Notes to Consolidated Financial Statements

KONICA CORPORATION AND CONSOLIDATED SUBSIDIARIES

1. Significant Accounting and Reporting Policies

(a) Basis of Presenting Financial Statements

The accompanying consolidated financial statements have been prepared from the accounts maintained by Konica Corporation (the "Company") and its consolidated subsidiaries in accordance with the provisions set forth in the Japanese Commercial Code (the "Code") and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards.

Certain items presented in the consolidated financial statements filed with the Ministry of Finance (the "MOF") in Japan have been reclassified for the convenience of readers outside Japan. In addition, the consolidated financial statements of cash flows are not required to be filed with the MOF, but have been prepared and included in the consolidated financial statements.

The consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all of its significant subsidiaries.

Investments in unconsolidated subsidiaries and significant affiliates (20 per cent to 50 per cent owned) are accounted for by the equity method. Investments in insignificant affiliates are stated at cost.

Costs in excess of the net assets of purchased consolidated subsidiaries are amortized on a straight-line basis, principally over five years.

Intercompany balances, transactions and profits have been eliminated in consolidation.

(c) Translation of Foreign Currencies

Translation of Foreign Currency Transactions

Revenue and cost or expense items arising from the transactions of the Company denominated in foreign currencies are translated into Japanese yen at relevant exchange rates prevailing at the time of transactions ("historical rates").

Accounts receivable or payable denominated in foreign currencies (short-term monetary items) are translated into yen at the historical rates. Investments in securities and investments in and advances to subsidiaries and affiliates denominated in foreign currencies are also translated at the historical rates.

Translation of Foreign Currency Financial Statements

The translations of foreign currency financial statements of overseas consolidated subsidiaries and affiliates into Japanese yen are made by applying the exchange rates prevailing at the balance sheet dates for balance sheet items, except that the common stock and additional paid-in capital accounts are translated at the historical rates and the statements of income are translated at average exchange rates.

(d) Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash on hand and amounts due from banks.

(e) Marketable Securities and Investment Securities

Marketable securities and investment securities are stated at cost, which is determined by the moving average method.

(f) Inventories

Inventories are valued principally on an average-cost basis.

(g) Property, Plant and Equipment Depreciation

Depreciation of property, plant and equipment for the Company and domestic consolidated subsidiaries is computed using the declining balance method except for depreciation of buildings acquired after April 1, 1998, based on the estimated useful lives of assets which are prescribed by Japanese income tax laws.

Depreciation of buildings acquired after April 1, 1998, is computed using the straight-line method, based on the same estimated useful lives as above. Also, in fiscal 1999 the companies adopted useful lives of buildings (other than improvements) shorter than those used in previous fiscal years, pursuant to the amendments of the Japanese income tax laws. Its effect was immaterial. Depreciation of foreign subsidiaries is computed using the straight-line method.

Ordinary maintenance and repairs are charged to income as incurred. Major replacements and improvements are capitalized. When properties are retired or otherwise disposed of, the property and related accumulated depreciation accounts are relieved of the applicable amounts and any differences are charged or credited to income.

(h) Retirement Plans

Employees of the Company are, under normal circumstances, entitled to a lump-sum retirement payment based upon the length of service and current salary at the time of retirement.

The Company has funded pension plans with trust banks and insurance companies to cover a portion of retirement benefits payable to employees. It is the policy of the Company to provide for "Reserve for employees' retirement allowances" in an amount equivalent to the present value of the liability for such retirement benefits payable to all eligible employees upon their voluntary retirement at the balance sheet dates, less the accumulated balance of fund assets at such dates.

Under the plans, 50 per cent of the retirement benefits payable to employees retiring at their mandatory retirement age is paid out of the pension plans. The past service costs are being amortized over a period of 12 years and 6 months.

Another pension plan provides for a portion of the retirement benefits, the past service cost of which is being amortized over a period of 20 years.

Employees of consolidated domestic subsidiaries are generally covered by unfunded retirement benefit programs. Several of the domestic subsidiaries have funded pension plans to cover a portion of the retirement benefit payments.

(i) Income Taxes

In fiscal 1999, the Company and its domestic subsidiaries adopted the deferred tax accounting method, which requires the adjustment of previously deferred taxes using the liability method, where deferred tax assets and liabilities are recognized for temporary differences between the tax basis of assets and their reported amounts in the financial statements. In accordance with generally accepted accounting standards for deferred tax accounting in Japan, the Company reflected the cumulative effect of adopting deferred tax accounting at the beginning of fiscal 1999 with a charge to retained earnings. Prior years' financial statements were not reclassified to conform to 1999 presentation.

In fiscal 1998, income taxes of the Company and its domestic subsidiaries are provided for in an amount currently payable based on the tax returns filed with the tax authority and adjusted for tax effects of temporary differences arising from elimination entries reflected in the consolidation procedures, such as the elimination of unrealized intercompany profit and allowance for bad debts provided against intercompany accounts receivable eliminated in consolidation.

Certain consolidated overseas subsidiaries account for income taxes on the basis of interperiod allocation whereby tax effects on temporary differences between tax and financial reporting are recognized.

(j) Research and Development Expenses

Expenses for research and development activities are charged to income as incurred. Total amounts charged to income for the fiscal years ended March 31, 1999 and 1998 were ¥27,944 million (US$229,049 thousand) and ¥26,666 million, respectively.

(k) Legal Reserve

Due to the amendment to the Consolidated Financial Statements Regulations, the presentations of the accounts in the consolidated financial statements have been changed for the fiscal year ended March 31, 1999.

"Legal Reserve," which was previously reported as a separate account within Shareholders' Equity, is included in "Retained Earnings." Accordingly, the beginning balance, the movements during the fiscal year, and the ending balance of the fiscal year of "Retained Earnings" include "Legal Reserve."

(l) Per Share Data

Net income per share of common stock has been computed based on the weighted average number of shares outstanding during the year.

Cash dividends per share shown for each year in the accompanying consolidated statements are dividends declared as applicable to the respective years.

2. United States Dollar Amounts

Amounts in U.S. dollars are included solely for the convenience of readers outside Japan. The rate of ¥122=US$1, the rate of exchange on June 28, 1999, has been used in translation. The inclusion of such amounts is not intended to imply that Japanese yen have been or could be readily converted, realized or settled in U.S. dollars at this rate or any other rate.

3. Marketable Securities

The aggregate book values and market values of current and non-current marketable equity securities as of March 31, 1999 and 1998 are as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Book value:			
Current	**¥16,723**	¥17,868	**$137,074**
Non-current	**13,943**	14,135	**114,287**
	¥30,666	¥32,003	**$251,361**
Market value:			
Current	**¥17,861**	¥22,699	**$146,402**
Non-current	**26,358**	26,683	**216,049**
	¥44,219	¥49,382	**$362,451**

Gross unrealized gains and losses pertaining to marketable equity securities as of March 31, 1999 are as follows:

	Millions of yen		Thousands of U.S. dollars	
	Gains	Losses	Gains	Losses
Current	¥ 6,241	¥5,103	$ 51,156	$41,828
Non-current	13,291	876	108,943	7,180

The net realized gains on marketable equity securities for the fiscal years ended March 31, 1999 and 1998 were ¥946 million (US$7,754 thousand) and ¥33 million, respectively.

The net valuation loss on marketable equity securities for the fiscal years ended March 31, 1999 and 1998 were ¥269 million (US$2,205 thousand) and ¥657 million, respectively.

4. Investments in and Loans to Unconsolidated Subsidiaries and Affiliates

Investments in and loans to unconsolidated subsidiaries and affiliates as of March 31, 1999 and 1998 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Investments	**¥3,205**	¥8,022	**$26,270**
Loans	**442**	776	**3,623**
	¥3,647	¥8,798	**$29,893**

The transactions of the Company and its consolidated subsidiaries with these unconsolidated subsidiaries and affiliates are as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Sales	**¥18,256**	¥25,857	**$149,639**
Purchases	**21,739**	26,411	**178,189**

Transaction balances as of March 31, 1999 and 1998 are as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Trade receivables	**¥6,019**	¥11,167	**$49,336**
Trade payables	**6,104**	8,214	**50,033**

5. Short-Term Loans

Short-term loans consist principally of bank borrowings. The average interest rates on these loans as of March 31, 1999 and 1998 were 4.2 per cent and 4.9 per cent per annum, respectively.

6. Long-Term Debt

Long-term debt as of March 31, 1999 and 1998 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
1.6% to 3.2% Japanese yen unsecured debentures, due 1999 to 2008	**¥ 57,750**	¥ 56,632	**$ 473,361**
1.0% to 5.7% mortgage loans from banks, due 1999 to 2005	**2,920**	2,390	**23,934**
6.6% to 7.8% mortgage or secured loans from government-sponsored banks and agencies, due 1999 to 2001	**941**	1,571	**7,713**
0.6% to 8.7% unsecured loans from banks and government-sponsored banks and agencies, due 1999 to 2008	**57,036**	37,296	**467,508**
Obligations under capital leases, due 1999 to 2006	**7,023**	5,380	**57,566**
	125,670	103,269	**1,030,082**
Less: Current portion included in current liabilities	**(26,901)**	(24,260)	**(220,500)**
	¥ 98,769	¥ 79,009	**$ 809,582**

At March 31, 1999, property, plant and equipment amounting to ¥5,695 million (US$46,680 thousand) at net book value was pledged as collateral for long-term debt of ¥4,685 million (US$38,402 thousand).

As is customary in Japan, long-term and short-term bank loans are made under general agreements which provide that additional security and guarantees for present and future indebtedness will be given at the request of the bank and that any collateral so furnished will be applicable to all indebtedness due to that bank. In addition, the agreements provide that the bank has the right to offset cash deposited against any long-term or short-term debt that becomes due and, in case of default and/or other specified events, against all other debt payable to the bank.

The aggregate annual maturities of long-term debt as of March 31, 1999 are as follows:

Years ending March 31	Millions of yen	Thousands of U.S. dollars
1999	¥ 26,902	$ 220,508
2000	21,278	174,410
2001	22,091	181,074
2002	14,679	120,320
2003 and thereafter	40,720	333,770
	¥125,670	$1,030,082

7. Income Taxes

The Company is subject to a number of different taxes in Japan, based on income, which in the aggregate indicate statutory tax rates of approximately 47.7 per cent and 51.4 per cent in 1999 and 1998, respectively. The following is a reconciliation between the statutory tax rate and the Company's effective tax rate:

	1999
Statutory tax rate	47.7%
Tax effect on loss of a consolidated subsidiary previously not recognized	122.7
Valuation allowance	(16.1)
Effect of tax rate change	(40.8)
Inventories, etc.	(35.5)
Other, net	(7.8)
Effective tax rate	70.2

The components of deferred tax assets in the amount of ¥5,688 million (US$46,623 thousand) included in "Current Assets" and ¥21,036 million (US$172,426 thousand) included in "Investments and Other Assets" as of March 31, 1999 are as follows:

	Millions of yen
Gross deferred tax assets:	
Tax effect on loss of a consolidated subsidiary previously not recognized	¥12,814
Tax loss carryforward	7,668
Temporary difference carrying from restructuring	1,886
Reserve for employees' retirement allowance	3,036
Inventories, etc.	3,827
Other, net	5,704
Subtotal	34,935
Valuation allowance	(6,413)
Deferred tax assets total	28,522
Gross deferred tax liabilities	
Deferral of taxes on profit of fixed assets	(1,798)
Net deferred tax assets	¥26,724

8. Shareholders' Equity

The Japanese Commercial Code provides that an amount equivalent to at least 10 per cent of cash distributions (cash dividends and bonuses to directors and corporate auditors) paid in a fiscal period should be appropriated to a legal reserve until this reserve equals 25 per cent of stated capital. The legal reserve is not available for cash dividends but may be used to reduce a deficit by a shareholders' resolution or may be capitalized by a Board of Directors' resolution.

On June 29, 1999, the shareholders approved a cash dividend to be paid to shareholders on record as of March 31, 1999 totaling ¥1,788 million (US$14,656 thousand), at the rate of ¥5.00 (US$0.04) per share of common stock. The related appropriation of retained earnings to the legal reserve was made in the amount of ¥179 million (US$1,467 thousand).

9. Commitments and Contingent Liabilities

The Company and its consolidated subsidiaries estimate that capital expenditures on fixed assets of approximately ¥30,837 million (US$252,762 thousand) will be required during the fiscal year ending March 31, 2000.

The Company and its subsidiaries were contingently liable, as of March 31, 1999, for trade notes discounted with banks of ¥202 million (US$1,656 thousand) and for loans guaranteed of ¥5,014 million (US$41,098 thousand).

10. Lease Transactions

Information on the Company's and consolidated subsidiaries' finance lease transactions (except for those which are deemed to transfer the ownership of the leased assets to the lessee) and operating lease transactions are presented below.

Lessee

1. Finance leases

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Machinery & equipment	**¥ 6,016**	¥—	**$49,311**
Tools & furniture	**5,747**	—	**47,107**
Others	**422**	—	**3,459**
	12,185	—	**99,877**
Less: Accumulated depreciation	**(6,042)**	—	**(49,525)**
Net book value	**¥ 6,143**	¥—	**$50,352**
Depreciation	**¥ 1,998**	¥—	**$16,377**

Depreciation is based on the straight-line method over the lease terms of the lease assets.

The scheduled maturities of future lease rental payments on such lease contracts as of March 31, 1999 and 1998 were as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Due within one year	**¥1,844**	¥1,845	**$15,115**
Due over one year	**4,299**	2,945	**35,238**
	¥6,143	¥4,790	**$50,353**
Lease rental expenses for the year	**¥1,998**	¥2,002	**$16,377**

2. Operating leases

The scheduled maturities of future lease rental payments on such lease contracts as of March 31, 1999 and 1998 were as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Due within one year	**¥ 6,565**	¥ 6,007	**$ 53,811**
Due over one year	**22,400**	24,203	**183,607**
	¥28,965	¥30,210	**$237,418**
Lease rental expenses for the year	**¥ 1,269**	¥ 1,227	**$ 10,402**

Lessor

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Leased tools & furniture:			
Purchase cost	**¥1,880**	¥—	**$15,410**
Accumulated depreciation	**(1,321)**	—	**(10,828)**
Net book value	**¥ 559**	¥—	**$ 4,582**

The scheduled maturities of future lease rental income on such lease contracts as of March 31, 1999 and 1998 were as follows:

	Millions of yen		Thousands of U.S. dollars
	1999	1998	**1999**
Due within one year	**¥ 367**	¥ 327	**$ 3,008**
Due over one year	**276**	421	**2,262**
	¥ 643	¥ 748	**$ 5,270**
Lease rental income for the year	**¥1,269**	¥1,227	**$10,402**
Depreciation for the year	**1,104**	—	**9,049**

As a result of the amendment to the Consolidated Financial Statement Regulations, the disclosure of information regarding leased assets and finance lease contracts as a lessee/lessor has become mandatory effective from the year ended March 31, 1999.

11. Segment Information

Segment information is reported in accordance with the requirements of the MOF. The photographic materials segment includes photographic film, photographic paper, photofinishing equipment and chemicals, videotapes and others. The business machines segment includes plain-paper copiers, printers, facsimile machines, cameras, optical products and others.