Broadmedia

March 14, 2018

Press Release

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Notice of Current Status Related to Damages from Fictitious Transactions Suffered by a Consolidated Subsidiary

Broadmedia Corporation (hereinafter "the Company") has been undertaking an investigation into the damages from fictitious transactions suffered by Fishing Vision Co., Ltd. (hereinafter "Fishing Vision"), a consolidated subsidiary of the Company, as stated in the press release announced on January 30, 2018 "Broadmedia Corporation Announced Damages from Fictitious Transactions Suffered by Consolidated Subsidiary and Postponement of Announcement of Financial Results for the First Three Quarters of the Fiscal Year Ending March 31, 2018."

The fictitious transactions had been occurring for a number of years. The impact is extensive and there are many items to be investigated, and the incident involves multiple external parties. As a result, the investigation is not complete as of today's date, but please be informed of the matters revealed to date.

The Company is currently proceeding with an extensive investigation to clarify the details of the situation. The Company deeply regrets the situation and offers its sincere apologies to all stakeholders for the concern caused.

The following are an overview of the fictitious transactions, the status of the investigation, and the response policy going forward.

1. Overview of situation and circumstances leading to discovery

Company A had been directly engaged in video production transactions with multiple clients for many years prior to 2007. In around the spring of 2007, the working capital burden was increasing because of an increase in orders due to the fact that the payment cycle of some major clients is 3-4 months after delivery. For this reason, Fishing Vision had been involved in transactions (hereinafter "the Transactions") to subcontract to Company A, for a 95% re-commission fee, the video production work for which Fishing Vision received orders from clients.

At the same time, Fishing Vision and Company A entered into a basic outsourcing agreement under which Company A would be commissioned to undertake sales activities, sales order operations, billing, and other businesses incidental to these operations, and that communications with clients concerning the Transactions should continue to be undertaken by Company A.

Under the new transaction structure, with regard to the fact that the payment cycle of some major clients is 3-4 months after delivery, the burden on the working capital of Company A was reduced by setting the payment cycle from Fishing Vision to Company A to the end of the month when delivery confirmation could be made.

Subsequently, through December 2017, the Transactions under a similar transaction structure continued without interruption, increasing from the initial transaction value of some 80 million yen/year, to 250 to 280 million yen/month in 2017. Total orders received in the Transactions until then amounted to some 12.2 billion yen.

During this period, the signed client documents required for the Transactions were accepted appropriately and the accounts receivable were paid on time. An audit corporation, Fishing Vision's accounting auditor, had been sending clients a confirmation letter of the balance of accounts receivable at the end of each fiscal year, and it has been confirmed the acknowledgement of accounts receivable of the Transactions at Fishing Vision was consistent with this.

However, because it was revealed on December 29, 2017 that there was a shortfall in accounts receivable from a large client that were due at the end of December 2017, Fishing Vision checked with Company A about the demand for payment to the client. In mid-January 2018, a lawyer contacted Fishing Vision on behalf of Company A and explained that Company A had been carrying out fictitious transactions for many years and had committed various fraudulent acts including the falsification of documents and seals necessary for transactions with the client, etc.

Fishing Vision and the Company (Broadmedia Corporation) received the report and commenced an internal investigation immediately, and established an Internal Investigation Committee on January 30, 2018. We are continuing the investigation with advice from external experts.

2. Operation flow of Transactions

The operation flow of the Transactions was as stated below, and there were no incomplete documents or delays in documents or payments.

(1) The client handed Company A an order sheet sealed by the person in charge, and the order sheet was accepted.
(2) Company A handed Fishing Vision the order sheet, which was accepted.
(3) Company A produced a product.
(4) Company A reported on the completion of production to Fishing Vision.
(5) Fishing Vision handed Company A a bill/delivery document/definite quotation/return receipt document of delivery.
(6) Company A delivered the product and a set of documents to the client.
(7) A DVD copy and the product (video) were delivered from Company A to Fishing Vision.
(8) The client sent a signed and sealed receipt document of delivery to Fishing Vision by mail.
(9) Accounts payable on the payment due date of the month were paid into the bank account of Fishing Vision under the client's name at the end of every month.

3. Confirmation of revenue by confirmation letter of balance of accounts receivable

Separately from the above operation flow, as part of the audit under the Companies Act, an audit corporation, which is the accounting auditor of Fishing Vision, sent multiple clients a confirmation letter of accounts receivable once a year (in February or March).

All the clients filled in all the necessary items on the confirmation letters, including the name of the company, the name of the person in charge, the account title, and the acknowledged balance, and sent the confirmation letters back to the accounting auditor with the clients' seals affixed. There was no discrepancy in the recognition of the amounts receivable.

4. Modus operandi of fictitious transactions

On the assumption of the above operation flow/confirmation process by the confirmation letters, the following facts have been confirmed as to the modus operandi of the Transactions in the current investigation by the Internal Investigation Committee. However, confirmation of whether or not a similar method was used in all the transactions is incomplete at the present time, as there are multiple related parties involved.

a Fabrication of order sheets, etc.

Individual B, the Representative Director of Company A, focused attention on the operation flow of Company A whereby Company A accepted order-related documents, etc. from clients. Taking advantage of the operation flow, he fabricated order sheets/receipt documents of delivery as if they had been prepared by the clients and hand delivered them to Fishing Vision.

In 2013 and thereafter, the operation flow was that receipt documents of delivery were sent by the clients directly to Fishing Vision, not hand delivered. In fact, however, Individual B sent them to Fishing Vision, making it look as if they had been sent by the clients by mail.

b Bank transfer

Accounts receivable were paid in full by multiple clients under the clients' names with almost no delay from the start of Transactions in April 2007 through the end of December 2017.

However, it has been confirmed that in fact, Company A withdrew cash from its account and made a remittance to Fishing Vision, writing the clients' names in a remitter column on a transfer voucher so that it looked as if the clients had made a bank transfer.

c Confirmation letter of balance of accounts receivable

A confirmation letter of the balance was sent directly from the accounting auditor to the individual clients, so there was no room for Company A to get involved in the first place. However, it has been confirmed that Individual B told the person in charge of each client in advance, "A confirmation letter of the balance will come to you from the accounting auditor in error. Since it is an error, I would like you to give it to me." Individual B obtained the unopened letter, filled in the necessary items using counterfeit client company seals/seals of the person in charge and sent it back to the accounting auditor. Confirmation in this regard has been undertaken with the relevant persons at some clients, and it has been confirmed that these people have the same recollection.

5. Situation of fictitious transactions

The Transactions occurred from April 2007 through December 2017. The total number of the Transactions was around 700, and the total orders received were around 12.2 billion yen. The investigation confirms that around 650 transactions worth some 12.0 billion yen that were carried out predominantly in 2011 and thereafter were fictitious by checking them against various data/vouchers available at Fishing Vision and the bank note/transfer voucher copies of Company A. As for the remaining 50 transactions worth about 200 million yen, it is difficult to determine whether such transactions were fictitious or genuine using the above method alone. Accordingly, we are asking multiple clients involved in the transactions to confirm the authenticity of the Transactions.

Individual B states, “Although there were genuine transactions at the start of the transactions, the transactions were gradually inflated and became fictitious.” Some 50 transactions about which it cannot be determined whether they were fictitious or genuine were carried out between the start of transactions and 2010. Although confirmation is not complete at this point in time, it is surmised that there is a possibility that they were genuine transactions.

6. Size of fictitious transactions and effect of financial statements

The value of the transactions about which it cannot be determined whether they were fictitious or genuine accounts for some 2% of the Transactions. The effects on the financial statements at the present time in the event that all transactions were fictitious are as mentioned below, but the effects may change depending on results of further investigations.

<Past income statements>

(1) Acknowledging that the transactions concerned were all fictitious and that there were no business transactions whose revenue and cost can be posted, the revenue and cost concerned were canceled on the income statement.

⇒As a result, the revenue, cost and operating income of each period decreased.

(2) As we acknowledged that all transactions were subject to consumption tax, the difference between consumption tax income and consumption tax paid had been paid. We now recognize that it was an excessive payment.

⇒We expensed the overpaid consumption tax as taxes and dues in each period, assuming that it would not be returned. As a result, selling, general and administrative expenses increased, reducing operating income and below.

(3) As for corporate income tax, no accounting revisions were made on the assumption that we would not qualify for revisions to tax charges retrospectively.

⇒Profits reduced due to the abovementioned accounting treatments (1) and (2), but there was no change in corporate income taxes.

<Past balance sheets>

(1) Accounts receivable from clients on the balance sheet are canceled at each period-end. (As payments were made to Company A in the current month, there are no accounts payable at each period-end.)

(2) Instead, the difference between the amount including tax paid to Company A by the specific point in time and the amount including tax received from clients (parties that can be recognized as clients) was changed to accounts receivable-other from Company A.

As a result of the above accounting treatments, the effects on major items such as the Company's consolidated financial statements for past years and for the first six months of the ongoing fiscal year at the present time are as stated below. However, the effects may change depending on the results of further investigations.

There is a difference from the amounts stated in the press release announced on January 30, 2018 "Broadmedia Corporation Announced Damages from Fictitious Transactions Suffered by Consolidated Subsidiary and Postponement of Announcement of Financial Results for the First Three Quarters of the Fiscal Year Ending March 31, 2018." The main factors behind this are that amounts corresponding to the overpaid consumption tax of past years were expensed as taxes and dues in the fiscal years concerned, as mentioned above, in addition to the advanced examination of the subject Transactions.

unit：million yen

Fiscal Year	Major Items	Before accounting revisions	After accounting revisions	Effect
FY2008 Full-year	Revenue	11,714	11,614	(100)
	Operating income	(393)	(399)	(6)
	Ordinary income	(1,067)	(1,073)	(6)
	Net income	(904)	(908)	(3)
	Net assets	5,270	5,261	(9)
	Total assets	8,836	8,826	(9)
FY2009 Full-year	Revenue	10,527	10,309	(217)
	Operating income	558	544	(14)
	Ordinary income	611	596	(14)
	Net income	1,174	1,166	(8)
	Net assets	6,728	6,704	(24)
	Total assets	9,325	9,301	(24)
FY2010 Full-year	Revenue	13,927	13,549	(378)
	Operating income	860	838	(21)
	Ordinary income	829	807	(21)
	Net income	450	436	(13)

	Net assets	6,771	6,727	(44)
	Total assets	9,676	9,632	(44)
FY2011 Full-year	Revenue	12,485	11,872	(612)
	Operating income	803	771	(32)
	Ordinary income	800	767	(32)
	Net income	479	458	(20)
	Net assets	7,469	7,392	(76)
	Total assets	11,811	11,734	(76)
FY2012 Full-year	Revenue	12,968	12,124	(844)
	Operating income	166	121	(44)
	Ordinary income	(215)	(260)	(44)
	Net income	(424)	(453)	(28)
	Net assets	6,930	6,809	(121)
	Total assets	12,529	12,408	(121)
FY2013 Full-year	Revenue	12,301	11,114	(1,187)
	Operating income	(618)	(681)	(62)
	Ordinary income	(1,134)	(1,196)	(62)
	Net income	(777)	(818)	(40)
	Net assets	6,117	5,933	(184)
	Total assets	11,099	10,915	(184)
FY2014 Full-year	Revenue	11,918	10,272	(1,646)
	Operating income	(1,147)	(1,236)	(89)
	Ordinary income	(2,358)	(2,447)	(89)
	Net income	(2,580)	(2,598)	(17)
	Net assets	4,444	4,175	(269)
	Total assets	8,978	8,708	(269)
FY2015 Full-year	Revenue	12,117	9,955	(2,162)
	Operating income	71	(46)	(117)
	Ordinary income	(198)	(316)	(117)
	Net income attributable to owners of parent	(1,082)	(1,142)	(60)
	Net assets	3,509	3,122	(387)
	Total assets	7,591	7,204	(387)
FY2016 Full-year	Revenue	13,158	10,413	(2,744)
	Operating income	187	38	(148)
	Ordinary income	134	(14)	(148)
	Net income attributable to owners of parent	(350)	(426)	(76)
	Net assets	2,942	2,406	(536)
	Total assets	7,800	7,263	(536)

FY 2017 Q2	Revenue	6,682	5,159	(1,523)
	Operating income	67	(3)	(70)
	Ordinary income	54	(16)	(70)
	Net income attributable to owners of parent	24	(0)	(25)
	Net assets	3,295	2,710	(585)
	Total assets	7,695	7,079	(615)

7. Insiders' involvement

The Company acknowledges that the matter is a case of fraud where the principal offenders are Individual B, the Representative Director and Individual C, the Director of Company A; also judging from a report by a lawyer on behalf of Company A to the effect that this is a fraud committed by Company A. The Internal Investigation Committee also reports that it is highly likely that no one has engaged in the fictitious transactions within the Company Group including Fishing Vision according to the investigation so far. However, as a result of a consultation with the accounting auditor, the Company decided to conduct an investigation equivalent to internal fraud cases to make a more careful decision, and it is therefore now conducting an analysis and inspection of entertainment expenses including duplicate inspections of clients/suppliers, duplicate inspections of insiders/suppliers, inspections of internal approval documents, revenue transitions, etc.

8. Relationships with anti-social forces

We asked external experts to investigate the relevant persons of Company A with particular focus on Individual B, however, relationships with anti-social forces have not been found.

9. Status of investigation and additional postponement of the deadline for financial results for the first three quarters of the fiscal year ending March 31, 2018

As stated in its press release announced on February 14, 2018 "Broadmedia Corporation Announces Approval of Postponement of Announcement of Financial Results for the First Three Quarters of the Fiscal Year Ending March 31, 2018," the postponement of the announcement of the financial results for the first three quarters of the fiscal year ending March 31, 2018 was approved and the Internal Investigation Committee had been leading the investigation to submit the financial results for the first three quarters of the fiscal year ending March 31, 2018, attaching an audit review report expressing an unqualified opinion by the deadline of March 14.

However, an additional investigation to see whether any insiders were involved was launched on February 14, as mentioned in 7. above. Moreover, it took time to determine which transactions are highly likely to be genuine transactions since the submission of materials from Company A was delayed in the investigation for identifying the fictitious transactions mentioned in 5. As a result, the number of transactions that are highly likely to be genuine transactions increased, and thus the items to be checked with the clients increased more than expected. Furthermore, confirmation of the audit status for the periods in which a former audit corporation was an accounting auditor is taking longer than expected. As a result, the investigation is not yet complete.

Given this situation, today we applied for the deadline for the financial results for the first three quarters of the fiscal year ending March 31, 2018 to be postponed again to April 13, 2018, which was subsequently approved. Accordingly, the earnings report for the third quarter will also be postponed again, and will be announced by April 13.

With regard to the ongoing investigation, we are proceeding with it, setting the completion target date to the end of March at the latest. We will announce the necessary details, including its completion, as soon as the investigation is completed.

10. Internal control issues and punishment of management

As mentioned in 7., the matter relates to damages suffered due to fraud, and no insider involvement is acknowledged at the present time. Nonetheless, we believe that Fishing Vision and the management of the Company have certain responsibilities for allowing the incident to occur and for not being able to detect it at an early stage.

With respect to the status of internal control, we are not making a final judgment, as the investigation is incomplete. However, it has been reported that part of the operation process, including the confirmation of product delivery or the drafting of an internal approval document, was not performed appropriately. The Transactions are suspended and are not expected to occur in the future. As for the process concerned related to other transactions, appropriate operation is being thoroughly implemented. Aside from this, an investigation into the enhancement/status of operation related to internal control is ongoing. As a result, if the enhancement/operation of internal control are acknowledged as being imperfect, the imperfections are to be corrected immediately, and preventive measures are to be implemented.

We acknowledge that the management of the Company is responsible for the sharp decline in the earnings forecast for the current period due to the effect of the incident, the significant delay in the submission of the quarterly financial report, and the errors in the settlement of accounts in past years. Accordingly, we are considering undertaking punitive action with regard to those involved. However, we believe that it is appropriate for us to make a decision regarding this once the full picture is revealed by the investigation. The decision will be announced immediately after the investigation is completed.

End

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