabilities And Stockholders' Equity	**$2,066**	**$1,938**

(1) March 31, 2006 balances were obtained from audited financial statements

See accompanying notes to the unaudited consolidated financial statements

Unaudited Consolidated Statements of Income

(Dollars in millions except per share data)

	Three months ended June 30,	
	2005	**2006**
Revenues	**$476**	**$660**
Cost of revenues	274	389
Gross profit	**202**	**271**
Operating Expenses:		
Selling and marketing expenses	32	45
General and administrative expenses	37	56
Total operating expenses	69	101
Operating income	**133**	**170**
Gain on sale of long term investment	-	1
Other income, net	7	28
Income before income taxes and minority interest	**140**	**199**
Provision for income taxes	18	23
Income before minority interest	**$122**	**$176**
Minority interest	-	2
Net income	**$122**	**$174**
Earnings per equity share		
Basic	$ 0.23	$ 0.32
Diluted	$ 0.22	$ 0.31
Weighted average equity shares used in computing earnings per equity share (See Note 2.11)		
Basic	539,163,684	549,991,125
Diluted	554,172,326	562,806,776

See accompanying notes to the unaudited consolidated financial statements

Unaudited Consolidated Statements of Stockholders' Equity and Comprehensive Income

(Dollars in millions)

	Common stock Shares (See Note 2.11)	**Common stock Par value**	**Additional paid-in capital**	**Comprehensive income**	**Accumulated other comprehensive income**	**Retained earnings**	**Total stockholders' equity**
Balance as of March 31, 2005	**541,141,098**	**$31**	**$266**		**$33**	**$923**	**$1,253**
Common stock issued	1,704,636	-	23		-	-	23
Cash dividends	-	-	-		-	(46)	(46)
Change in proportionate share of subsidiary resulting from issuance of stock by subsidiary	-	-	12	-	-	-	12
Comprehensive income							

Net income	-	-	-	$ 122	-	122	122
Other comprehensive income							
Unrealized gain on mutual fund investments, net of taxes				1	1		1
Translation adjustment	-	-	-	4	4	-	4
Comprehensive income				$127			
Balance as of June 30, 2005	**542,845,734**	**$31**	**$301**		**$38**	**$999**	**$1,369**
Balance as of March 31, 2006	**551,109,960**	**$31**	**$410**		**$9**	**$1,387**	**$1,837**
Common stock issued	2,576,392	-	31	-	-	-	31
Cash dividends	-	-	-	-	-	(265)	(265)
Amortization of stock compensation expenses	-	-	1	-	-	-	1
Income tax benefit arising on exercise of stock options			2	-	-	-	2
Stock split effected in the form of a stock dividend (See Note 2.11)	-	30			-	(30)	-
Comprehensive income							
Net income	-	-	-	$174	-	174	174
Other comprehensive income							
Translation adjustment	-		-	$(55)	$(55)		(55)
Comprehensive income		-	-	$119			
Balance as of June 30, 2006	**553,686,352**	**$61**	**$444**		**$(46)**	**$1,266**	**$1,725**

See accompanying notes to the unaudited consolidated financial statements

Unaudited Consolidated Statements of Cash Flows

		(Dollars in millions)
	Three months ended June 30,	
	2005	**2006**
OPERATING ACTIVITIES:		
Net income	**$122**	**$174**
Adjustments to reconcile net income to net cash provided by operating activities		

Depreciation and amortization	18	23
Minority interest	-	2
Amortization of stock compensation expenses	-	1
Deferred taxes	(1)	(2)
Others	-	(2)
Changes in assets and liabilities		
Trade accounts receivable	20	(57)
Prepaid expenses and other current assets	(5)	(10)
Unbilled revenue	(3)	(11)
Income taxes	11	-
Client deposits	(1)	-
Unearned revenue	8	12
Other accrued liabilities	(18)	(9)
Net cash provided by operating activities	**151**	**121**
Investing Activities:		
Expenditure on property, plant and equipment	(58)	(42)
Acquisition of minority interest in subsidiary	-	(116)
Investments in liquid mutual fund units	(64)	(375)
Redemption of liquid mutual fund units	36	180
Non-current deposits placed with corporations	(9)	(11)
Others	(1)	1
Net cash used in investing activities	**(96)**	**(363)**
Financing Activities:		
Proceeds from issuance of common stock on exercise of employee stock options and income tax benefits	23	33
Payment of dividends	(46)	(264)
Net cash used in financing activities	**(23)**	**(231)**
Effect of exchange rate changes on cash	2	(24)
Net increase/(decrease) in cash and cash equivalents during the period	34	(497)
Cash and cash equivalents at the beginning of the period	410	889
Cash and cash equivalents at the end of the period	**$444**	**$392**
Supplementary information:		
Cash paid towards taxes	$ 9	$25
Stock split effected in the form of a stock dividend (See Note 2.11)		

See accompanying notes to the unaudited consolidated financial statements

Notes to the Unaudited 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. The company provides solutions that span the entire software life cycle encompassing consulting, design, development, software re-engineering, maintenance, systems integration, package evaluation and implementation and infrastructure management services. In addition, the company offers software products for the banking industry and business process management services.

1.2 Basis of preparation of financial statements and consolidation

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.

Interim information presented in the consolidated financial statements has been prepared by the management without audit and, in the opinion of management, includes all adjustments of a normal recurring nature that are necessary for the fair presentation of the financial position, results of operations and cash flows for the periods shown, and is in accordance with GAAP. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the company's annual report on Form 20-F for the fiscal year ended March 31, 2006.

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.

The company accounts for volume discounts and pricing incentives to customers using the guidance in EITF Issue 01-09, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products). The discount terms in the company's arrangements with customers generally entitle the customer to discounts if the customer completes a specified cumulative level of revenue transactions. In some arrangements, the level of discount varies with increases in the levels of revenue transactions. The discounts are passed on to the customer either as check payments or as a reduction of payments due from the customer.The company recognizes discount obligations as a reduction of revenue based on the ratable allocation of the discount to each of the underlying revenue transactions that result in progress by the customer toward earning the discount. The company recognizes the liability based on its estimate of the customer's future purchases. Also, when the level of discount varies with increases in levels of revenue transactions, the company recognizes the liability based on its estimate of the customer's future purchases. If the company cannot reasonably estimate the customer's future purchases, then the liability is recorded based on the maximum potential level of discount. The company recognizes changes in the estimated amount of obligations for discounts using a cumulative catch-up adjustment. Furthermore, the company does not recognize any revenue up front for breakages immediately on the inception of an arrangement.

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 reflect 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. The income tax provision for the interim period is based on the best estimate of the effective tax rate expected to be applicable for the full fiscal year.

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, 2006 and June 30, 2006 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 factors which affect the fluctuations in the company's provisions for bad debts and write offs of uncollectible accounts include the financial health and economic environment of the clients. The company specifically identifies the credit loss and then makes the provision. 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 uses derivative financial instruments such as foreign exchange forward and option contracts to mitigate the risk of changes in foreign exchange rates on accounts receivable and forecasted cash flows denominated in certain foreign currencies. The counterparty for these contracts is generally a bank. Although the company believes that these financial instruments 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 and included in other income, net.

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 Trusts 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. Till March 2005, the company made 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. Effective April 1, 2005, a portion of the monthly contribution amount was paid directly to the employees as an allowance and the balance amount was contributed to the trusts.

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

Until March 31, 2006, the company applied 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 was recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS 123, Accounting for Stock-Based Compensation, established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans.

As allowed by SFAS 123, the Company elected to continue to apply the intrinsic value-based method of accounting described above, and adopted the disclosure requirements of SFAS 148, Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123 till March 2006.

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

	(Dollars in millions except per share data)
	Three months ended June 30, 2005
Net income, as reported	$122
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(4)
Pro forma net income	$118
Earnings per share: (See Note 2.11)	
Basic-as reported	$0.23
Basic-pro forma	$0.22
Diluted-as reported	$0.22
Diluted-pro forma	$0.21

From April 1, 2006, the company adopted FASB Statement No.123 (revised 2004), *Share-Based Payment* using the modified prospective approach. The company recorded amortization of stock compensation expense of $1 million during the three months ended June 30, 2006, using the fair value recognition provisions.

Impact on the financial statements due to the adoption of FASB Statement No.123 (revised 2004), *Share-Based Payment* using the modified prospective approach are given below.

Details	*(Dollars in millions)*
Operating income	(1)
Income before income taxes and minority interest	(1)
Net income	(1)
Cash flow from operating activities	(1)
Cash flow from financing activities	1
Earnings per equity share	
Basic	-
Diluted	-

There have been no grants of stock options by Infosys Technologies Limited during the three months ended June 30, 2006.

As of June 30, 2006, the unamortized stock compensation expenses under the 1998 and 1999 option plans was $2 million and the same is expected to be amortized over a weighted average period of approximately one year. The unamortized stock compensation expenses under the Progeon's 2002 Plan was $4 million and the same is expected to be amortized over a weighted average period of approximately two years.

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

	Three months ended	
	June 30, 2005	**June 30, 2006**

Dividend yield %	-	-
Expected term	1-6 years	1-6 years
Risk free interest rate	6.9%	8.1%
Volatility	50%	50%

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 Equity issued by subsidiaries

Changes in the proportionate share of Infosys in the equity of subsidiaries resulting from additional equity issued by the subsidiaries are accounted for as an equity transaction in consolidation.

2 Notes to the unaudited 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, 2006	**June 30, 2006**
Cost and fair values		
Cash and bank deposits	$771	$277
Deposits with corporations	118	115
	$889	$392

Cash and cash equivalents as of March 31, 2006 and June 30, 2006 include restricted cash balances in the amount of $1 million. The restrictions are primarily in account of unclaimed dividends.

2.2 Trade accounts receivable

Trade accounts receivable as of March 31, 2006 and June 30, 2006, net of allowance for doubtful accounts of $2 million and $4 million, amounted to $361 million and $ 408 million. The age profile of trade accounts receivable, net of allowances, is given below.

In %

	As of	
	March 31, 2006	**June 30, 2006**
Period (in days)		
0-30	60.9	82.7
31-60	31.2	5.6
61-90	3.5	7.2
More than 90	4.4	4.5
	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 has been 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 was amortized over a period of two years 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 Acquisition of minority interest in Progeon

On June 30, 2006, Infosys acquired 8,750,000 equity shares of Progeon Limited from Citicorp International Finance Corporation (CIFC) for a consideration of $116 million. As of June 30, 2006, Infosys holds 96.96% of the outstanding equity shares of Progeon Limited.

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

	(Dollars in millions)
Component	**Purchase price allocated**
Property, plant and equipment	$2
Net current assets	13
Deferred tax liabilities	(2)
Customer contracts	19
Goodwill	84
Total purchase price	$116

The identified customer contracts intangible is being amortized over a period of four years, 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 the business process management area.

2.5 Prepaid expenses and other current assets

Prepaid expenses and other current assets consist of the following:

	(Dollars in millions)	
	As of	
	March 31, 2006	**June 30, 2006**
Rent deposits	$4	$4
Security deposits with service providers	4	5
Loans to employees	20	21
Prepaid expenses	12	13
Other current assets	-	8
	$40	51

Other current assests as of June 30, 2006 include $7 million advanced to the Infosys Technologies Limited Employees' Gratuity Fund Trust. Other current assets also represent advance payments to vendors for the supply of goods and rendering of services and marked to market gains on foreign exchange forward and option contracts. Deposits with service providers relate principally to leased telephone lines and electricity supplies.

2.6 Property, plant and equipment - net

Property, plant and equipment consist of the following:

	(Dollars in millions)	
	As of	
	March 31, 2006	**June 30, 2006**
Land	$31	$31
Buildings	231	248
Furniture and fixtures	101	105
Computer equipment	171	180
Plant and equipment	128	135
Capital work-in-progress	128	111
	790	810
Accumulated depreciation	(299)	(314)
	$491	$496

Depreciation expense amounted to $18 million and $23 million for the three months ended June 30, 2005 and 2006. The amount of third party software amortized during the three months ended June 30, 2005 and 2006 was $8 million and $8 million.

2.7 Other assets

Other assets consist of the following:

	(Dollars in millions)	
	As of	
	March 31, 2006	**June 30, 2006**
Non-current portion of loans to employees	$8	$6
Non-current deposits with corporations	18	27
Others	1	-
	$27	$33

2.8 Loans to employees

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 $28 million and $27 million were outstanding as of March 31, 2006 and June 30, 2006.

The required repayments of employee loans outstanding as of June 30, 2006 are as detailed below.

	(Dollars in millions)
Repayment in the 12 months ending June 30,	**Repayment**
2007	$21
2008	3
2009	1
2010	1
2011	1
	$27

The estimated fair values of the loan to employee's receivables amounted to $24 million as of March 31, 2006 and $25 million as of June 30, 2006. 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, 2006	**June 30, 2006**
Accrued compensation to staff	$82	$50
Provision for post sales client support	3	3
Withholding taxes payable	20	27
Provision for expenses	49	57
Retainage	3	3
Others	3	7
	$160	$147

2.10 Employee post-retirement benefits

2.10.1 Gratuity

Net gratuity cost was $2 million and $2 million for the three months ended June 30, 2005 and June 30, 2006. The significant component of net gratuity cost is service cost of approximately $2 million and $2 million for the three months ended June 30, 2005 and June 30, 2006. Interest cost and expected return on assets was $1 million and $1 million for the three months ended June 30, 2005 and June 30, 2006.

The company had previously disclosed in the financial statements for the year ended March 31, 2006 that the company expects to contribute approximately $9 million to the gratuity trusts during fiscal 2007. As of June 30, 2006,

$9 million of contributions have been made.

2.10.2 Superannuation

From April 1, 2005, a portion of the monthly contribution amount has been paid directly to the employees as an allowance and the balance amount has been contributed to the trusts. $2 million was contributed to the trusts during the three months ended June 30, 2006.

2.10.3 Provident fund

The company contributed $3 million and $4 million to the provident fund during the three months ended June 30, 2005 and 2006.

2.11 Stockholders' equity

Infosys has only one class of capital stock referred to as equity shares. On June 10, 2006, the members of the company approved a 1:1 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 1 additional share being issued for every share held. As the change in the capital structure of the company has been effected before the date of issuance of these financial statements, the change in the capital structure has been given retroactive effect in the balance sheet as of June 30, 2006. The computations of basic and diluted EPS have also 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 options 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 was issued 4,375,000 (0.0005%) cumulative convertible preference shares in each of June 2002 and March 2004 for an aggregate consideration approximating $20 million.

The stock subscription agreement provided that 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 was convertible into one equity share of par value $0.20 each. Indian law requires redemption of preference shares within a period of 20 years.

The carrying value of the preference shares was $21 million as of March 31, 2005. On June 30, 2005, the preference shares have been converted to equity shares of Progeon as per the terms of the stock subscription agreement. As of March 31, 2006, CIFC held 8,750,000 equity shares of Progeon. Infosys' percentage ownership in Progeon immediately before and immediately after the conversion of preference shares was 99.5% and 73.4% respectively. The transaction resulted in a change of $12 million in the proportionate share of Infosys in the equity of Progeon and the change has been accounted for as an equity transaction in consolidation. As of March 2006, Infosys' equity holding in Progeon was 71.7%. On June 30, 2006, Infosys acquired 8,750,000 equity shares of Progeon Limited from CIFC for a consideration of $116 million. As of June 30, 2006, Infosys holds 96.96% of the outstanding equity shares of Progeon Limited.

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 during fiscal 2005. Further consideration of $1 million was received during the three months ended June 30, 2006 resulting in a gain of $1 million for the period.

Other income, net, consists of the following:

(Dollars in millions)

	Three months ended June 30,	
	2005	**2006**
Interest income	$6	$11
Income from mutual fund investments	3	4
Foreign exchange gains/(losses), net	(2)	12
Others	-	1
	$7	$28

2.14 Research and development

Research and development expenses were $6 million and $7 million for the three months ended June 30, 2005 and 2006.

2.15 Employees' Stock Offer Plans (ESOP)

In September 1994, the company established the 1994 plan, which provided for the issue of 48,000,000 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. 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 11,760,000 equity shares representing 11,760,000 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 52,800,000 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 options of the 1998 and 1999 ESOP during the three months ended June 30, 2005 and 2006 are set out below.

	Three months ended June 30, 2005		**Three months ended June 30, 2006**	
	Shares arising out of options	**Weighted average exercise price**	**Shares arising out of options**	**Weighted average exercise price**
1998 Option plan:				
Outstanding at the beginning of the Period	6,108,580	$20	4,546,480	$20
Forfeited	(28,680)	$21	(116,320)	$42
Exercised	(170,964)	$20	(180,550)	$18
Outstanding at the end of the period	5,908,936	$20	4,249,610	$20
Exercisable at the end of the period	3,874,064		3,682,694	$21
1999 Option plan:				
Outstanding at the beginning of the Period	28,109,874	$13	19,179,074	$13
Forfeited	(113,960)	$12	(30,444)	$12
Exercised	(1,533,672)	$13	(2,395,842)	$12
	26,462,242	$13	16,752,788	$13

Outstanding at the end of the period			
Exercisable at the end of the period	19,032,162	14,987,346	$13

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.

The activity in Progeon's 2002 Plan during the three months ended June 30, 2005 and 2006 are set out below.

	Three months ended June 30, 2005		**Three months ended June 30, 2006**	
	Shares arising out of options	**Weighted average exercise price**	**Shares arising out of options**	**Weighted average exercise price**
Progeon's 2002 Plan:				
Outstanding at the beginning of the period	3,116,518	$1.18	2,452,330	$3.01
Granted	703,300	$4.47	593,300	$13.16
Forfeited	(50,293)	$2.67	(33,300)	$3.95
Exercised	(6,750)	$0.99	(142,100)	$0.80
Outstanding at the end of the period	3,762,775	$1.78	2,870,230	$5.21

The weighted average fair value of options granted by Progeon during the three months ended June 30, 2005 and 2006 was $1.79 and $6.65. 503,775 options were exercisable as of June 30, 2006 with a weighted average exercise price of $2.23.

The aggregate intrinsic value of options exercised during the three months ended June 30, 2006 under 1998 option plan and 1999 option plan was $3 million and $51 million respectively. The aggregate intrinsic value of options exercised during the three months ended June 30, 2005 under 1998 option plan and 1999 option plan was $2 million and $18 million. The aggregate intrinsic value of options exercised under the Progeon's 2002 plan during the three months ended June 30, 2006 was $2 million.

As of June 30, 2006, options outstanding under the 1998 option plan and 1999 option plan had an aggregate intrinsic value of $78 million and $350 million respectively and a weighted-average remaining contractual term of 3.2 years and 2.9 years respectively. As of June 30, 2006, options exercisable under the 1998 option plan and 1999 option plan had an aggregate intrinsic value of $64 million and $308 million respectively and a weighted-average remaining contractual term of 2.8 years and 2.6 years respectively.

As of June 30, 2006, options outstanding and exercisable under the Progeon's 2002 plan had an aggregate intrinsic value of $23 million and $6 million respectively and a weighted-average remaining contractual term of 4.1 years and 3.1 years respectively.

2.16 Income taxes

The provision for income taxes in the income statement comprises:

	(Dollars in millions)	
	Three months ended June 30,	
	2005	**2006**
Current taxes		
Domestic taxes	$6	$9
Foreign taxes	13	16
	19	25
Deferred taxes		