# Investigation Report

September 11, 2017

Inabata & Co., Ltd. Internal Investigation Committee

Translation

Note: This document has been translated from the Japanese original for reference purposes only. In the event of any discrepancy between this translated document and the Japanese original, the original shall prevail.

To: Inabata & Co., Ltd.

Inabata & Co., Ltd. Internal Investigation Committee

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| Committee Chair (Director, President) | Katsutaro Inabata |
| Committee Member (Director, Senior Managing Executive Officer) | Kenichi Yokota |
| Committee Member (Executive Officer, General Manager, Risk Management Office) | Hiroyuki Hatamoto |
| Committee Member (Executive Officer, General Manager, Financial Management Office) | Nobukazu Kuboi |
| Committee Member (General Manager, Internal Audit Office) | Shigeru Kurimoto |
| Committee Member (Senior Manager, Legal Department of Risk Management Office) | Takashi Ban |
| Committee Member (Manager, Domestic Section of Legal Department of Risk Management Office) | Takeshi Hamakawa |
| Committee Member (Senior Manager, International Affiliate Management Department of Financial Management Office) | Yasushi Akinaga |
| Committee Member (Senior Manager, IR Department of Financial Management Office) | Yukinobu Fukuyama |
| Committee Member (Lawyer, Anderson Mori & Tomotsune) | Hidetaka Miyake |
| Committee Member (Certified Public Accountant, Deloitte Tohmatsu Financial Advisory LLC) | Shigeru Tsukishima |

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## Terminology List

| Term | Content |
|---|---|
| The Company | Inabata & Co., Ltd. |
| IKEG | INABATA EUROPE GmbH |
| X Company | Buyer of solar battery modules |
| Y Company | Supplier of solar battery modules |
| KPMG AZSA | KPMG AZSA LLC / Accounting Auditor of the Company |
| W audit corporation | Accounting Auditor of IKEG |
| A CPA | German CPA affiliated with W audit corporation |
| B CPA | CPA affiliated with W audit corporation |
| Mr. C | X Company / Managing Director |
| Mr. D | X Company / General Manager |
| Employee E | IKEG / Administration General Manager |
| Employee F | IKEG / Sales Manager |
| Employee G | IKEG / Sales General Manager |
| Current President H | IKEG / Managing Director |
| Former President I | The Company / Deputy General Manager, Information & Electronics Division III; former IKEG / Managing Director |
| Employee J | IKEG / Sales Assistant |
| General Manager K | The Company / General Manager, Internal Audit Office |
| Audit & Supervisory Board Member L | The Company / full-time Audit & Supervisory Board Member |
| Senior Manager M | The Company / Senior Manager, International Affiliate Management Department of Financial Management Office |
| Mr. N | IKEG / former Administration Manager |
| Z Company | Company that formerly outsourced the manufacture of solar battery modules to Y company |
| Director O | The Company / Director in charge of this matter |

## Part 1: Overview of the Investigation

### 1 Background to the setting up of the Internal Investigation Committee

In early July 2017, the Company came to a provisional understanding to the effect that a discrepancy of approximately ¥1.0 billion existed between inventory volume stated in the journal and the physical count of inventory volume (hereinafter, “the discrepancy”)[1] at a warehouse owned by the Company’s consolidated subsidiary in Germany, IKEG when conducting onsite stocktaking at the warehouse in Poland, one of the storage locations. The discrepancy concerned solar battery modules worth approx. ¥1.4 billion, which were purchased sometime between March and April, 2017.

At that point, the Company began an internal investigation such as by conducting onsite stocktaking at warehouses other than the one in Poland, but it was unable to determine the correct closing figures which, in an extremely serious development, led to the delay of the announcement of financial results that had been scheduled for August 14, 2017. Accordingly, the Company laid out a Group-wide investigative framework, with the Director and President as the Committee Chair, in addition to which the support of outside experts who have no interest relationships with the Company was obtained. The Company decided it was necessary to conduct a thorough investigation into the related facts, and on August 8, 2017, it launched the Internal Investigation Committee (hereinafter, “the Committee”) and on the same day made timely disclosure of the same.

### 2 Matters entrusted to the Committee (scope of investigation)

The solar battery modules involved in the discrepancy were purchased by IKEG from Y Company (hereinafter, “Y Company modules” or “Y Company module inventory”), and X Company, which was intended to be the buyer, was holding them as inventory prior to the handover, on behalf of IKEG. During the course of the internal investigation that preceded the setting up of the Committee, X Company acknowledged the fact that it had conducted the sale to the end user without authorization of IKEG, and it was discovered that the unauthorized sale by X Company was the supposed main cause of the discrepancy.

The Committee then determined to carry out an investigation into each of the following items,

[1]The details of the matters that were the cause of the discrepancy related to solar battery modules such as the precise timing of the purchase, the remaining inventory in value, the discrepancy in value, and the storage warehouse, were ascertained after the fact by the Committee during the course of its investigation.

as matters formally entrusted to the Committee, with the objective of clarifying the facts of the matter in relation to the uncertainty with regard to the unauthorized sale of Y Company modules (hereinafter, “the uncertainty”) by X Company.

1) Confirmation of the facts with regard to the uncertainty, including the existence or otherwise of any intentional involvement, such as collusion, cooperation or tacit approval by officers and employees of IKEG
2) In the event of intentional involvement, in the form of collusion, cooperation or tacit approval, by officers and employees of IKEG in 1) above becoming clear, an investigation into the existence or otherwise of similar events
3) Analysis of the origin of the discrepancy and of the causes of each of the above facts
4) Opinions on measures to prevent recurrence

## 3 Composition of the Internal Investigation Committee

The composition of the Committee is as follows. Moreover, the outside expert committee members, namely lawyer Hidetaka Miyake and certified public accountant Shigeru Tsukishima, have received no business from either the Company or IKEG, and have no interest relationships whatsoever with either the Company or IKEG.

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|---|---|
| **Committee chair** | Katsutaro Inabata (Director, President) |
| **Inside committee members** | Kenichi Yokota (Director, Senior Managing Executive Officer)<br>Hiroyuki Hatamoto (Executive Officer, General Manager, Risk Management Office)<br>Nobukazu Kuboi (Executive Officer, General Manager, Financial Management Office)<br>Shigeru Kurimoto (General Manager, Internal Audit Office)<br>Takashi Ban (Senior Manager, Legal Department of Risk Management Office)<br>Takeshi Hamakawa (Manager, Domestic Section of Legal Department of Risk Management Office)<br>Yasushi Akinaga (Senior Manager, International Affiliate Management Department of Financial Management Office)<br>Yukinobu Fukuyama (Senior Manager, IR Department of Financial Management Office) |
| **Outside expert committee members** | Hidetaka Miyake (Lawyer, Anderson Mori & Tomotsune)<br>Shigeru Tsukishima (Certified Public Accountant, Deloitte Tohmatsu Financial Advisory LLC) |

Also, the Committee has selected Deloitte Tohmatsu Financial Advisory LLC to assist in the performance of the investigation. The Committee has also assigned officers and employees of the Company and IKEG to engage in the investigation when appropriate.

## Part 2: Overview of the Investigation Procedure

### 1 Period over which the investigation was conducted

Having taken over the Company's internal investigation such as by conducting, from July 24, 2017 onwards, onsite stocktaking of the Y Company modules, the Committee conducted the investigation and review based on the results of the investigation from August 8, 2017 to September 11, 2017.

### 2 Period targeted by the investigation

Based on the understanding that the period in which IKEG carried out the transactions for the purchase of the Y Company modules began in December 2016, the target period of the investigation was specified as the year ended March 31, 2017 and the three months ended June 30, 2017.

### 3 Overview of investigation procedures conducted

The outline of the investigation procedures conducted by the Committee, which include the internal investigation before the Committee was set up, is as follows.

#### (1) Onsite stocktaking of Y Company module inventory, confirmation of evidence, etc.

Having grasped that IKEG's Y Company module inventory was stored in 10 locations around the world at commercial warehouses with which X Company had concluded warehouse contracts, the Committee obtained the cooperation of X Company to conduct onsite stocktaking and confirm evidence, etc., as described below.

1) Excluding Armenia and Lebanon, which are subject to travel restrictions by the Ministry of Foreign Affairs, the existence or otherwise of commercial warehouses was confirmed by visiting eight locations (Malaysia, Poland, Puerto Rico, Cyprus, El Paso, Ukraine, Italy and the Netherlands)
2) Confirmed discrepancy between the inventory recorded in the accounts and the physical count of inventory in Malaysia, Poland, El Paso and Puerto Rico, in which commercial warehouses and remaining inventory existed
3) For Italy and the Netherlands, where commercial warehouses existed but no inventory remained, no count of the actual items was conducted, and the fact of shipment was

confirmed using evidence and equivalents provided by X Company and, in some cases, visits to the destination of the shipments

4) For Armenia and Lebanon, where commercial warehouses could not be confirmed due to travel restrictions, no count of the actual items was conducted, and the fact of shipment was confirmed using evidence and equivalents provided by X Company

**(2) Interviews of individuals involved**

Interviews conducted by the Committee with the officers and employees of IKEG and other related parties, including those carried out during the course of the internal investigation before the Committee was set up, were as follows.

Furthermore, in interviews conducted after the Committee was set up from August 23, 2017 onward, outside expert committee members took the lead in questioning.

| Date of interview | Interviewee (affiliation / position) |
|---|---|
| August 3, 2017 | Mr. C (X Company / Managing Director)<br>Mr. D (X Company / General Manager) |
| August 5, 2017 | Employee E (IKEG / Administration General Manager) |
| | Employee F (IKEG / Sales Manager) |
| August 6, 2017 | Employee G (IKEG / Sales General Manager) |
| | Current President H (IKEG / Managing Director) |
| August 10, 2017 | Former President I (The Company / Deputy General Manager, Information & Electronics Division III; former IKEG / Managing Director) |
| August 23, 2017 | Employee E (IKEG / Administration General Manager) |
| | A CPA (W audit corporation / German Certified Public Accountant)<br>B CPA (W audit corporation / Certified Public Accountant) |
| | Employee J (IKEG / Sales Assistant) |
| August 24, 2017 | Employee J (IKEG / Sales Assistant) |
| | Employee F (IKEG / Sales Manager) |
| August 25, 2017 | Employee J (IKEG / Sales Assistant) |
| | Employee G (IKEG / Sales General Manager) |
| | General Manager K (The Company / General Manager, Internal Audit Office) |

| Date of interview | Interviewee (affiliation / position) |
|---|---|
| August 29, 2017 | Audit & Supervisory Board Member L (The Company / Full-time Audit & Supervisory Board Member) |
| | Senior Manager M (The Company / Senior Manager, International Affiliate Management Department of Financial Management Office) |
| September 1, 2017 | Former President I (The Company / Deputy General Manager, Information & Electronics Division III; former IKEG / Managing Director) |

**(3) Confirmation and examination of related materials**

The Committee confirmed and examined the following related materials, including external evidence obtained from X Company.

1) Disclosed materials, including the Company's securities reports, the rules for request for approval, rules for the *shinsa kaigi* (organization which reviews credit and individual important cases), rules for group company management, rules for internal audits, rules for credit management and other internal rules
2) Evidence related to the Y Company module transactions between IKEG and X Company, memo circulated for managerial approval of the Company and other related materials
3) Original logistics vouchers related to the acceptance and shipment of Y Company module inventory described in Part 2, 3 (1) above, provided by X Company

**(4) Digital forensics**

**(i) Preservation of electronic data evidence**

The Committee took steps to preserve evidence in the form of the following items targeted by the investigation and used by four persons involved in the transactions with X Company. The company-owned PCs used for work by Employee G, Employee E and Employee F have been retained as evidence at IKEG in Düsseldorf, Germany, and other items targeted by the investigation have been retained as evidence in Japan.

| Individuals subject to digital forensics (affiliation / position) | Items targeted by the investigation |
|---|---|
| Former President I (The Company / Deputy General Manager, Information & Electronics Division III; former IKEG / Managing Director) | 1) PST files downloaded from Office365<br>2) Two company-owned PCs used for work |
| Employee G (IKEG / Sales General Manager) | 1) PST files downloaded from Office365<br>2) One company-owned PC used for work |
| Emploee E (IKEG / Administration General Manager) | 1) PST files downloaded from Office365<br>2) One company-owned PC used for work |
| Employee F (IKEG / Sales Manager) | 1) PST files downloaded from Office365<br>2) One company-owned PC used for work |

**(ii) Processing and analysis of electronic data**

For the items targeted by the investigation as described in (i) above, electronic data processing and analysis was carried out in the countries where they were preserved to recover deleted files etc. The extracted emails and attached files came to 462,249 items in Japan and 355,560 items in Germany, all of which were uploaded to the Relativity review platform.

**(iii) Review of documents**

The email data uploaded to Relativity in Japan was narrowed down to 16,459 items by specifying the dates sent/received and through the use of keywords. These items were reviewed resulting in the extraction of 881 items related to the uncertainty caused by X Company. In addition to carrying out reviews of attached files, these items were also used as materials to establish the facts of the case, after interviews with relevant parties to elicit confirmations.

The email data uploaded to Relativity in Germany was also narrowed down to 3,774 items by specifying the dates sent/received and through the use of keywords. These items were reviewed resulting in the extraction of 93 items related to the uncertainty caused by X Company, and their contents were confirmed.

**(iv) Investigation of company-owned mobile devices used for work**

With regard to the four people that were subject to digital forensics, 70 messages including SMS messages on the company-owned mobile phone used for work (iPhone 6s) of Former President I were checked, but no data related to the uncertainty was extracted.

The cooperation of the other three individuals was sought in regard to investigating the data of company-owned mobile phones used for work, but cooperation was not obtained due to the devices including data relating to personal information.

### (5) Interview of KPMG AZSA

Because it was possible that the results of the investigation would have an impact on the Company's closing figures, the Committee conducted interviews with the KPMG AZSA engagement partner etc. in charge of the audit of the Company on August 31, 2017, obtaining information on the procedures carried out by KPMG AZSA for the purposes of financial statement audit and internal control audit during the period targeted by the investigation, on the outcomes of those procedures, and on the existence or otherwise, and content etc. of instructions from KPMG AZSA to W audit corporation.

## 4 Assumptions

The Committee's investigation is based on the following assumptions.

1) That the materials submitted to the Committee by IKEG, X Company and other related parties with regard to the uncertainty are exhaustive, and in addition that they are true and complete originals or exact copies of the same
2) That the Committee's investigation was not carried out under the compulsory investigatory powers, but based on voluntary cooperation by parties involved
3) That the purpose of the Committee's investigation was not to pursue the legal liability of the parties involved in relation to the uncertainty, and that it is not assumed that this report will be used for that purpose

## 5 Restrictions

The Committee's investigation was restricted in the following respects.

1) With respect to the commercial warehouses located in Armenia and Lebanon, due to travel restrictions on both countries by the Ministry of Foreign Affairs, neither

country was visited and the onsite stocktaking described in Part 2, 3 (1) above could not be conducted.

2) Of the data subject to the digital forensics described in Part 2, 3 (4) above, deleted data in the PST files downloaded from Office365 could not be recovered, so even assuming that the deleted email data had existed, it was not possible to review it.

3) Among individuals subject to the digital forensics, the Committee was unable to obtain the cooperation of Employee E, Employee G and Employee F with regard to their company-owned mobile phones used for work, as the devices included data related to personal information.

## Part 3: Facts Ascertained by the Investigation

### 1 Overview of the Group's overseas operations

#### (1) Overview of the Group

The Company was established in 1890 as Inabata Senryoten in Kyoto, and in 1918 the family type operating business reorganized itself as Inabata & Co., Ltd. (Inabata Shoten), expanding the scope of business with a primary focus on the chemicals business. Today, the Group consists of the Company, 55 subsidiaries, 15 affiliates and one other affiliated company. As an integrated, specialized trading company, the Company's main business is the manufacture and sale of products in the fields of Information & Electronics, Chemicals, Life Industry, Plastics, Housing & Eco Materials and others.

The Company's consolidated net sales were ¥586.6 billion in the year ended March 31, 2017, of which Plastics accounted for approximately 43% and Information & Electronics accounted for approximately 38%.

#### (2) Expansion of the Group's overseas operations

##### (i) Expansion of overseas operations

The Group straddles the five regions of Japan, southeast Asia, northeast Asia, the Americas and Europe, and has expanded to around 60 business locations in 18 countries worldwide. The Group has developed to cover a wide range of operations, with its main business being the manufacture and sale of products in the fields of Information & Electronics, Chemicals, Life Industry, Plastics, Housing & Eco Materials and others.

Overseas accounted for ¥312.9 billion of the Company's consolidated net sales of ¥586.6 billion in the year ended March 31, 2017, coming to more than half of the total.

Europe, where IKEG is located, consists of three trading companies and one fine chemicals manufacturing base in France, Germany, the UAE, and the business has been focused primarily on the fine chemical, environment and energy, auto and semiconductor segments.

Net sales in the European region in the year ended March 31, 2017 were ¥15.7 billion, approximately 2.7% of the Group total, but recently the solar battery-related sales have been growing rapidly, driving a significant increase in net sales from the ¥10.3 billion in the year ended March 31, 2016.

**(ii) Group company management system**

**a. Reporting, approval, and managerial approval by internal circular at the Company under the rules for group company management**

The "rules for group company management" are drawn up with the objective of facilitating the appropriate management of the group companies, and prescribe the matters on which each group company should submit requests to or report to the Company. Based on these rules, group companies must make written requests for approval and reports in relation to important items of business executions at group companies, and there is a system in place within the Company to deal with these appropriately.

In the "rules for group company management," the important items of business execution are enumerated as matters to be discussed, and the prescribed matters and procedures are described in detail, such as matters that can be approved within the local office, but that must be reported to the General Manager of the Financial Management Office of the Company, matters that require the approval of the General Manager of Financial Management Office of the Company, and matters that require a managerial approval by internal circular at the Company after being approved by the director in charge.

Additionally, important items of business execution at group companies that fall under matters that require a managerial approval by internal circular at the Company require, based on the "rules for request for approval," the approval of the President. Furthermore, for matters related to reviewing certain important items of business execution and for matters related to reviewing credit limits of amounts above specified thresholds for the customer, there is a system in place, based on the "rules for the *shinsa kaigi*," by which the President makes a decision after the deliberation of the *shinsa kaigi*. This is an organization for reviewing that assists the decision making of the President and is made up of persons appointed by full-time directors and the President.

**b. Supervision and guidance by the Financial Management Office**

In addition to the Company striving for appropriate management of group companies by the use of a personnel system that sends officers and employees of the Company to work at group companies, based on the “rules for group company management,” the Company has built a system in which the Financial Management Office, as needed and after consulting with the relevant departments, conducts the management of the group companies, which includes forming a grasp of and considering the details of operations, as well as guidance and training in such areas as credit management, accounting and internal control.

Management, including international affiliate operations, other than operations related to the settlement of the consolidated accounts is in the charge of the International Affiliate Management Department of the Financial Management Office. This office provides support of various kinds, arranges communications, and handles requests for approval in accordance with rules for group company management in cooperation with resident employees who are dispatched overseas from the Company to take charge of local management. In addition, it carries out management functions such as watching for abnormal developments monthly like buildups of inventory or delays in the collection of accounts receivable, and conducting checks locally.

In addition, in order to standardize the business procedures of overseas subsidiaries and maintain levels above what is prescribed, the International Affiliate Management Department of the Financial Management Office drew up the “IK Group Administrative Operations Rules” (hereinafter, “Administrative Operations Rules”) on January 5, 2016, and took initiatives to roll them out overseas.

**c. Internal audit, including evaluation of internal control**

The Company has set up the Internal Audit Office as an organization that reports directly to the President, and that handles the internal control evaluation system for financial reporting and performs business audits in accordance with the Financial Instruments and Exchange Act. However, a system has been put in place whereby the Internal Audit Office is divided into the overseas team and the domestic team, who evaluate internal control and carry out internal audits for overseas subsidiaries, and for the Company and domestic subsidiaries, respectively.

With regard to internal audits, these are conducted in accordance with the procedures and methods prescribed in the “rules for internal audits” and “internal audit implementation overview.” For the business audit of overseas subsidiaries, the frequency of visits is determined depending on the scale, type of business, etc., for example important business locations are visited at a frequency of once every two years, while other types of location are visited at a rate of once every three years. An audit implementation plan is drawn up at the time of the on-site audit for each location, and is implemented through procedures by conducting on-site audits after preliminary information gathering to conduct interviews, gather information on site, carry out onsite stocktaking and inspect the warehouses.

With regard to problems flagged by internal audits, as well as following up with appropriate checks and surveys to ascertain whether improvements to the specified details have been implemented or not, the Internal Audit Office meets regularly with KPMG AZSA and audit & supervisory board members to work together by exchanging information etc., and carries out follow-up work to verify improvements not only in the issues flagged during internal audits but also in the issues raised by audits of KPMG AZSA and audit & supervisory board members.

#### d. Overseas on-site audits by audit & supervisory board members

The audit & supervisory board of the Company consists of one full-time audit & supervisory board member, and three outside audit & supervisory board members. The full-time audit & supervisory board member (or the full-time audit & supervisory board member and one outside audit & supervisory board member) rotates through visits to overseas subsidiaries at a frequency of roughly once every three years, in order to conduct audit & supervisory board member audits of overseas subsidiaries.

In some cases the audit & supervisory board member accompanies KPMG AZSA to overseas on-site audits, and in some cases they visit on their own. In cases where they accompany KPMG AZSA to overseas on-site audits, as well as auditing the state of the financial audits conducted by KPMG AZSA, they also conduct business audits.

As well as communicating their opinions on the overseas on-site audit to the local subsidiary, they share information with the director in charge of the business in question after returning to Japan.

## 2 Overview of IKEG

### (1) History, details of business, etc.

IKEG was founded in December 2013 based in Düsseldorf, Germany as a wholly owned subsidiary of the Company, and its main business consists of the import, export and sale of electronic materials, plastics and fine chemicals.

IKEG mainly deals with business transactions in which it purchases products from Japanese or local companies and sells them to local customers.

**(2) Organizational structure and management system**

IKEG is a limited company under German law, and was originally established with capital of €2.0 million, but this was increased to €4.4 million in 2016. It has two subsidiaries, Inabata France S.A.S. and Pharmasynthese S.A.S., that conduct their business in France, but both of these are involved in the Life Industry segment and are not under the management of IKEG, with the Company itself performing management and administration etc.

IKEG's fiscal year runs from April 1 of every year to March 31 of the following year, and in the year ended March 31, 2017 its consolidated net sales were €114 million (statutory audit not completed), while as of July 2017 IKEG had 24 officers and employees.

As an institution under the law, IKEG has established a shareholder meeting and appointed a managing director, but the only shareholder is the Company, of which it is a wholly owned subsidiary.

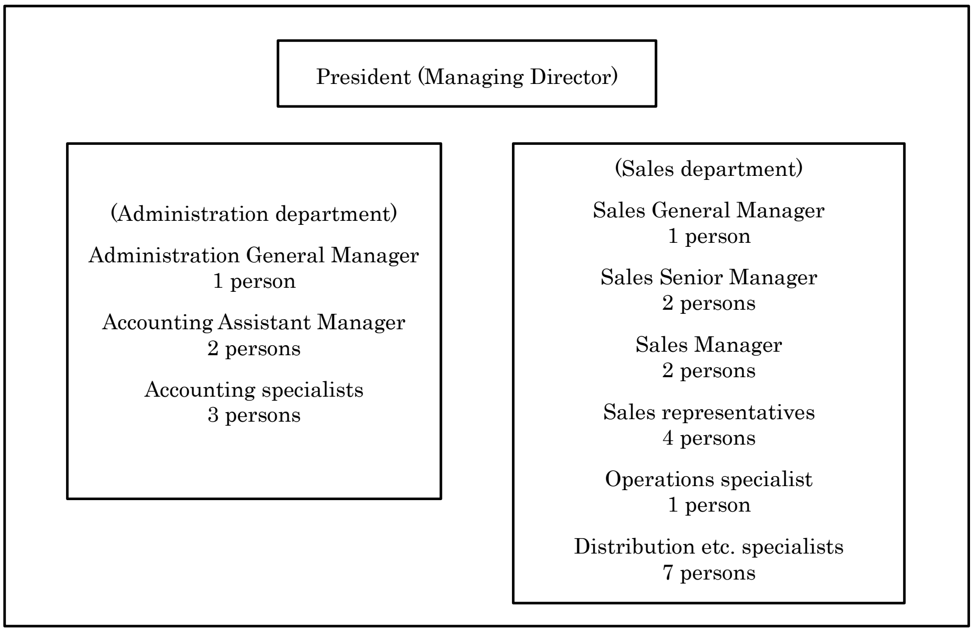
In addition, during the period targeted by the investigation, the managing directors were Former President I and Senior Manager M, but Senior Manager M was appointed to the post of Managing Director due to his position as Senior Manager of the International Affiliate Management Department of the Financial Management Office of the Company, and the on-site management of IKEG was entrusted to Former President I, who had been sent from the Company as president (hereinafter, "Former President I"). Moreover, in July 2017, after the ending of the period targeted by the investigation, Former President I resigned and at the point at which the Committee's investigation began, Current President H had been appointed managing director and president of IKEG (hereinafter, "Current President H").

**(3) Organizational system**

In terms of IKEG's organizational system, no formal departments and sections have been set up, and each employee carries out their duties in accordance with a position and job description set forth in their employment contract etc.

Working under the president are employees in the roles of Sales General Manager and Administration General Manager, and underneath those are assigned employees who carry out instructions of each manager, which means that the organizational structure of IKEG is divided into the sales department, which is in charge of customer sales, and the administration department, which is in charge of accounting, general administration, systems administration, etc.

The organization of IKEG at the time of the investigation by the Committee was basically as follows.




Within the sales department, four people were engaged in sales activities for products related to renewable energy, including solar battery modules, of whom Sales General Manager Employee G (hereinafter, “Employee G”) and Sales Manager Employee F (hereinafter, “Employee F”) were in charge of the X Company account. (Note that Employee F was promoted to Sales Manager in April 2017.) Also, Former President I was basically not involved in sales negotiations etc. His participation in transactions with X Company was limited to consulting with Employee G and other employees and receiving reports as appropriate, and dealing with reports etc. to the Company.

On the other hand, in the administration department Employee E (hereinafter, “Employee E”) supervised management as the Administration General Manager from January 2017 onward, but during the period targeted by the investigation, before Employee E was appointed, his predecessor Mr. N supervised management as the Administration General Manager.

**(4) Business operations**

**(i) Execution of business**

As a subsidiary of the Company, the “rules for group company management” are applied to IKEG, so for important items of business execution, it is required to report or submit request for approval to the Company based on these rules. When necessary, it had also obtained managerial approval by internal circular from the Company, but for items that could be approved within the local office by the president of the group company, business was executed by the decision of Former President I.

**(ii) Business processes**

IKEG did not have rules related to business authority, and as a local subsidiary had no rules related to the business processes that it had independently put in place and operated.

However, there were the Administrative Operations Rules created by the International Affiliate Management Department of the Financial Management Office of the Company in order to document standardized procedures for the business of overseas subsidiaries, with the aim of achieving at each company a certain level of operations necessary for the Group, and IKEG was one of the overseas subsidiaries to which these rules applied.

**(iii) Evaluation of internal control and internal audit by the Company**

IKEG is not designated an “important business location” according to the evaluation of internal control over financial reporting implemented by the Company based on the Financial Instruments and Exchange Act of Japan, and only the controls of the company as a whole were evaluated.

Also, IKEG was categorized as an overseas subsidiary scheduled to receive the Company’s internal audit at a frequency of once every three years, and when the Company conducted the most recent internal audit around March 2016, the only point flagged was the arrears in accounts receivable, and no major problems were noted. Furthermore, when the Internal Audit Department within the Internal Audit Office of the Company conducted the most recent internal audit around March 2016, transactions with X Company had already begun, but at that point there had been no delays in payment of accounts receivable from X Company.

**(iv) Overseas on-site audit by audit & supervisory board member of the Company**

In September 2016, full-time audit & supervisory board member of the Company, Audit & Supervisory Board Member L, accompanied KPMG AZSA for an overseas on-site audit of IKEG. At that time, IKEG's sales were increasing rapidly due to the solar battery module-related business and new business in the Middle East, and because there were several cases that had been brought up by the *shinsa kaigi* of the Company, including the X Company transactions, an audit by the audit & supervisory board member was conducted, and procedures for interviewing Former President I and others were implemented. Because delays in the recovery of receivables from X Company had already occurred, Audit & Supervisory Board Member L called attention to the transactions with X Company, but at that point the Y Company module transactions had not yet started.

#### (v) External audits etc.

IKEG's business year runs from April 1 of every year to March 31 of the following year, and from the year ended March 31, 2016 onward, IKEG had been undergoing statutory audit based on local laws from W audit corporation, based in Düsseldorf, Germany.

Moreover, with regard to the financial statements of IKEG that were created with the intention of being incorporated into the consolidated financial statements of the Company, W audit corporation conducted a review and reported the items it discovered to IKEG, but until the discrepancy was discovered, there was no relationship between W audit corporation and KPMG AZSA, the accounting auditor of the Company, that involved receiving direct instructions from KPMG AZSA and making a report on the results of that review.

## 3 Overview of Y Company module transactions

### (1) Overview of X Company and the transactional relationship

X Company was an account that had been opened by IKEG sales representative, Employee F, and IKEG's transactional relationship with X Company began in October 2015. At that time, IKEG was carrying out marketing activities to expand sales of parts and materials, such as cells and film, required for the manufacture of solar battery modules. This led to the conclusion of sales negotiations with X Company, which was involved in the manufacture and sale of solar battery modules, and IKEG began selling parts and materials for solar battery modules to X Company.

At that time, X Company, as a so-called fabless manufacturer, did not possess its own factory, and was selling solar battery modules, the production of which it outsourced to a contractor. Its business model consisted of supplying the contractor, which it selected in accordance with the trends in the solar battery module market that were influenced by the policies of individual countries, with parts, materials and know-how, cutting fixed costs to achieve a competitive price for the solar battery modules which were thus manufactured and which X Company sold. Also, at the time the Committee implemented its investigation, X Company was moving ahead with plans to produce cells in-house by establishing a production base in Italy for the cells used in the manufacture of solar battery modules.

X Company, as the operating company of the group, functions as the base for sales to the customers not located in the United States, and in addition to X Company in Germany, the main bases are in the United Kingdom and Greece. Because its management members including the founder and Managing Director Mr. C (hereinafter, “Mr. C”) and General Manager Mr. D (hereinafter, “Mr. D”) were residents of Greece, the management function is located in Athens, Greece.

Following this, IKEG’s transactions related to the supply of parts and materials for solar battery modules expanded, and around March 2016 IKEG began purchasing solar battery modules that X Company had manufactured and selling them to its customers. Many of these customers had been obtained through X Company’s efforts, and in the majority of transactions, solar battery modules for use with solar power generation projects were sold to special purpose companies (SPC) and construction contractors for those projects.

**(2) Circumstances in which credit limits were raised and payments were delayed**

At the time that it began transactions with X Company in October 2015, IKEG set a credit limit of €2.2 million, having obtained the approval of the Company. At the time the credit limit was set, X Company’s credit ranking was determined in accordance with the “rules for credit management” of the Company, and X Company was assigned to the “Caution required” category, and its credit ranking was judged to be “R-4: Customer with minor creditworthiness problems, conduct transactions while paying attention to changes in circumstances.”[2]

Directly after IKEG began transactions there was no track record of payment, but because demand was strong after transactions began, IKEG raised the credit limit for X Company to

[2] R rank is a credit ranking with a classification range of R-1 to R-7 that the Company has established to assign a credit ranking to business partners according to the creditworthiness of them. R-1 indicates most reliable and R-4 indicates the fourth highest credit ranking.

€10 million with the approval of the Company in November 2015. Furthermore, in March 2016, citing higher than expected monthly sales and an anticipated expansion in shipment volumes, IKEG raised the credit limit again to €14 million, with the approval of the Company. Transactions between IKEG and X Company grew sharply in line with the increase in the credit limit, so that the credit balance at the end of October 2015 was €0.16 million, whereas at the end of March 2016 it had reached €11 million, with the credit balance to X Company rising sharply despite a meager track record of payments.

However, payments from X Company were not made in the required steady manner. In April 2016, there was a delay in payment from X Company. From that point to the date of submitting this report, there was a continual cycle of collection and delay, so that X Company has been in perpetual payment delay without once cancelling that status. Also, with regard to the credit limit that was set to €14 million in March 2016, this was exceeded in June 2016 and continued uninterrupted in this state at the end of every month until it was resolved in May 2017. The Company did not have accurate knowledge of state of affairs because the Company was relying on reports from IKEG to keep abreast of the details regarding delayed payment amounts and credit limit breaches, and the reporting of the issue was not accurately conveyed by IKEG.

## (3) Status of Y Company module transactions

### (i) Background of commencement of the transactions

A large quantity of solar battery modules produced by Y Company, a manufacturer of solar battery modules, upon an order placed by US company Z Company remained in stock, and due to a bankruptcy of Z Company, it was decided that they would be sold off at as low a price as less than half the market price in the U.S. Then X Company expressed its intention to purchase them to use for their business operation.

IKEG thought that there should be no quality issue with the products as they were ordered by Z Company, which despite being in bankruptcy was a major company in the U.S., and it must be a golden opportunity for IKEG to procure solar battery modules at a competitive price with warranty by Y Company, and that at the same time it could also contribute to resolution to delinquent accounts payable by X Company if IKEG quickly sold them to X Company's customers by way of X Company with a high margin for X Company to raise the fund to repay the delinquent accounts payable, which swelled to €8.4 million as of October 31, 2016. Under the circumstances, IKEG decided to execute the transaction where it would buy Y Company modules from Y Company, replace the Z

Company label with the one of X Company, and sell them by way of X Company, or sell them directly to end-users and pay commissions to X Company.

Both purchase and sale transactions for Y Company modules were executed in US dollar.

**(ii) Status of transactions of purchasing from Y Company**

**a. Payment of advances**

IKEG purchased Y Company modules through a few transactions, but the transactions through which IKEG purchased Y Company modules that had been already produced and stored in warehouses in Turkey, the U.S., and Malaysia were those that eventually led to IKEG's acquisition of Y Company module inventory.

Of them, IKEG was not asked to make an advance payment to Y Company for the transactions involving the purchase of inventory in Turkey, but for the subsequent transactions involving the purchase of inventory in the U.S. and Malaysia, Y Company requested IKEG make an advance payment equivalent to 5% of the total transaction amount (with payment within 60 days from shipment and Ex-Works as the condition for the outstanding 95% of payment). In response, IKEG made a request for approval to the Company in November 2016 regarding the advance payment, and obtained approval by Director O of the Company for US$0.2 million of advance payment for the U.S. inventory on December 6, 2016, and on the next day, December 7, upon approval obtained by the Company's president for advance payment of US$0.5 million for the Malaysia inventory, IKEG paid the advance for the Y Company modules.

Though those advance payments were subject to managerial approval by internal circular of the Company, they did not fall under matters to be discussed by such meeting bodies as the *shinsa kaigi*. However, in the request for approval of the group company attached to a memo circulated for managerial approval it was clearly indicated that it was likely to sell all of the Y Company modules to be purchased and the sale would be done after receiving the advance payment from X Company. In addition, when Director O of the Company directly made an inquiry to the Former President I by email on November 29, 2016 in processing the request for managerial approval, Former President I explained to Director O that X Company would place the order and all of the products were planned to be sold by the end of January 2017 with advance payment.

The credit balance to X Company as of the end of November 2016 was €15 million, which exceeded the credit limit of €14 million, but taking into consideration the explanation by the IKEG side, the Company approved the advance payment to Y Company on the condition that the credit balance to X Company would not increase by the Y Company module transactions.

**b. Status of orders and payments to Y Company**

Except some transactions that IKEG directly sold Y Company modules to end-users and paid commissions to X Company, IKEG placed a total of five orders for the Y Company modules worth US$18.25 million, between October 17, 2016 and January 18, 2017, which includes transactions that required advance payments to Y Company mentioned in a. above.

The payments to Y Company were made intermittently during the period between November 11, 2016 and March 30, 2017, for the total amount of US$18.24 million.

In addition, in regard to the payments for the invoices from Y Company, while normally the sales assistant would create the payment slip after checking logistics vouchers and send it on to the accounting department, and the accounting department would make payment after confirming those details, in these cases, in the course of checking an enormous amount of invoices for many different Y Company module fixtures and quickly processing the payments, the payment slips were created and the payment was made without the logistics vouchers being checked.

**c. Y Company module inventory management, etc.**

When it initially began purchasing Y Company modules from Y Company, IKEG expected to have all of them be sold by the end of January 2017. IKEG was aware that they might be temporarily recorded as “Floating Goods” for the purpose of the accounting process, but did not assume that it would acquire Y Company modules to keep them in stock that required physical management.

It turned out, however, that because Y Company modules stored in Turkey, Malaysia and the U.S. at the time when IKEG purchased the modules had been actually produced for Z Company, they needed to be shipped in order to replace labels on the packages and products with the one of X Company, and the sales timing was significantly delayed from the initial plan due to unexpectedly prolonged negotiation between X Company and a transportation company, taxation issues over importing products warehoused in Malaysia to Europe, and prolonging of the work itself for re-labeling a large quantity of products.

As a result, contrary to the initial assumption, IKEG ended up receiving the Y

Company modules to keep them in stock that required physical management, but IKEG left the inventory management entirely to X Company and did not manage the details themselves such as whereabouts and quantity of the modules in stock, on the assumption of the sales department that they could quickly sell them all. What IKEG kept track of was limited to management of shipping status on excel spreadsheets indicating the modules were shipped from the original locations at the time of purchase to Puerto Rico, Ukraine, Lebanon, Poland and other locations based on logistics vouchers and emails provided by X Company, and they only had a rough understanding of the inventory status; for example, that labeling work or the like was in progress in a warehouse in Poland and other places.

IKEG recorded Y Company modules as assets in inventory for the period from December 2016 to March 2017, but because it had not originally planned to keep them in stock, they were not recorded as “Stock” for which the warehouse registrations are required, but classified as “Floating Goods.”

In May 2017, IKEG’s sales department was instructed from the Company to immediately register the warehouses for Y Company modules. IKEG decided to change the classification from “Floating Goods” to process warehouse registration. IKEG’s sales department did not, however, keep track of whereabouts and quantity of Y Company module inventory at that time, so it registered “Y-Turkey,” “Y-Malaysia,” and “Y-USA,” all of which were the original locations at the time of purchase.

**(iii) Status of sale transactions of Y Company modules**

**a. Overall picture of sale transactions**

As stated in (ii) above, although IKEG purchased Y Company modules at a total price of US$18.25 million, the balance on the inventory journal on June 30, 2017 was US$11.75 million. Y Company modules for the difference of US$6.50 million, excluding the portion returned to Y Company, were sold at a total price of US$7.90 million to X Company and two other companies.

Of those sold, Y Company modules with inventory book value of US$4.80 million were sold in transactions to X Company, which were properly conducted sale transactions for which IKEG issued invoices.

The status of this sale is provided in b. below.

### b. Status of sale to X Company

As stated in (ii) above, when IKEG purchased the Y Company modules, it initially assumed to have all of them be sold off by the end of January 2017, but partially because the work of re-labeling to the one for X Company took longer than expected, IKEG was not able to ship them as planned.

Furthermore, despite the precondition that X Company receive advance payments from end-users and pay them to IKEG prior to IKEG's purchase and sale transactions of the Y Company modules, IKEG placed priority on collection of the delinquent receivables, and didn't give adequate importance to demanding advance payments. Therefore, on its own discretion, IKEG executed sale transactions for the Y Company modules to X Company with the condition of payment within 120 days of sight. However, as far as IKEG was concerned, throughout the period from June 2016 to April 2017 there was no unused creditable amount on IKEG's line of credit for X Company as it was full to the limit and there continued to be a status whereby IKEG was unable to sell to X Company, even if X Company received orders from end-users, as long as the new credit amount pertaining to the order was not within the credit limit.

Under the circumstances, IKEG executed sale transactions for the Y Company modules by IKEG having X Company place an order and IKEG issuing an invoice for the unused creditable amount, measured by the difference between the credit balance and the credit limit, that became available either when accounts receivable from X Company were used to offset accounts payable to X Company for purchases of solar battery modules from X Company, or every time X Company repaid the accounts payable to IKEG (In purchasing the Y Company modules, IKEG received a package purchase order form from X Company, but for each individual sale, it also received the order form respectively).

X Company engaged in a transaction in which it was committed to supply materials to a contractor to outsource manufacturing of a certain quantity of solar battery modules every month, leading X Company to be loaded with them in stock when the market price went down in late 2016. X Company did not convert them to cash because of its policy not to sell below cost, and instead X Company continued to put themselves in a tough financial situation. Though IKEG's sales department was aware of the financial situation at X Company, it thought that X Company was repaying accounts payable to IKEG from funds obtained through sale of solar battery modules outsourced for production in Korea and other places. IKEG therefore had no reason to think X Company was selling the Y Company modules without authorization.

With regard to payment received from X Company, not only did it not indicate items for payment or corresponding invoices, IKEG's sales department did not do anything particular to manage payment received by confirming, for example, whether or not the fund for such payment received was obtained from an advance X Company had received from its customers, despite their initial arrangement that X Company would pay an advance to IKEG once it received advance money from its customers. These allowed IKEG to process payments made from X Company in any manner for its convenience, and every time it received money, IKEG reconciled it by applying the money to repay the account receivables standing longer to clear delinquent receivables as much as possible.

Below is a chronological record of payment received from X Company since January 2017. While it is likely that, in and after February 2017 when X Company sold the modules without authorization, payment received from X Company may have included the proceeds X Company acquired through the unauthorized sale, IKEG processed such payment from X Company without due checking.

(in €1,000)

| **Month in which payment was received** | January | February | March | April | May | June |
|---|---|---|---|---|---|---|
| **Amount received** | 373 | 1,277 | 3,832 | 1,863 | 1,258 | 897 |

As a result of the circumstances outlined above, there were properly conducted sale transactions of the Y Company modules to X Company to which IKEG issued invoices and eventually from December 2016 to June 2017, Y Company modules with inventory book value of US$4.80 million were sold at a total price of US$5.30 million.

## (4) Discrepancy from the subject inventory volume and its breakdown

### (i) Discrepancy of the inventory volume discovered from onsite stocktaking

The Committee conducted onsite stocktaking from July 24, 2017 to August 2, 2017, for 8 locations of the 10 locations of the warehouses storing the inventory based on names and locations of warehousing companies and other information provided by X Company to reconcile them against 137,376 units of the Y Company module inventory stated in the journal as of June 30, 2017. For the warehouses located in Armenia and Lebanon, which are subject to travel restrictions, the Committee conducted evidence verification.

As a result, of 137,376 units stated in the journal, the onsite stocktaking confirmed only

18,580 units being stored, and another 118,796 units of Y Company module inventory that ought to be found in stock were not in the warehouses, as shown below:

| Location | Journal volume | Quantity in stock confirmed by onsite stocktaking |
|---|---|---|
| Malaysia | 205 | 205 |
| Poland | 31,150 | 14,511 |
| Puerto Rico | 11,760 | 0 |
| Cyprus | 12,908 | 0 |
| El Paso | 30,056 | 3,864 |
| Ukraine | 45,749 | 0 |
| Armenia | 4,456 | – |
| Lebanon | 1,092 | – |
| Italy | 0 | 0 |
| Netherlands | 0 | 0 |
| **Total** | 137,376 | 18,580 |

**(ii) Status of unauthorized sale conducted by X Company**

The Committee further checked about the discrepancy in inventory volume discovered as stated in (i) above by obtaining evidence and equivalents concerning the stock and shipping status from X Company, and found out that X Company had sold the modules without authorization and before issuance of invoices by IKEG.

X Company, which admitted the unauthorized sale of Y Company module inventory, provided the Committee with evidence and equivalents of the unauthorized sale. The Committee then proceeded with further investigation, and confirmed that 117,503 units of Y Company modules in total had been sold by X Company without authorization during the period from February to July 2017, as shown below:

| Month in which modules were sold | February | March | April | May | June | July | **Total** |
|---|---|---|---|---|---|---|---|
| **Quantity sold** | 33,463 | 25,864 | 27,238 | 11,382 | 14,088 | 5,468 | 117,503 |

**(iii) Unclear discrepancy**

Of 118,796 units of discrepancy found as stated in (i) above, the Committee was not able to identify causes for the discrepancy of 1,293 units, the remaining units other than 117,503 units confirmed as having been sold by X Company without authorization.

## 4 Background for the discrepancy discovered

### (1) How IKEG sales department came to learn about unauthorized sale conducted by X Company

According to the email Employee F sent to X Company on March 15, 2017 and verbal statements provided by Employees G and F during interviews conducted by the Committee, in early March 2017, X Company reported to IKEG that it had sold the Y Company module inventory without authorization despite not having received an invoice issued by IKEG; and IKEG told X Company that IKEG would not allow shipping without the invoice being issued.

According to the email Employee F sent to X Company on June 19, 2017 and verbal statements provided by Employee F during interviews conducted by the Committee, there was another similar case around June 2017; X Company reported to IKEG that it had sold the Y Company module inventory without authorization when no invoice was issued by IKEG yet.

As a result of these circumstances, IKEG's sales department came to learn about the unauthorized sale of the Y Company module inventory conducted by X Company but because both cases were discovered upon voluntary reporting from X Company, and IKEG's sales department did not suspect any more cases other than those reported, IKEG did not conduct investigation such as onsite stocktaking for the Y Company module inventory at that point. The discrepancy was therefore not discovered.

### (2) Review by W audit corporation

When W audit corporation was conducting a statutory audit of the financial statements of IKEG for the year ended March 31, 2017 and a review on the financial statements of IKEG which were prepared for the purpose of being incorporated in the consolidated financial statements of the Company, as stated in Part 3, 2 (4) - (v), W audit corporation planned an onsite monitoring by attending onsite stocktaking to be performed by IKEG for the stock to be included in the balance sheet as of March 31, 2017. In preparation, A CPA and B CPA at W audit corporation held a meeting with Employee E and other members of IKEG administration department in early March 2017 to discuss the onsite stocktaking plan.

Back then, the Y Company module inventory was posted as “Floating Goods” in IKEG general ledger, and during the meeting, A CPA and B CPA were informed that they were floating goods in transit on the ocean.

In reality as of March 2017, at least part of the Y Company module inventory was not on the ocean but stored in a warehouse in Poland and other places, but in the IKEG’s plan, IKEG did not intend to include them for onsite stocktaking. Besides, as A CPA and B CPA had not been informed of the actual whereabouts of the inventory, the onsite stocktaking for the Y Company module inventory was after all not performed.

Due to the background, the review by W audit corporation did not lead to discovery of the discrepancy.

**(3) Audit by KPMG AZSA**

KPMG AZSA was aware through the audit it conducted on the consolidated financial statements of the Company for the year ended March 31, 2017 that IKEG, its subsidiary, received an increasing amount of money from X Company in March 2017, and also the count of inventory volume increased. However, KPMG AZSA did not discuss onsite stocktaking with the Company because the Company had explained to KPMG AZSA that the majority of the aforementioned increase in inventory volume count was due to the purchase of Y Company module inventory conducted in and after January 2017.

The discrepancy was therefore not discovered during the audit by KPMG AZSA.

**(4) Onsite stocktaking by International Affiliate Management Department of Financial Management Office**

As stated in Part 3, 1 (2) - (ii), the Company’s International Affiliate Management Department of the Financial Management Office, was responsible for monitoring abnormal numbers in monthly trend of the count of inventory volume and accounts receivable of overseas subsidiaries. Senior Manager M of International Affiliate Management Department, who was in charge of Europe (hereinafter “ Senior Manager M”) noticed that the Y Company module inventory at IKEG surged from around January to February 2017. Also, at an interview with Senior Manager M conducted in June 2017 for the purpose of regular information gathering by the audit & supervisory board, the large quantity of the stock with IKEG was pointed out for his attention.

Following up on it, and partly because there was a case of insufficient onsite stocktaking at an overseas location in the past as well, Senior Manager M investigated the status to find whether or not onsite stocktaking had been performed, by calling employee E and in other ways, and learned that the onsite stocktaking had not been performed at the end of March 2017 because the modules had been in transit on the ocean, but at the time of the telephone call, they were physically stored in warehouses.

Deciding that the onsite stocktaking should be soon conducted, Senior Manager M, together with Employee F at IKEG, visited the warehouse in Poland on July 5, 2017 to perform the onsite stocktaking. The onsite stocktaking found that only 22,990 units were confirmed as stored in the warehouse when IKEG data said 29,610 units as of July 4, 2017, revealing the discrepancy.

### (5) Explanation provided by X Company

Following the discovery of the discrepancy, the Current President H and Employee G of IKEG visited Athens to meet with X Company management. When Employee G arrived at the airport of Athens on July 24, 2017, Mr. C and Mr. D confessed that X Company had sold the Y Company module inventory without authorization by IKEG.

On the next day, July 25, when the Current President H and Employee G met Mr. C and Mr. D again at an office of X Company, they again explained that X Company had sold the Y Company modules without informing IKEG or obtaining permission from IKEG.

IKEG’s Former President I also later visited Athens, and on July 29, 2017, he met with Mr. C and Mr. D. Mr. D explained that while X Company received orders from its customer, IKEG did not allow X Company to buy modules because of the conditions with the credit limit. Under the circumstances, X Company decided to sell them because it would have breached the contract with the customer unless they had sold them.

Further, Senior Manager M and others visited Athens and on August 3, 2017, they conducted an interview with Mr. C and Mr. D. Mr. D explained in the same manner as the last, saying that X Company had sold the Y Company modules without getting permission from IKEG, and that this fact was never communicated to IKEG members.

Thereafter, X Company admitted the unauthorized sale by Mr. C signing the document entitled “Inabata’s goods in X Company’s warehouses” dated July 28, 2017, in which the fact that X Company had sold the Y Company modules kept in warehouses for IKEG without authorization by IKEG is described.

## 5 Whether or not IKEG officers and employees were involved in the unauthorized sale by X Company

### (1) Verification process

Employee G and Employee F, and the Former President I were the IKEG representatives responsible for transactions with X Company. On all occasions including interviews conducted before the Committee was set up, all of them denied any intentional involvement, such as collusion, cooperation or tacit approval to the unauthorized sale of Y Company modules by X Company.

Statements provided by Mr. C and Mr. D of X Company are consistent with what Employee G and other IKEG members stated; while Mr. C and Mr. D admitted the unauthorized sale of Y Company modules by X Company, they explained that X Company had not informed IKEG members of the unauthorized sale.

Therefore, on the one hand the Committee can infer to an extent that there was no involvement of Employee G and others, while on the other hand, however, we also confirmed that there were emails and other circumstantial evidence found in the course of the investigation on the facts of the uncertainty, which suggest at least Employee G and Employee F had been aware of the unauthorized sale of Y Company modules by X Company prior to the onsite stocktaking on July 5, 2017.

With the aim of fully unraveling the case, the Committee subsequently requested Employee G and Employee F to further explain about the circumstances and the evidence and investigated further to verify whether or not IKEG members had been involved.

### (2) Why the Y Company modules were classified as floating goods

As stated in Part 3, 4 (2) above, the Y Company module inventory was classified as Floating Goods on the system at March 31, 2017, but at least part of it had actually arrived at the warehouse in Poland and other locations, shipped from the original locations at the time of purchasing, and re-labelling work was in progress. IKEG sales department Employee G and Employee F were aware of them.

However, in planning the onsite stocktaking for the inventory as of March 31, 2017, IKEG administration department, including Employee E, was not informed of the status of the aforementioned Y Company module inventory. They therefore discussed with W audit corporation on the assumption that the Y Company module inventory was still in transit on the ocean and not available for onsite stocktaking. Consequently, the onsite stocktaking at the warehouse in Poland and other locations was not performed.

Looking from the circumstantial information, the Committee can deduce the hypothetical conclusion that IKEG sales department was in reality aware of the discrepancy in the Y Company module inventory at that time; despite that, it intentionally passed the incorrect information that the inventory was floating goods to the administration department and W audit corporation to avoid the discovery.

The Committee therefore verified the events before and after then. First, Employee E told that he had checked both with the system and with Employee F that the modules had been not-yet arrived floating goods, and had told W audit corporation to that effect as well. As A CPA and B CPA of W audit corporation made consistent remarks, the fact that the inventory was not floating goods had not been communicated to at least Employee E and W audit corporation.

Meanwhile, Employee F made statements that he believed he had told Employee E and W audit corporation that the Y Company module inventory had not been on the ocean but at the warehouse in Poland and other, but he had thought that those places were merely temporary stops to process re-labelling, which appeared to contradict what Employee E and A CPA and B CPA of W audit corporation testified.

Suppose that at this point Employee F intentionally told them incorrect information with the intention to prevent onsite stocktaking, it would be only natural to also see a sort of a trace of an attempt of employee F to stop or delay onsite stocktaking in collusion with X Company when the Company's Senior Manager M performed the onsite stocktaking in the warehouse in Poland on July 5, 2017. But on the contrary Employee F proactively collected information from X Company of the warehouse in Poland and other locations where the Y Company module inventory was stored, and no emails were found between Employee F and X Company or Employee F and Employee G which suggested the attempt of deterring onsite stocktaking. Thus there is no trace at all suggesting Employee F's intention of thwarting onsite stocktaking.

In view of all these, in respect of the Y Company modules treated as floating goods at March 31, 2017, there is no evidence to reasonably conclude that Employee F's intentional conduct of communicating incorrect information but rather it should be deduced that correct information did not come through due to gap of some sort in communication between Employee F and Employee E.

**(3) The issue with X Company having used to self-declare the unauthorized sale in the past too**

As stated in Part 3, 4 (1) according to emails Employee F sent to X Company on March 15, 2017 and June 19, 2017 and his explanation during interviews conducted by the Committee, there were at least twice around March and June 2017, around the same time as his emails were sent, where X Company sold the Y Company module inventory without authorization of IKEG and voluntarily informed IKEG in an after-the-fact manner.

Employee G also told at the interviews conducted by the Committee that he had been aware about the case around March 2017. Judging from evidence including emails, Employee G and Employee F were aware of the unauthorized sale of Y Company module inventory at least back around March 2017, and the Committee can deduce the hypothetical conclusion that they knowingly gave a tacit approval to X Company, fully aware of the possibility that X Company could continue in the same manner.

Meanwhile, however, in the abovementioned email from Employee F dated March 15, 2017, he wrote “Please be sure that we don’t release any, without our invoices. If you do it, it is serious offence to us!!” By the same token, he also clearly indicated in his series of emails to X Company, “Again, if you sell the goods before our invoice, it is criminal” dated June 19, 2017.

In view of these facts that Employee G and Employee F clearly indicated their no tolerance when they came to learn about the unauthorized sale by X Company, the point of question could remain that IKEG should have taken actions to protect the Y Company module inventory at that point in time, doubting there could be other unauthorized sale besides the one voluntarily declared. That said though, it cannot be concluded to the extent that the fact they came to learn about the unauthorized sale would be construed as IKEG’s tacit approval to subsequent unauthorized sale by X Company.

### (4) Increase in payments received from X Company

Since March 2016, €14 million of credit limit had been set by IKEG to X Company, but based on IKEG’s understanding, the credit balance throughout the period from June 30, 2016 to April 30, 2017 was at least full to the limit.[3] Nevertheless, there was a notable increase in payment received in and after February 2017, when the unauthorized sale of Y Company module inventory by X Company began.

In addition, according to what X Company explained after the discrepancy was discovered, a substantial portion of the proceeds received by the unauthorized sale of Y Company

[3] IKEG’s understanding at that time was as stated above. However, as described in Part 3, 3 (2) of this report, the true credit balance was actually exceeding the credit limit.

modules looked to be allocated to payments to IKEG.

At the same time, considering that IKEG members including Employee G and Employee F were fully aware of the situation where X Company was tight on finance, its payments to IKEG remained in arrears, and delinquent receivables remained long outstanding, it is unavoidable to assume that either IKEG was fully cognizant of the fact that the sharp increase in money received from X Company came from the unauthorized sale of Y Company modules, or, IKEG felt some doubt about it but chose to give a tacit approval to the unauthorized sale, by giving the increase in payments received first priority.

On this point, Employee G commented "Looking back now, I think the unauthorized sales of Y Company module inventory were the source of payments from X Company which temporarily increased. But back then, as X Company also had other products outsourced for manufacturing other than the Y Company modules, I thought X Company managed to raise money for repayment by selling them." Employee F also made a similar statement, saying that he did not check how X Company raised the money.

While in light of credit management, it is hard to believe this sort of explanation right away, there is no email or evidence found at all suggesting Employee G or Employee F had been looking to funds X Company would raise from the unauthorized sale of Y Company modules to get payment for IKEG's receivables and delinquent receivables. In addition, as stated in (3) above, emails were found in which they clearly indicated that they would never approve the unauthorized sale in the absence of invoices issued by IKEG.

Taking them into consideration, the Committee cannot deem this case, even with an increasing amount of money received from X Company, as tacit approval to the authorized sale of Y Company modules having been given by Employee G and Employee F.

**(5) Conclusion**

In addition to the results of verification stated in (1) to (4) above, no evidence establishing the involvement of IKEG officers and employees in the unauthorized sale of Y Company modules by X Company or a cover-up of the misconduct was found from investigations on email data of the Former President I, Employee G and Employee F. The Committee therefore concluded that there was no evidence indicating intentional involvement, such as collusion, cooperation or tacit approval, on the part of IKEG officers and employees.

## 6 Final amount of the discrepancy as of June 30, 2017

As a result of the investigation, the Committee has determined that unauthorized sales of Y Company module inventory was conducted by X Company from February to July 2017, and that the number of inventory items that had been shipped through unauthorized sale as of June 30, 2017 was 112,035 units.

Furthermore, there was an unclear discrepancy regarding 1,293 units, the cause of which is unknown. Assuming this discrepancy was recorded by June 30, 2017, the inventory discrepancy as of June 30, 2017 can be recognized as 113,328 units.

Accordingly, assuming an average price of €79.7959 per Y Company module unit, the inventory discrepancy can be recognized as €9.04 million as of June 30, 2017.

## Part 4: Presence or Absence of Similar Events

As stated in Part 3 above, because the Committee’s investigation found no evidence of involvement by the IKEG officers and employees in the unauthorized sale of Y Company modules by X Company, the Committee did not conduct the investigation to check whether or not there had been similar events.

## Part 5: Cause Analysis

### 1 The whole story of the subject event

The discrepancy, with very few minor exceptions of unclear discrepancy, directly arose from the unauthorized sale of Y Company modules by X Company. Any involvement by IKEG officers or employees in the unauthorized sale by X Company was not confirmed by the Committee's investigation.

Hence, on the one hand IKEG is considered as in the position of victim that suffered damage from the unauthorized sale of Y Company modules by X Company, while on the other hand, it is hard to deny that various problems can be pointed out regarding how IKEG officers and employees handled matters leading up to the discovery of the discrepancy, and in a sense, they made themselves a victim.

Therefore, in the following paragraphs we will examine the fundamental causes for the discrepancy stemming from the unauthorized sale of Y Company modules by X Company, in a bid to help IKEG establish appropriate preventive measures for the future.

### 2 Lack of communication between sales department and administration department in IKEG

As stated Part 3, 5 (2) above, part of the Y Company module inventory was stored in the warehouse in Poland and other locations as of March 31, 2017. Though sales department was fully aware of the status, IKEG administration department was left uninformed due to miscommunication. W audit corporation, after receiving an explanation from IKEG administration department that the inventory was floating goods, accepted IKEG's plan in which floating goods were not subject to the onsite stocktaking. During the interview conducted by the Committee, A CPA of W audit corporation stated that if W audit corporation had known the Y Company module inventory had been stored in the warehouse in Poland at the time of planning stage for the onsite stocktaking as of March 2017, onsite stocktaking would have been required for sure. So if, at that point, sales department and administration department had sufficiently communicated with each other and IKEG administration department had been informed of the actual whereabouts of the inventory, at least the onsite stocktaking done on March 31, 2017 would have discovered the discrepancy, and of all the unauthorized sales of Y Company modules by X Company during February and July 2017, it is very highly likely that unauthorized sales after April could have been prevented.

Employee E, Administration General Manager, had been dispatched from the Company as an expatriate and had just assumed the post in IKEG in February 2017. And what is more, because his predecessor left the Company soon after he returned to the Company, Employee E was in a way unlucky as having not being able to catch up with the status in detail. That said however, the balance of the Y Company module inventory as of March 31, 2017 was worth as large as approximately ¥1.4 billion, and naturally he should have checked the status thorough mutual communication between sales department and administration department to get the full visibility.

It is undeniable that the lack of communication between sales department and administration department in IKEG as illustrated above was one of the major causes for the unauthorized sale of Y Company modules by X Company to be particularly confounded.

**3 Lack of understanding about basic operational flow in IKEG sales department**

Looking at specific problems in the operational flow on the Y Company module transactions, IKEG delegated inventory management and logistics operations of Y Company modules purchased from Y Company to X Company. Because IKEG was not the party concerned that signed the contract for the warehouses where the modules were stored, it did not know the exact storage locations, and on the system it continued to post the inventory as Floating Goods. In May 2017, when it registered the warehouse upon instruction by the Company's director in charge, IKEG did not have the accurate information about the storage locations. Thus, the inventory was registered as being in the countries where the modules were originally purchased.

In purchasing the Y Company modules, while IKEG should have checked the logistics vouchers attached to the invoices issued by Y Company, it processed the payments for the invoices with no logistics vouchers. From the way they handled the payments, it appears that IKEG sales department processed those payments without particularly feeling any concern.

In addition, for the management of payment received from X Company, although a scheme that X Company would pay the advance X Company receives from end-users for the Y Company modules transactions had been initially assumed, there was no procedure that IKEG could check the source of the payment received from X Company to begin with, and also because there were no descriptions associating with the payments in the payment notices, IKEG conveniently allocated the payment received as X Company's delinquent receivables. It is hard to say that there was sufficient management.

X Company sold the Y Company modules without authorization because it was not able to procure enough modules to sell to the end-users because of the problem with credit limit by IKEG, but it was made possible only because X Company was left by IKEG to manage the inventory and logistics operations and X Company was given a chance to conduct the unauthorized sale. It is very highly likely that the unauthorized sale by X Company could have been prevented if IKEG had appropriately performed the inventory management and logistics operations. Furthermore, it can be also pointed out that if the money received had been appropriately managed, it would have been possible for IKEG to take actions by noticing at an early stage that the situation had deviated from the scheme's original premise.

In reviewing the case to find a fundamental cause for IKEG sales department to have failed to follow these basic procedures in inventory management and logistics operations that sales representatives for this type of regular commercial transactions involving logistics are naturally expected to follow, Employee G and Employee F explained at the interviews by the Committee that they had assumed once the Y Company modules were purchased, they would be soon sold, and had not assumed that IKEG must manage the inventory. Given the explanation, we could assume there had been some unique circumstances affecting this case that unexpectedly required inventory management.

In reality, however, IKEG sales department was not even fully aware of the existence of operational rules for overseas subsidiaries providing procedures of management of accounts receivables and inventory in the first place, and during the interviews by the Committee they looked to have little awareness of the fact that it is required to check the logistics vouchers attached to invoices received from a business partner at the time of product purchasing. It is therefore more appropriate to attribute the lack of awareness regarding management of inventory and logistic operations observed in this case to their absolute lack of understanding about the basic operational flow rather than special circumstances unique to this case.

Another problematic issue present overall in this case is that within the business flow two key processes, the management of physical status (inventory) and the management of cash flow (including the credit management), were managed within sales operations.

Among the processes required for executing a transaction, which includes order, payment, logistics, sales, invoicing and collection, it is necessary that the roles of creator, authorizer, and recorder for these processes be kept sufficiently separate. In this case, excluding the processes performed by the accounting department, such as payment authorization, all the processes were carried out by the sales department. For example, even in a case such as this one where the sales department issues the order, during the payment process the management of physical inventory using delivery forms etc. should have been carried out by the accounting department or another department. By separating the processes in this way, it may have been possible to be aware of the actual physical inventory and its location. As a result, the onsite stocktaking could have been effectively carried out and could have led to the early detection of X Company's unauthorized sale.

There is no question that in practice there are somewhat difficult aspects to strictly applying the Administrative Operations Rules at an entity with a relatively small number of employees, like IKEG. However, taking into account that IKEG sales department wasn't even adequately aware of the existence of the Administrative Operations Rules, the only conclusion is that the fundamental cause of this problem was a lack of understanding relating to the above-mentioned business flow.

## 4 Lack of risk awareness in IKEG sales department

X Company is a business partner that IKEG sales department developed, engaging in businesses that could complete locally alone, requiring few interactions with Japanese companies and the Company. Since the business deal began with the credit limit of €2.2 million in October 2015, IKEG increased the credit limit to €10 million in November of the same year, when there was no payment made then, and further increased it to no more than €14 million in March 2016. And as of April 30, 2016, when it was less than a year since the commencement of transactions, there was €0.4 million of delinquent receivables, but IKEG drastically expanded transactions to the level of €14 million which was the credit limit at the end of June 2016. In view of the typical path of relationship with any new business partner that they expand the transaction volume gradually while checking the past record, this course of events leading to the rapid expansion of the business size between IKEG and X Company can only be described as hasty and not properly thought through.

While a large amount of delinquent receivables from X Company were left outstanding, IKEG sales department executed the transactions of the Y Company modules as a step to resolve the delinquent receivables. It assumed a scheme based on such extremely optimistic outlook as that X Company would swiftly sell the modules and then would pay IKEG advances once X Company receives advances from end-users. There is no evidence at all that they carefully considered the possibility that their outlook may prove wrong, or the inventory holding risk in such case.

In addition, IKEG sales department was informed of the unauthorized sale of the Y Company modules by X Company in March 2017 at the latest, but they were only concerned about the outstanding balance exceeding the credit limit and the transactions executed prior to issuance of invoice by IKEG, they did not at all think beyond them to consider the risk that X Company could sell other inventory without authorization and that because of the risk they should protect the inventory.

It may be more understandable if the transactions had been with a business partner having a long track record and well-established trust relationship, but in this case, the counterpart was a new overseas local customer. Only if IKEG sales department had had a normal sense of risk, the drastic expansion of transaction with X Company, and the transactions of the Y Company modules as a resolution for resultant delinquent receivables might not have occurred. Also, we cannot deny the possibility that IKEG could have taken actions to protect the inventory and prevented any further unauthorized sale as soon as X Company informed IKEG of the unauthorized sale around in March 2017.

Therefore we conclude lack of sense of the risk by IKEG Sales Office was part of the causes for the case.

However, it will be necessary to further investigate and analyze what gave rise to the lack of awareness toward risks and the lack of understanding about the basic operational flow described in 3 above that were seen in IKEG sales department. It could be partially explained by the low level maturity of the organization as IKEG was only founded in December 2013 and many employees were local hires, so that it was hard to expect them to be familiar with the operational flow or highly sensitive to risks, and what is more, they had never experienced in failure with management of inventory and the like there. Under the circumstances, as Europe region did not have many Japanese manufacturers that are potential customers entering into the market, and in order for IKEG to survive as a trading firm, it was the top priority mission to develop local customers. It is possible that IKEG was too much focused on sales and paid insufficient attention to administration including the operational flow. Furthermore, after Employee G, who had had no experience in overseas business until he was assigned to IKEG, was appointed to supervise the sales, they were even increasingly inclined to neglect the basic operational flow. We have nothing left except to point out that the results of this investigation clearly highlights that IKEG executed business transactions with overseas local customers with the same level of risk awareness as the case of dealing with Japanese companies as business partner, resulting in a lacking sense of risks.

## 5 Malfunction of the Company’s management over the group companies

It may be called as the flip side of the coin on the lack of risk awareness of IKEG sales department mentioned in 4 above, but IKEG received approval from the Company of the credit limit to €2.2 million with caution required as the risk category at the commencement of the transactions with X Company, and also received subsequent approvals to two increases of the credit limit and the payment of advances relating to the transactions of Y Company modules in accordance with the rules for group company management. The question should be then why the Company's framework over the management of the group companies could not prevent the discrepancy that stems from IKEG's sloppy risk management.

On this point we are left with no other choice than to point out that these issues arose because the Company's management over the outstanding receivables exceeding the credit limit and delinquent receivables depended on reporting from overseas subsidiaries and there was no framework in place for the Company to proactively obtain timely and accurate information about them.

If the outline of the scheme and risks, etc. serving as underlying information subject to request for approval had been more carefully reviewed in light of the information obtained from the framework stated above from the standpoint of the Company's appropriate management over the group companies, there were chances where the advance payments for the transactions would not have been approved, or even if approved, some actions including closer monitoring on subsequent progress could have been taken.

For this reason, it is regarded as one major cause for this case that the Company's framework for managing the group companies was not effective enough.

## Part 6: Recommendation of future preventive measures

In light of the cause analysis stated in Part 5, the Committee recommends the following preventive measures for IKEG or the Group:

### 1 Measures in the operational management

#### (1) Ensure the Administrative Operations Rules are fully acquainted and acted accordingly

IKEG did not have a business rule as its original intra-company rule established and put in practice. Though the Administrative Operations Rules developed by the International Affiliate Management Department of the Financial Management Office of the Company, was supposed to be applied, as described in Part 5, not only did IKEG sale department not fully understand about it, but also was not fully aware of the existence of the rule itself, and the lack of understanding about the business rules was a cause for the unauthorized sale of the Y Company modules by X Company.

The Company must therefore get back to the basics for business operation, and first work to get the Administrative Operations Rules to be fully acquainted and put in practice in the Group including IKEG.

#### (2) Ensure thorough education and training on purchasing and inventory management, credit management and operational management

While lack of understanding on basic operational flows and lack of risk awareness were observed in IKEG sales department, there was a high demand for providing the same level of education and training as the one at the headquarters especially when there were many new local hires in overseas locations in the middle of rapid expansion of the Company's overseas business. And yet it is undeniable that those opportunities were not sufficiently provided.

Therefore, it is necessary to take actions for ensuring enhanced education and training in place on the basics such as purchasing and inventory management, credit management, and operational management, which are still open to further study on specific approaches though, mostly at the overseas locations where the headquarters finds it hard to directly monitor.

## 2 Measures in purchasing and inventory management

### (1) Set criteria for approval to a large quantity purchasing

The amount of purchase of the Y Company module inventory totaled US$18 million. In view of the size of IKEG back then, the credit limit to X Company, and the transactions status with X Company, etc. it was only reasonable to carefully consider the scheme and the potential risks, etc. but at the time of advance payment to be made, the managerial approval procedure was processed in accordance with the rules for group company management but the large quantity purchasing itself was not the matter subject to the managerial approval. Therefore the purchasing transaction commenced based on IKEG’s decision.

The Committee therefore sees that it is necessary for the Company to consider setting criteria for approval, defining a level of large quantity purchasing to be subject to the managerial approval as a mechanism for the headquarters level to carefully review a scheme and potential risks before such large quantity purchasing is processed.

### (2) Reinforce onsite stocktaking and book inventory practices

Though the discrepancy was discovered by the onsite stocktaking conducted in July 2017 as the International Affiliate Management Department of the Financial Management Office realized that the onsite stocktaking should be done for the Y Company module inventory recorded as the inventory at March 31, 2017, the Company was not able to take effective measures despite the fact that the sharp increase in the inventory at IKEG had been known since the end of 2016 through the meetings of General Managers of Divisions and Offices.

In view of these circumstances, it is necessary to introduce more detailed inventory management rules including ad-hoc onsite stocktaking in case of a sharp increase in inventory volume in addition to regular onsite stocktaking and regular and more frequent book inventory.

## 3 Measures to ensure smoother communication between sales department and administration department

Despite the small team of 24 officers and employees, within IKEG communication was insufficient and they were in the environment where risk-related and other information was not easily communicated. The Committee saw no evidence of a meeting body where both sales and administration departments attended to appropriately share information on deals and issues both departments are handling.

It is therefore necessary to make extra efforts to contrive ways for smooth communication between sales and administration departments. A new framework is needed such as regular meetings where both sales and administration departments attend to share information on matters including status of deals the sales department is working on and issues the administration department is dealing with.

In addition, because these issues may be seen not only at IKEG but at other overseas locations as well, group-wide initiatives must be continuously implemented.

## 4 Measures to reinforce capability of managing group companies

In this case problems were found in the Company's dependency on reporting from local entities for collecting information including management of credit line, inventory and receivables at the overseas subsidiaries. It is therefore necessary to establish a mechanism to allow the Company to automatically, timely, and accurately obtain such information.

Also in an entity with a relatively small number of staff members like IKEG, the Committee noticed that it is not always practical to adopt the Administrative Operations Rules as is. In such cases, the Company must take the initiative in ensuring thorough instruction to overseas subsidiaries to maintain appropriate allocation of roles in key functions, while implementing separation of duties in light of the unique situation at each respective location.

Further, in respect of the management of the group companies by the Company's Administrative Offices, there were more than a few cases like in the managerial approval procedure for advances for purchase of Y Company modules that the sales department went ahead to give a de-facto approval on important decision making, and either checking by Administrative Offices ended up as insufficient or too late. It is therefore necessary to consider measures to reinforce the level of involvement of Administrative Offices in the decision-making process.

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