

الاتصالات السعودية
SAUDI TELECOM



a Saudi Joint Stock Company

**Financial Statements for the
Year Ended December 31, 2002**

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AUDITORS' REPORT

To the shareholders
Saudi Telecom Company
(A Saudi Joint Stock Company)
Riyadh, Saudi Arabia

We have audited the accompanying balance sheet of Saudi Telecom Company (A Saudi Joint Stock Company) as of December 31, 2002, and the related statements of income, shareholders' equity and cash flows for the year then ended, and notes 1 to 23 which form an integral part of these financial statements as prepared by the Company in accordance with Article 123 of the Regulations for Companies and presented to us with all the necessary information and explanations. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 present fairly, in all material respects, the financial position of Saudi Telecom Company as of December 31, 2002, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting standards appropriate to the nature of the Company, and comply with the relevant provisions of the Regulations for Companies and the articles of the Company as these relate to the preparation and presentation of these financial statements. The Company maintains computerized Arabic accounting records required by the relevant regulations and the financial statements are in agreement therewith.

Deloitte & Touche
Bakr Abulkhair & Co.

Bakr A. Abulkhair
(License No. 101)
Muharram 5, 1424
March 8, 2003, except for note (22b) dated April 12, 2003

Saudi Telecom Company
(a Saudi Joint Stock Company)
Balance sheet as of December 31, 2002



	<u>Notes</u>	<u>2002</u> SR'000	<u>2001</u> SR'000
<u>ASSETS</u>			
Cash and cash equivalents	3	1,941,866	1,802,349
Accounts receivable, net	4	5,447,908	6,076,230
Inventories, net		410,655	447,544
Prepayments and other current assets		<u>126,380</u>	<u>97,318</u>
Total current assets		7,926,809	8,423,441
Property, plant and equipment, net	5	32,018,244	29,870,474
Investment in associates	6	769,634	667,151
Other investments	7	112,090	136,565
Other non-current assets		<u>86,066</u>	<u>71,914</u>
Total assets		<u>40,912,843</u>	<u>39,169,545</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>			
Accounts payable	8	6,932,435	7,305,415
Accrued expenses and other payables	9	4,091,111	4,776,095
Deferred revenue - current		1,582,984	1,217,124
Short-term borrowings	10	<u>583,333</u>	<u>1,216,667</u>
Total current liabilities		13,189,863	14,515,301
Deferred revenue		1,681,080	2,068,280
Long-term borrowings	10	650,000	683,333
Employees' end of service benefits	11	<u>1,382,570</u>	<u>1,428,345</u>
Total liabilities		<u>16,903,513</u>	<u>18,695,259</u>
Commitments and contingencies	17	-	-
Shareholders' equity			
Authorized, issued and outstanding share capital:			
300,000,000 shares on December 31, 2002			
240,000,000 shares on December 31, 2001			
Par value SR 50 per share	20	15,000,000	12,000,000
Legal reserve		1,509,923	1,155,340
Retained earnings		7,512,405	7,321,154
Unrealized loss on other investments	7	<u>(12,998)</u>	<u>(2,208)</u>
Total shareholders' equity	21	<u>24,009,330</u>	<u>20,474,286</u>
Total liabilities and shareholders' equity		<u>40,912,843</u>	<u>39,169,545</u>

The accompanying notes 1 to 23 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)



Statement of Income for the Year Ended December 31, 2002
(Saudi Riyals in thousands)

	<u>Notes</u>	<u>2002</u>	<u>2001</u>
Operating Revenues			
Wireline		10,607,248	11,791,851
Wireless		<u>12,939,817</u>	<u>7,989,517</u>
Total operating revenues		<u>23,547,065</u>	<u>19,781,368</u>
Operating Expenses			
Government charges	19	(6,299,389)	(3,963,678)
Access charges		(1,763,532)	(1,859,091)
Employee costs		(3,456,375)	(3,261,987)
Depreciation	5	(3,265,293)	(2,800,611)
General and administrative expenses	14	(2,569,454)	(1,768,550)
Repairs and maintenance		<u>(1,405,318)</u>	<u>(1,119,243)</u>
Total operating expenses		<u>(18,759,361)</u>	<u>(14,773,160)</u>
Operating Income		<u>4,787,704</u>	<u>5,008,208</u>
Other Income and Expenses			
Commission income	3 and 7	30,548	59,374
Earnings of investment in associates	6	123,162	102,441
Other, net	13	<u>(233,330)</u>	<u>(197,635)</u>
Other income and expenses, net		<u>(79,620)</u>	<u>(35,820)</u>
Net Income before Non-recurring Items and Zakat		<u>4,708,084</u>	<u>4,972,388</u>
Settlement of seconded employees' entitlements	15	-	(794,265)
Cost of early retirement program	16	<u>(1,070,000)</u>	<u>(600,208)</u>
Total non-recurring items		<u>(1,070,000)</u>	<u>(1,394,473)</u>
Net Income before Zakat		3,638,084	3,577,915
Provision for Zakat	12	<u>(92,250)</u>	<u>(99,190)</u>
Net Income		<u>3,545,834</u>	<u>3,478,725</u>

The accompanying notes 1 to 23 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)

Statement of Cash Flows for the Year Ended December 31, 2002
(Saudi Riyals in thousands)

	<u>2002</u>	<u>2001</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	3,545,834	3,478,725
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,265,293	2,800,611
Allowance for doubtful accounts	1,726,115	951,136
Settlement of seconded employees' entitlements	-	794,265
Loss on disposal / sale of property, plant and equipment	367,092	196,735
Undistributed earnings of investment in associates	(102,483)	(89,248)
Changes in:		
Accounts receivable	(1,097,793)	(2,070,647)
Inventories	36,889	(82,904)
Prepayments and other current assets	(29,062)	(44,397)
Other non-current assets	(14,152)	350,726
Accounts payable	523,134	(262,955)
Accrued expenses and other payables	(684,984)	307,488
Deferred revenue	(21,340)	497,854
Employees' end of service benefits	<u>(45,775)</u>	<u>142,929</u>
Net cash provided by operating activities	<u>7,468,768</u>	<u>6,970,318</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(5,780,155)	(5,230,177)
Investment in associates	-	(30,000)
Capital distributions related to other investments	<u>13,685</u>	<u>15,243</u>
Net cash used in investing activities	<u>(5,766,470)</u>	<u>(5,244,934)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(896,114)	-
Repayments of short-term borrowings	(1,350,000)	(250,000)
Proceeds from short-term borrowings	450,000	-
Repayments of long-term borrowings	(316,667)	(1,406,250)
Proceeds from long-term borrowings	<u>550,000</u>	<u>600,000</u>
Net cash used in financing activities	<u>(1,562,781)</u>	<u>(1,056,250)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	139,517	669,134
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>1,802,349</u>	<u>1,133,215</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>1,941,866</u>	<u>1,802,349</u>

The accompanying notes 1 to 23 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)

Statement of Changes in Shareholders' Equity for the Year Ended December 31, 2002

(Saudi Riyals in thousands)



	<u>Notes</u>	<u>Share Capital</u>	<u>Legal Reserve</u>	<u>Retained Earnings</u>	<u>Unrealized Gain/ (Loss) on Other Investments</u>	<u>Total Shareholders' Equity</u>
Balance at December 31, 2000		12,000,000	807,467	5,086,416	9,293	17,903,176
Net income		-	-	3,478,725	-	3,478,725
Dividends payable	21	-	-	(896,114)	-	(896,114)
Transfer to legal reserve	21	-	347,873	(347,873)	-	-
Unrealized loss on investment	7	-	-	-	(11,501)	(11,501)
Balance at December 31, 2001		12,000,000	1,155,340	7,321,154	(2,208)	20,474,286
Net income		-	-	3,545,834	-	3,545,834
Transfer to share capital	20	3,000,000	-	(3,000,000)	-	-
Transfer to legal reserve	21	-	354,583	(354,583)	-	-
Unrealized loss on investment	7	-	-	-	(10,790)	(10,790)
Balance at December 31, 2002		15,000,000	1,509,923	7,512,405	(12,998)	24,009,330

The accompanying notes 1 to 23 form an integral part of these financial statements.

1 DESCRIPTION OF BUSINESS, BACKGROUND 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.

The Council of Ministers’ Resolution No. 171 dated 2 Rajab 1423H (corresponding to September 9, 2002), approved opening the telecommunications sector for competition by partially liberalizing the mobile services in the last quarter of 2004, and the landline services in 2008.

b) Corporate background

The Company was established by the Royal Decree No. M/ 35, dated 24 Dhul Hujja 1418H (corresponding to April 21, 1998) as a Saudi Joint Stock Company, in accordance with the Council of Ministers’ Resolution No. 213, dated 23 Dhul Hujja 1418H (corresponding to April 20, 1998) which approved The Company’s Articles of Association (the “Articles”). The Company was wholly owned by the Government of the Kingdom of Saudi Arabia (the “Government”), however, the Council of Ministers, in its capacity as the Company’s Extraordinary General Assembly, has issued the Resolution No. 171, referred to in (1- a) above, whereby it approved increasing the Company’s capital from (12,000,000,000), SR twelve billion, to (15,000,000,000), SR fifteen billion, by transferring a part of the Company’s retained earnings to share capital, and, also, to sell (30%), thirty percent, of the Government’s shares in the Company by offering at least (20%), twenty percent, to Saudi individuals and not more than (10%), ten percent, to both of the Public Pension Fund and the General Organization for Social Insurance, in equal proportions. The subscription period ended on 3 Dhul Quada 1423H (corresponding to January 6, 2003).

The Company received its commercial registration number 101050269 as a Saudi Joint Stock Company on 4 Rabi Awal 1419H (corresponding to June 29, 1998).

Prior to 6 Muharram 1419H (corresponding to May 2, 1998), 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, the Saudi Communications Commission, was formed on 5 Rabi Awal 1422H (corresponding to May 28, 2001) 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) Period of the financial statements

In accordance with the Articles, the Company has fixed its financial year to begin on January 1 and end on December 31.

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 below:

a) Accounting convention

The financial statements are 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 financial statements 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 as revenue 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 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 comprise 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 maintain sufficiently detailed historical information to record property, plant and equipment based on the historical cost. 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 following are the principal bases used for valuation:

- | | |
|----------------------------------|------------------------------|
| • 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 any, up to the date the relevant assets are placed in service. Property, plant and equipment excluding land is depreciated using the straight line method over the following estimated useful lives:

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

A gain or loss resulting from the sale or disposal of property, plant and equipment are recognized in the statement of income. This represents the difference between the proceeds and the net carrying amount of the asset.

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 the equity method, the Company recognizes in the statement of income its relative share of the investee's results of operations and adjusts the carrying amount of its investment to reflect its pro rata share of the net assets of the investee.

i) Other investments

Available for sale marketable securities are carried at fair value with unrealized holding gains and losses recorded as a separate component of shareholder's equity. Available for sale securities for which fair value cannot be reliably measured are recorded at cost, holding losses are charged to the statement of income, and the cost basis of the investment is decreased if it is determined by management that such losses are of an other than temporary nature. Gains and losses resulting from the sale of available for sale marketable securities are 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 their value.

j) Zakat

The Company is subject to Zakat in accordance with the regulations of the Department of Zakat and Income Tax. The Company calculates and records the Zakat provision within 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 upon 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 within the statement 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 periods.

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 periods of relevant calls.

3 CASH AND CASH EQUIVALENTS

Surplus cash arising during the year is invested in short-term deposit accounts. The average rate of commission received on short-term deposit accounts during 2002 was 2.3% (2001: 4.1%). Total commission earned during the year on these accounts was SR 22.5 million (2001: SR 56.8 million). Commission earned on current accounts amounted to SR 6.7 million.

Cash and cash equivalents at the end of the year include balances on collection accounts held with different banks. As per the agreements with the banks those balances are to be transferred to the Company's main account on the fourth day of the subsequent month.

4 ACCOUNTS RECEIVABLE, NET

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

	<u>2002</u>	<u>2001</u>
	SR 000's	SR 000's
Trade accounts receivable	5,738,401	5,975,595
Unbilled revenue	<u>1,221,602</u>	<u>1,653,754</u>
	6,960,003	7,629,349
Allowance for doubtful accounts	<u>(1,512,095)</u>	<u>(1,553,119)</u>
	<u>5,447,908</u>	<u>6,076,230</u>

Notes to the Financial Statements for the Year Ended December 31, 2002

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, 2002 and 2001, the net amounts included in accounts receivable and accounts payable are as follows:

	<u>2002</u> SR 000's	<u>2001</u> SR 000's
International accounts receivable, net	<u>566,426</u>	<u>523,270</u>
International accounts payable, net	<u>935,504</u>	<u>974,949</u>

5 PROPERTY, PLANT AND EQUIPMENT

	<u>Land and</u> <u>Buildings</u>	<u>Telecommunications</u> <u>Plant and Equipment</u>	<u>Other</u> <u>Assets</u>	<u>Capital</u> <u>Work</u> <u>In Progress</u>	<u>Total</u>
(SR 000's)					
Gross book values					
At December 31, 2001	8,242,449	37,929,856	956,211	1,675,775	48,804,291
Additions	63,198	725,680	117,857	4,851,795	5,758,530
Transfers	354,310	4,339,892	3,186	(4,697,388)	-
Disposals	<u>-</u>	<u>(1,126,456)</u>	<u>(9,625)</u>	<u>-</u>	<u>(1,136,081)</u>
At December 31, 2002	<u>8,659,957</u>	<u>41,868,972</u>	<u>1,067,629</u>	<u>1,830,182</u>	<u>53,426,740</u>
Accumulated depreciation					
At December 31, 2001	3,103,873	15,212,611	617,333	-	18,933,817
Charge for the year	207,632	2,927,481	130,180	-	3,265,293
Disposals	<u>-</u>	<u>(781,846)</u>	<u>(8,768)</u>	<u>-</u>	<u>(790,614)</u>
At December 31, 2002	<u>3,311,505</u>	<u>17,358,246</u>	<u>738,745</u>	<u>-</u>	<u>21,408,496</u>
Net book values					
At December 31, 2002	<u>5,348,452</u>	<u>24,510,726</u>	<u>328,884</u>	<u>1,830,182</u>	<u>32,018,244</u>
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>

Land and buildings shown above include land of SR 2,312 million as of December 31, 2002 (2001: SR 2,320 million).

In accordance with the Royal Decree referred to in note (1-b) above, ownership of assets had been transferred to the Company as of May 2, 1998. However, transfer of legal ownership of certain lands is in progress. As of March 2003, value of lands for which legal ownership has been transferred into the Company' name amounted to SR 927 million. Ownership transfer of the remaining lands with value amounting to SR 1,385 million is in progress.

During 2002, the Company capitalized loan commissions totaling SR 56.4 million at a capitalization rate of 3.78% (2001: SR 164.6 million, at a capitalization rate of 6.85%) into property, plant and equipment.

6 INVESTMENT IN ASSOCIATES

Investment in associates consisted of the following:

	<u>2002</u> SR 000's	<u>2001</u> SR 000's
Arab Satellite Communications Organization ("Arabsat").	739,634	637,151
Arab Submarine Cables Company Ltd	<u>30,000</u>	<u>30,000</u>
	<u>769,634</u>	<u>667,151</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 telephone service (voice, data, fax and telex), television broadcasting, regional radio broadcasting, restoration services and leasing of capacities 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, lease, management and operation of a submarine cable connecting the Kingdom and the Republic of Sudan for telecommunications between them and any other countries. The Arab Submarine Cables Ltd has not started commercial operations upto December 31, 2002.

7 OTHER INVESTMENTS

Other investments consisted of the following:

	<u>2002</u> SR 000's	<u>2001</u> SR 000's
Available for sale – at market value:		
Investment in Newskies	13,919	18,942
Investment in New ICO	<u>82</u>	<u>-</u>
	<u>14,001</u>	<u>18,942</u>
Available for sale – at cost:		
Investment in Intelsat Ltd	55,649	58,123
Investment in Inmarsat	28,749	28,749
Investment in New ICO	<u>-</u>	<u>3,375</u>
	<u>84,398</u>	<u>90,247</u>
Held to maturity:		
Government bonds	<u>13,691</u>	<u>27,376</u>
Total other investments	<u>112,090</u>	<u>136,565</u>

During 2002, the Company has recorded unrealized holding losses of SR 11 million related to its investment valued at market value (2001: SR 12 million).

The investment in New ICO has been reclassified as available for sale - at market value, due to the availability of market prices following the trading in its shares.

Notes to the Financial Statements for the Year Ended December 31, 2002

The decrease in the cost of investment in Intelsat Ltd represents the shares distributed out of the remaining stake of Intelsat Ltd. in Newskies. Those shares have been added to the investment in Newskies.

The investment in Intelsat Ltd is still valued at cost due to non-commencement of trading in its shares.

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 maturities 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 1.3 million (2001: SR 2.6 million).

8 ACCOUNTS PAYABLE

Accounts payable consisted of the following:

	<u>2002</u>	<u>2001</u>
	SR 000's	SR 000's
Government	3,724,526	2,689,816
Capital	1,945,598	2,344,655
Trade	326,807	1,295,995
International settlements	<u>935,504</u>	<u>974,949</u>
	<u>6,932,435</u>	<u>7,305,415</u>

Government accounts payable for 2001 include dividends payable of SR 896 million. Refer to note (21) 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>2002</u>	<u>2001</u>
	SR 000's	SR 000's
Capital	1,190,856	1,724,043
Trade	1,067,288	499,827
Settlement of seconded employees' entitlements	711,604	775,934
Employee accruals	647,956	673,935
Early retirement	-	600,208
Other	<u>473,407</u>	<u>502,148</u>
	<u>4,091,111</u>	<u>4,776,095</u>

10 BORROWINGS

Borrowings as at December 31, 2002 consisted of the following:

	<u>SR 000's</u>
Short-term borrowings	-
Current portion of long-term borrowings	<u>583,333</u>
	<u>583,333</u>
Long-term borrowings:	
Between one and two years	466,667
Between two and three years	<u>183,333</u>
	<u>650,000</u>
Total borrowings	<u>1,233,333</u>

The Company obtained some loans and facilities in 2002 and 2001 from a number of local banks. Commission rates charged on all loans and facilities do not exceed the Saudi Interbank Offered Rate ("SIBOR") plus 0.7% per annum.

In 2001, the Company entered into a syndicated loan agreement for SR 2,500 million, to be utilized in future expansion and infrastructure projects. The Company utilized SR 550 million out of this loan in 2002 (2001: SR 600 million).

In the event of default, the banks have the right to offset the debt repayments against amounts routed through the collection accounts at those banks.

Unused financing facilities at December 31, 2002 totaled SR 3,250 million, including renewable short-term facilities totaling SR 1,900 million. These facilities expire starting June 2003 through December 2006.

Commissions incurred on borrowings have been capitalized into property, plant and equipment as explained in note (5) above.

11 EMPLOYEES' END OF SERVICE BENEFITS

The following is the employees' end of service benefits movement:

	<u>2002</u>	<u>2001</u>
	<u>SR 000's</u>	<u>SR 000's</u>
Balance at January, 1	1,428,345	1,285,416
Charge during the year	356,960	169,093
Settlements made during the year	<u>(402,735)</u>	<u>(26,164)</u>
Balance at December, 31	<u>1,382,570</u>	<u>1,428,345</u>

There are no assets designated specifically to cover this provision; instead it is paid out of operating cash flows as and when employees' services are terminated.

12 ZAKAT

The following are the major elements and amounts of the Zakat base:

	<u>2002</u> SR 000's	<u>2001</u> SR 000's
Share capital – Beginning of the year	12,000,000	12,000,000
Additions:		
Retained earnings – Beginning of the year	7,321,154	5,086,416
Legal reserve – Beginning of the year	1,155,340	807,467
Provisions – Beginning of the year	3,363,514	2,876,695
Adjusted net income	<u>3,689,996</u>	<u>3,967,613</u>
Total Additions	<u>15,530,004</u>	<u>12,738,191</u>
Deductions:		
Net property, plant & equipment and capital work in progress (limited to shareholders' equity before Zakat)	(24,112,370)	(21,481,091)
Investments	(881,724)	(803,717)
Non-current deferred costs	<u>(86,066)</u>	<u>(71,914)</u>
Total deductions	<u>(25,080,160)</u>	<u>(22,356,722)</u>
Zakat base	<u><u>2,449,844</u></u>	<u><u>2,381,469</u></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 Zakat charge.

Provision for Zakat:

	<u>2002</u> SR 000's	<u>2001</u> SR 000's
Balance at beginning of year	339,775	240,585
Amounts paid during the year	(339,671)	-
Charge for the year	<u>92,250</u>	<u>99,190</u>
Balance at December 31	<u><u>92,354</u></u>	<u><u>339,775</u></u>

Final assessments have not been made since inception through December 31, 2001, as additional information are needed by the Department of Zakat and Income Tax, which are being compiled.

13 OTHER INCOME AND EXPENSES, NET

The amount shown for 2002 includes losses on disposal of network equipment of SR 203.6 million (2001: SR 192.5 million). These losses represent the net book value of old equipment, adjusted by transfers to spare parts, which were disposed of as a result of modernizing the communications network by new technologies.

14 GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses comprise the following:

	<u>2002</u>	<u>2001</u>
	SR 000's	SR 000's
Provision for doubtful accounts	1,726,115	951,136
Consultancy	167,697	225,232
Commissions on sale of prepaid mobile cards	156,758	-
Printing of telephone cards and stationery	118,111	63,351
Utilities	110,381	95,951
Other	<u>290,392</u>	<u>432,880</u>
	<u>2,569,454</u>	<u>1,768,550</u>

15 SECONDED EMPLOYEES' PENSION SETTLEMENT

The amount shown in the 2001 statement of income represents the estimated liability on the Company, being 50% of the total amount payable towards the settlement of the MoPTT seconded employees' pensions upon their attaining the age of 60, in accordance with the Council of Ministers' Resolution No. 75 dated 5 Rabi Awal 1422H (corresponding to May 28, 2001). As per the Resolution, the 5,559 seconded employees are given the choice either to settle their entitlements in accordance with the Civil Pensions System or postpone settlement until issuance of the rules coordinating between the civil pensions system and the social insurance system.

As of December 31, 2002, 1602 employees chose to settle their entitlements in accordance with Civil Pensions System, and the Company has accordingly calculated the relevant amounts. For the remaining 3,957 employees, the Company has calculated an amount equal to 50% of their total pension entitlements upon their attaining the age of 60 based on the Civil Pensions System rules, in the absence of the coordinating rules referred to in the aforementioned Council of Ministers' resolution.

Upon issue of the coordinating rules, the Company will reconcile the amount on the basis of actual number of employees who choose to terminate their services or settle their pension entitlements. Accordingly, the resulting difference 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 2002 statement of income represents the cost of implementing the second phase of the early retirement program for the Company' employees, which had 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 projects. As of December 31, 2002 capital expenditure commitments outstanding amounted to approximately SR 1,641 million (2001: SR 3,791 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 2002, total rent expenses under operating leases amounted to SR 30 million (2001: SR 23 million).

Contingencies

In 2001 the Company contracted with a local contractor to build and operate payphones on a build, operate and transfer basis (BOT) for a period of seven years. A dispute arose between the two parties during execution of the agreement. As a result, the Contractor filed claims by the end of 2002 against the Company and the Company filed counter-claims.

Likewise, and 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, 2002 and 2001, 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, but 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 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 periods ended December 31, 2002 and 2001 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 with a number of major high credit quality financial institutions 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% of billed revenues in 2002 (2001: 4.6%). Billed revenues and expenses related to Government agencies in 2002 amounted to SR 698 million and SR 6,388 million (including Government charges discussed below), respectively (2001: SR 911 million and SR 4,149 million, respectively). Amounts receivable from and payable to Government agencies at December 31, 2002 totaled SR 2,510 million and SR 3,842 million, respectively (2001: SR 2,169 million and SR 1,963 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; 27% of the net revenues (as defined above).

For 2003 and thereafter; 20% of the net revenues (as defined above), in accordance with the amendment per the Council of Ministers' Resolution No. 171 referred to in note (1-a) above. The Resolution stipulates that reduction in the percentage will be reconsidered after opening the telecommunications sector for competition.

- **License Fees**

License fees is determined as 1% of net revenues (as defined above). A portion of this fee will be used to finance the operations of the Saudi Communications Commission.

- **Frequency Spectrum**

A fixed fee of SR 200 million per annum. This fee will continue until such time that the Saudi Communications Commission establishes new telecom regulations.

Notes to the Financial Statements for the Year Ended December 31, 2002

Government charges have been calculated as follows:

	<u>2002</u>	<u>2001</u>
	<u>SR 000's</u>	<u>SR 000's</u>
Commercial Provisioning	5,881,554	3,584,455
License Fees	217,835	179,223
Frequency Spectrum	<u>200,000</u>	<u>200,000</u>
	<u>6,299,389</u>	<u>3,963,678</u>

Associates

During the year, the Company incurred charges of approximately SR 37 million from Arabsat with respect to satellite utilization (2001: SR 36 million). Amounts receivable from and payable to Arabsat at December 31, 2002 are immaterial.

There were no dealings with the Arab Submarine Cables Company Ltd during 2002 and 2001.

20 INCREASE OF CAPITAL

In accordance with the Council of Ministers' Resolution No. 171, referred to in note (1-a) above, it has been approved to increase the Company's capital by transferring SR 3,000 million from retained earnings. Consequently, the Company's capital amounted to SR 15,000 million, comprising 300 million shares at par value of SR 50 per share.

21 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 net income as a legal reserve until such a reserve equals 50% of issued share capital. This reserve is currently not available for distribution to the shareholders of the Company. During 2002, the Company set aside SR 354.6 million (2001: SR 347.9 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, 2002 and 2001, the Board of Directors had not established such a reserve.

Dividends payable shown 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' Resolution No. 213 referred to in note (1-b) above.

22 SUBSEQUENT EVENTS

- a) The implementation of the GSM network expansion project commenced early in 2003. As of March 2003, an amount of about SR 2,700 million has been contracted for out of the total project cost.
- b) The Board of Directors, in its capacity as the Ordinary General Assembly of the Company, approved in April 2003 the distribution of dividends amounting to SR 750 million, being 5% of the paid-up capital. Only the shareholder outstanding on December 31, 2002 is entitled to these dividends.

23 RECLASSIFICATION

Certain comparative figures of 2001 have been adjusted to conform with the classifications used in 2002.