Broadmedia

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Press Release

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Notice of Status of Investigations into Damage from Fictitious Transactions Suffered by Consolidated Subsidiary

The Internal Investigation Committee established by the Company undertook an investigation into the damages from fictitious transactions suffered by Fishing Vision Co., Ltd. (hereinafter referred to as "Fishing Vision"), a consolidated subsidiary of the Company, as reported in a press release dated January 30, 2018 titled "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" and another press release dated March 14, 2018 titled "Notice of Current Status Related to Damages from Fictitious Transactions Suffered by a Consolidated Subsidiary."

The Company received a report from the Internal Investigation Committee on the content of the fictitious transactions, etc.. The details are as follows.

The Internal Investigation Committee reported to the Company that the Committee did not confirm any insider involvement in the damages from fictitious transactions as described in the "Notice of Establishment of a Third-Party Committee" released today. However, an insider who had completed interviews and investigations by the Internal Investigation Committee reported to the Company that additional investigations of the directors of the Company should be undertaken.

The Company understands that the Internal Investigation Committee performed necessary and sufficient investigations. However, after repeated consideration, the Company judges that the scope of the investigations must be expanded more cautiously in light of the possibility mentioned in the report concerned that its directors may have been aware of the fictitious transactions. This judgment led the Company to its decision to establish a third-party committee to conduct additional investigations.

Accordingly, depending on the results of the investigations undertaken by the third-party committee, there may be changes in the content below.

The Company deeply regrets the situation and offers its sincere apologies to all stakeholders for the concern caused.

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 February 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.

In addition, the payment of advances of up to 20 million yen to Company A was arranged because there have been certain levels of prior demand for funds reflecting the current status of the video production business. A lien was placed on the house of Individual B, the Representative Director of Company A, as collateral.

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 per year to 250 to 280 million yen per month in 2017. In these transactions, the number of companies recognized as being clients was 12, and the total orders received 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 continued the investigation with advice from external experts.

2. Structure, etc. of the Internal Investigation Committee

The Internal Investigation Committee consists of the Company’s Outside Auditors, Outside Director, corporate lawyers and others, and the Committee investigated the matter based on cooperation and advice on investigation methods, adequateness of the scope of investigation, etc. from an external consulting firm.

In addition, the Guidelines on the Third-Party Committee for the Investigation of Corporate Scandals are partially observed with respect to the methods of verifying facts, etc. in the investigation carried out by the Internal Investigation Committee.

3. 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, except that there was a delay in payment after contacting in advance in October 2017.

(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.

It should be noted that although in the past, the item described in (8) was also delivered via Company A to Fishing Vision, in 2013 the client started to deliver the item by mail directly to Fishing Vision based on advice from the Internal Audit Group. In addition, affixing the corporate seal to the item described in (1) became essential in addition to the seal of person in charge in the case of a major client.

4. 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).

Of the 12 clients involved in the matter, confirmation letters of the balance of accounts receivable were sent to five companies, and all five of the companies sent them back to the accounting auditor after they filled in all the necessary items, including their corporate names, the names of the persons in charge, the account titles and the acknowledged balances, with the clients' seals affixed. There was no discrepancy in the recognition of the amounts receivable.

5. 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.

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 February 2007 through the end of December 2017.

However, it has been confirmed that in fact, in all of the 42 actual transactions described in 6. below, Company A withdrew cash from its account and made a remittance to Fishing Vision, writing the clients' names in the remitter column on the transfer vouchers so that it looked as if the clients had made the bank transfers.

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, according to Individual B's statement, Individual B told the persons in charge of some of the clients in advance, "A confirmation letter of the balance will come to you from the accounting auditor in error. Since it is an error, please give it to me." Individual B obtained the unopened letters, filled in the necessary items using counterfeit client company seals and seals of the persons in charge and sent them back to the accounting auditor.

6. Situation of fictitious transactions

The Transactions occurred from February 2007 through December 2017. The total number of the Transactions was 694, and the total orders received were around 12.2 billion yen. The investigation confirms that 652 transactions worth some 12.0 billion yen 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 42 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 asked multiple clients involved in the transactions to confirm the authenticity of the Transactions.

As a result, it has been confirmed that 41 were genuine transactions whose transaction values matched the actual values, and that the remaining one was a genuine transaction but its value was inflated. It has been determined that excluding the inflated transaction value of the one transaction, these 42 transactions are recognized to have been genuine, and the posting of normal revenue and costs are to be maintained in the accounting treatment.

In chronological order, the situation of the fictitious transactions is summarized as follows: the transactions were genuine at first and were gradually inflated and became fictitious, and in fiscal year 2011 and thereafter all the transactions were fictitious.

FY2006: One out of one transaction was genuine.

FY2007: Nine out of 12 transactions were genuine, and three transactions for which orders were received in the latter half of the fiscal year were fictitious.

FY2008: 13 out of 20 transactions were genuine and seven were fictitious.

FY 2009: 16 out of 44 transactions were genuine; the value of one transaction was inflated; and 27 were fictitious.

FY 2010: Two out of 38 transactions were genuine and 36 were fictitious.

FY 2011 and thereafter: All 579 transactions were fictitious.

7. Size of fictitious transactions and effect on financial statements

Whether transactions were genuine or fictitious has been determined and journal entries have been completed. The effects on the financial statements are as follows.

<Past income statements>

(1) Acknowledging that the transactions falling under fictitious transactions are not business transactions whose revenue and costs can be posted, the revenue and costs concerned have been canceled on the income statement.

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

(2) As we acknowledged that all the transactions falling under fictitious transactions were subject to consumption tax, the difference between consumption tax income and consumption tax paid had been paid. We now recognize that this 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.

(4) As a result of the accounting treatment described in (1) and (2) above, the amount of the net assets of Fishing Vision decreased and the amount of goodwill in relation to the shares of Fishing Vision's stock increased.

⇒ As a result, operating income decreased.

<Past balance sheets>

(1) Accounts receivable from clients on the balance sheet in relation to transactions that fall under fictitious transactions have been canceled at the end of each period. (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) in relation to transactions that fall under fictitious transactions has been 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.

There are differences between the amounts below and the amounts stated in the Notice of Current Status Related to Damages from Fictitious Transactions Suffered by Consolidated Subsidiary announced on

March 14, 2018, and the said differences mainly reflect the fact that whether the transactions were genuine or fictitious has been determined, as described in 6. above.

unit：million yen

Fiscal Year	Major Items	Before accounting revisions	After accounting revisions	Effect
FY2008 Full-year	Revenue	11,714	11,686	(28)
	Operating income	(393)	(394)	(1)
	Ordinary income	(1,067)	(1,068)	(1)
	Net income	(904)	(905)	(0)
	Net assets	5,270	5,268	(1)
	Total assets	8,836	8,834	(1)
FY2009 Full-year	Revenue	10,527	10,389	(138)
	Operating income	558	551	(7)
	Ordinary income	611	603	(7)
	Net income	1,174	1,170	(4)
	Net assets	6,728	6,719	(9)
	Total assets	9,325	9,315	(9)
FY2010 Full-year	Revenue	13,927	13,550	(377)
	Operating income	860	838	(21)
	Ordinary income	829	807	(21)
	Net income	450	437	(13)
	Net assets	6,771	6,741	(30)
	Total assets	9,676	9,645	(30)
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	7,406	(62)
	Total assets	11,811	11,748	(62)
FY2012 Full-year	Revenue	12,968	12,124	(844)
	Operating income	166	122	(44)
	Ordinary income	(215)	(260)	(44)
	Net income	(424)	(453)	(28)
	Net assets	6,930	6,823	(107)
	Total assets	12,529	12,422	(107)
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	5,948	(169)

	Total assets	11,099	10,929	(169)
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)	(2,600)	(19)
	Net assets	4,444	4,189	(255)
	Total assets	8,978	8,722	(255)
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	3,136	(372)
	Total assets	7,591	7,218	(372)
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	2,420	(521)
	Total assets	7,800	7,278	(521)
FY2017 First-harf	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	2,724	(570)
	Total assets	7,695	7,093	(601)

8. Insiders' involvement

As a result of the investigation conducted by the Internal Investigation Committee, including interviews with insiders and others, the examination of relevant materials, email investigation and the preservation of data in cell phones and on hard disks of personal computers, it is reported that the matter is a case of fraud where the principal offenders are Individual B, the Representative Director, and Individual C, a Director of Company A, and that no one within the Company Group, including Fishing Vision, has been found to have engaged in the fictitious transactions.

9. Existence or non-existence of other fictitious transactions

The Internal Investigation Committee conducted an investigation equivalent to internal fraud cases, including duplicate inspections of clients and suppliers of Fishing Vision, duplicate inspections of insiders and suppliers, inspections of internal approval documents, analytical inspections of revenue transitions, etc., inspections of entertainment expenses and a questionnaire survey of all the employees of Fishing Vision. As a result, it is reported that no transactions of similar forms and no fictitious transactions that use similar methods were found to exist.

Furthermore, a questionnaire survey aimed at the Directors and General Managers of the business divisions of each Group company was also conducted. As a result, the questionnaire answers are reported to show that no transactions of similar forms and no fictitious transactions that use similar methods were found to exist in any of the Group companies, and that there are no transactions with the potential to give rise to fictitious transactions, regardless of the transaction format.

10. 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.

11. Circumstances behind the failure to prevent fraud damage

According to the report, the factors that led to the failure to prevent fraud damage are as follows:

- ✓ Although the deliverables were confirmed, the allocation of appropriate human resources and other control measures were not implemented.
- ✓ Although Fishing Vision has an organization structure for internal controls that wields mutual checks and balances functions, etc., including an organizational chart, Rules on Internal Document Approval and Rules on Division of Responsibilities, the structure was used at the level of mere formality.
- ✓ A number of clients were large companies and there was no delay in payments, etc.
- ✓ Although part of the operation flow was improved and internal controls were functioning as a result of internal audits, such improvement was limited.

There have been occasions in the past where suspicions arose within Fishing Vision about the quality level of the deliverables, which could have caused Fishing Vision to become aware of the fraud damage. However, it is reported that there were particular reasons for continuing the transactions thereafter.

12. Issues concerning internal controls, etc.

The Internal Investigation Committee reports the following points on the situation of internal controls.

- ✓ Although the handling of documents concerning the matter and other aspects of the operation flow were improved and internal controls were functioning after the Internal Audit Group pointed out the issues, further improvements should have been made.
- ✓ In the procedures for internal document approval regarding the matter, the president made a final decision on a draft prepared by the General Manager of the Corporate Management Division in the past. Upon the receipt of a suggestion from the Internal Audit Group, the section in charge of preparing a draft was changed to the Sales Planning Division. However, due to the insufficient handover of the relevant tasks, etc., the change lost substance. As a result, the checking of the content of the draft by the proposer was inadequate and decision-making requests were made ex post facto.
- ✓ The deliverables were confirmed by persons lacking the level of knowledge required for the task.
- ✓ In the circumstances surrounding the Transactions, a lack of sufficient checking and communication continued to be present.

Upon the receipt of the above report, the Company acknowledges that there are flaws in part of the company-wide internal controls and part of the internal controls on the operational process of Fishing Vision.

Accordingly, the Company has determined that internal controls on financial reporting for the end of the relevant business year were ineffective, and it plans to submit a reissued internal control report at a later date.

Procedures for internal document approval were also verified and a project drafted by the Corporate Management Division was discovered. It has been confirmed that the relevant operation flow has already been improved. In addition, it has been confirmed that similar forms of transactions do not exist in the Company and other subsidiaries, and the results of a similar survey showed that internal document approval is managed appropriately.

Looking at the other aspects of the matter, the following issues have been identified, among other things.

- ✓ Although the major clients are reputable, credit management was not sufficient.
- ✓ Credit investigations of other clients were not conducted on a regular basis.
- ✓ Because the transaction value of each project was not large and for other reasons, these projects were not subject to discussion by the Board of Directors, and there was no delay in payment or other issues. As a result, the reporting of the matter by the project executors to the Board of Directors was inadequate.

Moreover, with respect to the management of subsidiaries by the Company, it is reported that "the Company is not necessarily in a position to provide specific instructions to Fishing Vision on the management of individual transactions, etc., mainly because Fishing Vision is not the Company's wholly-owned subsidiary and its independence is respected." However, the Company considers that it should have implemented group governance in a more effective manner.

Taking the matters pointed out in the report into account, the Company and Fishing Vision plan to implement the measures described in 13. in the future, and this initiative has already commenced.

13. Future measures

Considering that Fishing Vision has been found to have a number of flaws in internal controls as well as issues that are not flaws but need to be improved, as described in 12. above, the Company has decided to take the following measures for the purposes of correcting the flaws in the internal controls of Fishing Vision, enhancing group governance and internal control structures and preventing the recurrence of similar matters in the future.

(1) The Company's involvement in the internal document approval and other approval processes of Fishing Vision

⇒ The Group has an effective checking system in which approval and verification by the Directors in charge of management or officers in charge of management sections are required in all or part of the processes of all the subsidiaries, excluding Fishing Vision, for the preparation of contracts, internal document approval and the affixing of seals. However, this system was not used by Fishing Vision. Accordingly, we will establish a system that enables the Company's involvement in the approval process of Fishing Vision in the same manner as in the case of the other subsidiaries in the future.

(2) Review of Fishing Vision's organizational structure

⇒ In Fishing Vision, there are many cases of the concurrent holding of positions by officers due to its organizational structure, and this has made it difficult to understand where the responsibilities lie, which has caused other issues. Accordingly, the situation of practical operations will be clarified and its organizational structure will be rearranged to allow the appropriate definition of the scope of responsibility and mutual checking between the sections.

(3) Enhancement of cooperation among the management sections of the Group

⇒ The Group has established a system in which the Company undertakes financial and accounting affairs and other management-related operations of the subsidiaries or in which persons responsible in the Company's management sections concurrently hold posts responsible for the subsidiaries' management sections. This system enables group-wide cooperation, and the Company is completely disconnected from the subsidiaries' sales sections. However, as Fishing Vision and certain other subsidiaries have independent management systems, the Company will establish a system that allows stronger cooperation in the same manner as with the other subsidiaries in the future.

(4) Establishment of a reporting structure according to business circumstances

⇒ As the individual transactions contained in the Transactions were not subject to discussions by the Board of Directors of Fishing Vision, reporting to the Board of Directors was not conducted appropriately in light of the size of the total trade value. The Company will review and reconfirm the situation of the transactions and risks of each group company and establish a system in which matters are presented and reported to the Board of Directors, etc. appropriately in accordance with the circumstances, not being bound solely by statutory requirements, etc.

In addition, regarding reports to the Company, the parent company, which are made in group meetings, etc. held on a regular basis, the Company will review the contents, rules, etc. of such reports in the future.

(5) Enhancement of internal auditing system

⇒ The Company and group companies have established the Internal Audit Group in order to examine and evaluate the internal control system of each company and provide instructions and advice for the optimization of the system. The Company will increase the frequency of internal audits in the future and work to reinforce the structure and administration of the system by conducting self-evaluation as to whether internal controls of the auditing target sections are properly developed and implemented in the future.

(6) Comprehensive compliance education

⇒ The Company and group companies have appointed Chief Compliance Officers and provide compliance education to employees, etc. on a regular basis. The Company will work to further enhance the compliance system by improving the levels and uniformity of compliance education, increasing education opportunities, etc. at the group companies.

If, as a result of an investigation to be conducted in the future by a third-party committee that the Company has decided to establish, any other flaws in internal controls, etc. are found in addition to the matters described in 12., the Company will examine countermeasures, etc. and promptly make a public announcement of the content of such countermeasures, etc.

14. Punishment of management

As described in 8., the matter relates to fraud damage suffered by a subsidiary, and no insider involvement has been acknowledged at the present time. Nonetheless, we believe that the management of the Company is responsible for allowing the incident to occur, for not being able to detect it at an early stage, for the sharp decline in the earnings estimates for the fiscal period ended March 31, 2018 compared to the initial forecast, for the delay in the results announcement for the first three quarter of the fiscal year ended March 31, 2018 and furthermore for the submission of the quarterly financial report by attaching a quarterly review report stating “Disclaimer of conclusion.”

Accordingly, we have decided to reduce the amount of remuneration for the Company’s Directors as described in the “Notice of Reduction of Officers’ Remuneration” announced today. Mr. Ryo Arisawa, Representative CEO of Fishing Vision and Director of the Company, resigned from the post of Representative Director of Fishing Vision as of March 26, 2018 and the post of Director of the Company as of March 28, 2018.

In the event that new facts, etc. are found in the future as a result of an investigation by the third-party committee that the Company has decided to establish, further punitive action, etc. may be taken.

End

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