REPORT OF THE AUDITORS TO THE MEMBERS OF NATIONAL AVIATION COMPANY OF INDIA LIMITED

1. We have audited the attached Balance Sheet of **National Aviation Company of India Limited**, as at 31st March 2008, the Profit and Loss Account of the Company for the period 30th March 2007 to 31st March 2008 and the Cash Flow Statement for theperiod ended on that date and annexed thereto. 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.

2. We conducted our audit in accordance with auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. As required by the Companies (Auditor's Report) Order, 2003 (as amended), issued by the Central Government in terms of Section 227 (4A) of the Companies Act, 1956, and on the basis of such checks as we considered appropriate and as per information and explanations given during the course of our audit, we annex hereto a statement on the matters specified in paragraphs 4 and 5 of the said Order.

4. We further report as under :

   i) *The depreciation of new fleet of aircraft has been charged on a lower rate than the rate prescribed in Schedule XIV of the Companies Act, considering the life of the aircraft as 20 years. This has resulted in understatement of depreciation by Rs.250 million and overstatement of Fixed Assets by the same amount. Hence, the loss for the period is understated to the extent of Rs. 250 million.*

   ii) *The Company has not identified stores and spares in nature of standby/ servicing equipments other than Airframe Equipment Rotables and Aero Engine Equipment Rotables relating to aircraft for the purpose of capitalizing the same as fixed assets or charging off on issue, in accordance with AS 10 - "Accounting for Fixed Assets" and AS 2 - "Valuation of Inventories" respectively issued by the ICAI. The impact of the same on the financial statements for the period is not ascertainable.*

   iii) *The Company has recognized revenue related to unutilized/partly utilized passenger and cargo sales, on an estimated basis, irrespective of actual passage and transportation. This is not in compliance of AS 9 - " Revenue Recognition" issued by the ICAI. The impact of the same on the financial statements for the period is not ascertainable.*

   iv) *The Company has not considered free passage to employees and hotel expenditure on crew as fringe benefits and accordingly not provided Fringe Benefit Tax thereon. The Company has provided/paid Fringe Benefit Tax on the basis of an estimate of expenses for the period. In the absence of adequate information, we are unable to ascertain whether the Company has considered all other eligible heads of expenses for the purpose of determining the liability on account of fringe benefits. The impact of the same on the financial statements for the period is not ascertainable.*

   v) *As stated in Note 15(a) of Schedule T, in the absence of reconciliation and confirmations in respect of Goods in Transit, certain Cash and Bank Balances, Sundry Debtors, Advances Recoverable and Current Liabilities and netting of debits / credits in various accounts, we are unable to comment on the impact of adjustments arising out of reconciliation/confirmation of such balances, on the financial statements. The impact of the same on the financial statements for the period is not ascertainable.*

   vi) *The Company has not provided towards doubtful dues from defaulted agent of Rs.71.2 million resulting in understatement of Provision for Bad and Doubtful Debts. This has resulted in understatement of loss for the period by Rs.71.2 million and overstatement of Sundry Debtors to the same extent.*

   vii) *Dues to/from Airport Authority of India (AAI)*

      a) *As stated in Note 26(a)(i) of Schedule T, the Company has reversed rental and route navigation dues to AAI to the extent of Rs.342 million without any confirmation of waiver by AAI.*

      b) *As stated in Note 26(a)(i) of Schedule T, the Company has not made a provision for doubtful debt of Rs.75.5 million due from AAI on account of rentals/license fee although the claim has been rejected by the latter.*

c) *As stated in Note 26(a)(ii) of Schedule T, the Company has an outstanding due for Ground Handling Income of Rs.1019.9 million from AAI which is not accepted by AAI.*

d) *The outstanding receivable/payable to AAI is subject to reconciliation and confirmation.*

Consequently, the loss for the period on account of the above is understated by Rs.1,437.4 million and Debtors are overstated by Rs.1,095.4 million and Creditors are understated by Rs. 342 million. The consequential impact on the financial statements on account of vii(d) above for the period is not ascertainable.

viii) *The basis of fixing charges by the Company for Airline Allied Services Ltd.(AASL) was not found to be adequately evidenced to our satisfaction for forming opinion as to reasonableness and arm's length nature of arrangement for determining lease & other charges.*

ix) *The Company has recognized a Deferred Tax Asset of Rs.13,712.8 million on Carry Forward Business Losses. In theabsence of virtual certainty of future taxable profits as required under AS 22 -"Accounting for taxes on Income", we are unable to ascertain the reasonableness of recognition of the Deferred Tax Asset.*

x) *As stated in Note 15(b) of Schedule T, closing balances of certain accounts have not been restated at FEDAI rates as required by AS 11 – "The effect of Changes in foreign exchange rates" issued by ICAI. The impact of the same on the financial statements for the period is not ascertainable.*

xi) *Certain items as stated in Note 7 of Schedule T are accounted for on cash basis, instead of on accrual basis as required under section 209 of the Companies Act, 1956. The impact of the same on the loss for the period is not ascertainable.*

xii) *We further report that without considering the items mentioned in the paragraphs 4(ii), 4(iii), 4(iv), 4(v), 4(vii)(d), 4(viii), 4(x), 4(xi) above, the effect of which could not be determined, had the observations made by us in paragraphs 4(i), 4(vi), 4(vii)(a), (b), (c), 4(ix), been considered, loss for the period would have been Rs. 37,733.0 million as against the reported figure of Rs.22,261.6 million. Accumulated losses would have been Rs.37,733.0 million as against the reported figure of Rs.22,261.6 million. Fixed Assets would have been Rs.218,420.7million as against the reported figure of Rs. 218,670.7 million. Current Liabilities & Provisions would have been Rs.52,438.1 million as against the reported figure of Rs.52,096.1 million. Current Assets, Loans and Advances would have been Rs.61,749.5 million as against the reported figure of Rs.62,916.1 million. Deferred Tax Asset of Rs.11,873.4 million would have been Deferred Tax Liability of Rs.1,839.4 million.*

5 .Attention is invited to :

i) As stated in Note 5 of Schedule T, fair value amounting to Rs. 51,295.1 million and consequential impact on Capital Reserve of Immovable Property at Vasant Vihar Housing Colony is subject to reinstatement of lease deed.

ii) The depreciation and amortization on immovable properties which are revalued is charged to the Capital Reserve instead of a charge to the current period's profit and loss account as stated in Note 6 of Schedule T;

iii) Recognition of revenue from the tenants of its premises to the extent of Rs. 1,309.8 million as stated in Note 35 of Schedule T;

iv) Handling and security services revenue, being recognized on the basis of quoted rates pending finalisation of agreements as stated in Note 16 of Schedule T;

v) The sharing of revenue with Airports Authority of India is still to be determined as stated in Note 32 of Schedule T;

vi) As stated in note 9 of schedule T, the non determination of liability if any, that may arise on the merger of Vayudoot Limited.

vii) The Company has not determined the provision of debts and dues outstanding for more than 3 years in respect of Government/PSU dues.

viii) As stated in Note 21 of Schedule T, the Company has entered into a lease arrangement for aircraft and engines and accounted the same under Finance Leases.

6. Further to our comments in the Annexure referred to in para (3) above, we report that:

i) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit.

ii) In our opinion, proper books of account as required by law have been kept by the Company *except as given in note 4(v) and 4(xi) above,* so far as appears from our examination of these books maintained at Central Accounts Office of the Company, incorporating the information/returns received from the stations and reports received from outsourced agencies and found to be generally adequate for the purpose of our audit.

iii) The Balance Sheet and the Profit and Loss Account dealt with by this report are in agreement with the books of account.

iv) In our opinion, the Balance Sheet, the Profit and Loss Account and the Cash Flow Statement dealt with by this report comply with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 *except as stated in notes 4(ii), 4(iii), 4(ix) and 4(x) above.*

v) In our opinion and to the best of our information and according to the explanations given to us, the said financial statements *subject to paragraphs above 4(i) to 4(xii)* and read with the notes thereon, give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

a) in the case of the Balance Sheet, of the state of affairs of the Company as at 31st March, 2008; and

b) in the case of the Profit and Loss Account, of the loss for the period 30th March 2007 to 31st March 2008.

c) in the case of the Cash Flow Statement, of the cash flows for the period 30th March 2007 to 31st March 2008.

7. The Company being a Government Company as defined in Section 617 of the Companies Act 1956, is exempted from the applicability of the provisions of Section 274(1)(g), of the said Act vide circular no.2/5/2001/CV.V general circular no.8/2002 dated March 22, 2002 issued by Ministry of Law, Justice and Company Affairs.

For and on behalf of
Kalyaniwalla & Mistry
Chartered Accountants

sd/-
Ermin K. Irani
Partner
Membership No. 35646

For and on behalf of
Arun K. Agarwal & Associates
Chartered Accountants

sd/-
Vimal Kumar Jain
Partner
Membership No. 86657

For and on behalf of
P.K. Chopra & Co
Chartered Accountants

sd/-
Samir Chopra
Partner
Membership No. 87870

Place : Mumbai
Date : 17 December 2008.

Annexure to the Auditors' Report

Referred to in paragraph (3) of our report of even date.

1) (a) The Company has maintained proper records showing full particulars, including quantitative details and location in respect of fixed assets *except rotables at certain locations. The Company has not updated fair value of assets in the fixed assets register at certain locations. The reconciliation of fixed asset register for aircraft rotables and all assets at certain locations with financial records is in progress.*

(b) The Company has a program of physical verification of fixed assets on a rotational basis so that every asset is verified once in every two year, which in our opinion is adequate. During the period, the management has conducted physical verification at a few locations. *In the absence of a reconciliation, between the book records and the physical count sheets, we are unable to ascertain whether the physical verification revealed any material discrepancy.*

(c) In our opinion and according to the information and explanations given to us, the Company has not disposed off substantial part of fixed assets during the period affecting the going concern assumption.

2) (a) The Company has a procedure of conducting physical verification of inventory at least once in a block of two years. *In our opinion, this interval is not reasonable.*

(b) The procedures of physical verification of inventories followed by the management are not adequate in relation to the size of the Company and nature of its business. The Company has carried out a physical verification of inventory during the period at a few locations. The Companyhas not obtained confirmations /certificates in respect of inventory lying with outside agencies and does not verify the inventory lying at shop floor.

(c) On the basis of our examination of the inventory records, in our opinion, the Company is maintaining proper records of inventory *except for Goods in Transit.* The discrepancies noticed on physical verification of inventory as compared to book records have been properly dealt with in the books of accounts.

3) (a) The Company has not granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Companies Act, 1956.

(b) Consequently, the question of commenting on the rates of interest and the other terms and conditions of the loans granted being prejudicial to the interests of the Company, receipt of regular principal and interest and reasonable steps taken for recovery of principal and interest does not arise.

(c) The Company has not taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act.

(d) Consequently, the question of commenting on the rates of interest and the other terms and conditions of the loans taken being prejudicial to the interests of the Company and payment of regular principal and interest does not arise.

4) In our opinion and according to the information and explanations given to us, there are adequate internal control procedures commensurate with the size of the Company and the nature of its business, for the purchases of inventory, fixed assets and sale of goods and services. *The Company has not reconciled sub-ledgers with the general ledger in respect of inventory and non reconciliation of certain accounts. Subject to above*, we have not observed any continuing failure to correct major weaknesses in internal controls.

5) (a) Based on the audit procedures applied by us and according to the information and explanations provided by the management, we are of the opinion that there are no particulars of contracts and arrangements referred to in section 301 of the Companies Act, 1956 that need to be entered into the register required to be maintained under that section.

(b) Hence the question of commenting whether the transactions made in pursuance of such contracts or arrangements, were made at prices which are reasonable having regard to prevailing market prices at the relevant time does not arise.

6) In our opinion and according to the information and explanations given to us, the Company has not accepted any deposits from the public and hence the provisions of section 58A, 58AA or any other provision of the Companies Act, 1956, read with the rules framed there under are not applicable.

7) *In our opinion, the internal audit function is not commensurate with the size of the Company and the nature of its business. It needs to be further strengthened for timely performance reporting, compliance, extending the scope, emphasizing on critical areas and monitoring actions taken so as to ensure effective internal control.*

8) As per the information and explanations given to us, the maintenance of cost records has not been prescribed by the Central Government under section 209(1)(d) of the Companies Act, 1956.

9) (a) According to the information and explanations given to us and on the basis of our examination of the books of account, during the period the Company has been generally regular in depositing undisputed statutory dues, including Provident Fund, Employees' State Insurance, Income Tax, Sales Tax, Wealth Tax, Service Tax, Customs Duty, cess and other statutory dues applicable to it with the appropriate authorities *except as stated below.*

We have been informed that at foreign station these dues are generally deposited with local authorities within the time stipulated.

The provident fund dues pertaining to the employees of the contractors/sub-contractors aggregating to Rs. 30.9 million are kept in a separate bank account in the absence of their registration numbers.

As stated in para 4(iv) in the Audit Report above, the Company has not considered free passage to employees and hotel expenditure on crew as fringe benefits and accordingly not provided Fringe Benefit Tax thereon. The Company has provided/paid Fringe Benefit Tax on the basis of an estimate of expenses for the period. In the absence of adequate information, we are unable to ascertain whether the Company has considered all other eligible head of expenses for the purpose of determining the liability on account of fringe benefits. The impact of the same on the financial statements for the period is not ascertainable.

The Company has not reconciled Service tax recoverable and Service tax payable as per books and as per returns filed. Amount of outstanding dues towards service tax of Rs.11.2 million was outstanding and which was subsequently paid along with interest.

The Company has not reconciled Tax deducted at source and payable as at period end. The Company has not deducted tax on certain liabilities as on 31st March 2008.

The Company has not reconciled the Customs duty collected and paid on account of sale of spares.

As stated above, in the absence of reconciliation, we are unable to determine whether there are any other undisputed dues payable in respect of above as at 31st March 2008 for a period of more than six months from the date they became payable.

(b) According to the information and explanations given to us, there are no dues outstanding of Sales Tax, Income Tax, Customs Duty, Wealth Tax, Service Tax, Excise Duty or cess on account of any dispute other than mentioned below:

Name of Statute	Amount (Rs. In Million)	Nature and Forum where dispute is Pending
Income Tax Act, 1961	2,949.9	Assessed Income Tax Demands – Commissioner of Income Tax (Appeals) and Income Tax Appellate Tribunal
Customs Act, 1962	632.6	Customs duty and interest – Commissioner of Customs (Appeals)
Municipal Authorities	100.1	Property Tax – Assistant Assessor and Collector
Sales Tax	67.9	Sales tax on sale of scrap, used oil and canteen sales demanded by the Sales Tax Department, Delhi.

10) This being the first year of registration of the Company the question of commenting on the accumulated losses does not arise.

11) According to the information and explanations given to us and based on the documents and records produced to us, the Company has not defaulted in repayment of dues to banks and financial institutions. There are no dues to debenture holders.

12) According to the information and explanations given to us and based on the documents and records produced to us, the Company has not granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities.

13) In our opinion and according to the information and explanations given to us, the nature of activities of the Company does not attract any special statute applicable to chit fund and nidhi/ mutual benefit fund/societies.

14) The Company does not deal in shares, securities, debentures and other investments.

15) According to the information and explanations given to us, the Company has given a guarantee for loans taken by subsidiary from banks. The terms of such guarantee are not prima facie prejudicial to the interests of the Company.

16) According to the information and explanations given to us, the term loans were applied for the purpose for which the loans were obtained.

17) According to the information and explanations given to us and on an overall examination of the Balance Sheet and Cash Flows of the Company, we report that short term loans have not been used for long term purposes.

18) The Company has not made any preferential allotment of shares to parties or companies covered in the register maintained under section 301 of the Companies Act, 1956.

19) The Company did not issue any debentures during the period.

20) The Company has not raised any money through a public issue during the period.

21) Based on the audit procedures performed and information and explanations given by the management, we report that no major fraud on and no fraud by the Company has been noticed or reported during the period.

For and on behalf of
Kalyaniwalla & Mistry
Chartered Accountants

sd/-
Ermin K. Irani
Partner
Membership No. 35646

For and on behalf of
Arun K. Agarwal & Associates
Chartered Accountants

sd/-
Vimal Kumar Jain
Partner
Membership No. 86657

For and on behalf of
P.K. Chopra & Co
Chartered Accountants

sd/-
Samir Chopra
Partner
Membership No. 87870

Place : Mumbai
Date : 17 December 2008.

Management Replies to draft audit report of the Statutory Auditors For the Financial Year 2007-08

Sr. No.	Audit Observations	Management Comments
1)	We have audited the attached Balance Sheet of **National Aviation Company of India Limited,** as at 31st March 2008, the Profit and Loss Account of the Company for the period March 30, 2007 to March 31, 2008 and the Cash Flow Statement for the period ended on that date and annexed thereto. 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.	This is a statement of fact.
2)	We conducted our audit in accordance with auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.	This is a statement of fact.
3)	As required by the Companies (Auditor's Report) Order, 2003 (as amended), issued by the Central Government in terms of Section 227 (4A) of the Companies Act, 1956, and on the basis of such checks as we considered appropriate and as per information and explanations given during the course of our audit, we annex hereto a statement on the matters specified in paragraphs 4 and 5 of the said Order.	This is a statement of fact.
4)	We further report as under:	
	i) The depreciation of new fleets of aircraft has been charged on a lower rate than the rate prescribed in schedule XIV of the Companies Act, considering the life of the aircraft as 20 years. This has resulted in under statement of depreciation by Rs. 250 million and over a statement of Fixed Assets by the same amount. Hence, the loss for the period is understated to the extent of Rs. 250 million.	The Company has made an application to the Ministry of Corporate Affairs for charging a lower rateon the new fleet of 777 and the Airbus aircraft considering the economic life of the Assets is 20 years. This rate is lower than the rate prescribed in Schedule XIV of the Companies Act. These aircraft viz. Boeing 777& Airbus 319 & 321 are the New Generation, State of art new technology aircraft. The approval from the Ministry of Corporate Affairs is still awaited. As per Accounting Standard 6, the Company is entitled to determine the useful/ economic life of the Asset and if the same is longer than that prescribed under the Act, the Company may choose the same accordingly with suitable disclosure. The rate of depreciation on the new fleet on Straight Line Basis would be 4.75% (95% of the cost is amortized over 20 years).
	ii) The Company has not identified stores and spares in nature of standby servicing equipments other than Airframe Equipment Rotables and Aero Engine Equipment Rotables relating to aircraft for the purpose of capitalizing the same as fixed assets or charging of an issue, in	The Company has a policy of charging all consumables on issue as consumption to the Profit & Loss Account. However, in respect of certain repairable spares, referred to as TL2, the Company charges the same to consumption

accordance with AS 10 – " Accounting for Fixed Assets" and AS 2- "Valuation of Inventories" respectively issued by the Institute of Chartered Accountants of India(ICAI). The impact of the same on the financial statement for the period is not ascertainable.	in the year of scrappage. However the company writes off the expenditure on the repairs to TL2 items to the Profit & Loss account in the year such repair expenditure is incurred..
iii) The Company has recognized revenue related to unutilized / partly utilized passenger and cargo sales, on an estimated basis, irrespective of actual passage and transportation. This is not in compliance of AS 9- " Revenue Recognition" issued by the ICAI. The impact of the same on the financial statement for the period is not ascertainable.	Due to Revenue Assessment being done based on the flown coupons more accurately, it has been possible to determine with reasonable accuracy taking into consideration the historical data, Revenue to be recognized from the Forward Sales Account where the Revenue is initially credited. Accordingly, this assessment has been carried out and the appropriate amount transferred to Revenue.
iv) The Company has not considered free passage to employees, hotel expenditure on crew as fringe benefits and accordingly not provided Fringe Benefits tax thereon. The company has provided / paid Fringe Benefit tax on the basis of an estimate of expenses for the period. In the absence of adequate information, we are unable to ascertain whether the company has considered all other eligible head of expenses for the purpose of determining the liability on account of Fringe Benefits. The impact of the same on the financial statement for the period is not ascertainable.	Pending final outcome of the representation made by the Company and the Board of Airlines Representatives (India) to the Government seeking total exemption on free passages with "Zero" value availed by the employees of the Company no provision for FBT has been made.Similarly, hotel expenditure on Crew is not considered as a Fringe Benefit as the employees are provided Hotel accomodation in India and abroad in the course of performance of their flying duties.However, excess provision to the tune of Rs. 17.00 lakhs in respect of FBT has been made to cover this head of expenditure.
v) As stated in note 15 (a) of schedule T, In absence of reconciliation and confirmations in respect of Goods in Transit, Cash and bank balances, Sundry Debtors, Advances Recoverable and Current Liabilties and netting of debits / credits in various accounts, we are unable to comment on the impact of adjustments arising out of reconciliation / confirmation of such balances, on the financial statements. The impact of the same on the financial statement for the period is not ascertainable.	Reconciliation and confirmation in respect of Accounts Receivable and Payable, Advance to Parties and other liabilities and netting of Debtors and Creditors in various accounts is a continuous process and there has been no dispute of any major amounts receivable or payable to parties.
vi) The Company has not provided towards doubtful dues from defaulted agent of Rs. 71.2 million resulting in understatement of Provision for Bad and Doubtful Debts. This has resulted in understatement of loss for the period by Rs. 71.2 million and overstatement Sundry Debtors to the same extent.	The Company has an insurance coverage for recovering dues from defaulting agents with M/s. Oriental Fire & General Insurance Company. The said Agent had defaulted in the year 2006-07 on payment of its dues when the coverage was operational. The claim has already been filed with the Insurance Company amounting to Rs. 71.2 million and it is expected to be realized during 2008-09.
vii) Dues to/from Airport Authority of India (AAI) a) As stated in Note 26(a)(i) of Schedule T, the Company has reversed rental and route navigation dues to AAI to the extent of Rs.342 million without any confirmation of waiver by AAI. b) As stated in Note 26(a)(i) of Schedule T, the Company has not made a provision for doubtful debt of Rs.75.5 million due from AAI on account of rentals/license fee although the claim has been rejected by the latter.	(a), (b), (c), (d) & (e) : The matter is under correspondence with M/s. AAI and in consultation with the Ministry of Civil Aviation. This issue is likely to be resolved soon. Outstanding Receivable/Payable to AAI is subject to the reconciliation and certain dues have been disputed.

	c) As stated in Note 26(a)(ii) of Schedule T, the Company has an outstanding due for ground handling Income of Rs.1019.9 million from AAI which is not accepted by AAI. d) The outstanding receivable /payable to AAI is subject to reconciliation and confirmation. Consequently, the loss for the period on account of the above is understated by Rs. 1437.4 million and debtors are overstated by Rs. 1095.4 million and Creditors are understated by Rs. 342 million, The consequential impact on the financial statement on account of vii(d) for the period is not ascertainable.	
viii)	The basis of fixing charges by the Company for Airline Allied Services Ltd. (AASL) was not found to be adequately evidenced to our satisfaction for forming opinion as to reasonableness and arms length nature of arrangement for determining lease & other charges.	The lease and other charges are fixed on 'fair' estimate basis, which is a normal business practice for charging such services, which is being consistently followed over the years.
ix)	The Company has recognised a Deferred tax asset of Rs 13712.9 million on Carry Forward Business Losses. In the absence of virtual certainty of future taxable profits as required under AS 22- "Accounting for Taxes on Income" we are unable to ascertain the reasonableness of recognition of the Deferred Tax Asset.	The Company (on merger of the erstwhile Air India and Indian Airlines) has provided an intergrated, international / domestic footprint which would significantly enhance the customer proposition, enable optimum utilisation of existing resources through improvement in load factors and yields on commonly serviced routes as well as deploy freed-up capacity of alternate routes. The merged entity would provide an opportunity to fully leverage the strong assets, capabilities and infrastructure and deploy the skilled and experienced manpower available to the optimum potential. With all the synergy benefits arising to the merged entity, the Company would be able to emerge as a key player in the domestic and international airlines industry. Recently, the Company has taken several measures in order to reduce its cost platform and as part of the turnaround strategy to face the impact of global recession. This includes reduction of capacity on certain domestic and international routes, hiring IATA as a Consultant for carrying out Fuel Gap Efficiency Analysis, reducing the weight of the *aircraft to improve fuel consumption,* return of leased aircraft, induction of new State-of-the-Art Technology aircraft, reducing meal wastage, rationalization of meal services on domestic and long haul flights and adopting long term measures aimed at Revenue enhancement. The entry of the Company into the Star Alliance, which is an alliance of 21 Airlines, introduction of dynamic Frequent Flyer Program, better HUB & SPOKE network arrangements to connect the non-stop flights are likely to lead to improvement in the Revenue. The Company has also made a proposal to the Government to increase the Equity base to enhance the Equity Capital by Rs. 1231.00 Crores and also provide a soft loan support equal to Rs. 2750.00 Crores repayable annually over a 15 year period at low interest rates. It is felt that this would strengthen the net worth and the Balance Sheet of the Company The Company has also

		made a request for increase in authorized capital to Rs. 5000/- Crores to strengthen the Equity Base + improve the Debt Equity Ratio.Government has also been providing support to the Company in the form of financial guarantees for long term loan taken for aircraft acquisition from international financial institutions.Adding to this, the cost control circular aimed at rationalization of expenditure and adoption of economic measures has already been introduced in the Company which include, inter alia, reduction of contractual employment, optimization of inventory levels, critical assessment of aircraft to be sent for outside repairs, austerity measures in the Company, reduction of distribution costs and migration to "Zero" Commission.Fuel prices which have till very recently been sky rocketing have started "Cooling Off" which would certainly encourage air travel in the country/globally as airlines prepare to reduce the fuel surcharge, passing the benefits to the passengers.As a result, due to these measures taken there is a definite / virtual certainty of future taxable profits being available to the Company for utilization of Deferred Tax Assets.Government has also designated Subsidiary Company of NACIL for exclusive ground handling arrangements at major airports either on a stand alone basis or in Joint Venture with a Strategic Partner.
x)	As stated in Note 15(b) of Schedule T, closing balances of certain accounts have not been re-instated at FEDAI rates as required by AS 11– " The effect of changes in foreign exchange rates" issued by ICAI. The impact of the same on the financial statements for the period is not ascertainable.	This is statement of fact.Year end balances of certain accounts have not been re-instated at year end rates due to complexity of transaction in different currencies.
xi)	Certain items are as stated in Note 7 of Schedule T, are accounted for on cash basis instead of accrued basis as required under section 209 of the Companies Act, 1956. The impact of the same on the loss for the period not ascertainable.	This is statement of fact.
xii)	We further report that without considering the items mentioned in the paragraphs 4(ii), 4(iii), 4(iv), 4(v), 4(vii)(d), 4(viii), 4(x), 4(xi) above, the effect of which could not be determined, had the observations made by us in paragraphs 4(i), 4(vi), 4(vii)(a), (b), (c), 4(ix), been considered, loss for the period would have been Rs. 37,733 million as against the reported figure of Rs 22,261.6 million. Accumulated losses would have been Rs. 37,733/- million as against the reported figure of Rs. 22,261.6 million. Fixed Assets would have been Rs 218,420.7 million as against the reported figure of Rs 218,670.7 million. Current Liabilities & Provisions would have been Rs. 52,438.1 million as against the reported figures of Rs. 52,096.1 million. Current Assets, Loans and Advances would have been Rs. 61,749.5 million as against the reported figure of Rs. 62,916.1 million. Deferred Tax asset of Rs. 11,873.4 million would have been deferred Tax liability of Rs. 1,839.4 million.	Please refer to our reply above that there is no understatement of loss.

5) Attention is invited to :	
i) As stated in Note 5 of Schedule T, fair value amounting to Rs. 51,295.1 million and consequential impact on Capital Reserve of Immovable property at Vasant Vihar Housing Colony is subject to reinstatement of lease deed.	Adequate disclosure to this effect has been given in the Notes to Accounts.
ii) The depreciation and amortization on immovable properties which are revalued is charged to the capital Reserve instead of a charge to the current period's profit and loss account as stated in Note 6 of Schedule V.	Based on an expert opinion, the additional charge of depreciation of Rs. 1338.0 million on the revalued amount fixed assets has been withdrawn from capital reserve. Adequate disclosure to this effect has been in the Notes to Accounts.
iii) Recognition of revenue from the tenants of its premises to the extent of Rs. 1309.8 million as stated in Note 35 of Schedule T.	Rent Receipts from Air India Building : The erstwhile Air India Board in its 8th meeting held on 24 November 1994 approved the appointment of an Estate Officer, issuance of fresh Notices to all the Licensees of Air India Building for eviction and appointment of Mr. M.K. Shah, Advocate to represent Air India in the proceedings under the Public Premises (Eviction of Unauthorized Occupants) Act 1971. Accordingly, Eviction Notices were issued to all occupants after which these occupants were treated as unauthorized occupants and became liable for payment of mesne profits/damages. The Estate Officer conducted proceedings under the Public Premises Act and as a result eviction orders were passed against all the occupants during the period 1996 to 2002 under the circumstances, appliable Rent for the period upto March 2008 has been recognized from the existing / past tenants of Air India Building.
iv) Handling and security services revenue, being recognized on the basis of quoted rates pending finalization of agreements as stated in Note 16 of Schedule T.	Adequate disclosure to this effect has been given in the Notes to Accounts.
v) The sharing of revenue with Airports Authority of India is still to be determined as stated in Note 32 of Schedule T.	The Centre for Perishable Cargo developed by Airport Authority of India (AAI) with the financial assistance of Agricultural and Processed Food Products Export Development Authority (APEDA) was handed over to the Company by AAI as per Ministry of Civil Aviation's letter No. 2021/AS&F/ Misc./ 2003 dated 03.09.2003, whereby the sharing of revenue of Rs. 153.07 Million with AAI is yet to be determined.
vi) As stated in note 9 of schedule T, the non determination and non ascertainability of liability if any that may arise on the merger of Vayudoot Limited.	Adequate disclosure to this effect has been given in the Notes to Accounts.
vii) The Company has not determined the provision of debts and dues outstanding for more than 3 years in respect of Government/PSU dues.	A Senior Committee comprising the ED of the Region with the Senior Commercial Manager and the Regional Finance Manager has been formed for each region to review and follow up on all the Government Debts and make suitable recommendations on the provision, if any, required to be made in the books.

viii) As stated in Note 21 of Schedule V, the Company has entered into a lease arrangement for aircraft and engines and accounted the same under Finance Lease.	The Service Tax Liability of Financial Lease transactions has not been provided based on legal opinion received.
6. Further to our comments in the Annexure referred to in para (3) above, we report that:	
i) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit.	This is statement of fact.
ii) In our opinion, proper books of account as required by law have been kept by the Company *except as given in note 5(iii) and 5(x) below,* so far as appears from our examination of these books maintained at Central Accounts Office of the Company, incorporating the information/returns received from the stations and reports received from outsourced agencies and found to be generally adequate for the purpose of our audit.	This is statement of fact.
iii) The Balance Sheet and the Profit and Loss Account dealt with by this report are in agreement with the books of account.	This is a statement of fact.
iv) In our opinion, the Balance Sheet, the Profit and Loss Account and the Cash Flow Statement dealt with by this report comply with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 *except as stated in notes 4(ii), 4(iii), 4(ix), 4(x) above.*	This is a statement of fact.
v) In our opinion and to the best of our information and according to the explanations given to us, the said financial statements *subject to paragraphs 4(i) to 4(xii) above* and read with the notes thereon, give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:	This is a statement of fact.
a) in the case of the Balance Sheet, of the state of affairs of the Company as at 31st March, 2008; and	This is a statement of fact.
b) in the case of the Profit and Loss Account, of the loss for the period ended 30th March 2007 to 31st March 2008.	This is a statement of fact.
c) in the case of the Cash Flow Statement, of the cash flows for the period ended 30th March 2007 to 31st March 2008.	This is a statement of fact
7) The Company being a Government Company as defined in Section 617 of the Companies Act 1956, is exempted from the applicability of the provisions of Section 274(1)(g), of the said Act vide circular no.2/5/2001/CV.V general circular no.8/2002 dated March 22, 2002 issued by Ministry of Law, Justice and Company Affairs.	This is a statement of fact.

(ANNEXURE REFERRED TO IN PARAGRAPH (3) OF THE REPORT OF EVEN DATE OF NATIONAL AVIATION COMPANY OF INDIA LIMITED FOR THE YEAR ENDED ON 31ST MARCH 2008)

Sr. No.	Audit Observations	Management Comments
1)	Referred to in paragraph (3) of our report of even date.	
	(a) The Company has maintained proper records showing full particulars, including quantitative details and location in respect of fixed assets except rotables at certain locations. The Company has not updated fair value of assets in the fixed assets register at certain locations.The reconciliation of fixed asset register for aircraft rotables and all assets at certain locations with financial records is in progress.	Audit comments are factual. Rotables in respect of Airframe Equipment-Aero Engine Equipment – as identified each year have been capitalized since 1993-94, for which the yearwise and itemwise computerized listings are maintained.
	(b) The Company has a program of physical verification of fixed assets on a rotational basis so that every asset is verified once in every two year, which in our opinion is adequate. During the period, the management has conducted physical verification at a few locations. In the absence of a reconciliation, between the book records and the physical count sheets, we are unable to ascertain whether the physical verification revealed any material discrepancy.	Audit comments are factual. Reconciliation of Fixed Assets Inventory statements with our records is a continuous process. If any discrepancy is found, the same will be rectified as an ongoing exercise.
	(c) In our opinion and according to the information and explanations given to us, the Company has not disposed off substantial part of fixed assets during the period affecting the going concern assumption.	This is a statement of fact.
2)	(a) The Company has a procedure of conducting physical verification at least once in a block of two years. In our opinion, this interval is not reasonable.	The Company has a procedure of conducting verification on a perpetual basis and discrepancies, if any, are adjusted in the year in which they occur.
	(b) The procedures of physical verification of inventories followed by the management are not adequate in relation to the size of the Company and nature of its business. The Company has carried out a physical verification of inventory during the period at a few locations. The Company has not obtained confirmations/certificates in respect of inventory lying with outside agencies and does not verify the inventory lying at shop floor.	The Company is in the process of obtaining confirmation / verification in respect of inventory lying with the outside agencies.
	(c) On the basis of our examination of the inventory records, in our opinion, the Company is maintaining proper records of inventory except for Goods in *Transit*. The discrepancies noticed on physical verification of inventory as compared to book records have been properly dealt with in the books of accounts.	This is a statement of fact
3)	(a) The Company has not granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Companies Act, 1956.	This is a statement of fact.
	(b) Consequently, the question of commenting on the rates of interest and the other terms and conditions of the loans granted being prejudicial to the interests of the Company, receipt of regular principal and interest and reasonable steps taken for recovery of principal and interest does not arise.	This is a statement of fact

	(c) The Company has not taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act.	This is a statement of fact
	(d) Consequently, the question of commenting on the rates of interest and the other terms and conditions of the loans taken being prejudicial to the interests of the Company and payment of regular principal and interest does not arise.	This is a statement of fact
4)	In our opinion and according to the information and explanations given to us, there are adequate internal control procedures commensurate with the size of the Company and the nature of its business, for the purchases of inventory, fixed assets and sale of goods and services. The Company has not reconciled sub-ledgers with the general ledger in respect of inventory, non reconciliation of certain accounts, Subject to above, we have not observed any continuing failure to correct major weaknesses in internal controls.	The Company has partially migrated to an accounting system based on ERP (Enterprise Resource Planning) Oracle effective 1st April 2007. **Most of the financial accounts have been reconciled with the Subsidiary Ledgers on the ERP. There are no material discrepancies between the Subsidiary Ledger and General Ledgers.** Differences if any will be reconciled during the course of next year.
5)	(a) Based on the audit procedures applied by us and according to the information and explanations provided by the management, we are of the opinion that there are no particulars of contracts and arrangements referred to in section 301 of the Companies Act, 1956 that need to be entered into the register required to be maintained under that section.	This is a statement of fact
	(b) Hence the question of commenting whether the transactions made in pursuance of such contracts or arrangements, were made at prices which are reasonable having regard to prevailing market prices at the relevant time does not arise.	This is a statement of fact
6)	In our opinion and according to the information and explanations given to us, the Company has not accepted any deposits from the public and hence the provisions of section 58A, 58AA or any other provision of the Companies Act, 1956, read with the rules framed there under are not applicable.	This is a statement of fact
7)	In our opinion, the internal audit function is not commensurate with the size of the Company and the nature of its business. It needs to be further enhanced for timely performance reporting, compliance, extending the scope, emphasizing on critical areas and monitoring actions taken so as to ensure effective internal control.	Internal Audit is out-sourced to two different Chartered Accountant Firms and an In-House Internal Audit Dept. conducts audit at periodic intervals of Indian/Foreign stations. The Internal Audit reports are also seen periodically by the Management and necessary corrective action taken.
8)	As per the information and explanations given to us, the maintenance of cost records has not been prescribed by the Central Government under section 209(1)(d) of the Companies Act, 1956.	This is a statement of fact.
9)	(a) According to the information and explanations given to us and on the basis of our examination of the books of account, during the period the Company has been generally regular in depositing undisputed statutory dues, including Provident Fund, Employees' State Insurance, Income Tax, Sales Tax, Wealth Tax, Service Tax, Customs Duty, Cess and other statutory dues applicable to it with the appropriate authorities *except as stated below.*	

We have been informed that at foreign stations these dues are generally deposited with local authorities within the time stipulated.	The Company complies with the payment of Statutory Dues in terms of local laws at Foreign stations.
The provident fund dues pertaining to the employees of the contractors/sub-contractors aggregating to Rs. 30.9 million are kept in a separate bank account in the absence of their registration numbers.	This is a statement of fact. PF Dues pertaining to the employees of the Contractors/Sub-Contractors are kept in a separate bank account since the issue of contract labour is subjudice.
As stated in para 4(iv) in the Audit Report above, the Company has not considered free passage to employees, hotel expenditure on crew, as fringe benefits and *accordingly not provided Fringe Benefit Tax thereon.*	The Company has clarified its position in reply to Audit Para 4(iv) above.
The Company has not reconciled Service tax recoverable and Service tax payable as per books and as per returns filed. The Company has not paid service tax on finance leases. The Company has not deposited Service tax dues collected from a disputed debtor amounting to Rs 11.2 million.	The Service Tax is being paid after availing input credits as per the service tax computed. The Service Tax Liability of Financial Lease Transactions has not been provided based on legal opinion received.
The Company has not reconciled Tax deducted at source and payable as at period end. The Company has not deducted tax on certain liabilities as on March 31,2008.	The Company cannot deduct tax on any adhoc provisions made in the accounts unless the provisions are correctly ascertainable / determinable. To the extent TDS is deducted on all determinable liability and deposited into treasury.
The Company has not reconciled the Customs duty collected and paid on account of sale of engineering spares.	Custom duty is paid as and when the same determined on sale of spares..
As stated above, in the absence of reconciliation, we are unable to determine whether there are any other undisputed dues payable in respect of above as at 31st March 2008 for a period of more than six months from the date they became payable.	To the best of our knowledge and belief there are no dues payable in respect of above for a period of more than 6 months from the date they become payable.
(b) According to the information and explanations given to us, there are no dues outstanding of Sales Tax, Income Tax, Customs Duty, Wealth Tax, Service Tax, Excise Duty or cess on account of any dispute other than mentioned below:	

Name of Statute	Amount (Rs. In Million)	Nature and Forum where dispute is pending
Income Tax Act, 1961	2.949.9	Assessed Income Tax Demands – Commissioner of Income Tax (Appeals) and Income Tax Appellate Tribunal
Customs Act, 1962	632.6	Customs duty and interest – Commissioner of Customs (Appeals)
Municipal Authorities	100.1	Property Tax – Assistant

		Assessor and Collector
Sales Tax	67.9	Sales Tax on sale of scrap used oil and canteen sales demanded by Sales Tax Department Delhi.

10)	This being the first year of registration of the Company the question of commenting on the accumulated losses does not rise.	This is a statement of fact.
11)	According to the information and explanations given to us and based on the documents and records produced to us, the Company has not defaulted in repayment of dues to banks and financial institutions. There are no dues to debenture holders.	This is a statement of fact.
12)	According to the information and explanations given to us and based on the documents and records produced to us, the Company has not granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities.	This is a statement of fact.
13)	In our opinion and according to the information and explanations given to us, the nature of activities of the Company does not attract any special statute applicable to chit fund and nidhi/mutual benefit fund/ societies.	This is a statement of fact.
14)	The Company does not deal in shares, securities, debentures and other investments.	This is a statement of fact.
15)	According to the information and explanations given to us, the Company has given a guarantee for loans taken by subsidiary from banks. The terms of such guarantee are not prima facie prejudicial to the interests of the Company.	This is a statement of fact.
16)	According to the information and explanations given to us, the term loans were applied for the purpose for which the loans were obtained.	This is a statement of fact.
17)	According to the information and explanations given to us and on an overall examination of the Balance Sheet and Cash Flows of the Company, we report that short term loans have not been used for long term purposes.	This is a statement of fact.
18)	The Company has not made any preferential allotment of shares to parties or companies covered in the register maintained under section 301 of the Companies Act, 1956.	This is a statement of fact.
19)	The Company did not issue any debentures during the period.	This is a statement of fact.
20)	The Company has not raised any money through a public issue during the period.	This is a statement of fact.
21)	Based on the audit procedures performed and information and explanations given by the management, we report that no major fraud on and no fraud by the Company has been noticed or reported during the period.	This is a statement of fact.