Megadiamond Industries, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

April 30, 1980

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the company's significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

Consolidation

The consolidated financial statements include the accounts of its wholly-owned subsidiaries, after elimination of significant intercompany accounts and transactions.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Property, Plant and Equipment

Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated useful lives, using both straight-line and accelerated methods.

Maintenance, repairs and minor renewals are charged to operations as incurred, except that expenditures which increase the useful lives of the assets are capitalized. When property, plant and equipment are sold or retired, the cost of the assets and the related accumulated depreciation are deducted from the accounts and the resulting gain or loss is reflected in the consolidated statement of earnings.

Income Taxes

As discussed in note E, the company has capitalized certain leases for financial statement purposes. Payments under these leases are being expensed for income tax purposes. The resulting deferred tax benefits have been reflected in the accompanying financial statements for the differences between earnings for tax and financial statement purposes.

Investment Credit

Investment tax credits are accounted for by the flow-through method. Under this method, credits are recognized as a reduction of income tax expense in the year the assets giving rise to the credit are placed in service.

Patents

Costs incurred in connection with obtaining patents are being amortized over a five-year period.