7. Explanation of Extraordinary Items

Extraordinary Income **<u>Total: 294.8 billion yen</u>**

(1) Asset Sales

A. Gain on Sales of Marketable Securities **<u>134.6 billion yen</u>**

- At the request of FANUC, we sold shares in the company in May and November of 2003.

  Capital gain: 117.0 billion yen (Sales proceeds: 217.5 billion yen)

  - On an unconsolidated basis, there was a capital gain of 217.1 billion yen, and because profits on an unconsolidated basis are taxable, the contribution to net income on a consolidated basis was limited to 28.1 billion yen.
  - Since Fujitsu's equity stake in FANUC was reduced to 18.6%, its results are no longer consolidated under equity-method accounting. As a result, other income (equity in earnings of affiliates) was reduced by approximately 5 billion yen. And because holdings are treated as ordinary investment securities and valued at their market price, there was a resulting increase in capital of 67.0 billion yen.
- Sale of ordinary equity portfolio and other holdings

  Capital gain: 17.5 billion yen (Sales proceeds: 35.5 billion yen)

B. Gain on Sales of Fixed Assets **<u>13.6 billion yen</u>**

- Securitization of the land and buildings of Fujitsu Solution Square (located in Kamata, Tokyo), and the sale of other properties that had been used for employee recreation.

  Capital gain: 13.6 billion yen (Sales proceeds: 29.3 billion yen)

(2) Transfer of Substitutional Portion of Employees' Pension Plan **<u>146.5 billion yen</u>**

- Fujitsu applied for an exemption from the obligation to pay benefits for future employee services related to the substitutional portion of the employees' pension plan, in which we and our domestic subsidiaries participate. On March 23, 2004, we received approval of the exemption from the Minister of Health, Labor and Welfare. Accordingly, as of the approval date, we recognized the elimination of both the employee retirement obligations and pension assets relating to the substitutional portion, resulting in an extraordinary gain of 146.5 billion yen. The rise in stock prices toward the end of the fiscal year increased the amount of the capital gain.
- The unfunded portion of pension plan obligation was 435.0 billion yen (a large reduction of 336.2 billion yen compared to the previous fiscal year). Of that amount, the impact of the portion transferred to the government was approximately 130 billion yen. The other major factor behind the reduction was the rise in stock prices at the end of the fiscal year.
- The reduction in next fiscal year's pension expense burden was approximately 20 billion yen. There was an approximately 20 billion yen increase in assets, a roughly 10 billion yen reduction resulting from the substitutional portion transfer, and the discount rate was revised from 3.0% to 2.5%, increasing the burden by 10 billion yen.

Extraordinary Losses **<u>Total: 187.5 billion yen</u>**

(1) Restructuring Charges **<u>164.2 billion yen</u>**

A. Global Restructuring Focusing on North America **<u>75.7 billion yen</u>**

- For customers expanding their businesses on a global basis, we are enhancing our ability to offer leading-edge hardware and software on a global basis under a consistent Fujitsu brand and to continually provide high-quality one-stop solutions in each region.
- In fiscal 2003, we consolidated two computer hardware operations in the U.S., Fujitsu PC Corporation (focusing on PCs) and Fujitsu Technology Solutions Inc. (focusing on

servers), a subsidiary of Fujitsu IT Holdings (FIH, the former Amdahl), integrating them into the newly established Fujitsu Computer Systems. This move created a unified organization for hardware offerings and enabled a reduction in overlapping functions and personnel, and an elimination of assets.

- In software and services, we realigned the operations of Fujitsu Consulting (the former DMR), which had been a subsidiary of FIH, to focus on the North American market. In conjunction with this, operations in Spain were sold to a third party, and other European operations were merged into Fujitsu Services (the former ICL). Operations in Oceania were merged into Fujitsu Australia Limited. These moves enabled a reduction in overlapping functions and personnel, and an elimination of assets.
- The scope of personnel reductions, primarily in North America and Europe, was approximately 1,000 employees globally.
- In North America, Fujitsu Computer Systems and Fujitsu Consulting were made direct subsidiaries of Fujitsu Limited, and the FIH holding company is being liquidated. As a result of these measures, we took a one-time charge to write off the goodwill associated with the acquisition of Amdahl, the predecessor of FIH, as well as currency translation adjustments of past investments.
- Amount of Loss

  Restructuring charges: 28.9 billion yen (personnel reductions, asset disposals)
  Goodwill write-offs, etc.: 46.8 billion yen (including currency translation adjustments on investments)
- These moves completed the global restructuring designed to create a consistent Fujitsu brand and presence. Under a new global business model we will develop our business worldwide, with closer coordination among operations in each region.

B. Fundamental Reform of Software & Services Business in Japan **68.3 billion yen**

- We posted an extraordinary loss of 68.3 billion yen to cover potentially uncollectable accounts in 2004 and 2005.

<Method of Calculation>

- In fiscal 2003, in addition to calculating potential future losses relating to projects whose worsening profitability had become apparent, we carried out an exhaustive analysis of all projects under development to predict future returns, including for work not yet implemented.
- Losses for projects completed in fiscal 2003 were recognized as operating losses for the period.

<Content of Deterioration in Profitability>

- The projects for which the deterioration in profitability was particularly apparent were large-scale projects of relatively long-term contract duration of 2-3 years. Many of these contracts were structured solely around the outcome of development work, and it was determined that it would be difficult to cover the costs incurred on these contracts. At present, Fujitsu's systems engineering group is working at full capacity, and it seems that many of the problems stemmed from aggressive expansion of sales orders, despite potential difficulties that might likely arise due to the rapid shift toward open standards.
- In these projects, along with the wider choices available with open system standards, systems development work has become more complex. Moreover, because our customers' business environments are continually changing, and with an increase in the number of development items subject to tight delivery deadlines, there have been an increasing number of cases with unanticipated expansions in the scope of the project and the personnel required. In almost all cases neither Fujitsu nor our customers were able to accurately anticipate the amount of work required.

<Premise for Recognizing Extraordinary Loss>

- Ordinarily with system development projects, revenue is recognized using the completed contract method. Because of this, all development costs, including orders to subcontractors, are accumulated at the end of the project. Under this standard practice, project profitability is usually not recognized before these processes are completed. Upon becoming aware of some underperforming projects that will continue over coming years, we undertook a thorough review of all projects – normally done at the time of completion – to confirm details with respect to contracts with customers and the progress of development work being done by partners and subcontractors.

- In conjunction with the change in our policy regarding loss recognition and the decision to post an extraordinary loss, we have thoroughly analyzed all of our deals and contracts, and while of course we will also quickly recognize any losses in the future, we will make concerted efforts to prevent such losses from occurring in the first place. Therefore, reforming our business management structure for that purpose is of primary importance.

<Measures Going Forward>

- To prevent such losses from occurring in the future, in February we established a Business Risk Management Office that audits all large deals, and also put in place a structure for having third parties quickly check all other deals. In addition, we are promoting the usage of our innovative TRIOLE and SDAS initiatives to respond to open systems requirements.
- Through such measures as increasing the transparency of contractual arrangements with customers and suppliers, we are reforming our business practices and are committed to increasing the level of customer satisfaction. Specifically, we will prohibit any oral agreements, and, following the usual practice of corporate contracts in the U.S. and Europe, will pursue agreements with customers over detailed plans and, as much as possible, seek to have the timing of cash flows match the work requirements.
- In addition, through the internal implementation of percentage of completion accounting methodology, we will strictly enforce our new rules regarding early recognition of any losses and take a very clear approach to project management with the aim of improving the profitability of our software and services business.

<Impact on Earnings in Fiscal 2004 and Beyond>

- In terms of the impact on earnings in fiscal 2004 and beyond, which is predicated on the thorough implementation of the measures described above, the new procedures will undergo a comprehensive review in the first quarter, and, throughout our organization we will make every effort to ensure that the losses recognized now lead to improved profitability in fiscal 2004.
- Finally, in terms of external factors, we continue to study the possibility of implementing new international accounting standards in 2005, at the same time they will become required in Europe. The percentage of completion accounting standards have been the most contentious aspect of the new international accounting standards, but we are now putting them into practice internally a year in advance. We also intend to pursue the implementation of these standards with our overseas subsidiaries, such as Fujitsu Consulting in the U.S. and Fujitsu Services in Europe. We view this as an important step that will boost our position as a leading global player in the software and services business.

C. Other Restructuring Charges **<u>20.1 billion yen</u>**

- We recognized an extraordinary loss on other restructuring charges, primarily related to restructuring initiatives implemented by publicly traded domestic subsidiaries, including FDK (5.6 billion yen), Fujitsu Support and Service (4.1 billion yen), and Shinko Electric (2.0 billion yen).

(2) Other Extraordinary Losses

A. HDD Litigation-Related Expenses **10.2 billion yen**

- With respect to claims relating to certain Fujitsu-manufactured hard disk drives, we posted an extraordinary charge to cover the settlement and related expenses of a class action lawsuit in the U.S., as well as corrective measures for customers. In fiscal 2002 we posted a charge of 30.6 billion yen to cover expenses for corrective measures for products. The amount of the loss posted in fiscal 2003 could not be determined at the end of the prior fiscal year because claims were still in the process of being negotiated.

B. Casualty Losses **4.7 billion yen**

- We posted a casualty loss for the cost of repairing damages our Iwate plant incurred in the earthquake off the coast of Miyagi Prefecture on May 26, 2003.

C. Other **8.4 billion yen**

- In accordance with the implementation in fiscal 2003 of a new system for calculating social insurance premiums based on an employee's total compensation, we posted a charge to cover the impact of the change in relative contributions.