

# Notes to the Consolidated Financial Statements

Kenwood Corporation and Consolidated Subsidiaries  
For the years ended March 31, 2004 and 2003

## 1. Significant Accounting Policies

The following is a summary of the significant accounting policies adopted by Kenwood Corporation (the "Company") and its consolidated subsidiaries in the preparation of the accompanying consolidated financial statements.

### (a) Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared based on the consolidated financial statements filed with the Financial Service Agency as required by the Securities and Exchange Law of Japan, which are prepared in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing the accompanying consolidated financial statements, certain reclassifications and rearrangements have been made to present them in a form which is more familiar to readers outside Japan. In addition, the notes to the consolidated financial statements include information which is not required under accounting principles generally accepted in Japan, but is presented herein as additional information. Certain reclassifications have been made to the 2003 consolidated financial statements to conform to the 2004 presentation.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Company is incorporated and operates. The translation of Japanese yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and have been made at the rate of ¥106 to \$1, the approximate rate of exchange at March 31, 2004. Such translation should not be construed as representation that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

### (b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its significant 47 (51 in 2003) subsidiaries (together, the "Group").

Under the control or influence concept, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

Kenwood Electronics Precision Cebu, Inc., Kenwood Electronics Precision (HK) Ltd., and Kenwood Logistics (HK) Ltd. were excluded from scope of consolidation because those companies had been liquidated during the fiscal year 2004.

On January 1, 2004, Kenwood Service Corporation merged Kenwood Logistics Corporation in order to improve the service functions and the distribution operations of the corporate group.

Investments in an unconsolidated subsidiary is accounted for by the equity method.

Investments in the remaining unconsolidated subsidiaries and associated companies are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not have been material.

The excess of the cost of an acquisition over the fair value of the net assets of the acquired subsidiary is being amortized over five years.

All significant intercompany balances and transactions have been eliminated in consolidation. All material intercompany profit included in assets resulting from transactions within the Group is eliminated.

### (c) Cash Equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits, certificate of deposits, and commercial paper, all of which mature or become due within three months of the date of acquisition.

### (d) Foreign Currency Transactions

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into

Japanese yen at the exchange rates at the balance sheet date. The foreign exchange gains and losses from translation are recognized in the consolidated statement of income.

### (e) Foreign Currency Financial Statements

In translating the financial statements of foreign subsidiaries and associated companies into Japanese yen, all assets and liabilities and revenues and expenses are translated at the current exchange rates in effect at balance sheet date, except for shareholders' equity which is translated at the historical exchange rates in effect at the time of the transactions. Differences arising from such translation are shown as "Foreign currency translation adjustments" in a separate component of shareholders' equity.

### (f) Inventories

Inventories maintained by the Company and its domestic subsidiaries are principally stated at average cost. Inventories maintained by foreign subsidiaries are principally stated at the lower of cost, determined by the first-in, first-out method, or market.

### (g) Depreciation

Depreciation of property, plant and equipment is principally computed on the declining-balance method for the Company and its domestic subsidiaries and on the straight-line method for foreign subsidiaries over their estimated useful lives.

The estimated useful lives are as follows:

Buildings and structures .....	3 to 60 years
Machinery and equipment .....	2 to 16 years
Tools, furniture and fixtures .....	2 to 20 years

Ordinary maintenance and repairs are charged to income as incurred. Major replacements and improvements are capitalized.

Software for company use is carried at cost less accumulated amortization, which is calculated by the straight-line method principally over their estimated useful lives (five years). Software installed in products is carried at cost less accumulated amortization, which is calculated by the proportion of the actual sales volume of the products during the current year to the estimated total sales volume over the estimated salable years of the products or by the straight-line method over the estimated salable years of the products (one to five years), considering the nature of the products.

### (h) Marketable and Investment Securities

The Company has classified all debt and equity securities as available-for-sale securities based on the management's intention. Available for-sale securities other than non-marketable are reported at fair value with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity.

Non-marketable available-for-sales securities are stated at cost determined by the moving-average method.

For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

### (i) Stock Issue Costs

Stock issue costs, which are capitalized and included in other assets, net of accumulated amortization, are amortized using the straight-line method over three years.

### (j) Liability for Employees' Retirement Benefits

The Company has a funded defined benefit pension plan covering substantially all employees.

The Company and domestic consolidated subsidiaries account for the liability for retirement benefits based on projected benefit obligations and plan assets at the balance sheet date.

Prior service costs are amortized using the straight-line method over 5 years, which are less than the average remaining years of service of the employees.

Actuarial gain or loss is amortized mainly using the

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straight-line method over 10 years, which are less than the average remaining years of service of the employees, and the amortization will be started in the year in which the gain or loss is recognized.

The transitional obligation as of April 1, 2000, is being amortized over 15 years.

### (k) Income Taxes

The provision for income taxes is computed based on the pretax income included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

The Group files a tax return under the consolidated corporate-tax system from the fiscal year ended March 31, 2003, which allows companies to base tax payments on the combined profits or losses of the Company and its wholly owned domestic subsidiaries. Under the consolidated-tax system, a surcharge tax of 2% of taxable income is levied in addition to the national corporate income tax rate for the fiscal years ended March 31, 2003 and 2004.

### (l) Leases

All leases of the Company and domestic subsidiaries are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

### (m) Derivative Financial Instruments

The Group uses foreign currency forward contracts and interest rate swaps as a means of hedging exposure to foreign currencies and interest risks. The Group does not enter into derivatives for trading or speculative purposes.

Derivative financial instruments are classified and accounted for as follows: a) all derivatives are recognized as either assets

or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the consolidated statements of income and b) for derivatives used for hedging purposes, if derivatives qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until maturity of the hedged transactions.

The foreign currency forward contracts are utilized to hedge foreign currency exposures for export sales and procurement of raw materials from overseas suppliers. Trade receivables and payables denominated in foreign currencies are translated at the contracted rates if the forward contracts qualify for hedge accounting.

Forward contracts applied for forecasted transactions are also measured at fair value and the unrealized gains / losses are deferred until the underlying transactions are completed.

Interest rate swaps are utilized to hedge interest rate exposures of long-term debt. Swaps which qualify for hedge accounting are measured at market value at the balance sheet date and the unrealized gains or losses are deferred until the maturity of the transactions.

### (n) Appropriations of Retained Earnings

Appropriations of retained earnings, if any, are reflected in the accompanying consolidated financial statements for the following year upon shareholders' approval.

### (o) Per Share Information

Basic net income per share is computed by dividing net income available to common shareholders, by the weighted-average number of common shares outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share reflects the potential dilution that could occur if diluted securities were exercised or converted into common stock. Diluted net income per share of common stock assumes full conversion of the outstanding preference shares at the time of issuance.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends to be paid after the end of the year, if any.

## 2. Investment Securities

All the debt and equity securities, classified as available-for-sale securities, are included in non-current investment securities. The carrying amounts and aggregate fair values of the available-for-sale securities as of March 31, 2004 and 2003, are as follows:

	2004							
	Millions of yen				Thousands of U.S. dollars			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equity Securities	¥ 1,356	¥ 449	¥ (22)	¥ 1,783	\$ 12,792	\$ 4,236	\$ (208)	\$ 16,820
Total	¥ 1,356	¥ 449	¥ (22)	¥ 1,783	\$ 12,792	\$ 4,236	\$ (208)	\$ 16,820

  

	2003			
	Millions of yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equity Securities	¥ 1,362	¥ 5	¥ (274)	¥ 1,093
Total	¥ 1,362	¥ 5	¥ (274)	¥ 1,093

Proceeds from sales of available-for-sale securities for the year ended March 31, 2004 and 2003, were ¥35 million (\$330 thousand) and ¥13 million, respectively. Gross realized gains on these sales, computed on the moving average cost basis,

were ¥0.2 million for the year ended March 31, 2003, and gross realized losses computed on the moving average cost basis, for the year ended March 31, 2004 and 2003, were ¥8 million (\$75 thousand) and ¥1 million, respectively.

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2004, and 2003 were as follows:

	Carrying amount		
	Millions of yen		Thousands of U.S. dollars
	2004	2003	2004
Available-for-sale:			
Equity securities	¥ 414	¥ 265	\$ 3,906
Debt securities	1,500	1,500	14,151
Total	¥ 1,914	¥ 1,765	\$ 18,057