

the same amount in the cost of the related asset. Subsequently, the Company and its subsidiaries accrete the liability to its present value each period, and depreciate the capitalized cost over the useful life of the related asset.

l. Leases

The Company and its subsidiaries lease fixed assets under direct financing leases and operating leases as a lessor. Income from direct financing leases is recognized by amortizing unearned income over the lease term at a constant periodic rate of return on the net investment. Operating lease income is recognized over the lease term on a straight-line basis.

The Company and its subsidiaries lease fixed assets under capital leases and operating leases as a lessee. For capital lease obligations, interest expense is recognized over the lease term at a constant periodic rate on the lease obligation. Depreciation of the leased assets is recognized over the lease term on a straight-line basis. Rental expense on operating leases is recognized over the lease term on a straight-line basis.

m. Retirement and Severance Benefits

The Company and certain subsidiaries have defined benefit pension plans covering substantially all of their employees. The costs of the defined benefit pension plans are accrued based on amounts determined using actuarial methods, in accordance with SFAS 87, "Employers' accounting for pensions."

n. Guarantees

In accordance with FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," the Company and its subsidiaries recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken for those guarantees newly issued or modified after December 31, 2002.

o. Revenue recognition

The Company and its subsidiaries act as either principal or agent in their trading transactions for earning revenues. The Company and its subsidiaries recognize revenues from sales of products, the development of natural resources, and the development and sale of real estate. In addition to these revenue transactions, the Company and its subsidiaries recognize revenues from supporting services such as supporting customers' trading activities, leasing and software services activities. The Company and its subsidiaries recognize revenues at the time that revenues are realized or realizable and earned. Revenues are realized or realizable and earned when all of the following criteria are met; 1) persuasive evidence of an arrangement exists, 2) the goods have been delivered or the services have been rendered to customers, 3) the sales price is fixed or determinable and 4) collectibility is reasonably assured.

The Company and its subsidiaries recognize revenues from product sales, including wholesale, retail sales, manufactured product sales, processed product sales, development of natural resources, and development and sale of real estate, at the time the delivery conditions agreed with customers are met. These conditions are usually considered to

have been met when goods are received by the customer, the warehouse receipts are transferred, or the acceptance from the customer is received. Depending on the nature of the contract, revenues from long-term construction are accounted for by the completed contract method unless estimates of costs to complete and the extent of progress toward completion of long-term contracts are reasonably dependable, in which case the Company and its subsidiaries use the percentage-of-completion method.

Transactions which derive revenues from service-related activities are originated in various fields such as financial and logistics services, and information, communications and technical support. The revenues are recognized when the contracted services have been rendered to the third-party customers pursuant to the arrangements. Transactions from other activities of the Company and its subsidiaries include software development and maintenance services, and leasing aircraft, real estate, industrial machinery and other assets. Revenues from other activities are recognized upon customer acceptance for software development, over the contractual period for software maintenance services, and over the terms of the underlying leases on a straight-line basis for aircraft, real estate, industrial machinery and other assets.

Reporting Revenue Gross versus Net

In accordance with Emerging Issues Task Force ("EITF") 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," the Company and its subsidiaries present certain revenue transactions with corresponding cost of revenues on a gross basis as "Sales revenue" in the consolidated statements of operations, for transactions traded as a primary obligor in manufacturing, processing and service rendering and for sales with general inventory risk before customer order. The revenues that are recognized on a net basis are presented as "Trading margins and commissions on trading transactions" in the consolidated statements of operations.

Trading Transactions

"Total trading transactions," as presented in the consolidated statements of operations, is a measure commonly used by similar Japanese trading companies and represents gross transaction volume of the sales contracts in which the Company and its subsidiaries act as principal or agent. Total trading transactions in the consolidated statements of operations are presented in accordance with Japanese accounting practice, and are not meant as a substitute for sales or revenues in accordance with U.S. GAAP.

p. Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities

The Company and certain subsidiaries transferred the substitutional portion of the Employees' Pension Funds to the Japanese Government during the year ended March 31, 2004. In accordance with EITF 03-2, "Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities," the Company and certain subsidiaries recognized a "Settlement loss from the transfer of the substitutional portion of the Employees' Pension Fund" of ¥22,767 million