4.2. Work performed

Work step 1

We were provided by Accounting department from Telekom Srbija with post-separation listing of WIP stocks (209,270 thousand Dinars) and materials (155.304 thousand Dinars), and footed them respectively. We have agreed the post-separation listings to Statutory opening balance sheet of Telekom Srbija as of 1 June 1997.

Work step 2

We were provided by PTT with the pre-separation stock listing as of 31 May 1997. Comparison of the PTT pre-separation stock listings revealed the following discrepancies:

Net book value of stock	Telekom opening balance	PTT closing balance	Differences identified
Materials	155.304	228.966	73.662
WIP in stock	209.270	212.400	3.130
TOTAL:	364.574	441.366	76.792

We have compared those listings by detailed accounts and by working units and found out that the largest difference relate to Direkcija za drustveni standard and Working unit Belgrade. We obtained the explanation from management that the above differences are the result of unreconciled stock records, updated on the basis of goods received note with stock general ledger, where postings are based on suppliers invoice, when received.

We were unable to confirm that all stocks were transferred from PTT to Telekom Srbija books, due to the following reasons:

- no stock count was held at 1 June 1997;
- the split between post and t telecommunication business stocks was conducted on coding and description of items, taking into account nature of stock item.
- stock count was undertaken at the end of June 1997
- PW noticed serious weakness during the stock count at 30 June 1997 which could affect the results of stock count
- differences between actual stock count and accounting records have been posted with certain delay due to the lack of supporting documentation.

Based on the above stated facts concerning the reconciliation of PTT and Telekom Srbija stock ledgers and arising from stock count, PW made appropriate adjustments.

In order to get reasonable assurance that all stocks were transferred to Telekom Srbija we performed the alternative procedure. We reviewed stock count listing as of 31 December 1997 held by PTT and we did not recognize any stock items, which should be, according to its nature, transferred to Telekom Srbija.

Work step 3

We were provided by Accounting Department from Telekom Srbija with stock count listing derived from stock count held as of 31 December 1997. Based on the following sample:

- Working unit Novi Sad, work step 2 - 10 items;
- Working unit Zrenjanin - 14 items; and
- Working unit Pristina - 13 items,

we found out discrepancies at Working unit Zrenjanin in the amount of 6.016 thousand Dinars. This amount was subsequently corrected in the Telekom Srbija stock general ledger.

Work step 4

We relied upon PW disclosures relating to stock count held at Telekom Srbija as of 31 December 1997. We summarized below the main features of stock count which significantly differs form those noticed for stock count held on 1 June 1997:

- there are good written procedures issued by management for stock count;
- warehouses are well organized and are closed for the purposes of stock count;
- items are well labeled;
- stock counts are conducted by commission of three members, following the written procedures;
- stock sheet are printed with all necessary data with exception of quantities

Work step 5

We have clarified with Telekom Srbija management, in broad terms, the following valuation principles:

Cost of stock includes invoiced value and transport and handling expenses.

Stocks are primarily stated at the lower of cost and net realizable value as determined using weighted average method.

Stocks are presented net of provision which is charged to other expense , made where appropriate to reduce the value of stock to net realizable value. In particular, for slow moving and obsolete stocks.

WIP in stock is valued at cost and adjusted for the revaluation. Stock of materials, spare parts and other inventory are valued at cost and, when used, charged to income ad an expense.

PW noticed certain problems regarding the distinction between stocks of materials to be charged to income and WIP in stock which is anticipated to be used immediately in the course of construction. It was also noted that there are certain difficulties in allocation of materials from suppliers' invoices to particular investment project.

Work step 6

We have reviewed the accounting process for making up the cost of stock. We selected two items of each type of inventories and agreed them with goods received note (raised by warehouse) and relevant suppliers invoice in order to prove that established procedures were followed. The quantities received are recorded on a stock card available for each type of stock.

Work step 7

We confirmed with Telekom Srbija, responsible officer the following statements, which were also elaborated by PW, regarding the obsolete stock:

- stock appears in the data base as newly acquired at 1 June 1997. Therefore, no aging analysis is produced;
- Telekom Srbija accounting policy for provisioning of obsolete and slow moving stocks base on new accounting law, which allows more flexible policy, is in process of defining;
- PW calculated provision for obsolete stocks as of the date of separation arriving at 10% provision applied on cost of stock at 1 June 1997. According to PW view the amount of provision seems reasonable which is, from our point of view, acceptable.

4.3. Issues

Except for matters raised regarding differentise to make distinction between stock of materials and WIP in stock and allocation of materials to particular investment project there is no major issue concerning stocks.

5. Cash

We initially proposed the following procedures based on the balances presented in Illustrative separated accounts, April 1997 – Draft.

Work step		Performed	Alternative Procedures/Notes
1	Obtain a post-separation break down of cash for Telekom Srbija - Foot listing - Agree totals for each category to the opening balance sheet		Only cash on gyro account
2	Obtain a pre-separation breakdown for PTT. From listing select a sample (sample size.....) - Determine if items are to be transferred by reference to Clause 1.1. "Telecommunication Business" of the Acknowledgement of Transfer - Agree to post-separation Telekom Srbija cash listing, if appropriate.	N/A	
3	Organize and obtain confirmations form the banks of Telekom Srbija	N/A	
4	Select a sample from post-separation breakdown for Telekom Srbija (Sample size.....): - Agree to bank confirmations if appropriate - Otherwise agree to original certificates - Obtain bank reconciliation and test on scope basis reconciling items to source documentation and cash book	✓	Agreed to NBY gyro-account statement

The only cash item in the opening balance sheet was cash kept on gyro-account held with the National bank of Yugoslavia (NBY), which we confirmed with NBY statement as of 1 June 1997.

6. Accounts Receivable

We initially proposed the following procedures based on the balances presented in Illustrative separated accounts, April 1997 - Draft.

Work step		Performed	Alternative Procedures/Notes
1	Obtain a post-separation accounts receivable listing for Telekom Srbija - Foot listing - Agree listing total to the opening balance sheet.	N/A	
2	Obtain a pre-separation accounts receivable listing for PTT. From listing select a sample of debtors. (Sample size.....) - Determine if debtor is to be transferred by reference to Clause 1.1. "Telecommunication Business" of the Acknowledgement of Transfer" - Agree to post-separation Telekom Srbija accounts receivable listing if appropriate.	N/A	
3	Obtain an account receivable aged listing - Compare current debtors to the previous months revenues, bearing in mind the stage of billing cycle - Compare overall aging of debtors and debtor days to prior periods	N/A	
4	Obtain analysis of bad debt provision and compare to prior periods and historical write-off record. Discuss major balances with management.	N/A	

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Work step		Performed	Alternative Procedures/Notes
5	Select a sample from the post-separation Telekom Srbija accounts receivable listing (Sample size.....) - Agree to subsequent cash receive, by looking up customer payment profile on the billing system - If cash not yet received, review correspondence with customer discussing payment of the balances and discuss with management.	N/A	

As of 1 June 1997, there was no accounts receivable balance presented in the Opening balance sheet of Telekom Srbija. After audit work was performed by PW the only receivables identified were intercompany receivables in the amount of 17.270 thousand Dinars, subsequently netted-off against intercompany payables. This amount represents subscription for June 1997 included in invoices for May 1997 increased by appropriate turnover tax.

We confirmed that this balance was recorded at Telekom Srbija books as of 30 June 1997 representing a part of income for June 1997, while at 1 June 1997 it represented deferred income (15.700 thousand Dinars) and turnover tax (1.570 thousand Dinars).

II Liabilities

1. Relevant Extracts from the Share Sale and Purchase Agreement

Our work on the liabilities has been conducted in accordance with the following clauses in the Share Sale and Purchase Agreement:

Clause 5.1. "The PTT represents and warrants to each of SIN and OTE that, as of the Closing Date and except with respect to the agreement and transaction relating to the Mobtel Agreement or any claim or proceeding that may have been made or may be made or brought and/or involve the PTT, Mobtel or any third party arising thereunder or relating there to:

Clause 5.1(l) "Liabilities. The liabilities of Telekom Srbija as at the Closing Date shall be as set forth in Exhibit "A" to this Agreement".

EXHIBIT "A" Liabilities of Telekom Srbija (as at Transfer Date)

"The aggregate liability of Telekom Srbija as at the Transfer Date for actual, invoiced amounts outstanding and payable in respect of the following balance sheet items (each a "Liability", and collectively, the "Liabilities") shall be set forth below.

Balance Sheet Item	Liability
1 Domestic equipment and supply contracts	Not in excess of 250 million Dinars
2 International contracts	Not in excess of 80 million DM (or the equivalent amount, calculated at the exchange rate for the contract currencies into DM in effect on June 1, 1997)
3 Short term financial debt with domestic banks	Not in excess of 130 million Dinars
4 Other liabilities	Not in excess of the sum of (i) current assets of Telekom Srbija as at the Closing Date, (ii) Net International Settlements of Telekom Srbija as at the Closing Date, and (iii) 35 million DM

The liabilities stated above do not reflect any contractual contingent obligations of Telekom Srbija existing on the Transfer Date, which shall be in addition to such Liabilities and provided by the contracts listed in Annex 1 attached to this Exhibit "A".

The liabilities stated above also do not reflect (i) any current obligations of Telekom Srbija existing on the Transfer Date in respect of its employees as further described on Exhibit "B" hereto, (ii) any obligations of Telekom Srbija arising after the Transfer Date and (iii) obligations of Telekom Srbija arising in connection with the Shared Services Agreement, all of which items (i), (ii) and (iii) shall be in addition to such Liabilities".

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DRAFT - PRELIMINARY AND TENTATIVE, FOR DISCUSSION PURPOSES ONLY

2. Agreed Work Steps Summary

To address the points in Clause 5.1(l) from the Share Sale and Purchase agreement we proposed in our Arrangement Letter to perform the following procedures. Where we have been unable to carry out our proposed work or work performed by Price Waterhouse, on which we placed our reliance, has dictated different approach and extended procedures, we employed alternative procedures as described below.

Work Step		Performed	Alternative Procedures/Notes
1	Obtain post-separation listings for the different liability captions for Telecom Serbia: - Foot listing	✓	Post-separation listing was not produced for each liability caption. Footing was done for two different listings comprising post-separation listings of liabilities.
	- Agree listing totals to the opening balance sheet	✓	
	- Compare totals to maximum limits set out in Exhibit A of the Share sale and purchase agreement	✓	See Section II 5 Overview of Aggregate Liabilities
2	Identify per discussion with management and review of documentation (such as fixed asset listing and trade creditors listing) the large telecommunication equipment supply contracts: - Review contracts and their transaction history;	✓	Review was made for contracts with domestic and foreign suppliers for fixed assets and domestic sub-contractors or importers of fixed assets.
	- Organize and obtain supplier confirmation letters from the suppliers identified to confirm the liabilities outstanding;	✓	Confirmations obtained for: short term borrowings - see Section 3.1. long term borrowings - see Section 3.2. trade payables - see work carried out under Section 3.3.
	- Review replies and check any significant reconciling items to source documentation.	✓	

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