

الاتصالات السعودية
SAUDI TELECOM



a Saudi Joint Stock Company

**Financial Statements for the
Years Ended December 31, 2001 and 2000**

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TO: THE BOARD OF DIRECTORS OF SAUDI TELECOM COMPANY

We have audited the accompanying balance sheet of SAUDI TELECOM COMPANY (a Saudi Joint Stock Company wholly owned by the Government of Saudi Arabia and formed pursuant to Royal Decree No. M/35), as of December 31, 2001 and the related statements of income, changes in shareholder's equity and cash flows for the year then ended and the notes from 1 to 21 which are an integral part of these financial statements which were prepared by the management in accordance with Article (123) of the Companies Regulation and presented to us together with all the information and explanations which we requested. We express our opinion on these financial statements based on our audit and the information and explanations we obtained which we considered necessary for the purposes of our audit.

We conducted our audit in accordance with generally accepted auditing standards. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **SAUDI TELECOM COMPANY** as of December 31, 2001 and the results of its operations and its cash flows for the year then ended based on the presentation and disclosure of the information included in the financial statements and in conformity with generally accepted accounting principles in the Kingdom of Saudi Arabia as summarized in Note 2.

We are also of the opinion that the preparation and presentation of the above financial statements comply with the Commercial Code and the Company's by-laws and are in agreement with the accounting records which are computerized in accordance with the related commercial books regulations.

Arthur Andersen & Co.

Arfan K. Ayass
License No. 98

Date: 13 Rabi Al Awwal 1423H (May 25, 2002)
Riyadh, Saudi Arabia

Saudi Telecom Company
(a Saudi Joint Stock Company)
Statements of Income for the Years Ended December 31, 2001 and 2000
(Saudi Riyals in thousands)

	<u>Notes</u>	<u>2001</u> SR'000	<u>2000</u> SR'000
<u>Assets</u>			
Cash and cash equivalents	3	1,802,349	1,133,215
Accounts receivable, net	4	6,076,230	4,956,719
Inventories, net		447,544	364,640
Prepayments and other current assets		<u>97,318</u>	<u>52,921</u>
Total current assets		8,423,441	6,507,495
Property, plant and equipment, net	5	29,870,474	27,637,643
Investment in associates	6	667,151	547,903
Other investments	7	136,565	163,309
Other non-current assets	3	<u>71,914</u>	<u>422,640</u>
Total assets		<u>39,169,545</u>	<u>35,278,990</u>
<u>Liabilities and Shareholders' Equity</u>			
Accounts payable	8	7,305,415	6,672,256
Accrued expenses and other payables	9	4,776,095	3,674,342
Deferred revenue - current		1,217,124	917,799
Short-term borrowings	10	<u>1,216,667</u>	<u>1,434,783</u>
Total current liabilities		14,515,301	12,699,180
Deferred revenue		2,068,280	1,869,751
Long-term borrowings	10	683,333	1,521,467
Employees' end of service benefits	11	<u>1,428,345</u>	<u>1,285,416</u>
Total liabilities		<u>18,695,259</u>	<u>17,375,814</u>
Commitments and contingencies	17	-	-
<u>Shareholders' equity</u>			
Common shares: par value SR 50 per share, authorized, issued and outstanding shares: 240,000,000		12,000,000	12,000,000
Retained earnings		7,321,154	5,086,416
Legal reserve		1,155,340	807,467
Unrealized (loss)/gain on other investments	7	<u>(2,208)</u>	<u>9,293</u>
Total Shareholders' equity	20	<u>20,474,286</u>	<u>17,903,176</u>
Total liabilities and Shareholders' equity		<u>39,169,545</u>	<u>35,278,990</u>

The accompanying notes 1 to 21 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Statements of Income for the Years Ended December 31, 2001 and 2000
(Saudi Riyals in thousands)

	<u>Notes</u>	<u>2001</u>	<u>2000</u>
Operating Revenues			
Wireline		11,791,851	11,855,030
Wireless		<u>7,989,517</u>	<u>5,075,307</u>
Total operating revenues		<u>19,781,368</u>	<u>16,930,337</u>
Operating Expenses			
Government charges	19	3,963,678	3,345,110
Access charges		1,859,091	1,953,621
Employee costs		3,261,987	2,918,998
Depreciation and amortization	5	2,800,611	2,399,444
General and administrative expenses	14	1,768,550	1,493,572
Repairs and maintenance		<u>1,119,243</u>	<u>961,717</u>
Total operating expenses		<u>14,773,160</u>	<u>13,072,462</u>
Operating Income		<u>5,008,208</u>	<u>3,857,875</u>
Other Income and Expenses			
Commission income	3,7	59,374	93,690
Earnings of investment in associates	6	102,441	64,484
Other, net	13	<u>(197,635)</u>	<u>35,493</u>
Total other income and expenses		<u>(35,820)</u>	<u>193,667</u>
Net Income before Non-recurring Items and Zakat		<u>4,972,388</u>	<u>4,051,542</u>
Non-recurring Items			
Seconded employees' entitlements	15	(794,265)	-
Cost of early retirement program	16	<u>(600,208)</u>	-
Total non-recurring items		<u>(1,394,473)</u>	-
Net Income before Zakat		3,577,915	4,051,542
Provision for Zakat	12	<u>(99,190)</u>	<u>(98,669)</u>
Net Income		<u>3,478,725</u>	<u>3,952,873</u>

The accompanying notes 1 to 21 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)

Statements of Cash Flows for the Years Ended December 31, 2001 and 2000
(Saudi Riyals in thousands)

	<u>2001</u>	<u>2000</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	3,478,725	3,952,873
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized loss on other investments	-	11,812
Depreciation and amortization	2,800,611	2,399,444
Provision for doubtful accounts	951,136	746,553
Seconded employees' entitlements	794,265	-
Cost of early retirement program	600,208	-
Loss/(Gain) on sale/disposal of property, plant and equipment	196,735	(14,853)
Undistributed earnings of investment in associate	(89,248)	(49,704)
Changes in:		
Accounts receivable	(2,070,647)	(1,682,357)
Inventories	(82,904)	(138,461)
Prepayments and other current assets	(44,397)	36,281
Other non-current assets	350,726	(399,446)
Accounts payable	(262,955)	(1,443,954)
Accrued expenses and other payables	(292,720)	802,863
Deferred revenue	497,854	648,150
Employees' end of service benefits	<u>142,929</u>	<u>163,289</u>
Net cash provided by operating activities	<u>6,970,318</u>	<u>5,032,490</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(5,230,177)	(5,742,249)
Investment in associates	(30,000)	-
Proceeds from sale of property, plant and equipment	-	16,153
Capital distributions related to other investments	<u>15,243</u>	<u>16,193</u>
Net cash used in investing activities	<u>(5,244,934)</u>	<u>(5,709,903)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of short-term borrowings	(250,000)	(300,000)
Proceeds from short-term borrowings	-	400,000
Repayments of long-term borrowings	(1,406,250)	(1,043,750)
Proceeds from long-term borrowings	<u>600,000</u>	<u>850,000</u>
Net cash used in financing activities	<u>(1,056,250)</u>	<u>(93,750)</u>
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	669,134	(771,163)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>1,133,215</u>	<u>1,904,378</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>1,802,349</u>	<u>1,133,215</u>

The accompanying notes 1 to 21 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)

Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2001 and 2000

(Saudi Riyals in thousands)



	<u>Notes</u>	<u>Common Shares</u>	<u>Retained Earnings</u>	<u>Legal Reserve</u>	<u>Unrealized Gain/(Loss) on Other Investments</u>	<u>Total Shareholders' Equity</u>
Balance at December 31, 1999		12,000,000	1,528,830	412,180	-	13,941,010
Net income		-	3,952,873	-	-	3,952,873
Transfer to legal reserve	20	-	(395,287)	395,287	-	-
Unrealized gain on investment	7	-	-	-	9,293	9,293
Balance at December 31, 2000		12,000,000	5,086,416	807,467	9,293	17,903,176
Net income		-	3,478,725	-	-	3,478,725
Dividends payable	20	-	(896,114)	-	-	(896,114)
Transfer to legal reserve	20	-	(347,873)	347,873	-	-
Unrealized loss on investment	7	-	-	-	(11,501)	(11,501)
Balance at December 31, 2001		12,000,000	7,321,154	1,155,340	(2,208)	20,474,286

The accompanying notes 1 to 21 form an integral part of these financial statements.

1 DESCRIPTION OF BUSINESS, CORPORATE STATUS AND BASIS OF PRESENTATION

a) Description of business

Saudi Telecom Company (the “Company”) is the sole entity engaged in the provision of telecommunications services in the Kingdom of Saudi Arabia (the “Kingdom”). The Company provides a range of telecommunications services including fixed local, national and international telephone services, telex, telegraph, data transmission, leased lines, public telephones and public network services. The Company also provides mobile and radio paging services in the Kingdom.

b) Corporate status

The Company was established by the Royal Decree No. M/ 35, dated April 21, 1998 (24 Dhul Hujja 1418, based on the Hijra calendar system, which is the calendar used in the Kingdom, hereinafter referred to as “H”) as a Saudi Joint Stock Company, in accordance with the Council of Ministers Resolution No. 213, dated April 20, 1998 (23 Dhul Hujja 1418H) which approved The Company’s Articles of Association (the “Articles”). The Company is wholly owned by the Government of the Kingdom of Saudi Arabia (the “Government”).

The Company received its commercial registration number 101050269 as a Saudi Joint Stock Company on June 29, 1998 (4 Rabi Awal 1419H). The shares of the Company are not allowed to be sold to the public until appropriate authorization is received.

Prior to May 2, 1998 (6 Muharram 1419H), the provision of public telecommunications services in the Kingdom was operated by the telegraph and telephone division of the MoPTT (hereinafter referred to as “Telecom Division”). Pursuant to Royal Decree No. M/35, the Telecom Division, with its various components and technical and administrative facilities was transferred to the Company. A regulatory body, Saudi Telecom Commission, was formed on May 28, 2001 (5 Rabi Awal 1422H) to regulate the telecommunications industry within the Kingdom.

The Company commenced its operations as Kingdom-wide provider of telecommunications services on May 2, 1998 with the initial term of the Company being fifty years from the date of the Royal Decree. This term may be extended.

c) Financial period

The Company has fixed its financial year to begin on January 1 and end on December 31, according to the Company’s Articles.

d) Preparation of the financial statements

The financial statements have been prepared in accordance with regulations and standards promulgated by the Saudi Organization for Certified Public Accountants, which functions under the auspices of the Ministry of Commerce.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted by the Company are summarized as follows:

a) Accounting convention

The financial statements have been prepared under the historical cost convention, with the exception of property, plant and equipment transferred from the Telecom Division, as explained in note g below.

b) Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

c) Revenue recognition

Revenue is recognized when services are rendered based on the access to, or usage of, the exchange network and facilities. Usage revenues are based upon minutes of traffic processed. Charges billed in advance are deferred and recognized over the period the services are rendered. Unbilled revenue is recognized in the period to which it relates. Non-refundable up-front activation fees received from subscribers are deferred and recognized over the estimated service lives of the subscribers.

d) Financial instruments

Financial instruments include cash, investments, accounts receivable and payable, other receivables and payables and short and long-term borrowings. The Company does not currently use financial instruments that reduce exposure to fluctuations in foreign currency exchange and commission rates.

e) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and all highly liquid investments with a maturity of 90 days or less when purchased. Cash and cash equivalents are stated at cost.

f) Inventories

Inventories, which are principally cables and consumables, are stated at weighted average cost, net of allowances. Inventory items that are considered an integral part of the network assets, such as emergency spares, which cannot be removed from the exchange, are recorded within property, plant and equipment. Inventory items held by third parties responsible for upgrading and expanding the network are recorded within 'capital work in progress'.

g) Property, plant and equipment and depreciation

Prior to May 2, 1998, the Telecom Division did not sufficiently maintain detailed historical information to record property, plant and equipment based on the historical cost method. Consequently all property, plant and equipment transferred by the Telecom Division on May 2, 1998 has been included in these financial statements at a valuation which was performed by the Company with the assistance of independent international and local valuation experts. The principal bases used for valuation are as follows:

- | | |
|----------------------------------|------------------------------|
| • Land | Appraised value |
| • Buildings, plant and equipment | Depreciated replacement cost |

Property, plant and equipment acquired by the Company after May 2, 1998 is recorded at historical cost.

Cost or valuation of the network comprises all expenditures up to the customer connection point. It also includes contractors' charges, materials and direct labor and commission costs, if appropriate, up to the date the relevant assets are placed in service. Property, plant and equipment excluding land is depreciated on a straight line basis over the following estimated useful lives:

	<u>Years</u>
Buildings	22 – 30
Telecommunications plant and equipment	5 – 25
Other assets	5

Agreements entered into for the indefeasible right to use capacity are accounted for as capital leases if the criteria are met and amortized over the estimated useful lives of the associated assets or the lease periods whichever is shorter. If the capital lease criteria are not met, they are accounted for as operating leases.

Upon sale or disposal of property, plant and equipment, the gain or loss determined by the difference between the proceeds and the net carrying amount of the asset is recognized in the statement of income.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their recoverable amount may be permanently less than their carrying amount. If the sum of the expected future undiscounted cash flows from these assets is less than the carrying amount of the assets, a loss is recognized for the difference between the fair value and carrying amount of the assets. Fair value is determined on the basis of discounted cash flows or by reference to the replacement cost of used equipment, the cost of alternative technologies or from recent transactions for similar assets, or from market prices. The loss is recognized in the period in which the impairment has occurred.

Repairs and maintenance costs are expensed as incurred, except to the extent that they increase productivity or extend the useful life of an asset, in which case they are capitalized.

h) Investment in associates

The Company accounts for investments in common stock in which it has at least 20% ownership under the equity method. Under this method, the Company recognizes in the statement of income its relative share of the associate's results of operations and adjusts the carrying amount of its investment to reflect its pro rata share of the net assets of the associate.

i) Other investments

Available for sale securities are reported at fair value with unrealized holding gains and losses recorded as a separate component of Shareholders' equity. However, available for sale securities with no reasonably determinable fair values are reported at cost. Holding losses are charged to the statement of income and the cost of the investment is decreased if it is determined by management that such losses are of an other than temporary nature. When available for sale securities are sold, the resulting gain or loss is recognized in the statement of income and previous unrealized holding gains and losses on such securities are reversed.

Investments held to maturity (Government bonds) are reported at cost and adjusted for amortization of premiums and accretion of discounts, if any. Provisions are made for any permanent diminution in value.

j) Zakat

The Company is subject to Zakat in accordance with the regulations of the Department of Zakat and Income Tax. The Company accrues for its Zakat liability in the financial statements. Adjustments arising from final Zakat assessments are recorded in the year in which such assessments are made.

k) Employees' end of service benefits

End of service termination benefits are payable as a lump sum to all employees employed under the terms and conditions of Saudi Labor and Workman Law on termination of their employment contracts. The liability is calculated as the current value of the vested benefits to which the employee is entitled, should the employee leave at the balance sheet date. Termination payments are based on employees' final salaries and allowances and their cumulative years of service, as defined by the conditions stated in the laws of the Kingdom.

l) Foreign currency transactions

The Company maintains its financial records in Saudi Arabian Riyals (SR), the Company's functional currency, with transactions being recorded at the appropriate rate of exchange prevailing at the date of the transaction. Foreign currency receivables, payables and other monetary assets and liabilities are translated using rates of exchange prevailing at the balance sheet date. Exchange gains and losses arising on the settlement of foreign currency transactions and all unrealized gains and losses on foreign currency denominated monetary balances are recorded in the statements of income.

m) Government charges

Government charges are the costs incurred for the right to operate the Kingdom's telecommunications services, including use of the frequency spectrum for wireless services. Government charges are accrued in the relevant period.

n) Access charges

Access charges represent the costs to connect to foreign carriers' networks for calls made by the Company's subscribers. Access charges are recognized in the period of relevant calls.

3 CASH AND CASH EQUIVALENTS

Surplus cash arising during the year is invested in short-term deposits. The average rate of commission received on short-term deposit accounts during 2001 was 4.1% (2000: 6.5%). Total commission earned during the year on these accounts was SR 57 million (2000: SR 91 million).

In 2000, a cash deposit of SR 375 million was reclassified as other non-current assets due to restrictions on the use of such deposit, as stated in the provisions of a loan agreement. This amount has been used in 2001 to repay the last installment of the loan.

4 ACCOUNTS RECEIVABLE, NET

Accounts receivable, net of allowance for doubtful accounts, consisted of the following:

	<u>2001</u>	<u>2000</u>
	SR 000's	SR 000's
Trade accounts receivable	5,975,595	4,744,980
Unbilled revenue	<u>1,653,754</u>	<u>1,531,018</u>
	7,629,349	6,275,998
Allowance for doubtful accounts	<u>(1,553,119)</u>	<u>(1,319,279)</u>
	<u>6,076,230</u>	<u>4,956,719</u>

Notes to the Financial Statements for the Years Ended December 31, 2001 and 2000

The Company has agreements with foreign network operators, whereby amounts receivable from and payable to the same foreign network operator are subject to the right of set off. At December 31, 2001 and 2000, the net amounts included in accounts receivable and accounts payable are as follows:

	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
	Accounts Receivable SR 000's	Accounts Receivable SR 000's	Accounts Payable SR 000's	Accounts Payable SR 000's
Gross international trade accounts	4,848,690	4,181,079	5,300,369	4,727,699
Less: Debt subject to right of set off	<u>(4,325,420)</u>	<u>(3,687,472)</u>	<u>(4,325,420)</u>	<u>(3,687,472)</u>
Net international trade accounts	<u>523,270</u>	<u>493,607</u>	<u>974,949</u>	<u>1,040,227</u>

5 PROPERTY, PLANT AND EQUIPMENT, NET

(SR 000's)	<u>Land and Buildings</u>	<u>Telecommunications Plant and Equipment</u>	<u>Other Assets</u>	<u>Capital Work In Progress</u>	<u>Total</u>
<i>Gross book value</i>					
At December 31, 2000	7,881,297	30,923,348	787,316	4,462,458	44,054,419
Additions	58,235	686,810	184,363	4,300,769	5,230,177
Transfers	302,917	6,778,851	5,684	(7,087,452)	-
Disposals	<u>-</u>	<u>(459,153)</u>	<u>(21,152)</u>	<u>-</u>	<u>(480,305)</u>
At December 31, 2001	<u>8,242,449</u>	<u>37,929,856</u>	<u>956,211</u>	<u>1,675,775</u>	<u>48,804,291</u>
<i>Accumulated depreciation</i>					
At December 31, 2000	2,911,648	12,972,575	532,553	-	16,416,776
Charge for the period	192,225	2,502,546	105,840	-	2,800,611
Disposals	<u>-</u>	<u>(262,510)</u>	<u>(21,060)</u>	<u>-</u>	<u>(283,570)</u>
At December 31, 2001	<u>3,103,873</u>	<u>15,212,611</u>	<u>617,333</u>	<u>-</u>	<u>18,933,817</u>
<i>Net book value</i>					
At December 31, 2001	<u>5,138,576</u>	<u>22,717,245</u>	<u>338,878</u>	<u>1,675,775</u>	<u>29,870,474</u>
At December 31, 2000	<u>4,969,649</u>	<u>17,950,773</u>	<u>254,763</u>	<u>4,462,458</u>	<u>27,637,643</u>

Land and buildings shown above include land of SR 2,320 million as of December 31, 2001 (2000: SR 2,320 million).

In accordance with the Royal Decree referred to in note 1b above, ownership of assets had been transferred to the Company as of May 2, 1998, although in certain instances (principally land), transfer of legal ownership is in progress. As of March 2002, value of land for which legal ownership has been transferred into the Company' name amounted to SR 1,464 million. Ownership transfer of the remaining lands with value amounting to SR 671 million is currently in progress.

During 2001, the Company capitalized commission totaling SR 164.6 million (2000: SR 192.6 million) into property, plant and equipment. See Note 10 for further discussion.

6 INVESTMENT IN ASSOCIATES

Investment in associates consisted of the following:

	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Arab Satellite Communications Organization ("Arabsat").	637,151	547,903
Arab Submarine Cables Company Ltd	<u>30,000</u>	<u>-</u>
	<u>667,151</u>	<u>547,903</u>

Arabsat

In 1977, the Telecom Division acquired 36.66% of the common stock of Arabsat. This organization was established by the member states of the Arab League in April 1976. Arabsat offers a number of services to member states, as well as to all public and private sectors within its coverage area, principally the Middle East.

Current services offered include regional telephony (voice, data, fax and telex), television broadcasting, regional radio broadcasting, restoration services and leasing of capacity on an annual or monthly basis.

Arab Submarine Cables Company Ltd.

The Company owns 40% of the shares of the Arab Submarine Cables Company Ltd. This company has been formed for the purpose of construction, leasing, management and operation of a submarine cable for telecommunications between the Kingdom and the Republic of Sudan and any other countries.

7 OTHER INVESTMENTS

Other investments consisted of the following:

	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Available for sale – at market value:		
Investment in Newskies	<u>18,942</u>	<u>30,443</u>
	<u>18,942</u>	<u>30,443</u>
Available for sale – at cost:		
Investment in Intelsat Ltd	58,123	59,681
Investment in Inmarsat	28,749	28,749
Investment in New ICO	<u>3,375</u>	<u>3,375</u>
	<u>90,247</u>	<u>91,805</u>
Held to maturity:		
Government bonds	<u>27,376</u>	<u>41,061</u>
Total other investments	<u>136,565</u>	<u>163,309</u>

As of December 31, 2001, the Company has recorded unrealized holding losses of SR 2.2 million related to its investment in Newskies. (2000: Unrealized holding gains of SR 9.3 million).

Notes to the Financial Statements for the Years Ended December 31, 2001 and 2000

During 2001, Intelsat was privatized and transferred to a limited liability company named "Intelsat Ltd". Intelsat Ltd plans to make an Initial Public Offering during 2002. Accordingly, the investment will be reported at fair value in accordance with the Company's accounting policy.

During 1999, the Government issued bonds to the Company in exchange for amounts due for telecommunication services provided. The bonds were issued at face value with commission rates ranging from 6.29% to 7.12% and maturing through August 2003. Payments of principal and commission will be received throughout the term every six months. Total commission earned on these investments during the year totaled SR 2.6 million (2000: SR 3.5 million).

8 ACCOUNTS PAYABLE

Accounts payable consisted of the following:

	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Government	2,689,816	1,315,024
Capital	2,344,655	3,024,471
Trade	1,295,995	1,292,534
International settlements	<u>974,949</u>	<u>1,040,227</u>
	<u>7,305,415</u>	<u>6,672,256</u>

Government accounts payable include dividends payable of SR 896 million. Refer to Note 20 for more details.

Certain accounts payable balances are set off against accounts receivable balances as fully explained in Note 4.

9 ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables consisted of the following:

	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Capital	1,724,043	2,449,260
Trade	499,827	290,577
Seconded employees' entitlements	775,934	-
Employee accruals	673,935	565,534
Early retirement program	600,208	-
Other	<u>502,148</u>	<u>368,971</u>
	<u>4,776,095</u>	<u>3,674,342</u>

10 BORROWINGS

Repayment of borrowings at December 31, 2001 is scheduled as follows:

	<u>SR 000's</u>
Short-term borrowings	900,000
Current portion of long-term borrowings	<u>316,667</u>
Long-term borrowings:	
Between one and two years	400,000
Between two and three years	<u>283,333</u>
	<u>683,333</u>
Total borrowings	<u>1,900,000</u>

The Company obtained loans and facilities in 2001 and 2000 from several local banks. Commission charged on all loans and facilities does not exceed the Saudi Interbank Offered Rate ("SIBOR") plus 0.7% per annum.

The first loan of SR 2,250 million and related commission has been paid on due dates. Final installment was paid in the fourth quarter of 2001.

In 2001, the Company entered into a syndicated loan agreement for SR 2,500 million, to be utilized for future expansion and infrastructure projects. During the year, the Company utilized SR 600 million out of this facility.

In the event of default by the Company, the banks have the right to offset the borrowings repayments against cash routed through the Company's collection accounts at those banks.

Unused financing facilities at December 31, 2001 totaled SR 3,000 million. These facilities expire starting June 2002 through December 2002.

The net impact of loans commission on the financial statements is as follows:

	<u>2001</u>	<u>2000</u>
	SR 000's	SR 000's
Total commission expense incurred	164,635	232,197
Amortization of deferred gain	-	<u>(39,614)</u>
Net commission expense	164,635	192,583
Capitalized commission (Note 5)	<u>(164,635)</u>	<u>(192,583)</u>
	<u> -</u>	<u> -</u>

11 EMPLOYEES' END OF SERVICE BENEFITS

The movement in employees' end of service benefits was as follows:

	<u>2001</u>	<u>2000</u>
	SR 000's	SR 000's
Balance at January 1	1,285,416	1,122,127
Charge during the year	169,093	186,461
Settlements made during the year	<u>(26,164)</u>	<u>(23,172)</u>
Balance at December 31	<u>1,428,345</u>	<u>1,285,416</u>

There are no assets designated specifically to cover this liability; instead it is paid out of operating cash flows as and when employees leave the Company.

12 ZAKAT

The major items and balances of the Zakat base are as follows:

	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Share capital – beginning of the year	<u>12,000,000</u>	<u>12,000,000</u>
Additions:		
Retained earnings – beginning of the year	5,086,416	1,528,830
Legal reserve – beginning of the year	807,467	412,180
Provisions – beginning of the year	2,876,695	2,743,011
Adjusted net income	<u>3,967,613</u>	<u>3,946,775</u>
Total additions	<u>12,738,191</u>	<u>8,630,796</u>
Deductions:		
Net property, plant & equipment and capital work in progress (limited to Shareholders' equity before Zakat)	21,481,091	18,001,845
Investments	803,717	711,212
Non-current deferred costs	<u>71,914</u>	<u>47,640</u>
Total deductions	<u>22,356,722</u>	<u>18,760,697</u>
Zakat Base	<u>2,381,469</u>	<u>1,870,099</u>

Since the Zakat base is less than the adjusted net income, the Zakat rate of 2.5% is applied to adjusted net income to determine the provision for Zakat.

Provision for Zakat	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Balance at beginning of year	240,585	141,916
Charge for the year	<u>99,190</u>	<u>98,669</u>
Balance at December 31	<u>339,775</u>	<u>240,585</u>

Final Zakat assessments and Zakat payments have not been made since inception until December 31, 2001.

13 OTHER INCOME AND EXPENSES, NET

The amount shown for 2001 includes losses on disposal of property, plant and equipment of SR 192.5 million. The loss represents the net book value of old equipment disposed of by the Company as a result of upgrading the communications network with new technologies.

14 GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses were as follows:

	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Provision for doubtful accounts	951,136	746,553
Consultancy	225,232	310,985
Utilities	221,207	288,752
Other	<u>370,975</u>	<u>147,282</u>
	<u>1,768,550</u>	<u>1,493,572</u>

15 SECONDED EMPLOYEES' ENTITLEMENTS

The amount shown in the statement of income for 2001 represents the Company's estimated liability, being 50% of the total amount payable towards the settlement of the MoPTT seconded employees' pensions, in accordance with the Council of Ministers' Decree No. 75 dated May 28, 2001 (5 Rabi Awal 1422H). As per the Decree, the seconded employees of 5,559 were given the choice to either settle their entitlements in accordance with the Civil Service Pension Scheme ("CSPS") or postpone settlement until issuance of the rules coordinating between the systems of the General Organization for Social Insurance and CSPS.

As of December 31, 2001, 813 employees chose to settle their entitlements in accordance with CSPS, and, accordingly, the Company has calculated the relevant liability. For the remaining 4,746 employees, the Company has calculated an amount equal to 50% of their entitlements based on CSPS rules, in the absence of the rules referred to in the aforementioned decree.

Upon issuance of these rules, the Company will adjust the calculated amount on the basis of actual number of employees who choose to terminate their services or settle their pension entitlements. The resulting variance from the currently reported amount will be recognized in the statement of income for the year in which the rules are issued.

16 COST OF EARLY RETIREMENT PROGRAM

The amount shown in the statement of income for 2001 represents the cost of implementing the early retirement program for the Company's employees, which has commenced in 2001.

17 COMMITMENTS AND CONTINGENCIES

Commitments

The Company enters into commitments during the ordinary course of business for major capital expenditures, primarily in connection with its telephony network expansion programs. As of December 31, 2001 outstanding capital expenditure commitments amounted to approximately SR 3,791 million (2000: SR 1,520 million).

Certain land and buildings are leased for use in the Company's operations under operating lease commitments, expiring at various dates in the future. During 2001, total rent expense under operating leases amounted to SR 23 million (2000: SR 41.3 million). The table below shows the aggregate rental commitments under non-cancelable operating lease arrangements as of December 31, 2001.

<u>Years</u>	<u>SR 000's</u>
2002	20,726
2003	19,823
2004	18,842
2005	18,162
2006	17,929
Thereafter	<u>41,058</u>
Total minimum rental commitments	<u>136,540</u>

Contingencies

In the normal course of business, the Company is subject to proceedings, lawsuits and other claims. Such outstanding matters are not expected to result in a material impact on the Company's financial position or results of operations as reflected in the financial statements.

18 FINANCIAL INSTRUMENTS

Fair value

The carrying values of all financial instruments approximate their fair values at December 31, 2001 and 2000, as discussed below:

- For cash and cash equivalents, accounts receivable and payable and other receivables and payables, fair value is deemed to approximate their carrying amount due to their short-term nature.
- For marketable equity instruments, fair value is based on quoted market prices.
- For Government bonds and borrowings, fair value is based on discounted cash flows.
- For all other investments, fair value is based on management estimates.

The Company does not utilize derivative financial instruments to manage foreign currency exchange and commission rate risks due to factors explained below.

Commission rate risk

The Company manages its cash position by controlling the timing between its cash inflows and cash outflows. Surplus cash is invested to generate the Company's commission income through holding balances in short-term bank deposit accounts, however the commission rate risk attached is not considered to be significant.

Due to the Company's debt portfolio, which consists of various commission rates and maturity terms, management does not consider commission rate risk to be significant.

Consequently, the Company has not used derivative financial instruments to mitigate exposure to commission rate risk.

Exchange rate risk

The Company believes that it is not exposed to significant exchange rate risk since the Company's functional currency is the Saudi Arabian Riyal, which is the principal currency in which the Company transacts. This currency is currently fixed, within a narrow range, against the U.S. dollar.

Transactions denominated in foreign currencies other than the U.S. dollar are immaterial. Consequently, the net effect of foreign currency transactions during the years ended December 31, 2001 and 2000 is immaterial.

Concentrations of credit risks

Financial instruments that subject the Company to concentrations of credit risk consist primarily of temporary cash balances and accounts receivable. The Company does not consider itself exposed to a concentration of credit risk with respect to accounts receivable due to its diverse customer base (residential, professional, large business and public entity customers) operating in numerous industries and located in many regions.

The Company deposits its cash balances at financial institutions with high credit rating and operates a policy of limiting its balances deposited with each institution.

Consequently, the Company does not believe that there is a significant risk of non-performance by these financial institutions.

19 RELATED PARTY TRANSACTIONS

Government Agencies

The Company provides various voice, data and administrative services to the Government.

Government agencies accounted for approximately 3.7% of gross revenues in 2001 (2000: 5%). Revenues and expenses related to Government agencies in 2001 amounted to SR 734 million and SR 4,149 million (including Government charges discussed below), respectively (2000: SR 837 million and SR 3,433 million, respectively). Balances receivable from and payable to Government agencies at December 31, 2001 totaled SR 1,792 million and SR 1,963 million, respectively (2000: SR 1,643 million and SR 189 million, respectively).

Government Charges

The Company is charged by the Government for the right to operate as the Kingdom-wide provider of telecommunications services based on a proportion of net revenues. Net revenues is defined as total operating revenues less access charges as reflected in the statement of income. Effective from January 1, 1999, the Government charge is determined as follows:

- **Commercial Provisioning**
For 1999, 2000 and 2001, 20% of the net revenues (as defined above).
For 2002 and thereafter, 27% of the net revenues (as defined above).
- **License Fees**
License fees will be determined as 1% of net revenues (as defined above). A portion of this fee will be used to finance the operations of the Saudi Telecom Commission.
- **Frequency Spectrum**
A fixed fee of SR 200 million per annum. This fee will continue until such time that the Saudi Telecom Commission establishes new telecom regulations.

Notes to the Financial Statements for the Years Ended December 31, 2001 and 2000

The charges for the years ended December 31, 2001 and 2000 are calculated as follows:

	<u>2001</u> SR 000's	<u>2000</u> SR 000's
Commercial Provisioning	3,584,455	2,995,343
License Fees	179,223	149,767
Frequency Spectrum	<u>200,000</u>	<u>200,000</u>
	<u>3,963,678</u>	<u>3,345,110</u>

Arabsat

During the period, the Company incurred charges of approximately SR 36 million (2000: SR 30 million) from Arabsat with respect to satellite utilization. Balances receivable from and payable to Arabsat at December 31, 2001 totaled SR 0.9 million and nil, respectively (2000: SR 10 million and SR 6 million, respectively).

20 SHAREHOLDERS' EQUITY

According to the Articles, the Company is subject to the following provisions:

- To set aside, as a reserve within Shareholders' equity, 10% of its net income as a legal reserve until such a reserve equals 50% of issued capital. This reserve is currently not available for distribution to the Shareholders. During 2001, the Company set aside SR 347.9 million (2000: SR 395.3 million).
- Based upon a proposal from the Board of Directors, a percentage of net income may be appropriated by the Shareholders to establish a special reserve to be allocated to specific projects. As of December 31, 2001 and 2000, the Board of Directors has not established such a reserve.

Dividends payable reflected within accounts payable in the 2001 balance sheet represent 5% of net revenues for the year, in accordance with Paragraph (4) of the Council of Ministers' Decree No. 213 referred to in Note 1b above. In March 2002, SR 825 million has been paid against the dividends payable.

21 SUBSEQUENT EVENTS

During 2002, another phase of the early retirement program will be implemented. Total cost of this phase has initially been estimated at SR 693 million, and is expected to be recognized in the statements of income for 2002.