

Investigation Report

July 20, 2015

Independent Investigation Committee
For Toshiba Corporation

TRANSLATION FOR REFERENCE PURPOSES ONLY

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To Toshiba Corporation

Independent Investigation Committee
For Toshiba Corporation

Committee Chairman

Koichi Ueda

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Glossary

Terminology	Description
Toshiba	Toshiba Corporation
Company	The business segment/organization of Toshiba that has management accountability (profit and loss responsibility)
Corporate	A collective term for the CEO, executive officers in charge of business groups, executive officers in charge of the Corporate Staff, and the Corporate Staff as a whole
back-end process	The process from packaging of integrated circuits which have been created in the front-end process, through inspections and examinations of those integrated circuits, to the completion of those integrated circuits as finished goods
Subsidiary	Subsidiaries of Toshiba (as stipulated in Article 2(iii) of the Companies Act)
Ernst & Young	Ernst & Young ShinNihon LLC
CEO Monthly Meeting	Monthly reporting meetings for all Companies (meetings where each Company and separated-company reports to the CEO of Toshiba on the performance and outlook of its business and the status of the execution of its policy)
Total Amount (<i>Shukei-chi</i>)	Estimated amount when results from undetermined measures are not included (same as Total Contract Cost)
Order Policy Meeting	Order acceptance policy meeting
Corporate Staff	Departments with a function of supporting Corporate and a shared service function
front-end process	Process of building integrated circuits on silicon substrates called wafers
Toshiba Group	Business group comprising Toshiba and its Subsidiaries
Power Systems Company	The Power Systems Company
Total Contract Cost (<i>Nariyuki-chi</i>)	Estimated amount when results from undetermined measures are not included (same as Total Amount)
the Committee	The Independent Investigation Committee
the Investigation	The investigation conducted by the Committee
this Report	The investigation report prepared by the Committee
Masking Price	The supply price in transactions in which Toshiba provides parts to ODMs in PC Business, etc., where that price is a certain amount that exceeds the parts procurement price
Masking Difference	Difference between the Masking Price, which is the supply price for parts in transactions in which Toshiba provides parts to ODMs in PC Business, etc., and the procurement price
Loss-Making Project	Project in which a Contract Loss (accumulated) of JPY 200 million or more arise

Q1, Q2, Q3, Q4	1st quarter, 2nd quarter, 3rd quarter, 4th quarter
ASIC	LSI for specific uses and specific customers called Application Specific IC
ASSP	General purpose LSI called Application Specific Standard Product
BRF Meeting	Business Risk Follow Meetings (same as BRM Meetings); meetings where implementing departments regularly report to the CP and confirm and follow matters such as the progress and profitability of projects and the status of responses to instructions and comments at the time of Order Policy Meetings with respect to projects that have been deliberated and determined at Order Policy Meetings and other important projects
BRM Meeting	Business Risk Management Meetings (same as BRF Meetings)
Buy-Sell Transactions	Series of transactions where TTIP has purchased key PC parts from each parts vendor, and sells purchased parts materials to ODMs at the Masking Price (supply for value), and ODMs that have been supplied parts manufacture PCs together with parts they have procured themselves and deliver finished PCs to TTIP
BU Director	Business Unit Director
C	Chairman
C/O	Carry Over (this term is used in Toshiba to collectively mean various measures taken as improvement plans in the Visual Products Business and the PC Business)
CD	Cost Down (cost reduction)
CFO	Executive Officer in charge of the Corporate Finance & Accounting Division (Chief Financial Officer)
CP	President of the Company
CPU	Central Processing Unit
CS Company	Community Solutions Company
DM Company	Digital Media Network Company
DN Company	Digital Products & Network Company
DS Company	Digital Products & Service Company
EV	Corporate Executive Vice Presidents
EVP	Vice President of the Company
FOB-UP	To increase (UP) the price (FOB price) of products sold by Toshiba to overseas affiliated companies
GCEO	Executive officer in charge of business groups
GPM	Group Manager
HDD	Hard disk drive
M Ratio	Ratio of the total estimated construction profit divided by the total estimated cost
NET	NET refers to costs incurred from the perspective of Toshiba's applicable sales department. To illustrate, if part of the work is outsourced to an internal Toshiba factory, the estimate from the factory is an internal

	<p>transaction price that incorporates profit for the factory, such that the NET figure is larger than the total estimated cost of contract work to the extent of an amount equivalent to factory profits (however, these terms might not be clearly differentiated within Toshiba, and NET might be used to refer to the total estimated cost of contract work).</p> <p>When the applicable Toshiba sales department contemplates the acceptance of an order, the decision is made based on the amount of income earned by that sales department, meaning the difference between SP and NET. When recording the total estimated cost of contract work and provisions for contract losses for accounting purposes, an amount equivalent to those internal profits is eliminated.</p>
ODD	Optical Disk Drive
ODM	Original design manufacturing: Designing, developing, and manufacturing of products to be sold with the brand of the contracting company
OEM	Original equipment manufacturing: manufacturing of products to be sold with the brand of the contracting company
P	President
PC	Personal computer
PCS Company	Personal & Client Solutions Company
PC Company	PC & Network Company
SEV	Senior Vice President
S&S Company	Semiconductor & Storage Company
SIS Company	Social Infrastructure Systems Company
SP	This term is basically used as having the same meaning as “total estimated income from contract work,” but it is sometimes used inclusive of potential anticipated future additional consideration from the perspective of business management. Therefore, SP as used in this Report might refer to a figure inclusive of potential anticipated future additional consideration or an effective agreed amount applicable for accounting purposes.
SRPJ	System LSI Business Unit Revival Project
TEG	Toshiba Europe GmbH
TIC America	Toshiba International Corporation
TIH	Toshiba Information Equipment (Hangzhou) Co., Ltd.
TLSC	Toshiba Lifestyle Products & Service Corporation
TOV	Turn out of value
TPSC	Toshiba Plant Systems & Services Corporation
TTI	Toshiba Trading Inc.
TTIP	Taiwan Toshiba International Procurement Corp.
VP Company	Visual Products Company
WEC	Westinghouse Electric Corporation

Chapter 1. Overview of the Investigation

I. Background to the establishment of the Independent Investigation Committee

1. Establishment of the Special Investigation Committee

On February 12, 2015, Toshiba Corporation (“**Toshiba**”) received a report order from the Securities and Exchange Surveillance Commission (“**SESC**”) pursuant to Article 26 of the Financial Instruments and Exchange Act and was subject to a disclosure inspection with respect to some projects in which the percentage-of-completion method was used, among others. At the end of March 2015, in the course of a self-investigation by Toshiba for the purpose of responding to the indication by SESC pertaining to the percentage-of-completion method in the disclosure inspection, it was noted that some matters require investigation in respect of some of Toshiba’s infrastructure projects in which the percentage-of-completion method was used during FY 2013. Toshiba takes the situation noted up to that point seriously and on April 3, 2015 it decided to establish the Special Investigation Committee to conduct an investigation of the relevant facts with Masashi Muromachi, Chairman of the Board, as the Committee Chairman and an external attorney-at-law and a certified public accountant as Committee Members.

During the course of the investigation by the Special Investigation Committee, it was found that, in respect of some infrastructure projects in which the percentage-of-completion method was used, the total amount of the contract cost was underestimated and a Contract Loss (including provisions for contract losses) was not recorded in a timely manner. Also, issues requiring investigation were identified, other than the issue of estimates of total cost of contract work in the projects in which the percentage-of-completion method was used, and it appeared that it would take time to conduct a detailed investigation of those facts and to investigate the cause.

2. Establishment of the Independent Investigation Committee

Taking this situation into consideration, in order to further increase the credibility of the findings of the investigation with stakeholders, on May 8, 2015, Toshiba decided to change the framework of the investigation from one conducted by the Special Investigation Committee to one to be conducted by an Independent Investigation Committee (the “**Committee**”) comprising independent and impartial external experts who do not have any interests in Toshiba and delegated the investigation to the Committee, which conforms to the guideline prescribed by the Japan Federation of Bar Associations.

On May 15, 2015, Toshiba decided to appoint members to the Committee and delegated the investigation, and on June 2, 2015, the Special Investigation Committee reported to the Committee on the progress of the investigation of the projects in which the percentage-of-completion method was used and the Committee received supporting documentation from the Special Investigation Committee.

II. Delegated matters (scope of the Investigation)

1. Initial delegated matters

The matters delegated by Toshiba to the Committee as of May 17, 2015, constituted an investigation of the appropriateness of the accounting treatments pertaining to projects in which the percentage-of-completion method was used and other matters delegated by Toshiba to the Committee; and where an accounting treatment subject to that investigation is deemed inappropriate, to investigate the cause and to recommend recurrence prevention measures.

2. Additional delegated matters

On May 22, 2015, accounting treatments subject to the investigation by the Committee were added by Toshiba ((2) through (4) were added), and the matters to be investigated were as follows.

- (1) Accounting in relation to projects in which the percentage-of-completion method was used;
- (2) Accounting in relation to recording of operating expenses in the Visual Products Business;
- (3) Accounting in relation to the valuation of inventory in the Semiconductor Business, mainly discrete and system LSIs; and
- (4) Accounting in relation to parts transactions, etc. in the PC Business.

3. Specific accounting treatment subject to the Investigation by the Committee

Toshiba and the Committee agreed and acknowledged the scope of the investigation delegated to the Committee by Toshiba, which should cover the following specific accounting treatments (which were disclosed by Toshiba on May 26).

- (1) Accounting in relation to projects in which the percentage-of-completion method was used

The Committee was delegated to investigate whether, in projects in which the percentage-of-completion method was used, there have been inappropriate accounting treatments such as a failure to record provisions for contract losses in an appropriate and timely manner or overstating profits due to inappropriate estimates of total cost of contract work because, for example, cost reduction measures with low feasibility were factored into those estimates.

(2) Accounting in relation to recording operating expenses in the Visual Products Business

The Committee was delegated to investigate whether, in accounting in relation to recording operating expenses in the Visual Products Business, there have been inappropriate accounting treatments such as where (i) the timing of the recording of a provision was not appropriate or (ii) some costs were recorded in a subsequent period by adjusting the purchase price with a vendor and deferring part of that payment until the subsequent period.

(3) Accounting in relation to the valuation of inventory in the Semiconductor Business, mainly discrete and system LSIs

The Committee was delegated to investigate whether revisions of the TOV have not been appropriately accounted for in the semiconductor manufacturing process, which is separated into the front-end process, in which integrated circuits are fabricated on silicon substrates called wafers, and the back-end process, in which integrated circuits fabricated in the front-end process become finished goods after being packaged, inspected, and tested, leading to an overstatement of ending inventory, which, in turn, has resulted in overstated profits. It was also delegated to investigate whether valuation losses were appropriately recorded with respect to the inventory of semi-finished and finished discrete semiconductor and system LSI products that were discontinued due to business restructuring and held in stock for customer service.

(4) Accounting in relation to parts transactions, etc. in the PC Business

When Toshiba outsources the manufacturing of personal computers (“PCs”) to overseas original design manufacturers (“ODMs”), parts necessary for PC manufacturing, such as liquid crystal panels, hard disk drives, memory, etc., are bought in bulk and sold to ODMs by the Toshiba Group, while finished PC products that have been processed and manufactured at ODMs are purchased by the Toshiba Group. In those parts transactions, in order to prevent the divulgence of information by masking from ODMs the Toshiba Group’s purchase prices, the sales prices for parts sold to the ODMs were set higher than the purchase prices, but as the market prices of parts declined, the difference between the purchase prices and the sales prices set by the Toshiba Group widened. The Committee was delegated to investigate, taking into account these facts and the possibility that a considerable portion of the parts sold to the ODMs were built into finished products and returned to the Toshiba Group, whether the accounting in relation to amounts equivalent to profits recorded at the time of sales of parts was appropriate.

III. Structure of the Committee

The structure of the Committee is as follows.

Committee Chairman, Attorney-at-law

Koichi Ueda (former Superintending Prosecutor, Tokyo High Public Prosecutors Office)

Committee Member, Attorney-at-law

Hideki Matsui (Co-Representative, Marunouchi Sogo Law Office)

Committee Member, Certified Public Accountant

Taigi Ito (former Deputy Chairman, Japanese Institute of Certified Public Accountants)

Committee Member, Certified Public Accountant

Kazuyasu Yamada

The Committee also assigned the following assistants to assist the Investigation:

Marunouchi Sogo Law Office

(Attorneys-at-law Yoshihiro Inoue, Taizo Ota, Takashi Nuibe, Wataru Nagashima, Kentaro Naruse, Kyota Konnai, Yasuhiro Washino, Akihiro Iwamoto, Yasuhiro Arai, Isao Wakabayashi, Rui Fujii, and Chika Kamata)

Asahi Law Office

(Attorneys-at-law Keiichi Nambu and Jun Yamazaki)

Kaneko & Iwamatsu Law Office

(Attorneys-at-law Kengo Iida and So Joishi)

Harada Kokusai Legal Professional Corporation, Tokyo Office

(Attorney-at-law Hidemasa Suzuki)

Shinbashi Toranomom Law Office

(Attorney-at-law Shigeki Takeyama)

Deloitte Tohmatsu Financial Advisory LLC

(Certified Public Accountant Masami Nitta and 76 other people)

IV. Report of investigation progress and handing over of supporting materials by the Special Investigation Committee

As stated above, on June 2, 2015 the Committee received from the Special Investigation Committee a report on the progress of its investigation into projects in which the percentage-of-completion method was used and some of the materials it collected in the course of that investigation.

The main materials received from the Special Investigation Committee are:

- Accounting data, profitability management data, and the like related to orders received
- Notes taken from in interviews with officers and employees conducted by the Special Investigation Committee
- Data obtained as a result of digital forensic investigations conducted by the Special Investigation Committee of the servers used by Toshiba and PCs used for work by officers and employees

As a matter of course, however, the Investigation by the Committee is not restricted in any way by the Special Investigation Committee and the results of the Investigation by the Committee are not constrained in any way by the investigation by the Special Investigation Committee.

V. Outline of the Committee's investigation method and assumptions of the Investigation

1. Outline of the Investigation method

(1) Investigation period

The Committee conducted its Investigation and deliberated on the findings of the Investigation from May 15, 2015 to July 20, 2015. However, the Committee's investigation is based on information mainly obtained before July 17, 2015.

(2) Subject period of investigation

The period subject to the Investigation is from FY 2009 to the third quarter of FY 2014 (however, FY 2008 is also included, as it represents a comparison year in the FY 2009 securities report).

(3) Outline of the investigation method

The outline of the method of the Investigation conducted by the Committee is as follows, in addition to the inspection and verification of information received from the Special Investigation Committee mentioned above. (Please refer to the respective sections for descriptions of the inspection methods for each matter subject to

investigation.)

(A) Interviews with officers and employees

In the course of the Investigation, the Committee conducted one or multiple interviews with the directors, representative executive officers, executive officers, and employees of Toshiba (“**Officers and Employees,**” including previous titles). When necessary, the Committee also conducted interviews with Officers and Employees of consolidated Subsidiaries of Toshiba. A total of 210 Officers and Employees were subject to interviews.

(B) Interviews with the accounting auditor

In the course of the Investigation, the Committee conducted multiple interviews with the audit team (those responsible for the audit and those assisting in the audit) of Ernst & Young ShinNihon LLC, which is Toshiba’s accounting auditor.

(C) Inspection and verification of information

In the course of the Investigation, the Committee requested the disclosure of information from Toshiba (including accounting information, internal rules, meeting documents, meeting minutes, and other information) which was possibly related to the matters subject to investigation, and it inspected and verified that information received from Toshiba.

(D) Digital forensics

In the course of the Investigation, the Committee conducted digital forensics of PCs used for work by Officers and Employees who might be connected to the matters subject to the Investigation.

An outline of the digital forensics is set out in Exhibit 1.

(E) Establishment of a whistleblower system

The Committee established a whistleblower system through which the Committee can be contacted, and it received reports and accumulated information related to the matters subject to the Investigation through telephone calls, postal mail, and e-mail.

2. Assumptions of the Investigation

The Investigation and the investigation results of the Committee (including this Report, hereinafter the same in this Section 2), are subject to the following general

limitations and reservations (see the relevant sections for limitations and reservations applicable to each matter to be investigated).

(1) While the Committee feels that sincere cooperation was provided by Toshiba, it should be noted that the Committee's investigation is based on the voluntary cooperation of Toshiba's Officers and Employees, with no compulsory investigative authority afforded to the Committee. As such, the Committee's investigation findings cannot be completely devoid of fault or oversight.

(2) In response to the Committee's requests for information disclosure including documentation, etc., it is the Committee's understanding that Toshiba provided timely and appropriate disclosure. Also, except where specifically stated in this Report, it is the Committee's understanding that Toshiba has not withheld information that might have possibly had a material impact on the Investigation and its findings.

(3) It is the Committee's understanding that originals exist for all documents and electronic records disclosed to the Committee. Also, it is the Committee's understanding that the contents of all copies obtained are identical to the originals and that the originals are all genuine.

(4) The Investigation and findings of the Committee are intended to be used for the confirmation of facts concerning the matters subject to investigation at Toshiba, and to investigate the causes and to formulate and evaluate remedies to prevent recurrence, in the event that the accounting treatment is considered inappropriate, and it is not anticipated that they be used for any other purpose.

(5) The Investigation and the results of the Investigation by the Committee have been undertaken based on the delegation from Toshiba and solely on behalf of Toshiba. As such, it is not anticipated that the results of the Investigation of the Committee be relied on by any third party and the Committee is not liable to a third party in any respect whatsoever.

(6) This Report has been prepared in Japanese. Even if an English translation of this Report is prepared, the Committee assumes no responsibility in respect of such English version of this Report.

(7) The Investigation has been conducted solely by the methods described in 1(3) above, and no other method of investigation has been used. Also, no verification has been undertaken using any information other than the information obtained through the methods described in 1(3) above.

(8) When the Committee obtained information in the course of the Investigation pertaining to matters other than the matters subject to the Investigation that have been

agreed on and confirmed with Toshiba, the Committee promptly informed Toshiba of those matters and asked Toshiba to confirm whether Toshiba should respond in relation to such information. The Committee has not investigated or checked any matters other than those that have been delegated under the agreement with Toshiba, except for the matters contained in this Report.

(9) Through the Investigation of the delegated matters, items in annual securities reports from previous years (including items referenced in securities registration statements) that need to be restated have been identified. The Committee has not considered secondary effects that might result from restatement of those items. For example, secondary effects might occur in relation to the following items:

- (a) Matters pertaining to inventory valuation
- (b) Matters pertaining to fixed asset impairment
- (c) Matters pertaining to the recoverability of deferred tax assets

(10) Unless stated otherwise, job titles mentioned in this Report refer to titles held at that time.

VI. Adjustment amounts in the Investigation (by consolidated fiscal year)

(JPY 100 million)

Delegated Item	Item	FY	FY	FY	FY	FY	FY	FY	Total
		2008	2009	2010	2011	2012	2013	2014	
		Annual	Annual	Annual	Annual	Annual	Annual	Q1-Q3	
Percentage-of-Completion Method	Sales	(40)	(0)	53	(2)	(30)	(73)	(37)	(128)
	Pre-Tax Income	(36)	1	71	(79)	(180)	(245)	(9)	(477)
Parts Transactions	Sales	-	-	-	-	-	-	-	-
	Pre-Tax Income	(193)	(291)	112	(161)	(310)	(3)	255	(592)
Recording of Operating Expenses	Sales	-	-	-	(3)	2	(5)	(15)	(21)
	Pre-Tax Income	(53)	(78)	(82)	32	(1)	30	64	(88)
Semiconductor Inventory	Sales	-	-	-	-	-	-	-	-
	Pre-Tax Income	-	(32)	(16)	(104)	(368)	165	(5)	(360)
	Sales	(40)	(0)	53	(5)	(28)	(78)	(52)	(149)

Total	Pre-Tax Income	(282)	(400)	84	(312)	(858)	(54)	304	(1,518)
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Chapter 2. Overview of Toshiba

I. Overview of Toshiba business

Established in 1904, Toshiba is a stock company (*kabushiki kaisha*), the purpose of which is to manufacture, etc. electric machinery and instruments. Toshiba conducts business in six major divisions, namely Energy & Infrastructure, Community Solutions, Healthcare, Electronic Devices, Lifestyle, and Others. The main products in each division are as follows.

Division	Main products
Energy & Infrastructure	Nuclear power generation systems, thermal power generation systems, hydroelectric power generation systems, fuel cells, power generation business, solar power generation systems, power distribution systems, instrumentation control systems, fair collection systems, transportation equipment, electric motors, electro-wave equipment, government administration systems, etc.
Community Solutions	Broadcasting systems, road equipment systems, water and sewage systems, environmental systems, elevators, escalators, LED lighting, lighting equipment, industrial lighting parts, tubes, HVAC (heating, ventilating and air-conditioning), compressors, POS systems, multi-function machines, etc.
Healthcare	X-ray diagnostic equipment, CT equipment, MRI equipment, diagnostic ultrasound equipment, sample testing equipment, radiotherapy equipment, medical imaging solutions, etc.
Electronic Devices	Small-signal devices, optical semiconductors, power semiconductors, logic LSI, image sensors, analog ICs, NAND flash memory, storage devices, etc.
Lifestyle	Televisions, Blu-ray Disc players and other recording and playing devices, PCs, tablets, refrigerators, washing machines, cookware, cleaners, air conditioners for domestic use, etc.
Others	IT solutions, distribution services, etc.

II. Overview of in-house Companies

Toshiba introduced the in-house Company system, under which each division is treated and operated as its own independent Company, in 1999. Under the in-house Company system, the Company is put in place as the business segment (organization) that has its own management accountability (profit and loss responsibility) and gives the CP authority over business execution matters pertaining to the Company other than certain important items. The CP determines the medium-to-long term business strategies of the Company, important matters, etc. for the Company and has the authority to make optimal use of management resources on a broad scale.

As the time of performing the Investigation, the Companies comprised the following seven companies and two divisions.¹

- Industrial ICT Solutions Company
- Power Systems Company (*Denryokusha*)
- Social Infrastructure Systems Company (SIS Company)
- Community Solutions Company (CS Company)
- Healthcare Company
- Semiconductor & Storage Products Company (S&S Company)
- Personal & Client Solutions Company (PCS Company)

An Executive Officer responsible for each business group is called GCEO. The GCEO gives the necessary instructions and supervision to CPs, etc. as appropriate, acting in the role of President from Corporate's standpoint, and bears a responsibility to the President for his or her allotted business group. As a general rule, CPs report to GCEOs instead of reporting to P about the business operations of the Company, etc. Those reports are deemed to be reports to the President.

Corporate² refers to organizations that have a "group headquarters function."

III. Overview of Toshiba's corporate governance

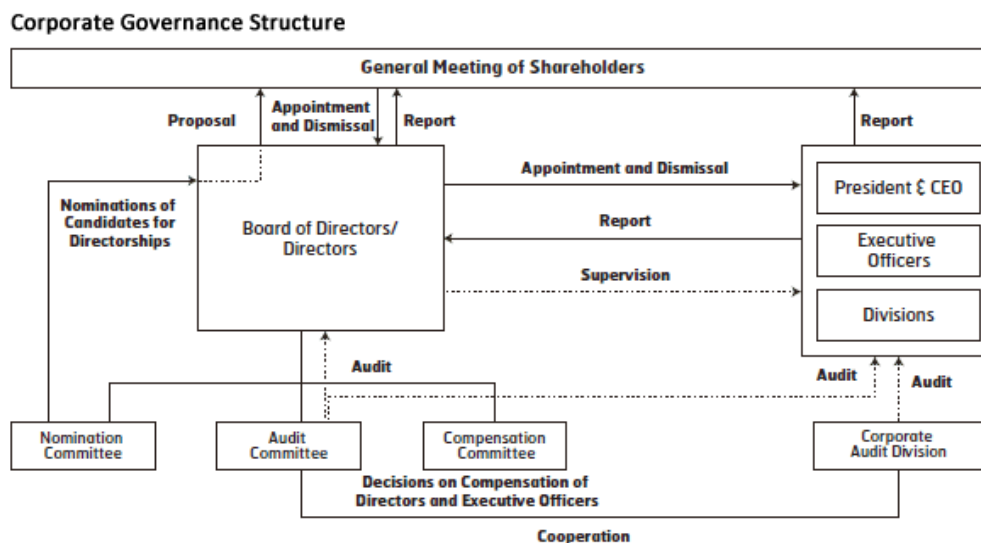
1. Overview of the corporate governance system

After introducing the executive officer system in 1998 and the in-house company system in 1999, Toshiba established a voluntary Nomination Committee and

¹ The Materials & Devices Division and the ODD Division.

² The Rules for Segregation of Duties stipulate that "Corporate" refers only to the President and the executive officer in charge of the Corporate Staff to whom the Board of Directors has delegated the power to make decisions. However, in this Report, "Corporate" is the term used to collectively mean the organizations that have the group headquarters function, including GCEOs.

Compensation Committee in June 2000. In June 2001, Toshiba reformed its management structure through methods such as establishing a three-member outside director system and reducing the director term of office to one year. Since June 2003, Toshiba has adopted a company with committees (now a company with a nominating committee) system. Currently, eight of the sixteen directors do not serve concurrently as executive officers. Half of those directors who do not serve concurrently as executive officers are outside directors.



(Source: Toshiba website)

With regard to the overview of each committee, the Nomination Committee comprises one internal director and two outside directors; the Audit Committee comprises two internal directors (on a full-time basis) and three outside directors; and the Compensation Committee comprises two internal directors and three outside directors. The chairmen of the Nomination Committee and Compensation Committee are outside directors.

As a company with a nominating committee, Toshiba assigns authority to decide matters regarding the execution of operations through the Board of Directors to the executive officers, except with regard to statutory matters and matters that have a significant impact on the corporate value and shareholder returns which are set out by the Board of Directors. The Board of Directors plays a supervisory role with regard to the execution of operations. Decisions regarding the most important of the matters concerning the execution of operations, for which the authority has been assigned to the executive officers, are made by the President and CEO at meetings such as the Corporate Management Meeting, etc., which meets once a week as a general rule. Other matters are determined by the Company Presidents and CEOs, etc., at Company Management Meetings, etc.

The Corporate Governance Committee serves to review the approach for group governance and measures for optimization.

2. Board of Directors

The matters to be determined by or reported to the Toshiba Board of Directors include the following.

(1) Matters to be determined

(A) The management philosophy, management vision, conduct standards, corporate governance, strategies or systems (business domains and internal control systems pertaining to risk compliance, etc.), medium-term business plans, annual budget outlines, and other policies of the Toshiba Group (Article 416(1)(i)(a) of the Companies Act) (Article 8-(1) of the Board of Directors Rules)

(B) The following matters set out in the Ordinance of the Ministry of Justice as those necessary for the execution of the duties of the Audit Committee (Article 416(1)(i)(b) of the Companies Act) (Article 8-(3) of the Board of Directors Rules)

(a) Matters regarding directors and employees assisting in the performance of duties by the Audit Committee (Article 112(1)(i) of the Ordinance for Enforcement of the Companies Act)

(b) Matters regarding the independence of directors and employees mentioned in the preceding item from executive officers (Article 112(1)(ii) of the Ordinance for Enforcement of the Companies Act)

(c) The system for reporting by executive officers and employees to the Audit Committee and other systems regarding reporting to the Audit Committee (Article 112(1)(iii) of the Ordinance for Enforcement of the Companies Act)

(d) Other systems to ensure that audits by the Audit Committee are conducted effectively (Article 112(1)(iv) of the Ordinance for Enforcement of the Companies Act)

(C) Approval of financial statements, business reports, and their accompanying detailed statements, temporary financial statements, and consolidated financial statements (Article 416(4)(xiii) of the Companies Act) (Article 8-(18) of the Board of Directors Rules)

(D) Approval of second quarter financial reports (Article 8-(19) of the Board of Directors Rules)

(2) Matters to be reported

(A) Matters that the members of the Audit Committee deem to be facts that may inflict significant damage on the company and should be reported to the Board of Directors (Article 9-(9) of the Board of Directors Rules)

(B) Matters that the Board of Directors determines and deems to require ongoing reports from the perspective of business risk, etc. (Article 9-(10) of the Board of Directors Rules)

3. Systems pertaining to internal controls

Toshiba requires all of the Toshiba Group companies in Japan and abroad to adopt the “Toshiba Group Standards of Conduct,” which defines the values and code of conduct that all executives and employees share. Number 13 (“Accounting”) of the Toshiba Group Standards of Conduct stipulates the following.

1. Toshiba Group Corporate Policy

Toshiba Group Companies shall comply with all applicable laws and regulations regarding accounting and conduct proper accounts management and financial reporting in accordance with generally accepted principles.

2. Standards of Conduct for Toshiba Group Officers and Employees

Officers and employees shall:

- (1) maintain proper and timely accounts in accordance with generally accepted accounting principles;
- (2) promote the prompt release of accurate accounts; and
- (3) endeavor to maintain and improve the accounting management system, and establish and implement internal control procedures for financial reporting.

In accordance with the Internal Control Reporting System, Toshiba has implemented the following internal control systems to ensure the appropriateness of stock company (*kabushiki kaisha*) business operations.

(1) System to ensure executive officers’ compliance with laws and regulations and the Articles of Incorporation in the execution of their duties

(A) Executive officers periodically report to the Board of Directors on the execution of their duties and are required to report on necessary items to the Board of Directors as necessary.

(B) The General Manager of the Corporate Audit Division periodically reports to the Board of Directors on internal audit results.

(C) The Audit Committee periodically interviews executive officers and the General Manager of the Corporate Audit Division reports to the Audit Committee on internal audit results.

(D) Executive officers report to the Audit Committee on any material violation of laws and regulations without delay in accordance with the Rules concerning Reporting to the Audit Committee.

(2) System for retention and management of information concerning executive officers' execution of their duties

(A) In accordance with the Rules concerning the Document Retention Period, executive officers appropriately retain and manage material documentation, such as information materials for the management meetings and decision-making documents, and other documents such as account books and records.

(B) Executive officers run a system that allows directors to access important information, such as information materials for the management meetings, decision-making documents, account books and records and business reports.

(3) Rules and other systems concerning risk management

(A) In accordance with the Basic Rules concerning Risk-Compliance Management, the Chief Risk-Compliance Management Officer (hereinafter referred to as the “**CRO**”) formulates and promotes measures concerning crisis and risk management in his/her capacity as the chairman of the Risk-Compliance Committee.

(B) In accordance with the Basic Rules concerning Business Risk Management, executive officers formulate and promote measures necessary for continuously clarifying business risk factors and minimizing loss in the event that risk is realized.

(4) System to ensure that executive officers efficiently execute their duties

(A) The Board of Directors determines the basic management policy and approves the medium-term business plan and annual budgets prepared by the executive officers.

(B) The Board of Directors delegates authority and responsibilities to executive officers in an appropriate manner and executive officers clarify the authority and responsibilities of the executive officers and employees in accordance with the Rules for Segregation of Duties and the Rules for Managerial Duties.

(C) Executive officers set concrete targets and roles of divisions and employees.

(D) Executive officers make decisions on business operations based on appropriate procedures in accordance with the Board of Directors Rules, the Corporate Authorization Standards, the Company Authorization Standards, and other rules.

(E) Executive officers follow up annual budget implementation and appropriately carry out performance evaluation by means of monthly meetings and the Performance Evaluation Committee.

(F) Executive officers promote strengthening of information security systems and operate the accounting system, the authorization system and other information processing systems in an appropriate manner.

(5) System to ensure that employees' performance of their duties conforms to laws and regulations and the Articles of Incorporation

(A) The President & CEO ensures, through continuous execution of employee education etc., that employees comply with the Toshiba Group Standards of Conduct clarifying values and codes of conduct to be shared by all officers and employees.

(B) The CRO formulates and promotes measures concerning compliance with laws and regulations in his/her capacity as the chairman of the Risk-Compliance Committee in accordance with the Basic Rules concerning Risk-Compliance Management.

(C) The executive officer in charge endeavors to detect problems early and deal with them in an appropriate manner by making use of the whistleblower system.

(6) System to ensure the appropriateness of business in a stock company (*kabushiki kaisha*) and corporate groups comprising a parent company and subsidiaries

(A) Toshiba requests its Subsidiaries to adopt and implement the Toshiba Group Standards of Conduct.

(B) Toshiba requests its Subsidiaries to report to Toshiba in accordance with the Principles of Business Communication in the event that material issues arise in their business operations.

(C) Toshiba formulates appropriate measures for internal controls, including that of its Subsidiaries, and requests its Subsidiaries to promote the measures according to their situations.

(D) Toshiba requests its Subsidiaries to establish audit systems in accordance with the Toshiba Group Auditors' Audit Policy.

(E) Toshiba executes management audits of its Subsidiaries as necessary.

(7) Matters concerning directors and employees to assist in the performance of duties by the Audit Committee

In order to assist the Audit Committee in the performance of its duties, Toshiba has established the Audit Committee Office, consisting of five or so members. No director is assigned to assist the Audit Committee in the performance of its duties.

(8) Matters concerning independence of directors and employees mentioned in the preceding paragraph from executive officers

Matters regarding the assignment of employees to the Audit Committee Office are discussed with the Audit Committee in advance.

(9) System for reporting by executive officers and employees to the Audit Committee and other systems concerning reporting to the Audit Committee

(A) Executive officers and employees make timely reports to the Audit Committee in accordance with the Rules concerning Reporting, etc. to the Audit Committee in the

event that any material issue arises that may affect operation and financial performance.

(B) The President & CEO provides members of the Audit Committee designated by the Audit Committee with opportunities to attend important meetings, including the Management Committee meetings.

(10) Other systems to ensure that audits by the Audit Committee are conducted effectively

(A) The President & CEO regularly exchanges information with the Audit Committee.

(B) Executive officers and employees report to the Audit Committee on the performance of their respective duties through regular Audit Committee interviews and routine interviews, etc.

(C) The General Manager of the Corporate Audit Division discusses the policy and the plan for internal audits at the beginning of each fiscal year with the Corporate Audit Committee in advance and makes timely reports on the internal audit results to the Audit Committee.

(D) The Audit Committee has accounting auditors provide explanations and reports concerning the accounting audit plan at the beginning of each fiscal year, the situation of accounting audits during each period, and the results of the accounting audits at the end of each fiscal year.

(E) The executive officer in charge provides explanations to the Audit Committee concerning the interim settlement of accounts and settlement of accounts at the end of fiscal year as well as quarterly settlement of accounts prior to the approval by the Board of Directors.

(F) The President & CEO informs the Audit Committee in advance and provides explanations concerning the assignment of the General Manager of the Corporate Audit Division, taking into consideration the independence of the General Manager of the Corporate Audit Division from other executive officers and divisions.

4. Risk management system

The Risk-Compliance Committee, a cross-departmental organization led by the CRO, works to help Toshiba prevent, respond to, and safeguard against the recurrence of projects that involve substantial risk. Toshiba's in-house Companies and Toshiba Group companies in Japan and abroad also conform to equivalent systems.

5. Corporate Audit Division audits and Audit Committee audits

The Corporate Audit Division, which serves as Toshiba's internal audit department, reports directly to the President. It carries out audits of the Company, Corporate Staff, Toshiba Group companies, etc. from the perspective of appropriate operational procedures, accountability of results, and legal compliance. The Corporate Audit Division holds advance discussions with the Audit Committee on the formulation of

each fiscal year's audit policy and audit plans. It also holds semimonthly liaison meetings with the Audit Committee for pre-audit discussions and to share audit information on the departments subject to audit. The Corporate Audit Division carries out audits on legal compliance regarding organizations, etc., to determine their compliance with various laws and regulations and manage legal compliance.

Operating on this foundation, the Audit Committee delegates to the Corporate Audit Division as a general rule on-site and detailed investigations into the maintenance and functional status of the internal control systems at Toshiba and Toshiba Group companies.

The results of audits by the Corporate Audit Division are compiled into reports and reported to the President. The Audit Committee receives reports of audit results each time and performs its own firsthand audits if the Audit Committee determines that it is necessary based on these reports.

The Audit Committee also has accounting auditors provide explanations concerning the audit plan at the beginning of each fiscal year, and requests further explanation and reports as needed on the situation of audits during each period and the results of audits and the end of each fiscal year.

The Toshiba internal regulations stipulate that the Audit Committee must receive reports detailing the maintenance and operating status of the internal control system (including internal control-related matters pertaining to financial reports).

6. Operation of internal control systems

Toshiba's systems of internal controls, explained above, have not always functioned as effectively as originally expected. Chapter 3 and the subsequent chapters provide a discussion of these problems.

IV. Overview of overall budget control

1. Process for formulating medium-term business plans and budgets

(1) Formulating medium-term business plans and budgets

The Strategic Planning Division and the Corporate Finance & Accounting Division consult with Corporate about the basic policies regarding management of Toshiba Group and the framework for business and management, hold a Kickoff Meeting around the end of December, and start work on formulating medium-term business plans and budgets. When putting together their medium-term plans and budgets, the Company adheres as closely as possible to the Corporate Finance & Accounting Division's "Guide" target values. (However, there have been periods where the Corporate Finance & Accounting Division did not directly specify Guide.)

(2) Submission and approval of medium-term business plans and budget outline proposals

After preparing medium-term business plans and budget outline proposals, the Company submits those items to the Strategic Planning Division and the Corporate Finance & Accounting Division. The Strategic Planning Division and the Corporate Finance & Accounting Division gather the medium-term plans and budget proposals that have been submitted and formulate a medium-term business plan for the subsequent three fiscal years and a budget outline proposal for the subsequent fiscal year at the top management budget review meeting held in early March. After the top management budget review meeting, the President responds to the budget proposals submitted by the Company with “Challenges” to improve the figures in the proposals. The Companies then revise the figures accordingly.

The formulated medium-term business plans and budget outline proposals are then decided upon at the Corporate mid-term plan and budget meeting and approved by the Board of Directors.

(3) Monthly performance reports

The Companies provide monthly reports to Corporate on budget execution status. The Companies collaborate with the relevant Corporate Staff to take any measures in each case, if it is necessary for budget completion. Section 2 below provides a detailed description of the specific process.

(4) Approval of financial reports

In-house Companies close accounts in accordance with the Accounting Manual and submit the corresponding financial reports to the Corporate Finance & Accounting Division.

The Corporate Finance & Accounting Division gathers the financial report proposals from the in-house Companies and prepares the financial statements. The financial statements are approved by the President in accordance with the Corporate Authorization Standards, and the Board of Directors then approves the financial statements through an audit by the accounting auditors and the Audit Committee.

2. Process for managing forecasts and actual performance

With regard to the management of forecasts and actual performance, every month, the Companies submit the actual performance results for the preceding month and the forecasts for the current month and subsequent six-month periods to the Corporate Finance & Accounting Division. The Corporate Finance & Accounting Division then compiles the actual performance results and forecasts and reports to the CFO, who then

reports to the P. Based on the Companies' actual performance results for the preceding month and forecasts for the current month, the Corporate Finance & Accounting Division submits proposals to the P about how to give performance improvement instructions (called "Challenges") to each Company. The P then determines the content of each Challenge. CPs report on their respective Companies' forecasts and performance results at CEO Monthly Meetings each month, where the P may issue Challenges to CPs as necessary.

V. Performance evaluations

The performance evaluation system involves evaluating and providing feedback on the results of the previous fiscal year's management activity at the beginning of the fiscal year in order to energize the organization, promote autonomous responsible management, and improve the corporate value of the Toshiba Group. The Company and the Company divisions³ are subject to performance evaluations.

The performance evaluation process involves calculating the evaluation points for each evaluation item, totaling the evaluation points, and then performing a quantitative evaluation to determine the rank. Then, qualitative evaluations are carried out based on the level of contribution of each management activity to the company and a final, comprehensive evaluation is compiled.

For the quantitative evaluation, Toshiba calculates evaluation points for each of the six evaluation items (Toshiba Group profit and loss, operating profit, net sales, interest-bearing debt, working capital income and expenditures, and number of days in inventory) by comparing the data with targets, budget, the previous fiscal year's data, etc., totals the evaluation points, and then categorizes the management activities into ten ranks (from S+ to D-).

The Performance Evaluation Committee reviews the performance evaluations from a company-wide perspective and then submits the results for discussion at the Corporate Management Meeting.⁴ After the Corporate Management Meeting has reviewed the results, the President makes the final decision on the performance evaluations. Performance evaluation results for the Company and the Company divisions are reflected in bonuses.

³ The three divisions overseeing the SIS Company's Railway & Automotive Systems Division are also subject to performance evaluations.

⁴ The Corporate Management Meeting, which formulates strategies, etc. and makes decisions on other CEO decision matters, meets on a weekly basis as a general rule.

Chapter 3. The Percentage-of-Completion Method

I. Overview of the percentage-of-completion method

1. Overview of accounting treatment under the percentage-of-completion method

The percentage-of-completion method refers to accounting treatment for contract work⁵ where the total income from contract work and total cost of contract work, along with the extent of contract progress as of the fiscal year end, are reasonably estimated, and the income from contract work and costs of contract work for the current fiscal period are recorded on that basis.

Specifically, where the cost-to-cost approach is applied when using the percentage-of-completion method,⁶ contract income and contract costs are calculated using the following formula.

Contract income and contract cost calculation using the cost-to-cost approach

- Contract income for the current period
= Estimated total income from contract work × Extent of contract progress as of fiscal year end (*)
- contract income recorded in prior periods related to that contract work
*Accumulated contract cost to-date / Total estimated cost of contract work

- Contract cost for the current period
= Accumulated total contract cost - Contract costs recorded in prior periods related to that contract work

To apply the percentage-of-completion method, it is required to be able to reliably estimate three elements, namely: “total income from contract work,” “total cost of contract work,” and “extent of contract progress as of the fiscal year end.”

If those three elements can be estimated reliably, the percentage-of-completion method must be applied. If a reliable estimate cannot be prepared, the completed contracts method⁷ must be applied.

⁵ Contract work refers to contracts on services related to civil engineering, architecture/building, ship building and some manufacturing of machinery, where payment is made upon completion of the work and where basic specifications and work details are conducted under direction of the client.

⁶ Toshiba uses the cost-to-cost approach for estimating contract progress. The cost-to-cost approach entails estimating contract progress by dividing the cumulative cost of contract work by the total estimated cost of contract work. Where contract progress as of the fiscal year end is assessed using the cost-to-cost approach, a timely and appropriate re-evaluation of the total cost of contract work through an analysis of budget vs. actual performance will normally ensure confidence in the contract progress estimate.

⁷ The completed contracts method refers to accounting treatment for a contract that recognizes the total income from contract work and total cost of contract work only upon the completion of such work and delivery of the subject item.

Further, where the “total cost of contract work” is likely to exceed the “total income from contract work,” and if those amounts can be reasonably estimated, that expected excess amount (“**Contract Loss**”) should be recorded as a provision for contract losses in the period in which the Contract Loss is identified. That treatment must be applied under both the percentage-of-completion method and the completed contracts method.

Provision for Contract Losses to be recorded

= Total estimated cost of contract work - Total estimated income from contract work - Recorded cumulative profit and loss for the current period

2. General risks associated with the percentage-of-completion method

As explained above, the application of the percentage-of-completion method requires an estimation of the “total income from contract work” and the “total cost of contract work” and the quantification of “incurred contract cost” on a quarterly basis. It should be noted that, while “total income from contract work” is an estimate, it is determined by negotiating with the customer, and contract cost is an accumulation of actual costs incurred, so generally there is a risk of misstatement associated with the “total estimated cost of contract work,” which is determined internally. Specifically, if the “total cost of contract work” is underestimated, the following misstatements will arise in accounting.

(1) Overstated sales

If the “total cost of contract work” at the end of a quarter is understated, the extent of work progress will be overstated, resulting in overstated sales.

(2) Understated or unrecorded provision for contract losses (provision for loss-making contracts)

For loss-making contract work, if the “total cost of contract work” at the end of a quarter is underestimated, the “provision for contract losses” (provision for loss-making contracts) will be understated or unrecorded.

(Table 1) Calculation example

	Total estimated income from contract work (1)	Total estimated cost of contract work (2)	Actual cost of contract work (3)	Extent of work progress (4) = (3) / (2)	Accrued sales (1) × (4)	Provision (2) – (1)
Reasonable estimate exists	100	120	60	50%	50	10 (Note 1)
Cost is underestimated		80		75%	75	0

(Note 1) Recorded only when (2) is greater than (1). Accrued profit and loss recorded for the current period (sales – cost of sales) is deducted.

(Table 2): Projects subject to the Investigation arranged by the above classifications

1	Project A	○	○
2	Project B	—Note 2	○
3	Project C	○	○
4	Project D	○	○
5	Project E	○	○
6	Project F	○	○
7	Project G	○	○
8	Project H	○	○
9	Project I	—Note 3	○
10	Project J	○	—Note 4
11	Project K	○	○
12	Project L	—Note 3	○
13	Project M	○	○
14	Project N	○	○
15	Project O	○	—Note 4
16	Project P	○	○
17	Project Q	○	○
18	Project R	○	○
19	Project S	—Note 3	○

(Note 2) There is no sales overstatement, as sales were not recorded in the first place.

(Note 3) There is no sales overstatement, as the percentage-of-completion method was not used in this project.

(Note 4) There is no provision understatement, as this is not a Loss-Making Project.

3. Important terminology used by Toshiba for the percentage-of-completion method

At Toshiba, the terms “SP” and “NET,” corresponding respectively to the accounting terms “total estimated income from contract work” and “total estimated cost of contract work,” are used internally (although the manner of their use is not necessarily uniform at the working level). These terms have the following meanings.

Term	Description
Total estimated income from contract work	<p>Definition: total estimated amount of consideration received by a contractor as set forth in a contract agreement</p> <p>With regard to an estimated value for accounting purposes, only the portion of the value that has been substantially agreed to with the customer can be considered (increases based on future negotiations cannot be included until there is a substantial agreement with the customer).</p>
SP	<p>This term is basically used as having the same meaning as “total estimated income from contract work,” but it is sometimes used inclusive of anticipated future additional consideration from the perspective of business management. Therefore, SP as used in this Report might refer to a figure inclusive of potential anticipated future additional consideration or an effective agreed amount applicable for accounting purposes.</p>
Total estimated cost of contract work	<p>Definition: an estimate of total costs incurred by a contractor to perform its obligations under a contract agreement</p>
NET	<p>NET refers to costs incurred from the perspective of Toshiba’s applicable sales department. To illustrate, if part of the work is outsourced to an internal Toshiba factory, the estimate from the factory is an internal transaction price that incorporates some profit for the factory, such that the NET figure is larger than the total estimated cost of contract work to the extent of factory profits. However, these terms might not be clearly differentiated within Toshiba and NET might be used to refer to the total estimated cost of contract work.</p> <p>When the applicable Toshiba sales department contemplates the acceptance of an order, the decision is made based on the amount of income earned by that sales department, or the difference between SP and NET. When recording the total estimated cost of contract work and provisions for contract losses for accounting purposes, an amount equivalent to those internal profits is eliminated.</p>

II. Scope of the Investigation

1. Subject period of the Investigation

The period subject to the Investigation is from FY 2009 to the third quarter of FY 2014. (However, FY 2008 is also included, as it represents a comparison year in the

2. Scope of and items subject to the Investigation

Based on “II. Delegated matters (scope of the Investigation),” “Chapter 1. Overview of the Investigation,” the main scope of the Investigation⁸ was transactions with respect to which accounting treatment was conducted by Toshiba and its consolidated Subsidiaries using the percentage-of-completion method. Based on its internal rules, Toshiba conducts accounting treatment using the completed contracts method for transactions with contract amounts that are below a certain level or where the construction periods are short,⁹ even if those transactions satisfy the requirements for applying the percentage-of-completion method, and therefore, as a general rule, those transactions are not included in the scope of the Investigation. In terms of time period, projects in which the percentage-of-completion method was used and that were ongoing as of the end of the third quarter of FY 2014 or that were completed during the period from FY 2009 to the end of the third quarter of FY 2014 were subject to the Investigation.

Further, the main scope of the Investigation was the reasonableness of the total estimated costs of contract work, in light of the fact that the materials received from the Special Investigation Committee identified underestimations of total estimated costs of contract work as problems in many of the projects acknowledged by the Special Investigation Committee in the course of its investigation to have been subject to inappropriate accounting treatment.

III. Investigation method and procedures

1. Basic policy of the Investigation method

The Committee carried out sampling and investigated the transactions described in “3. Transactions subject to the Investigation,” “II. Scope of the Investigation” in accordance with the method described below.

Given the generally high uncertainty of estimation for accounting purposes in the percentage-of-completion method as indicated in the Practical Guidelines No. 91 “Audit

⁸ According to the materials received from the Special Investigation Committee, projects acknowledged by the Special Investigation Committee in the course of its investigation to have been subject to inappropriate accounting treatment were added to the scope of the Investigation, even though they are not transactions in which the percentage-of-completion method was used.

⁹ The Power Systems Company and the SIS Company use the completed contracts method to process construction transactions that have a contract amount of JPY 1 billion or less, or a construction period of one year or less. The CS Company conducts the same accounting treatment with respect to projects that have a contract amount of JPY 500 million or less or a construction period of one year or less. Each subsidiary sets certain criteria including amounts and construction periods according to its size and other factors.

Treatment Related to the Application of the Percentage-of-Completion Method, Etc.” issued by the Audit and Assurance Practice Committee of the Japanese Institute of Certified Public Accountants and the fact that the materials received from the Special Investigation Committee identified underestimations of total estimated costs of contract work as problems in many of the projects acknowledged by the Special Investigation Committee in the course of its investigation to have been subject to inappropriate accounting treatment, the Committee focused mainly on determining whether there were any underestimations of total estimated cost of contract work and whether the recording of provisions for contract losses was appropriate in the sample investigation.

2. Sampling method

In light of the purpose of the Investigation, the Committee sampled transactions¹⁰ that satisfied any of the following requirements and were for amounts that exceeded a certain level.

(1) Projects recognized as having risks in the estimation of total costs of contract work for business management purpose

Generally, since the total estimated cost of contract work is usually checked and evaluated when an order is received or a bid is being considered or when it is recognized that costs might increase or there might be an impact on financial statements, the Committee analyzed the following materials and selected projects in which risks had been identified for business management purpose. In order to understand the additional risks recognized by the accounting auditor and the Corporate Audit Division, the Committee reviewed a number of documents, including management confirmation letters,¹¹ on-site audit result reports prepared by the accounting auditor, and audit reports from the Corporate Audit Division.

- Materials from Order Policy Meetings held at each Company regarding individual transactions
- Quarterly report materials from the Companies
- Various managerial documents from the Companies
- Meeting materials from CEO Monthly Meetings

¹⁰ Among those sampled projects, Loss-Making Projects were projects where it was expected that the final Contract Loss amount would be JPY 500 million or more and projects other than Loss-Making Projects were projects where it was expected that the amount of impact on profit and loss from underestimation of the total estimated cost of contract work would be JPY500 million or more.

¹¹ As a general rule, the Committee did not investigate matters that have been treated as uncorrected misstatements in accounting audits or quarterly reviews during the subject period of the Investigation because they have already been recognized by Ernst & Young ShinNihon and Toshiba.

(2) Projects in which risks were found in estimates of total estimated costs of contract work through analysis of accounting figures¹²

Since the underestimation of total costs of contract work, which was the main target of the Investigation, appears in accounting treatment in the form of (i) overstated sales or (ii) understated provisions for contract losses, the Committee conducted an accounting figure analysis and identified projects where signs of such overstatement or understatement were able to be inferred. Specifically, the Committee analyzed changes in the total estimated income from contract work/total estimated cost of contract work and the accounting figures of the subject transactions, and isolated projects that met the following requirements.

- Projects in which losses over a certain threshold were recorded in the latter half of the contract work period
- Projects in which unusual movement was observed in the total estimated cost of contract work

3. Investigation procedures

The Committee investigated, mainly by following the procedures set out below, the projects sampled by the method described above.

- Review of accounting data, profitability management data, evidence, etc. related to orders received
- Review of materials and minutes of various project review meetings, including Order Policy Meetings and cost management meetings
- Interviews with the Officers and Employees involved
- Digital forensics of PCs used for work by Officers and Employees

¹² The analysis of accounting figures was conducted mainly on Toshiba itself and Subsidiaries that routinely record sales of JPY 10.0 billion or more using the percentage-of-completion method or that have a project incurring loss of roughly JPY 500 million or more.

IV. Facts identified in the Investigation

1. Total adjustment amounts

List of total adjustment amounts

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Power Systems Company							
Sales Adjustment	(40)	2	51	0	(0)	(11)	7
Gross Profit Adjustment	(36)	12	60	(21)	(5)	(24)	17
SIS Company							
Sales Adjustment	-	-	-	-	-	(55)	(12)
Gross Profit Adjustment	-	-	-	(57)	(8)	(243)	32
CS Company							
Sales Adjustment	-	-	-	(2)	(30)	(7)	(19)
Gross Profit Adjustment	-	-	-	(0)	(156)	12	(19)
Other Projects							
Sales Adjustment	-	(2)	2	-	-	-	(13)
Gross Profit Adjustment	-	(11)	11	-	(10)	10	(40)
Total							
Sales Adjustment	(40)	(0)	53	(2)	(30)	(73)	(37)
Gross Profit Adjustment	(36)	1	71	(79)	(180)	(245)	(9)

2. Power Systems Company

(1) Overview of the Power Systems Company

The Power Systems Company mainly focuses on supplying power generation systems such as nuclear and thermal power generation systems. The following is an overview of the Power Systems Company.

(A) Divisions, etc. in the Company

The Power Systems Company consists of the Nuclear Energy Systems & Services Division and the Thermal & Hydro Power Systems & Services Division as well as multiple plants and other organizations.¹³

The operations of the Nuclear Energy Systems & Services Division include designing and constructing facilities such as nuclear power plants, fast reactors, and reprocessing plants, conducting periodic inspections and reconstruction work of existing plants, and developing applied products such as heavy-ion irradiation systems, nuclear fusion, and high-temperature superconductors.

The operations of the Thermal & Hydro Power Systems & Services Division include manufacturing and selling facilities such as steam turbines, turbine generators, water turbines, water turbine generators, power generation monitoring and control systems, wind turbine generators, and geothermal power generators, and constructing thermal and hydro power plants.

(B) Budget preparation and control

At the Power Systems Company, a three-year medium-term business plan is prepared each year, the part of which regarding the first year constitutes the budget for the following fiscal year. The medium-term business plan is prepared in accordance with the following process.

Each division and other organization prepares business strategies and figure plans for a three-year medium-term plan based on the “Medium-Term Plan Basic Policy” presented by Corporate every December, and reports those to the Company Medium-Term Plan Examination Committee the following January. The Power Systems Company compiles the medium-term business plans submitted by each division and other organization and submits that collated plan to Corporate at the end of January. Based on this, Corporate and the Power Systems Company discuss concrete measures in February, and the Power Systems Company’s medium-term plan is finalized in March based on those discussions.

The Power Systems Company reports as follows to Corporate each month on the status of achieving the budget prepared through the above process.

The Power Systems Company reports to the Corporate Finance & Accounting Division at the beginning of each month on the actual performance for the previous month. After the Power Systems Company receives reports from each division on matters such as an overview of that division’s business and a forecast for the current period, it examines those reports at internal meetings called monthly forecast meetings in the Power Systems Company in around the middle of each month, and the Power Systems Company reports monthly forecasts to the Corporate Finance & Accounting Division based on the results of that examination. Those reports are delivered to the

¹³ The Fuel Cells Business Promotion Department, the Power and Industrial Systems Research and Development Center, the Keihin Product Operations, the Fuchu Operations – Power Systems, etc.

President of Corporate at CEO Monthly Meetings held during the last ten days of each month. (The meetings held each January and July are referred to as “quarterly reporting meetings,” and the status of achieving quarterly budgets and forecasts for the fiscal year are reported and considered at those meetings.)

Further, the Power Systems Company has meetings with the GCEO to confirm in advance the matters that will be explained at each CEO Monthly Meeting, and it also has meetings with the GCEO to confirm afterwards and consider the matters raised at each CEO Monthly Meeting.

If it is necessary to subsequently communicate and consider the matters raised at a CEO Monthly Meeting, a meeting for receiving feedback might be held in the Power Systems Company after that CEO Monthly Meeting for the CP, the Vice President, the General Manager of the Business Strategy & Planning Division, the General Manager of the Accounting Division, and others to attend.

Meetings referred to as “position evaluation meetings” are held in the Power Systems Company around the same time as the CEO Monthly Meetings in the last month of each quarter (June, September, December and March) after the financial forecasts have been submitted, and the forecasts for the current period are reported by each division and matters such as whether there are deviations from the forecasts are considered at those meetings.

(C) Internal control for financial reporting in the Power Systems Company and other matters

The internal control described below has been implemented in the Power Systems Company with respect to the receipt of orders, the treatment of projects in which the percentage-of-completion method is used, and handling Loss-Making Projects.

(a) Approval of the receipt of project orders

a. Approval of the receipt of orders at the Nuclear Energy Systems & Services Division

At the Nuclear Energy Systems & Services Division of the Power Systems Company, the CP has authority to approve whether to receive orders of projects where the amount is JPY 5.0 billion or more per project and where the Vice President of the Nuclear Energy Systems & Services Division judges it is likely that that project will have a significant impact on the management of the Power Systems Company (the “**CP Approval Project**”) and the Vice President has authority to approve all other projects.

The CP Approval Project is referred to an Order Policy Meeting within the Power Systems Company (the “**Power Systems Company Order Policy Meeting**”) for approval before the order receipt. The Power Systems Company Order Policy Meetings are attended by the CP, the EVP, the Managing Director, the Vice President of the Nuclear Energy Systems & Services Division, the General Manager of the Legal Division, the General Manager of the HR & Administration Division, the General Manager of the

Accounting Division, the General Manager of the Technology Strategy & Administration Division, the General Manager of the Production Planning Division, the General Manager of the Procurement Planning Division, the General Manager of the Business Strategy & Planning Division, and any other person whose attendance is considered necessary by the CP, and the planning department or sales department of the Nuclear Energy Systems & Services Division acts as the secretariat of those meetings.

On the other hand, a project that the Vice President of the Nuclear Energy Systems & Services Division has authority to approve will be referred to an Order Policy Meeting within the Nuclear Energy Systems & Services Division (the “**Nuclear Energy Systems & Services Order Policy Meeting**”) for approval before the order receipt if the Vice President of the Nuclear Energy Systems & Services Division judges it to be necessary. The Nuclear Energy Systems & Services Order Policy Meetings are to be attended by (i) the Vice President as the chairperson, (ii) the Manager of the General Planning Department as the organizer, (iii) the Senior Manager of the Marketing & Sales Department as the presenter, and any other member of a related department or staff department whose attendance is considered necessary by the Vice President or the Senior Manager of the sales department.

b. Approval of the receipt of orders at the Thermal & Hydro Power Systems & Services Division

Similarly, at the Thermal & Hydro Power Systems & Services Division of the Power Systems Company, the CP has authority to approve whether to receive orders of projects where the amount is JPY 5.0 billion or more per project and where the Vice President of the Thermal & Hydro Power Systems & Services Division judges it is likely that that project will have a significant impact on the management of the Power Systems Company (the “**CP Approval Project**”); and the Vice President, the General Manager of the Marketing Division or the Senior Manager of sales department has authority to approve all other projects.

The Vice President of the Thermal & Hydro Power Systems & Services Division has authority to approve projects where the order amount is JPY 1.0 billion or more and less than JPY 5.0 billion per project, and in principle those projects are referred to Order Policy Meetings within the Thermal & Hydro Power Systems & Services Division (the “**Thermal & Hydro Power Systems & Services Division Order Policy Meeting**”).

The Senior Manager of sales department has authority to approve projects where the order amount is less than JPY 1.0 billion per project. Further, if a General Manager of the Marketing Division has been appointed, he or she will have authority to approve projects where the order amount is JPY 1.0 billion or more and less than JPY 3.0 billion per project. If the Senior Manager of sales department or the General Manager of the Marketing Division judges that a project that he or she has authority to approve is likely to significantly impact the management of the Thermal & Hydro Power Systems & Services Division, that project will be referred to a Thermal & Hydro Power Systems & Services Division Order Policy Meeting.

The following members attend Thermal & Hydro Power Systems & Services Division Order Policy Meetings and discuss matters: (i) the Vice President as the chairperson and

(ii) the BU Director, the Thermal & Hydro Power Plant Engineering Technology Executive, the Thermal & Hydro Power Technology Executive, and the General Manager of the Business Planning Division as the presenters, and when necessary other related persons.

(b) Handling projects in which the percentage-of-completion method is used

a. Applicable requirements for the percentage-of-completion method

Toshiba treats the following projects as projects in which the percentage-of-completion method is used if they fulfill the requirement that the total estimated income from contract work, the total estimated cost of contract work, and the extent of contract progress as of the fiscal year-end are capable of being reliably estimated.

- Long-term contracted construction where the total estimated income from contract work is JPY 1.0 billion or more and the contract work period is one year or more

- Of contracted construction where the total estimated income from contract work is JPY 1.0 billion or more and the contract work period is for three months or more and less than one year, those for which the subject item is not delivered during the fiscal year in which the construction work starts

Even if the total estimated income from contract work is less than JPY 1.0 billion, the percentage-of-completion method can be used if the outcome of the construction activity is considered reliable.

b. Internal control for financial reporting on projects in which the percentage-of-completion method is used

At the Power Systems Company, internal control over financial reporting of projects in which the percentage-of-completion method is used is implemented through the following six work processes. Although most staff members of the divisions and departments related to those processes understood the following processes, it cannot be necessarily said that the Power Systems Company has thoroughly informed all staff members that they are required to comply with those work processes.

Note that the term “planning department” in the following processes and the processes described in (c) “Handling of Loss-Making Projects” indicates the planning department in each division rather than the Business Strategy & Planning Division of the Company, and this corresponds to the “General Planning Department” in the Nuclear Energy Systems & Services Division.

(a) Registration as a project subject to the percentage-of-completion method

- Personnel at the sales department, administration department, or planning department decide on whether a project is subject to sales that are to be recorded using the percentage-of-completion method based on project number data, etc. and register

that project in the system, and then that person's superior at the sales department, Plant Business Management Department, or planning department confirms that that is a project in which the percentage-of-completion method should be used based on materials that are the basis for the SP and the contract work period and gives approval for that project.

- When an attempt is made to issue a number for a project where the SP is JPY 1.0 billion or more, a confirmation message is displayed indicating whether that is a project in which the percentage-of-completion method should be used.

(b) Calculation of estimated costs

- Personnel at the administration department or personnel at the engineering department calculate estimated costs based on a request from the sales department, determine the delivery date, and prepare an estimate cost sheet. The operations accounting department, a superior at the administration department, or a superior at the engineering department examines the contents of that estimate cost sheet closely and approves that form based on documentary evidence. The approved estimate cost sheet is circulated to the sales department.

- Personnel at the administration department or personnel at the sales department prepares direct selling cost estimates, and the superior at the administration department or superior at the sales department examines the direct selling cost estimates closely and approves that estimate based on documentary evidence.

- A superior at the administration department or a superior at the sales department confirms that the NET and direct selling cost entered in the system are consistent with the amount in the above estimate cost sheet and the above direct selling cost estimate, and then approves those amounts.

- Personnel at the administration department or personnel at the sales department confirm with operations, the engineering departments, or the procurement departments every month or every quarter on whether there has been any change in the estimated costs, and when the estimate costs need to be changed after that confirmation, the NET is changed on the system. A superior at the administration department or a superior at the sales department confirms that the NET or the sales expenses that has been changed and entered in the system is consistent with the amounts in that documentary evidence, and then approves that changed NET and or sales expenses.

Also, if the terms of a contract are amended, a change to the NET and the SP is performed in the same manner.

(c) Calculation of the amount of sales to be recorded based on the percentage-of-completion method

- Toshiba's percentage-of-completion method system has a framework in which the amount of sales to be recorded and the amount of sales costs to be recorded are automatically calculated based on the percentage-of-completion method.

(d) Verification of the amount of sales to be recorded based on the

percentage-of-completion method

- Personnel at the planning department and personnel at the accounting department verify the consistency of the original data (contract amounts, cumulative injection amounts, and estimated total costs) used in calculations made using the percentage-of-completion method.

(e) Recording of sales

- Toshiba's percentage-of-completion method system automatically journalizes entries and records sales.

(f) Reversing entries of recorded sales

- Upon the completion of construction, sales are recorded on the system as the total contract amount, so to prevent double entries of sales, sales recorded using the percentage-of-completion method are reversed through the following process.

- When sales are recoded on the system as the total contract amount, the data is automatically linked with the percentage-of-completion method system and reversal entries of sales and sales costs are recorded using an automatic link (monthly) of the percentage-of-completion method system to the general account.

(c) Handling Loss-Making Projects

At Toshiba, regardless of whether the percentage-of-completion method is applied, the expected losses from the next period are to be recorded as "provisions for contract losses for orders received" in accordance with the following flow with respect to projects where (i) it is expected that losses of JPY 200 million or more will arise at the end of the current period and (ii) the amount of those losses can be reasonably estimated.

According to the Rules for Action on J-SOX¹⁴ provided as internal control pertaining to financial reporting in the Power Systems Company, Loss-Making Projects are to be handled through the following process:

- (i) Identifying Loss-Making Projects
- (ii) Recording provisions for contract losses for each quarter
- (iii) Reversing provisions for contract losses for the previous quarter

Of the above, the process of internal control of (i) and (ii) pertaining to financial reporting related to the handling of Loss-Making Projects is as follows. (Note that the process of (iii) is a formal process to prevent a provision for contract losses being

¹⁴ This is a general term for the assessment documents prepared based on Article 5 of the Detailed Rules for Action on J-SOX (last amended May 16, 2010) whose purpose is to assess the effectiveness of internal control pertaining to financial reporting.

recorded twice in a particular quarter and the previous quarter.)

a. Identifying Loss-Making Projects

At the Power Systems Company, identifying Loss-Making Projects is conducted by preparing a “Schedule for Provision for Contract Losses for Orders Received” through the following work process as internal control pertaining to financial reporting.

(a) Personnel at the sales department or the administration department receive answer forms regarding actual estimated costs from the engineering department or operations when a large amount of loss is anticipated, and if, after confirming related documents such as order forms, the above answer forms, and direct selling cost estimates, the amount of losses will be JPY 200 million or more, those personnel will forward those related documents to their superiors at their relevant departments.

(b) The superiors at the sales department or the administration department will confirm the amount of losses based on those related documents, affix a seal of approval to each document, obtain the approval of the planning department, and send those documents to personnel at the Accounting Division.

(c) Personnel at the Accounting Division prepare a “Schedule for Provision for Contract Losses for Orders Received” based on communications from personnel at the planning department, and a superior at the Accounting Division will examine the schedule closely including each related document and then affix a seal of approval to the “Schedule for Provision for Contract Losses for Orders Received.”

* To ensure that no Loss-Making Projects are omitted when identifying Loss-Making Projects, personnel at the planning department send to the sales department or the administration department each quarter a confirmation list of Loss-Making Projects that lists projects where the contract amount is JPY 1.0 billion or more and the amount of losses is JPY 100 million or more from the list of backlog orders on the system, and will request that the sales department or the administration department confirms that list. In addition, personnel at the planning department will request personnel at the Accounting Division to prepare the latest “Schedule for Provision for Contract Losses for Orders Received” at the end of each quarter with respect to projects in which a provision for contract losses was recorded based on the above procedures for identifying Loss-Making Projects.

b. Recording provisions for contract losses for each quarter

At the Power Systems Company, provisions for contract losses for each quarter are recorded using the “Schedule for Provision for Contract Losses for Orders Received” and it is expected that provisions for contract losses for each quarter will be recorded by going through processes for identifying Loss-Making Projects described in a. above.

(d) De facto rules at the Power Systems Company

At the Power Systems Company, rules were used that were different from the rules for matters such as the handling of Loss-Making Projects in relation to provisions for contract losses described above.

Specifically, according to the Rules for Action on J-SOX, it is not necessary to report to or obtain a decision or approval from the Vice President and the CP in the recording of provisions for contract losses and procedures for registering in the system total estimated costs of contract work, which support the necessity for recording the provisions.

However, as a de facto rule, it was the practice that provisions for contract losses cannot be recorded without the approval of the CP except for the recording of small provisions, and it was also the practice that it was necessary to obtain such approval even to change the total estimated cost of contract work, which supports the necessity for recording such provisions for contract losses.

(e) Business and responsibilities of the Accounting Division

At the Power Systems Company, the Accounting Division is to attend the Power Systems Company Order Policy Meetings for the CP Approval Projects, and is also responsible for:

- Managing and assisting with accounting matters in specific projects
- Accounting matters in decision-making within the Company
- Matters related to documentation, evaluation, and auditing related to internal control in accounting
- Preparing rules for accounting matters
- Promoting and supporting training and education related to accounting matters
- Managing and training related to recording profits, recording expenses, and calculating manufacturing and sales costs

That is to say, it was expected that the Accounting Division will create a system in which the accounting treatment of the Power Systems Company is conducted appropriately and play a role in managing that system.

(2) Project A

(A) Outline of Project A

This is a project in which the Power Systems Company received an order from Local Government A in January 2012 with a contract amount of JPY 7.1 billion to manufacture system equipment with an (initial) delivery date of March 2016.

(B) Accounting treatment in question and appropriateness thereof

At the Power Systems Company Order Policy Meeting on October 24, 2011, the

Total Amount of the NET pertaining to Project A was JPY 9.0 billion, but in order to win the bid, which was necessary in terms of business strategy to establish a past record in order to increase sales in these types of projects in the future, the Power Systems Company set the NET challenge value at JPY 7.0 billion in light of the competition situation and decided on a bid price of JPY 7.1 billion. For starters, the NET estimate of JPY 7.0 billion included unsubstantiated cost reductions measures because that was based on an assumption that future cost reduction negotiations, etc. would succeed, but the Power Systems Company did not record a provision for contract losses at the outset of the contract.

Further, on August 12, 2013, it was reported that the NET estimate was JPY 8.8 billion, but in September 2013, the NET was registered at JPY 7.1 billion, which was the same amount as the SP, and the recording of sales under the percentage-of-completion method commenced. However, there was no specific estimate that supported a NET of JPY 7.1 billion, which was registered, and further, even though it was reported in March 2014 that the NET estimate is JPY 8.9 billion, the total estimated cost of contract work was not changed, and following that, an increase in the NET was recognized and a provision for contract losses was recorded for the first time in December 2014.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	71	71
Total estimated cost of contract work	-	-	-	-	-	69	78
Net profit and loss	-	-	-	-	-	2	(7)
FY profit and loss							
Sales	-	-	-	-	-	41	15
Gross profit	-	-	-	-	-	1	(8)
Cumulative profit							
Sales	-	-	-	-	-	41	56
Gross profit	-	-	-	-	-	1	(7)

While the Power Systems Company did not record a provision for contract losses in January 2012 at the time of the order receipt, it should have recorded a provision for

contract losses for the reasonable amount exceeding the total estimated cost of contract work over the contract amount (total estimated income from the contract work) at the time of the order receipt. With that correction, the total estimated cost of contract work for the fourth quarter of FY 2011 would be JPY 9.0 billion, and the amount of impact on profit and loss would be negative JPY 1.9 billion.

Also, after the second quarter of FY 2013, the total estimated cost of the contract work should have been revised in a timely manner, with the resultant provision for contract losses likewise recorded based on the revised total estimated cost of the contract work.

Furthermore, profit and loss resulting from the application of the percentage-of-completion method from the second quarter of FY 2013 should have been recorded based on a regularly revised total estimated cost of contract work.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	71	71	71	71
Total estimated cost of contract work	-	-	-	90	90	88	88
Net profit and loss	-	-	-	(19)	(19)	(17)	(17)
FY profit and loss							
Sales	-	-	-	-	-	32	17
Gross profit	-	-	-	(19)	-	2	(0)
Cumulative profit							
Sales	-	-	-	-	-	32	49
Gross profit	-	-	-	(19)	(19)	(17)	(17)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated	-	-	-	71	71	-	-

income from contract work							
Total estimated cost of contract work	-	-	-	90	90	18	10
Net profit and loss	-	-	-	(19)	(19)	(18)	(10)
FY profit and loss							
Sales	-	-	-	-	-	(9)	2
Gross profit	-	-	-	(19)	-	1	8
Cumulative profit							
Sales	-	-	-	-	-	(9)	(6)
Gross profit	-	-	-	(19)	(19)	(18)	(10)

(C) Facts identified by the Independent Investigation Committee

(a) Circumstances leading to receipt of order

a. Details of Power Systems Company Order Policy Meetings and determination of bid prices

As Project A constituted a CP Approval Project, the first Power System Company Order Policy Meeting was held on October 19, 2011. At that meeting, the Nuclear Energy Systems & Services Division reported to Yasuharu Igarashi CP that, as the estimate of the NET for Project A, the Total Amount is JPY 9.0 billion, the current commitment amount with the expected effect of the cost reduction measures deducted from the Total Amount was JPY 8.0 billion, and the challenge value, which was the NET that the Company should aim at as a final goal, is JPY 7.5 billion, and it also proposed a bid price of JPY 8.0 billion in light of those figures. However, Yasuharu Igarashi CP attempted to further reduce costs and instructed the Nuclear Energy Systems & Services Division to review the NET estimate again.

The second Power Systems Company Order Policy Meeting was held on October 21 and the Nuclear Energy Systems & Services Division reported to Yasuharu Igarashi CP that the current commitment amount was JPY 7.9 billion and the challenge value was JPY 7.4 billion, and it proposed a bid price of JPY 8.0 billion.

Further, the third Power Systems Company Order Policy Meeting was held on October 24 and the Nuclear Energy Systems & Services Division reported to Yasuharu Igarashi CP that the current commitment amount would remain JPY 7.9 billion and the Challenge amount would be changed to JPY 7.0 billion as the estimated total NET, and it proposed a bid price of JPY 7.0 billion. After receiving that proposal, Yasuharu

Igarashi CP decided to make a bid at JPY 7.1 billion and he instructed the Nuclear Energy Systems & Services Division to execute that decision. Hence, although the Total Amount of the NET was set at JPY 9.0 billion at the Power Systems Company Order Policy Meetings, Yasuharu Igarashi CP gave an instruction to lower the NET amount by reviewing the estimate and decided to make a bid at JPY 7.1 billion, which was significantly lower than the Total Amount of JPY 9.0 billion, and the background leading to that is that while manufacturing of system equipment was a new business and sales were expected to increase in the future, at that time Toshiba had repeatedly failed to receive orders for those types of projects and it needed to somehow receive an order for Project A to expand the business in the future.

b. Receipt of the order

On December 24, 2011, the Power Systems Company made a bid for Project A at a bid price of JPY 7.1 billion and won that bid, and on January 17, 2012 it received an order for the manufacturing system equipment from Local Government A.

c. Failure to record a provision for contract losses upon the order receipt (fourth quarter of FY 2011)

In the fourth quarter of FY 2011, with respect to Project A, no procedures were taken to identify Loss-Making Projects in connection with the recording of provisions for contract losses, and no provisions for contract losses were recorded.

(b) Circumstances up to the third quarter of FY 2013

A meeting referred to as a “steering meeting” was held on July 4, 2013 for the Vice President, Technology Executives and others to discuss matters such as cost reduction measures. At that meeting, the project department that was the sales department reported that the estimated NET was JPY 8.4 billion. In response, Vice President A1 of the Nuclear Energy Systems & Services Division gave an instruction for the NET to be JPY 6.9 billion or less through CD.

Further, at the steering meeting held on August 12, 2013, the project department reported that there were some omission in the NET estimate previously reported and the estimate of the NET after adding those amounts came to JPY 8.8 billion. In response, Technology Executive A said that it was not possible to change the target to a NET of JPY 6.9 billion without the approval of the Vice President.

Then, at the steering meeting held on August 23, 2013, there was a report from the project department that the NET estimate could be reduced to JPY 7.1 billion. It was therefore determined at that meeting that the recording of sales under the percentage-of-completion method as a NET of JPY 7.1 billion should commence.

In response to that decision, the recording of sales under the percentage-of-completion method commenced on September 26, 2013 with JPY 7.1 billion as the NET on the system.

As the SP of Project A was JPY 7.1 billion, which was the same amount as the NET on the internal system, procedures to identify Loss-Making Projects did not commence

even in the second quarter or the third quarter of FY 2013 and a provision for contract losses was not recorded.

(c) Circumstances during the fourth quarter of FY 2013

At the steering meeting held on January 24, 2014, the project department reported that based on current projections the estimate of the NET of Project A would be JPY 9.2 billion, and it was proposed that contract losses of approximately JPY 2.0 billion be recorded for Project A based on that figure. However, Vice President A2, who had become Vice President of the Nuclear Energy Systems & Services Division that month, gave approval for a revision of the estimate of the NET (which would result in a loss), but did not give approval for the amount of JPY 9.2 billion as the estimate of the NET or the amount of approximately JPY 2.0 billion as the contract losses, and he instructed the project department to reconsider whether a further cost reduction was possible.

In response to that instruction, the project department reported at the steering meeting held on February 24, 2014 that the projected losses would be approximately JPY 1.7 billion because it was expected that cost reduction measures would be taken for the NET (the corresponding total estimated cost of contract work would amount to JPY 8.8 billion).

In response to that report, Vice President A2 reported to Yasuharu Igarashi CP in March 2014 that losses of up to approximately JPY 1.7 billion would arise for Project A if the NET estimate is revised, but Yasuharu Igarashi CP gave an instruction to further improve profits because efforts to reduce costs had been insufficient. That instruction was conveyed by Vice President A2 to personnel at the project department.

At the subsequent steering meeting held on March 24, 2014, the NET estimate reported by the project department was JPY 8.9 billion (the corresponding total estimated cost of contract work was JPY 8.8 billion), and that still exceeded the total estimated income from contract work of JPY 7.1 billion.

However, personnel at the project department and the Plant Business Management Department did not commence the procedures to revise the NET on the internal system and identify Loss-Making Projects at the end of the fourth quarter of FY 2013, nor did they record any contract losses.

(D) Causes of inappropriate accounting treatment

(a) Direct causes of inappropriate accounting treatment

a. Company

It can be surmised that the causes of the failure to commence procedures to identify Loss-Making Projects and the failure to record provisions for contract losses from the outset of the order to the third quarter of FY 2014 are as described below.

Although, at the Power Systems Company, it is expected under the Rules for Action on J-SOX that recording of provisions for contract losses is expected to be carried out by personnel at the sales department or the administration department (for Project A, the

project department and the Plant Business Management Department) by commencing procedures to identify Loss-Making Projects described above, as explained above, it was in fact the practice that without the approval of the CP, it was not possible to record provisions for contract losses or to revise the total estimated cost of contract work (NET registered on the internal system), which supports the necessity for recording provisions for contract losses.

Further, Yasuharu Igarashi CP believed that provisions for contract losses should be recorded when it became clear that losses would definitely arise and it was never acceptable to record provisions for contract losses before it becomes clear that losses will definitely arise because that would weaken motivation for cost reductions in the division and would deteriorate earnings, and he had previously clarified such belief. It can therefore be surmised that personnel at the project department and the Plant Business Management Department did not commence procedures to identify Loss-Making Projects, which would have led to recording the provisions for contract losses, because they thought Yasuharu Igarashi CP would not approve the recording of provisions for contract losses as it had not become clear that losses would definitely arise.

It can also be recognized that Yasuharu Igarashi CP did not encourage those personnel to record provisions for contract losses from the outset of the contract because of his belief described above, but even in the fourth quarter of FY 2013 when several years had passed since the receipt of the order and there would be little or no possibility of cost reductions, he still took a strict attitude towards the recording of losses. Considering the background facts that in FY 2013 the Power Systems Company's business was worsening (the budget for the operating profit of the Power Systems Company in FY 2013 was JPY 73.1 billion, but in the end the actual operating profit was only JPY 5.8 billion), that Hisao Tanaka P at that time applied pressure at a CEO Monthly Meeting for a "Challenge" to the Power Systems Company of making it absolutely certain that the budget is achieved and that at the same time Hisao Tanaka P asked Yasuharu Igarashi CP about the deterioration of the business of the Power Systems Company, there is a considerable degree of possibility that Yasuharu Igarashi CP intended to somehow avoid recording losses at that time.

Further, with respect to the second quarter of FY 2014 and thereafter, Mr. Shigenori Shiga was appointed CP and he showed an attitude that he approved recording necessary provisions for contract losses even before it became clear that losses would definitely arise. However, it can be presumed that personnel at the project department did not request approval for the recording of provisions for contract losses because they were afraid that that would adversely affect the profit and loss of the Nuclear Energy Systems & Services Division as a whole.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(b) Problems in internal control

In addition to the causes set out in (a) above, the following can be listed as indirect

causes for the inappropriate accounting treatment in Project A.

a. Internal control in the Company

The Accounting Division of the Company was expected to have a monitoring function to ensure appropriate accounting treatment, and that division played a role in internal control. The General Manager of the Accounting Division of the Company was an attending member of the Power Systems Company Order Policy Meetings, and it can be believed that was for the purpose of securing the appropriateness of accounting treatment with respect to important CP Approval Projects. However, although the reason is unknown, the General Manager of the Accounting Division did not actually attend any Power Systems Company Order Policy Meetings for Project A, and it is likely that the Accounting Division was not aware that Project A was a Loss-Making Project. As a result, the Accounting Division did not fulfill its role of securing the appropriateness of accounting treatment upon receipt of order for the project.

In addition, under both the Rules for Action on J-SOX and the de facto rules described above, the Accounting Division was not supposed to be involved in recognizing contract losses when calculating total estimated costs of contract work or commencing procedures to identify Loss-Making Projects (the Accounting Division only responded if there was separate consultation and considered matters itself if there was a clear inconsistency or abnormality in contents directly linked to accounting treatment).

Therefore, internal control by the Accounting Division was not functioning sufficiently with respect to Project A.

b. Auditing by the Corporate Audit Division

Although the Corporate Audit Division conducted an audit of the Nuclear Energy Systems & Services Division in September 2012, it was pointed out in the audit report pertaining to that audit that with respect to Project A “profits will not be generated with the current NET estimate of JPY 6.85 billion (commitment amount of JPY 6.9 billion and gross profit of JPY 250 million) in contrast to the SP of JPY 7.1 billion, so further CR¹⁵ will be required in the future.” Given that, it is likely that the Corporate Audit Division was not aware that Project A was a Loss-Making Project.

However, if the Corporate Audit Division had conducted an appropriate audit by, for example, reviewing materials from the three Power Systems Company Order Policy Meetings held in October 2011, it would have been able to recognize that the NET estimate for Project A would exceed the SP, so it can be considered that internal control by the Corporate Audit Division was not functioning sufficiently.

c. Other

No facts were found indicating that the Audit Committee or the accounting auditor

¹⁵ This means cost reduction, and has the same meaning as CD, the same hereinafter in this chapter.

pointed out any issue regarding Project A.

(3) Project B

(A) Outline of Project B

This is a project in which the Power Systems Company received an order from National Research and Development Corporation B in May 2013 with a contract amount of JPY 2.1 billion for an entire project of detailed design and production of system equipment to be installed in that research institute with an (initial) delivery date of March 2015.

(B) Accounting treatment in question and appropriateness thereof

In Project B, the total amount of the NET was estimated at JPY 3.4 billion at the Power Systems Company Order Policy Meeting held on April 23, 2013, but the Power Systems Company decided to make a bid for JPY 2.2 billion because that was necessary in terms of business strategy, and ultimately it received an order for JPY 2.1 billion (the amount of the order was changed under an additional contract to JPY 2.2 billion in the fourth quarter of FY 2013). Therefore, Contract Loss was expected from the outset of the order, but the Power Systems Company did not record a provision for contract losses at that time or thereafter in the following quarters.

Further, even though it was possible in Project B to produce a reliable estimate of the total estimated cost of contract work at the outset of the order and the requirements to apply the percentage-of-completion method had been satisfied, the Power Systems Company did not commence recording sales using the percentage-of-completion method.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	-	-	-	-	-	-
Net profit and loss	-	-	-	-	-	-	-
FY profit and loss	-	-	-	-	-	-	-
Sales	-	-	-	-	-	-	-

Gross profit	-	-	-	-	-	-	-
Cumulative profit	-	-	-	-	-	-	-
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	-	-	-

The Power Systems Company should have recorded a provision for contract losses (JPY 1.3 billion) for the amount exceeding the total estimated cost of contract work over the total estimated income from contract work for the first quarter of FY 2013 upon receiving the order for Project B. Also, the Power Systems Company should have commenced recording sales using the percentage-of-completion method from the first quarter of FY 2013, when it received the order for this project.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	22	22
Total estimated cost of contract work	-	-	-	-	-	34	34
Net profit and loss	-	-	-	-	-	(12)	(12)
FY profit and loss							
Sales	-	-	-	-	-	4	8
Gross profit	-	-	-	-	-	(12)	0
Cumulative profit							
Sales	-	-	-	-	-	4	12
Gross profit	-	-	-	-	-	(12)	(12)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
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Total estimated income from contract work	-	-	-	-	-	22	22
Total estimated cost of contract work	-	-	-	-	-	34	34
Net profit and loss	-	-	-	-	-	(12)	(12)
FY profit and loss							
Sales	-	-	-	-	-	4	8
Gross profit	-	-	-	-	-	(12)	0
Cumulative profit							
Sales	-	-	-	-	-	4	12
Gross profit	-	-	-	-	-	(12)	(12)

(C) Facts identified by the Independent Investigation Committee

(a) Background to receipt of the order

a. Details of the Nuclear Energy Systems & Services Order Policy Meetings and determination of bid prices

Project B is a project that the Vice President of the Nuclear Energy Systems & Services Division has authority to approve, and based on the fact that the Vice President of the Nuclear Energy Systems & Services Division judged that it was necessary, two Nuclear Energy Systems & Services Order Policy Meetings were held on April 19 and April 23, 2013, and the Vice President B of the Nuclear Energy Systems & Services Division and other related people attended those meetings and the bid price and the NET were discussed.

At those Nuclear Energy Systems & Services Order Policy Meetings, with respect to Project B, the expected bid price was set at JPY 2.2 billion, but the project department issued a NET estimate with a commitment amount of JPY 3.0 billion, which was calculated from the Total Amount of JPY 3.4 billion incorporated with an expected cost reduction, and even if the commitment amount had been achieved, it was anticipated from the initial stage that Contract Loss would arise. An amount with those anticipated losses was set as the expected bid price because, if additional orders were received (onsite final adjustment testing, etc.) from National Research and Development Corporation B, which placed the order, it was expected that the entire project affiliated with Project B would be profitable, and it was also expected that developing system equipment and achieving past record in Project B would be advantageous for sales

activities in other similar projects, so a decision was made to position Project B as a strategic sales project.

b. Order receipt

The Power Systems Company participated in a bid for Project B with a bid price of JPY 2.2 billion. Ultimately, the Power Systems Company was the only bidder, so it won with its bid of JPY 2.2 billion.

After the Power Systems Company won that bid, the final amount of the order was reduced to JPY 2.1 billion through the negotiations with National Research and Development Corporation B, and on May 9, 2013, the Power Systems Company and National Research and Development Corporation B entered into a contract for Project B with a delivery date of the end of March 2015.

c. Failure to record a provision for contract losses at the time of the order receipt and failure to apply the percentage-of-completion method

In the first quarter of FY 2013, with respect to Project B, no procedures were commenced to identify Loss-Making Projects, which would have led to the recording of provisions for contract losses, and no provisions for contract losses were recorded.

Furthermore, the percentage-of-completion method was not applied.

(b) Background from the second quarter of FY 2013

a. Failure to record a provision for contract losses

From September 2013, a meeting called the “CR Working Group” was held several times in order to discuss CR for Project B. The main participants in the CR Working Group were the project department, the Plant Business Management Department, and the Advanced System Design & Engineering Department of the Isogo Nuclear Engineering Center. When necessary, the CR Working Group was also attended by related departments including the Advanced System Design & Engineering Department and the Field Engineering Department of the Isogo Nuclear Engineering Center, as well as the Machinery & Equipment Department of the Keihin Products Operation. As a result of those meetings, in around February 2014 an amount of JPY 2.7 billion was arrived at as a NET estimate incorporated with various CRs that had been considered up to that point, but that estimate was still higher than the SP of JPY 2.1 billion at that time. Moreover, from the initial order receipt, activities had been conducted to secure additional SP, and due to factors such as an increased order price associated with specification changes and orders for additional work, the SP increased to JPY 2.2 billion in March 2014, and in February 2015, the final SP became JPY 2.3 billion.

Meanwhile, personnel at the General Planning Department prepared lists confirming Loss-Making Projects and sent those lists to the sales department and other related departments in accordance with the Power Systems Company’s process for identifying

Loss-Making Projects, and in the list confirming Loss-Making Projects prepared in December 2013, Project B was listed in the list of projects with losses of JPY 100 million or more because its total estimated income from contract work was approximately JPY 2.1 billion and its total estimated cost of contract work was approximately JPY 2.4 billion. Project B also was listed in a list of projects with losses of JPY 100 million or more in a list confirming Loss-Making Projects that was prepared after that, and the amount of those losses was calculated as JPY 200 million or more (note that the lists of Loss-Making Projects prepared in June and September 2014 indicated losses of less than JPY 200 million, which is not subject to a loss-making application). In spite of that, from the second quarter of FY 2013 to the third quarter of FY 2014, personnel at the project department and the Plant Business Management Department did not commence procedures for identifying Loss-Making Projects, which would have led to recording of a provision for contract losses, and no provision for contract losses was recorded.

b. Failure to apply the percentage-of-completion method

Until the third quarter of FY 2014, no procedures were taken for the application of the percentage-of-completion method with respect to Project B, and the percentage-of-completion method was not applied.

(D) Causes of inappropriate accounting treatment

(a) Failure to record a provision for contract losses

a. Company

It is surmised that personnel at the project department and the Plant Business Management Department did not conduct procedures to identify Loss-Making Projects, which would have led to the recording of a provision for contract losses, for the following reasons.

As explained above, under Yasuharu Igarashi CP, the Power Systems Company operated by de facto rules that differed from the Rules for Action on J-SOX, or to put it another way, it was not possible to record a provision for contract losses or to revise the total estimated cost of contract work which would have substantiated the need for such a provision, without obtaining the approval of the CP. Yasuharu Igarashi CP of the Power Systems Company had previously clarified his position that, as explained above, a provision for contract losses should not be recorded until it becomes clear that losses will definitely arise. Given that stance taken by Yasuharu Igarashi CP, even if there had been an attempt to record a provision for contract losses by personnel at the project department and the Plant Business Management Department, or even by Vice President B, it could be naturally expected that there would have been strong opposition from Yasuharu Igarashi CP, who would claim that it was still possible to reduce losses through measures such as cost reduction, so it can be surmised that a conscious effort

was made to avoid commencing procedures for identifying Loss-Making Projects. Note that the reason for the failure to record a provision for contract losses from the second quarter of FY 2014 (after the appointment of Mr. Shigenori Shiga as CP) was the same as the reason described with respect to Project A above.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(b) Failure to apply the percentage-of-completion method

a. Company

As explained above, at the Power Systems Company, from among projects that meet the requirement of being in a condition in which it is possible to reliably estimate the total income from contract work, the total cost of contract work, and the extent of contract progress as of the fiscal year-end, the percentage-of-completion method is applied with respect to contract projects with an order amount of JPY 1.0 billion or more and a contract period of one year or more. At the stage of the order receipt for Project B, the specifications and designs of equipment and facilities were almost finalized and production could start almost immediately after the order receipt and, as the equipment and facilities themselves did not have complicated structure, it was possible to reliably estimate the total estimated cost of contract work. Based on these facts, it can be recognized that Project B fulfilled the requirements for the application of the percentage-of-completion method at the time of the order receipt.

The following could be considered as the reasons why the percentage-of-completion method was not applied to Project B in spite of the above.

Many of the persons at the project department and the Plant Business Management Department were aware that recording a provision for contract losses would be unavoidable once sales started to be recorded using the percentage-of-completion method. However, as explained above, even if there had been an attempt to record a provision for contract losses for Project B, it was naturally expected that there would be strong opposition from Yasuharu Igarashi CP, who would claim that it was still possible to reduce losses through measures such as cost reductions. It can therefore be surmised that personnel at the project department and the Plant Business Management Department failed to apply the percentage-of-completion method due to a conscious effort to delay the recording of a provision for contract losses, and that that was done under the pretext that it was believed that it would be possible to secure additional SP for Project B by amending the original contract or executing an additional contract, and that, since Project B was a new project that was the first of that type to be handled by the Power Systems Company, there was a possibility of somewhat reducing the total estimated cost of contract work through future CR.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(c) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project B.

a. Internal control in the Company

(a) Accounting Division

Members of the Accounting Division have accounting knowledge and are in a position to exercise a checks and balances function independent of divisions, but according to the allocation of authority for order of the Power Systems Company, members of the Accounting Division do not attend Plant Order Policy Meetings. It can therefore be recognized that the Accounting Division was not aware that Project B was a project that was expected to result in deficit from the time of order receipt. Furthermore, according to the Rules for Action on J-SOX and the de facto rules, unless the sales department commenced procedures for the application of the percentage-of-completion method or procedures for identifying Loss-Making Projects, there was no way for the Accounting Division to learn of the existence of projects to which the percentage-of-completion method should be applied or Loss-Making Projects.

It can therefore be evaluated that internal control by the Accounting Division was not functioning with respect to Project B.

(b) General Planning Department

As explained above, it can be recognized that Project B was listed many times as a project in which losses of JPY 200 or more million would arise in the Loss-Making Project confirmation lists prepared by the General Planning Department each quarter from December 2013, and in light of that, it was clear that Project B should have been identified as a Loss-Making Project. With that in mind, the General Planning Department, which prepared those lists, should have reviewed the Loss-Making Project confirmation lists and then recommended or instructed that the project department and the Plant Business Management Department commence procedures to identify Project B as a Loss-Making Project.

However, the General Planning Department simply went through the formalities of preparing a Loss-Making Project confirmation list each quarter, sending that list to the project department and the Plant Business Management Department, and requesting confirmation. There was no indication that the General Planning Department recommended or instructed that personnel at those departments commence procedures for identifying Loss-Making Projects.

It can therefore be evaluated that internal control by the General Planning Department was not functioning sufficiently with respect to Project B.

b. Other

No facts were found indicating that the Corporate Audit Division audited the Nuclear Energy Systems & Services Division from the order receipt for Project B until the third quarter of FY 2014.

In addition, no facts were found indicating that the Audit Committee or the accounting auditor pointed out any issue regarding Project B.

(4) Project C

(A) Outline of Project C

This is a project where the Power Systems Company received an order from prime contractor C in June 2001 with a contract amount of JPY 1.1 billion for the design, construction, and repair and maintenance of the equipment and facilities attached to a power plant with an (initial) delivery date of December 2009, which was related to the construction of the equipment and facilities attached to Power Plant C.

(B) Accounting treatment in question and appropriateness thereof

While an acceptance inspection was conducted by the prime contractor C ●●●● in December 2009, there were ongoing problems in Project C with the equipment and facilities attached to the power plant at the time of the acceptance inspection, which was caused by factors such as the adoption of new technology and requests for changes in specifications. Hence, the Power Systems Company conducted remediation work based on an agreement with the prime contractor C even after the receipt of an inspection acceptance document. Some of that remediation work was outsourced to TPSC, a Subsidiary (that remediation work for which TPSC was requested is hereinafter referred to as the “**TPSC Remediation Work**”), with the remediation work including the TPSC Remediation Work being conducted intermittently from FY 2010 to FY 2014. However, the Power Systems Company did not issue an official work order to TPSC in respect of the TPSC Remediation Work during the term from FY 2010 to the first quarter of FY 2014, and, it did not include the TPSC Remediation Work in the total estimated cost of contract work, citing ongoing pricing negotiations with TPSC with respect to the construction costs pertaining to the TPSC Remediation Work, as the basis for not doing so.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from	11	11	11	11	11	11	11

contract work							
Total estimated cost of contract work	43	53	60	72	78	93	105
Net profit and loss	(32)	(42)	(49)	(61)	(67)	(81)	(94)
FY profit and loss							
Sales	(0)	4	1	(1)	1	(1)	(1)
Gross profit	(19)	(9)	(7)	(12)	(7)	(10)	(17)
Cumulative profit							
Sales	6	10	11	10	11	11	10
Gross profit	(32)	(42)	(49)	(61)	(67)	(77)	(94)

However, the construction work was in practical terms ordered by the Power Systems Company to TPSC, and that work was actually undertaken by TPSC. So, the Power Systems Company should have timely included the costs for the TPSC Remediation Work in the total estimated cost of contract work and should have recorded sales and a provision for contract losses using the percentage-of-completion method for FY 2010 and each fiscal year thereafter.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below. Further, for the adjustment, reasonable total estimated cost of contract work and accrued contract costs for each fiscal year were calculated based on an amount of JPY 2.1 billion as the construction work price that the Power Systems Company finally agreed to with TPSC with respect to the TPSC Remediation Work, and sales and provisions for contract losses are recorded based on those figures.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	11	11	11	11	11	11	11
Total estimated cost of contract work	43	53	60	75	86	103	110
Net profit and	(32)	(42)	(49)	(64)	(75)	(92)	(98)

loss							
FY profit and loss							
Sales	(0)	4	1	(1)	1	(0)	0
Gross profit	(19)	(9)	(7)	(15)	(12)	(17)	(7)
Cumulative profit							
Sales	6	10	11	10	11	11	11
Gross profit	(32)	(42)	(49)	(64)	(75)	(92)	(98)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	-	0	3	8	10	5
Net profit and loss	-	-	(0)	(3)	(8)	(10)	(5)
FY profit and loss							
Sales	-	-	(0)	0	(0)	1	1
Gross profit	-	-	(0)	(3)	(5)	(7)	10
Cumulative profit							
Sales	-	-	(0)	0	(0)	1	1
Gross profit	-	-	(0)	(3)	(8)	(15)	(5)

(C) Facts identified by the Independent Investigation Committee

(a) Background until remediation work for Project C

On June 29, 2001, the Power Systems Company received from prime contractor C an order for the design, construction, and maintenance of equipment and facilities attached to Power Plant C for JPY 1.1 billion, and on December 22, 2009, an acceptance

inspection was conducted by prime contractor C. However, in Project C, troubles arose with the equipment and facilities attached to the power plant for reasons not attributable to the ordering party, so the Power Systems Company conducted remediation work at no cost from January 2010 pursuant to the agreement with prime contractor C.

Moreover, in addition to the trouble mentioned above, a large amount of additional costs also arose in Project C, and in the third quarter of FY 2009, when the acceptance inspection was performed, the total estimated cost of contract work had already risen to JPY 5.3 billion and the project was expected to result in massive deficit. The Power Systems Company applied the percentage-of-completion method to Project C in June 2005, and from March 2008, the Power Systems Company began sequential recording of provisions for contract losses due to increases in the total estimated cost of contract work, except for the cost of contract work related to the TPSC Remediation Work, which is discussed below.

(b) Status of transactions with TPSC related to remediation work

From 2010, the Power Systems Company intermittently requested estimates for remediation work from TPSC, and in addition to receiving estimates from TPSC, the Power Systems Company had TPSC Remediation Work performed by issuing work orders and requesting that TPSC perform a portion of the remediation work. A total of 202 estimates for TPSC Remediation Work were issued from 2010 until March 2015, and the total price amounts for contract work service in those estimates reached JPY 4.2 billion.

Even so, for Project C and other projects, there were negotiations between the Power Systems Company and TPSC to reduce the price amounts for work contract service set out in the estimates submitted by TPSC, and it was normal to reach an agreement to reduce that amount by about half. The Power Systems Company and TPSC expected a formal order for the work (“**Formal Order**”) to be issued by exchanging a formal work order and order confirmation at the stage where an agreement has been reached, but TPSC was to start the actual work before a Formal Order was issued.

Accordingly, even with respect to the remediation work for Project C, negotiations to reduce the price amount for work contract service for the TPSC Remediation Work were conducted between the Power Systems Company and TPSC for a long period from 2010 until 2015, but at the same time, TPSC serially began the TPSC Remediation Work from 2010. Upon gradual completion of work by TPSC, onsite personnel from the Power Systems Company confirmed the details of the work with TPSC and then confirmed completion of the work by signing and affixing a seal to “Work Completion Reports” issued by TPSC.

Ultimately, in March 2015, the Power Systems Company reached an agreement with TPSC for a total price amount for contract work service of JPY 2.1 billion for all TPSC Remediation Work conducted from 2010 (work listed in the 202 estimates) and issued a Formal Order to TPSC.

(c) Accounting treatment for the TPSC Remediation Work

a. Treatment pertaining to application of the percentage-of-completion method

Regarding Project C, even after the acceptance inspection by prime contractor C was completed in December 2009 and only remediation work remained, the Power Systems Company continued to record sales using the percentage-of-completion method. Accordingly, the construction cost for remediation work was added to the total estimated cost of contract work using the percentage-of-completion method.

Yet, when the Power Systems Company outsourced work to external vendors, the work normally started after a Formal Order had been issued; i.e., after a work order and order confirmation had been exchanged. Therefore, as a general rule, in projects to which the percentage-of-completion method was applied, there was a structure in which the order amount was added to the total estimated cost of contract work by the time an official work order was issued through the act of placing a formal order, at the latest.

That said, even at the stage before a work order is issued by placing a formal work order, to manage the total estimated cost of contract work in the Company, the administration department recorded an assessment amount that was reevaluated internally by the Power Systems Company with respect to the estimate amount that was submitted by an external vendor as a temporary total estimated cost of contract work and included in the total estimated cost of contract work, and such treatment was also applied when TPSC was the contractor.

However, since no Formal Order for the TPSC Remediation Work in Project C was issued from the first quarter of FY 2010 until the third quarter of FY 2014, the order cost was not added as a determined amount to the total estimated cost of contract work. Furthermore, until the first quarter of FY 2014, in regards to the estimate amounts listed in the estimates received from TPSC, personnel at the administration department (in the case of Project C, the Plant Business Management Department) did not enter the assessment amount that had been reevaluated internally by the Power Systems Company as a temporary estimated cost of contract work. (In the second quarter of FY 2014, in regards to the cost of contract work for the TPSC Remediation Work, an assessment amount of JPY 1.5 billion was added to the total estimated cost of contract work as a temporary cost of contract work and, based on that addition, a provision for contract losses was recorded. It can be surmised that that was done because it was nearly certain that the remediation work would be finished during 2014, and there was strong recognition within the Power Systems Company that the payment of a certain amount to TPSC could not be avoided and, although a Formal Order had not been issued, that provision was recorded based on a provisional estimate amount at that time.) Construction costs for the TPSC Remediation Work that had already been completed were not added to the accrued contract cost for Project C.

Hence, for an unusually long period after 2010, a situation continued where construction costs for the TPSC Remediation Work were not added to the total estimated cost of contract work or to the accrued contract cost for Project C, and that effectively removed the premise for accounting treatment based on timely and appropriate application of the percentage-of-completion method.

b. Treatment as a Loss-Making Project

With respect to Project C, a large amount of additional costs other than the construction cost for the TPSC Remediation Work was incurred, and Project C was identified as a Loss-Making Project and every fiscal year procedures for recording provisions for contract losses were taken. However, as explained above, the construction cost for the TPSC Remediation Work was not included in the total estimated cost of contract work, which was the basis for the calculation of the amount recorded in the provision for contract losses, and no provision for contract losses was recorded for that amount of the cost of contract work (as explained above, part of that provision for contract losses was recorded in the second quarter of FY 2014).

(D) Causes of inappropriate accounting treatment

(a) Company

Under the Rules for Action on J-SOX, personnel at the sales department and the Plant Business Management Department are in a position in which they should check on whether there is a change in the total estimated cost of contract work each month or each quarter and, if a check indicates a change in the total estimated cost of contract work, reflect that change and circulate related materials for the purpose of preparing an “Schedule for Provision for Contract Losses for Orders Received,” which would lead to the recording of a provision for contract losses. Moreover, substantially, since an order for the TPSC Remediation Work was issued to TPSC from the Power Systems Company, from the perspective of appropriate management of the total estimated cost of contract work, the cost of contract work associated with that work should have been estimated in a timely manner and the total estimated cost of contract work should have been adjusted when it was reasonably expected that the TPSC Remediation Work would be conducted even if there was no Formal Order, and procedures should have been commenced to record a provision for contract losses based on that.

However, personnel at the sales department and the Plant Business Management Department did not change the total estimated cost of contract work for the TPSC Remediation Work, and they did not commence procedures to record a provision for contract losses that would have been based on such a change (as explained above, normally the Power Systems Company could also include the costs of contract work of the TPSC Remediation Work in the total estimated cost of contract work in the internal system by treating an assessment amount calculated by reevaluating within the Power Systems Company the estimate amount set out in TPSC’s estimate as a temporary estimated cost of contract work, but that treatment was not executed by those personnel. Furthermore, as explained above, in the second quarter of FY 2014, part of the construction cost for the TPSC Remediation Work was included in the total estimated cost of contract work as a temporary cost of contract work, and based on that inclusion, a provision for contract losses was recorded. However, the fact that timely treatment was not performed in the preceding quarters is still an issue.) As a result of the failure to change the total estimated cost of contract work, the cost of contract work for serially completed TPSC Remediation Work was not recorded as accrued contract costs.

The following items can be considered as causes for inappropriate accounting treatment in Project C.

When conducting the cost reduction negotiations with TPSC, personnel at the sales department and the Plant Business Management Department believed that there might be defects in some of the TPSC Remediation Work, so they expected it would ultimately be possible to negotiate with TPSC for a greater reduction in the cost of contract work for TPSC Remediation Work than was normally possible. Accordingly, unlike orders to other external vendors, negotiations for a reduction in the construction cost related to the TPSC Remediation Work were not completed, and there is a considerable degree of possibility that the fact that those negotiations were incomplete was the main reason for the failure to make timely changes to the total estimated cost of contract work related to the construction cost for the TPSC Remediation Work and the failure to commence procedures to record a provision for contract losses based on those changes.

However, it can be evaluated that it was an expectation regarding a cost reduction whose grounds were not necessarily clear, and because Project C had already become a project that would result in significant deficit and losses had arisen at the time the remediation work started, personnel at the sales department and the Plant Business Management Department intended to postpone the recording of further significant losses by adding the cost of remediation work to the total estimated cost of contract work, so it can be surmised that the possibility cannot be denied that those personnel failed to make timely and appropriate changes to the total estimated cost of contract work and failed to commence procedures for the recording of a provision for contract losses under the pretext that negotiations with TPSC were ongoing.

(b) Corporate

No facts were found indicating that Corporate was involved in this matter.

(c) Problems in internal control

In addition to the causes set out in (a) above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project C.

a. Internal control in the Company

The Accounting Division of the Company possesses accounting knowledge and is in a position to exercise a checks and balances function independent of divisions. However, the Rules for Action on J-SOX do not require the involvement of the Accounting Division in changes to the total estimated cost of contract work or in the circulation of related materials for the preparation of a Schedule for Provisions for Loss-Making Orders Received, which would lead to the recording of a provision for contract losses. Moreover, in actual practice, the Accounting Division was not proactively involved in such procedures.

Hence, no facts were recognized that the Accounting Division issued any recommendation or instruction to the sales department or the Plant Business Management Department in regards to Project C, and internal control by the Accounting Division was not functioning sufficiently with respect to Project C.

b. Auditing by the Corporate Audit Division

In July 2010 and September 2012, the Corporate Audit Division audited the Nuclear Energy Systems & Services Division, but no indication was made regarding Project C.

Remediation work for Project C continued until FY 2014 even though the completion of the acceptance inspection in December 2009, and although the contract amount was JPY 1.1 billion, Project C incurred losses of several hundred million yen each fiscal year from FY 2009 until FY 2013. However, regarding this Project with this abnormally significant deficit, no indication was made when the Corporate Audit Division audited the Nuclear Energy Systems & Services Division. It can be surmised that that lack of indication substantiates the fact that internal control by the Corporate Audit Division was not functioning sufficiently.

c. Other

No facts were found indicating that the Audit Committee or the accounting auditor pointed out any issue regarding Project C.

(5) Project D

(A) Outline of Project D

This is a project where the Power Systems Company received an order from client D in July 2011 with a contract amount of JPY 18.9 billion to construct Power Plant D with an (initial) delivery date of August 2016.

(B) Accounting treatment in question and appropriateness thereof

In Project D, an equipment system in which foreign currency purchases are combined with Toshiba's steam turbine generators was adopted, and the contract costs pertaining to foreign currency purchases, etc. included in the total estimated cost of contract work were foreign currency denominated. But the Power Systems Company recorded estimated contract costs of arranged items that have not yet undergone an acceptance inspection and was denominated in a foreign currency using the exchange rate prevailing at the time of the order receipt (1 USD = 85.0 JPY) from FY 2011.

Further, according to the Accounting Manual of Toshiba, if arranged items denominated in a foreign currency are included in the total estimated cost of contract work and the foreign currency has not been procured, those foreign currency purchases are to be converted using the most recent monthly rate and the total estimated cost of contract work is to be revised accordingly.

As of the end of FY 2013, the total estimated cost of contract work was in excess of the total estimated income from contract work due to exchange rate fluctuations and other factors, but since the Power Systems Company believed that there was a

possibility of cost reductions including regaining the amount equivalent to increased costs through exchange rate differences, it did not revise the total estimated cost of contract work or record a provision for contract losses. Even in subsequent quarters, the Power Systems Company did not record any provision for contract losses until the third quarter of FY 2014.

Change in profit and loss before adjustment (Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	189	188	188	188
Total estimated cost of contract work	-	-	-	179	179	182	182
Net profit and loss	-	-	-	10	9	6	6
FY profit and loss							
Sales	-	-	-	0	6	33	38
Gross profit	-	-	-	0	0	1	1
Cumulative profit							
Sales	-	-	-	0	6	39	77
Gross profit	-	-	-	0	0	1	2

There are no specific grounds to support the above cost reduction, and the Power Systems Company should have revised the total estimated cost of contract work and recorded a provision for contract losses as early as the fourth quarter of FY 2013.

The amount of increase in the total estimated cost of contract work in the fourth quarter of FY 2013 would have been JPY 1.9 billion, and the amount of impact on profit and loss would be negative JPY 1.5 billion.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income on	-	-	-	189	188	188	188

contract work							
Total estimated cost of contract work	-	-	-	179	179	201	201
Net profit and loss	-	-	-	10	9	(14)	(14)
FY profit and loss							
Sales	-	-	-	0	6	29	35
Gross profit	-	-	-	0	0	(14)	-
Cumulative profit							
Sales	-	-	-	0	6	35	70
Gross profit	-	-	-	0	0	(14)	(14)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	-	-	-	-	19	20
Net profit and loss	-	-	-	-	-	(19)	(20)
FY profit and loss							
Sales	-	-	-	-	-	(4)	(4)
Gross profit	-	-	-	-	-	(15)	(1)
Cumulative profit							
Sales	-	-	-	-	-	(4)	(8)
Gross profit	-	-	-	-	-	(15)	(16)

(C) Facts identified by the Independent Investigation Committee

(a) Background to receipt of the order and subsequent circumstances

Project D constitutes a CP Approval Project, so Power Systems Company Order Policy Meetings were held regarding Project D on July 6 and July 8, 2011. At the Power Systems Company Order Policy Meeting on July 6, an SP of JPY 21.9 billion and a NET of JPY 21.9 billion were proposed as an estimate by the Thermal & Hydro Power Systems & Services Division, and at the Power Systems Company Order Policy Meeting held on July 8, Yasuharu Igarashi CP approved an SP of JPY 18.9 billion.

On July 26, the Power Systems Company received an order for Project D from client D. While the contract amount was to be determined through separate consultation according to the work orders, an agreement was reached on January 15, 2013 for a contract amount of JPY 18.8 billion.

From the second quarter of FY 2011 following the order receipt, the percentage-of-completion method was applied to Project D with a total estimated income from contract work of JPY 18.9 billion and a total estimated cost of contract work of JPY 18.0 billion, and sales were to be recorded. That total estimated cost of contract work of JPY 18.0 billion included the cost for arranged items denominated in a foreign currency (foreign currency purchases, etc.).

(b) Circumstances during the fourth quarter of FY 2013

According to the Accounting Manual, if the contract costs of arranged items denominated in a foreign currency are included in the total estimated cost of contract work and the foreign currency has not been procured, those foreign currency purchases are to be reviewed using the most recent monthly rate.¹⁶ However, in actuality, of the costs of contract work of arranged items denominated in a foreign currency, although arranged items denominated in a foreign currency that had already undergone an acceptance inspection were calculated using the exchange rate at the time of acceptance, the estimate for arranged items denominated in a foreign currency that had not yet undergone an acceptance inspection was calculated using the exchange rate at the time of the order receipt (in the case of Project D, 1 USD = 85.0 JPY), unless there was a significant fluctuation in the exchange rate.

Based on the treatment described above, with respect to estimates for arranged items denominated in a foreign currency that had not yet undergone an acceptance inspection, a NET estimate was calculated in each quarter at the exchange rate at the time of the order receipt (1 USD = 85.0 JPY). As a result, the NET estimates shown below were recorded in the internal system in each fourth quarter from FY 2011 to FY 2013.

Fourth quarter of FY 2011: JPY 17.9 billion

Fourth quarter of FY 2012: JPY 17.9 billion

Fourth quarter of FY 2013: JPY 18.2 billion

Based on the total estimated costs of contract work until the fourth quarter of FY 2013,

¹⁶ Detailed Rules for the Accounting Manual 6-2 “Sales Guidelines” II 1.[2](f)

they were not to exceed the total estimated income from contract work, so no provision for contract losses was recorded.

However, the exchange rate in the fourth quarter of FY 2013 was 1 USD = 101.9 JPY, which significantly diverged from the exchange rate at the time of the order receipt (1 USD = 85.0 JPY). If the estimate for arranged items denominated in a foreign currency that had not yet undergone an acceptance inspection had been revised based on the exchange rate at that time (the effect of the exchange rate difference would have been a cost increase of JPY 1.1 billion) and if an appropriate revisions had been made with respect to other costs, losses would have been incurred and it would have been necessary to record a provision for contract losses.

In April 2014 at the latest, personnel at the Thermal Power Domestic Sales Department of the Thermal & Hydro Power Systems & Services Division were concerned about cost increases due to the exchange rate differences and independently estimated the increase in the total estimated cost of contract work, and they realized that avoiding the recording of Contract Loss would require profit improvement of JPY 1.3 billion (even without taking the exchange rate differences into account), and that further profit improvement of approximately JPY 900 million would be required when considering the impact of the exchange rate difference discussed above, while at the same time they believed that CD with a high degree of certainty would only be JPY 1.1 billion. Accordingly, a provision for contract losses should have been recorded in the fourth quarter of FY 2013, but no provision for contract losses was recorded.

There was no indication that those personnel reported to Vice President D or other superiors in the fourth quarter of FY 2013 regarding the matters listed above.

(c) Circumstances from the first quarter to the third quarter of FY 2014

In July 2014, personnel at the Thermal Power Domestic Sales Department reported the details described in (b) above to Vice President D as part of a report on activities for securing profitability in Project D.

Furthermore, in October 2014, those personnel reported to Vice President D that avoiding the recording of Contract Loss would require profit improvement of JPY 1.0 billion (even without taking exchange rate differences into account), and that further profit improvement of approximately JPY 900 million would be required when considering the impact of the exchange rate difference discussed above, and they also reported that CD with a high degree of certainty would only be JPY 900 million.

However, until the third quarter of FY 2014, there was no revision of the total estimated cost of contract work, and procedures were not commenced for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses.

(D) Causes of inappropriate accounting treatment

(a) Direct causes of inappropriate accounting treatment

a. Company

From the fourth quarter of FY 2013, personnel at the Thermal Power Domestic Sales Department had an awareness of the above matters, and that awareness should have led those personnel to revise the total estimated cost of contract work in a timely manner and commence procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses.

Moreover, from the first quarter of FY 2014, Vice President D received reports as described above, and Vice President D should have taken measures such as recommending personnel at the Thermal Power Sales Domestic Department to revise the total estimated cost of contract work in a timely manner and to commence procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contact losses.

In spite of that, those personnel did not perform the necessary procedures, and further, Vice President D did not take measures such as recommending those personnel to perform those necessary procedures. It can be considered that that failure to take measures was due to the following.

The possibility cannot be completely denied that the cause was that it was believed that there would be some room for profit improvement for Project D in the future, including recovery of the amount of increased costs due to exchange rate differences.

However, there was no indication that measures for the above profit improvements were specifically considered, and considering circumstances such as the pressure within the Power Systems Company to definitely achieve budget targets and “Challenge” targets raised at CEO Monthly Meetings, etc., there would be a considerable amount of possibility that those personnel and Vice President D attempted to avoid recording a provision for contract losses, the doubt remains that there was an intent to postpone the recording of losses.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(b) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project D.

a. Internal control in the Company

The Accounting Division of the Company possesses accounting knowledge and is in a position to exercise a checks and balances function independent of divisions. Even so, it can be recognized that the Accounting Division was unaware that Contract Loss of JPY 200 million or more was anticipated for Project D. According to the Rules for Action on J-SOX and the de facto rules, unless the sales department commences to conduct those procedures, there was no way for the Accounting Division to learn of the existence of Loss-Making Projects. Therefore, internal control by the Accounting Division was not

functioning sufficiently with respect to Project D.

b. Audit by the Corporate Audit Division

The Corporate Audit Division audited the Thermal & Hydro Power Systems & Services in around November 2012, but no indication was made regarding Project D.

c. Other

No facts were found indicating that the Audit Committee or the accounting auditor pointed out any issue regarding Project D.

(6) Project E

(A) Outline of Project E

This is a project where the Power Systems Company received an order in February 2007 from client E with a contract price of JPY 54.5 billion for a set of ●●●●●●●● for Power Plant E with an (initial) delivery date of August 2010.

(B) Accounting treatment in question and appropriateness thereof

With respect to Project E, there was an increase in material costs following the execution of the contract. Therefore, it was anticipated that a Contract Loss of JPY 1.2 billion would arise upon the establishment of a midterm business plan for the following fiscal year and thereafter in December 2007, even if additional contract amount negotiations and CDs were taken into account. But a provision for contract losses was not recorded in the third quarter of FY 2007. Even following that, no provision for contract losses was recorded until a loss of JPY 6.9 billion was recorded upon completion of the contract in August 2010.

Change in profit and loss before adjustment (Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	545	545	577	-	-	-	-
Total estimated cost of contract work	545	544	645	-	-	-	-
Net profit and	(0)	0	(69)	-	-	-	-

loss							
FY profit and loss							
Sales	332	121	33	-	-	-	-
Gross profit	(3)	1	(69)	-	-	-	-
Cumulative profit							
Sales	423	544	577	-	-	-	-
Gross profit	(0)	0	(69)	-	-	-	-

However, as losses were anticipated as of December 2007, the total estimated cost of contract work should have been increased (JPY 3.7 billion) and a provision for contract losses (JPY 1.1 billion) should have been recorded in the third quarter of FY 2007.

Even following that, even though losses were anticipated upon the establishment of a midterm business plan for the following fiscal year and thereafter in December 2008 because costs increased further and the CD plan had not been achieved, the total estimated contract cost was not increased and a provision for contract losses was not recorded. The amount of increase in the total estimated cost of contract work for FY 2008 would be JPY 5.1 billion in the third quarter, and the amount of impact on profit and loss would be negative JPY 4.0 billion.

In the fourth quarter of FY 2009, the total estimated cost of contract work was further increased. The amount of impact on profit and loss for the fourth quarter of FY 2009 would be negative JPY 900 million.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	545	577	577	-	-	-	-
Total estimated cost of contract work	596	637	645	-	-	-	-
Net profit and loss	(52)	(60)	(69)	-	-	-	-
FY profit and loss							
Sales	300	106	85	-	-	-	-

Gross profit	(40)	(8)	(9)	-	-	-	-
Cumulative profit							
Sales	387	492	577	-	-	-	-
Gross profit	(52)	(60)	(69)	-	-	-	-

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	32	-	-	-	-	-
Total estimated cost of contract work	52	92	-	-	-	-	-
Net profit and loss	(52)	(60)	-	-	-	-	-
FY profit and loss							
Sales	(32)	(15)	51	-	-	-	-
Gross profit	(36)	(9)	60	-	-	-	-
Cumulative profit							
Sales	(37)	(51)	-	-	-	-	-
Gross profit	(51)	(60)	-	-	-	-	-

(C) Facts identified by the Independent Investigation Committee

(a) Background to receipt of the order

Since Project E constitutes CP Approval Projects, the Power Systems Company Order Policy Meeting for Project E was held on March 29, 2006 and the bid price was approved by Masao Namiki CP.

On February 27, 2007, the Power Systems Company received the order for Project E from client E, with a contract amount of JPY 54.5 billion, for which the NET was calculated to be JPY 51.3 billion. The Power Systems Company started the application of the percentage-of-completion method for Project E from December 2006 on the premise of this estimated amount (JPY 51.3 billion).

(b) Situation from the end of the third quarter to the fourth quarter of FY 2007

Around December 2007, during discussions at the Power Systems Company concerning the medium-term business plan for FY 2008, a loss of JPY 1.2 billion was anticipated to arise for Project E as a reasonable estimate at the time.

Based on this anticipated loss, during the preliminary explanation of the monthly report for the second half of FY 2007 held on January 17, 2008, the domestic sales department personnel in the Thermal Power Plant Division (integrated into the Thermal & Hydro Power Systems & Services Division from April 2008) reported to Hideo Kitamura CP that a loss of JPY 1.2 billion was anticipated and they would like to record a provision for contract loss. In response, Hideo Kitamura CP questioned the management of revenue and expenditure and pointed out the overoptimism in the CD forecast. However, there was no evidence recognized to suggest that Hideo Kitamura CP said no to the recording of a provision for contract loss at the time.

On January 25, 2008, a quarterly reporting meeting¹⁷ for the Power Systems Company was held at Corporate. At the meeting, the Power Systems Company explained to Atsutoshi Nishida P that a loss of JPY 1.2 billion was expected to arise for Project E. Having heard this explanation, Atsutoshi Nishida P questioned why Project E became a Loss-Making Project and why the taking of necessary measures was delayed, to which the Power Systems Company responded that at the time of the order receipt, they had also incorporated future CD, but the project now stands at a loss of JPY 1.2 billion.

At the Power Systems Company monthly reporting meeting for February subsequently held on February 14, 2008, Hideo Kitamura CP pointed out that recovery of the loss for Project E had not been made and stated that no recording of a provision for contract loss would be made if this could not be recovered.

However, when personnel of the domestic sales department explained the measures for improving the profitability of Project E to Hideo Kitamura CP on February 20, 2008, Hideo Kitamura CP indicated that they should make efforts to resolve the loss, and that Project E was the only project the Power Systems Company could rely on to achieve results in the second half of FY 2007, so they should use all possible means before the end of March, and did not approve the recording of a provision for contract loss.

Subsequently, on March 26, the sales personnel again explained the profitability improvement measures for Project E to Hideo Kitamura CP. However, Hideo Kitamura CP demanded that a profit improvement of JPY 5.0 billion be achieved without fail, and did not approve the recording of a provision for contract loss. The sales personnel who received the demand from Hideo Kitamura CP sought to avoid the generation of loss by increasing SP, and consulted with the Accounting Division of the Power Systems Company, whereby, they were told that an increase in SP would be possible even without evidence, based on the fact that a quotation had been submitted to and received by the customer. As such, it was eventually concluded that SP would be increased by JPY 5.0 billion, as indicated by Hideo Kitamura CP, and a report would be

¹⁷ The attendees were Atsutoshi Nishida P, Norio Sasaki EV, General Manager of the Corporate Finance & Accounting Division, Hideo Kitamura CP, EEVP and others.

made to Corporate that Project E would not be classified as a Loss-Making Project. (However, there are no facts that indicate that the SP was actually increased at the time.)

As a result, in the third and fourth quarter of FY 2007, no revision of NET based on an anticipated loss of JPY 1.2 billion was made by the domestic sales department personnel, and no procedures were commenced to identify Loss-Making Projects leading to the recording of provisions for contract loss.

(c) Situation from the first quarter of FY 2008

At the BRF Meeting held on May 15, 2008, Vice President E and others of Thermal & Hydro Power Systems & Services Division reported to Yasuharu Igarashi CP that the total estimated income from contract work would be JPY 57.4 billion with a total estimated cost of contract work of JPY 62.3 billion as the Total Contract Cost, and also reported the figures on a revised basis of the total estimated income from contract work of JPY 60.2 billion and the total estimated cost of contract work of JPY 60.0 billion. Vice President E and others reported to Yasuharu Igarashi CP at the BRF Meetings held on June 3, August 26, and December 24 regarding a total estimated income from contract work of JPY 57.4 billion and a total estimated cost of contract work of JPY 62.3 billion as the Total Contract Cost, and a total estimated income from contract work of JPY 60.2 billion and a total estimated cost of contract work of JPY 60.0 billion as a revised base. During the meeting on August 26, Yasuharu Igarashi CP pointed out the possibility of the CD amounting to JPY 2.0 billion being too rigid. Furthermore, in the discussions on the medium-term business plan for FY 2009 held around December 2008, a loss of JPY 2.4 billion was anticipated to arise.

At the BRF Meeting on December 24, 2009, a report was made to Yasuharu Igarashi CP of a total estimated income from contract work of JPY 57.5 billion with a total estimated cost of contract work of JPY 62.7 billion as the Total Contract Cost, and a revised base of total estimated income from contract work of JPY 60.3 billion and the same base of total estimated costs of contract work of JPY 60.2 billion.

However, under these circumstances, no revision of NET registered in the internal system was conducted based on the Total Contract Cost of the total estimated cost of contract work at the time, nor were any procedures commenced to identify Loss-Making Projects leading to the recording of a provision for contract loss.

Project E was eventually completed in August 2010, and recorded a loss of JPY 6.9 billion in the settlement of accounts for FY 2010.

(D) Causes of inappropriate accounting treatment

(a) Accounting treatment from the end of the third quarter to the fourth quarter of FY 2007

a. Company

From events that took place from the third and fourth quarters of FY 2007 above, a loss of JPY 1.2 billion was anticipated to arise for Project E and it can be recognized that the related people including Hideo Kitamura CP were aware of these facts. As such, the Power Systems Company should have revised the total estimated cost of contract work based on this amount in the third quarter of FY 2007 (or at the latest in the fourth quarter) and commenced procedures to identify Loss-Making Projects. However, no such procedures were taken.

The following are conceivable as reasons the procedures were not conducted.

At the Power Systems Company, as mentioned above, although the Rules for Action on J-SOX allowed for personnel of the sales department or the administration department to commence procedures to revise a total estimated cost of contract work and procedures to identify Loss-Making Projects, the de facto rule did not allow the recording of a provision for contract loss without the approval of CP.

Since Hideo Kitamura CP did not approve the recording of a provision for contract loss, as indicated above, this can be recognized as the reason that necessary procedures were not implemented by the sales department personnel, etc.

With regard to the reason why Hideo Kitamura CP failed to approve the recording of a provision for contract loss, he stated that, although it was tight, he believed that it was possible to reduce the loss with further efforts. The possibility of such expectations held by Hideo Kitamura CP certainly cannot be denied. However, looking at the facts such as that he stated that he did not believe that Project E would show a profit, and that, as stated above, he had stated that the loss for Project E had not been recovered so the recording of a provision for contract loss should be withheld at the time of the monthly report in February 2008, it can be surmised that Hideo Kitamura CP intended to postpone the recording of a provision for the contract loss.

b. Corporate

Judging from the events that took place in the quarterly reporting meeting for the fourth quarter of FY 2007 detailed above, it can be surmised that both Atsutoshi Nishida P and Norio Sasaki GCEO knew that the loss of JPY 1.2 billion for Project E was anticipated to arise. However, no facts were found indicating that Atsutoshi Nishida P and Norio Sasaki GCEO were involved in the inappropriate accounting treatment.

(b) Accounting treatment from April 2008

a. Company

From events that took place from April 2008 detailed above, the anticipated loss for Project E was growing with the passing of time, and it can be recognized that those involved, from Yasuharu Igarashi CP down, were aware of this.

As such, at the Power Systems Company, although the total estimated cost of contract work should have been revised on each occasion of the anticipated increase in losses even from the first quarter of FY 2008, and procedures should have been timely commenced to identify Loss-Making Projects, none of these procedures were taken

even once.

The following could be considered to be reasons for not carrying out those procedures. As mentioned earlier, at the Power Systems Company, unless approval was obtained from CP, it was not possible to record a provision for contract loss or revise a total estimated cost of contract work that backed the necessity of such. As stated earlier, Yasuharu Igarashi CP had made it even clearer than before to take the attitude of recording a provision for contract loss only when the generation of loss had been made certain, and was creating strong pressure to achieve the budget targets. Based on such an attitude and under such pressure from Yasuharu Igarashi CP, it was well expected that if the sales department personnel tried to record the provision for contract loss, he or she would face strong objections from Yasuharu Igarashi CP, stating the possibility of reducing the loss through further cost reduction, etc. In addition, it can be surmised that the sales department personnel did not seek to obtain an approval from Yasuharu Igarashi CP to record the provision for contract loss in light of the fact that Hideo Kitamura CP failed to approve the recording of a provision for contract loss in the fourth quarter of FY 2007.

b. Corporate

No facts were found indicating that Corporate was involved in the inappropriate accounting treatment for Project E in FY 2008.

From the first quarter of FY 2009, Hideo Kitamura, who used to be the CP of the Power Systems Company until the fourth quarter of FY 2007, assumed the post of GCEO, and Hideo Kitamura GCEO was aware of the anticipated loss for Project E, as stated above.

Furthermore, as mentioned below, in the audit report concerning the audit conducted by the Corporate Audit Division on the Thermal & Hydro Power Systems & Services Division in February 2009, the audit results indicated that “there is a possibility of losses being generated in Project F and Project E.” The results of the audit conducted by the Corporate Audit Division were then reported to P.

No facts were found to indicate a suggestion to revise the total estimated cost of contract work or a suggestion to commence procedures to identify Loss-Making Projects in response to this from Atsutoshi Nishida P or Hideo Kitamura GCEO was made to the Power Systems Company.

However, the reporting of audit results by the Corporate Audit Division to Atsutoshi Nishida P was carried out not through the report itself, but based on an A3-sized one-page summary. The summary did not list Project E, and even judging from the small listing in the above report, it cannot be identified that Atsutoshi Nishida P was aware of the amount of loss that could be generated by Project E, the outlook thereof, and whether or not a provision for contract loss would be recorded in relation thereto.

Furthermore, as the recording of a provision for contract loss as detailed above had to be approved by CP in the Power Systems Company, and since there were no facts to indicate that Hideo Kitamura received reports regarding the recording of a provision for contract loss for Project E after assuming the post of GCEO, it cannot be identified that he was aware that it was not recorded even though a provision for contract loss should have been recorded.

(c) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project E.

a. Internal control in the Company

The Accounting Division of the Company was expected to provide a checks and balances function to conduct appropriate accounting treatment from an independent standpoint. However, for Project E, it had given an unsubstantiated opinion in the fourth quarter of FY 2007 that it was possible to increase the amount of total estimated income from contract work by submitting a quotation to the customer, knowing of the strong demand made by Hideo Kitamura CP. Although it cannot be considered that such opinion was expressed with an active intent to avoid the recording of a provision for contract loss while being aware that the opinion was unsubstantiated, the fact that they could not exercise their function to guarantee the appropriateness of accounting treatment as the Accounting Division with appropriate accounting knowledge cannot be denied.

Furthermore, the Accounting Division was aware that loss was anticipated to be generated for Project E, and was in the position where it should have suggested or instructed the revision of total estimated cost of contract work and the commencement of procedures to identify Loss-Making Projects leading to the recording of provisions for contract loss. However, it must be said that the fact that they have failed to take any action thereafter indicates that internal control by the Accounting Division was not functioning at all.

b. Audit by Corporate Audit Division

An audit of the Thermal & Hydro Power Systems & Services Division was conducted by the Corporate Audit Division in February 2009, and the audit report of this audit indicates that “there is a possibility of losses being generated in Project F and Project E.” Since the Corporate Audit Division had the duty to manage the audit of internal Companies, including the Power Systems Company, having acknowledged the “possibility of losses being generated,” it can be surmised that they should have audited the degree of anticipation of loss or whether appropriate accounting treatment had been carried out. However, judging from the fact that nothing was pointed out by the Corporate Audit Division, it can be recognized that internal control by the Corporate Audit Division was not functioning appropriately.

c. Other

No facts were found indicating that the Audit Committee or the accounting auditor pointed out any issue regarding Project E.

(7) Project F

(A) Outline of Project F

This is a project where the Power Systems Company received an order from client F in March 2006 with a contract price of JPY 30.6 billion with respect to construction work on ●●●●●● generators to be installed at Power Plant F with an (initial) delivery date of October 2009.

(B) Accounting treatment in question and appropriateness thereof

With respect to Project F, it was already anticipated that in the fourth quarter of FY 2007 a Contract Loss of JPY 2.0 billion would arise due to additional costs following the execution of the contract, but a provision for contract losses was not recorded through the incorporation of unsubstantiated cost reductions, and a Contract Loss of JPY 2.0 billion were recorded in the third quarter of FY 2009, when the project was completed.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	349	352	-	-	-	-	-
Total estimated cost of contract work	349	373	-	-	-	-	-
Net profit and loss	0	(20)	-	-	-	-	-
FY profit and loss							
Sales	152	48	-	-	-	-	-
Gross profit	(0)	(21)	-	-	-	-	-
Cumulative profit							
Sales	305	352	-	-	-	-	-
Gross profit	0	(20)	-	-	-	-	-

Most of those CD measures were unsubstantiated, so properly speaking, the total estimated cost of contract work should have been increased and a provision for contract losses should have been recorded for that fiscal period. The amount of increase in the total estimated cost of contract work for FY 2007 was JPY 7.0 billion in the fourth quarter, and the amount of impact on profit and loss would be negative JPY 2.1 billion.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	352	352	-	-	-	-	-
Total estimated cost of contract work	373	373	-	-	-	-	-
Net profit and loss	(20)	(20)	-	-	-	-	-
FY profit and loss							
Sales	144	65	-	-	-	-	-
Gross profit	-	-	-	-	-	-	-
Cumulative profit							
Sales	288	352	-	-	-	-	-
Gross profit	(20)	(20)	-	-	-	-	-

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	3	-	-	-	-	-	-
Total estimated cost of contract work	23	-	-	-	-	-	-
Net profit and	(21)	-	-	-	-	-	-

resulting in an increase (approximately JPY 400 million), the total was expected to be JPY 35.7 billion.

On the other hand, NET was estimated to be approximately JPY 40.9 billion before the application of CD measures, incorporating the risk accompanying the increased cost for additional orders (approximately JPY 3.1 billion) and the increased cost of additional orders (approximately JPY 3.7 billion). However, this was reported as being expected to be reduced to JPY 35.7 billion (same as SP) by the application of CD measures.

However, taking into consideration that, of these CD measures, those for the risk of the increased amount of costs following additional orders (approximately JPY 3.1 billion) would be realized with JPY 1.0 billion, the remaining amount of at least approximately JPY 2.0 billion can only be described as lacking reasonable grounds.

(c) From the first quarter of FY 2008

On May 30, 2008, a contract for an additional order for ●●●● spares reported in the previous BRM Meeting was entered into at JPY 4.2 billion. With this addition, the Power Systems Company revised its SP to JPY 34.8 billion and NET to JPY 34.7 billion, in the first quarter of FY 2008, incorporating the order for additional construction work with the amount of JPY 30 million that was already received in March 2007.

Thereafter, at the BRF Meetings held at the Power Systems Company from May through December 2008, SP of approximately JPY 35.3 billion and NET of approximately JPY 39.1 billion were reported for Project F as the Total Contract Cost, indicating that the forecast was in a tight situation, and several discussions were conducted on the possibility of contract loss.

However, no revision of the total estimated cost of contract work or the commencement of procedures to identify Loss-Making Projects was subsequently conducted.

Project F was finally completed in the second half of FY 2009 and a Contract Loss of JPY 2.0 billion was recorded in the settlement of accounts for FY 2009.

(D) Causes of inappropriate accounting treatment

(a) Direct causes of inappropriate accounting treatment

a. Company

Considering the events indicated above, the total estimated cost of contract work should have been revised in the fourth quarter of FY 2007, incorporating the increased amount of costs for additional orders, etc. (approximately JPY 3.7 billion), and the risk of cost increase accompanying the additional order (approximately JPY 3.1 billion). However, this was not conducted and a provision for contract loss was not recorded.

Furthermore, although several discussions concerning the possibility of Contract Loss under difficult circumstances took place at the BRF Meeting in subsequent

quarters, no procedures were carried out to record the provision for contract loss.

It has been recognized that people involved in the Thermal Power Plant Division (Thermal & Hydro Power Systems & Services Division from April 2008), which was in charge of Project F, were aware of these facts, and the following can be considered to be the reasons the required procedures were not carried out.

The sales department personnel at the Thermal Power Plant Division held an optimistic view that an increase of SP could be anticipated with the additional order for ●●●● spares with relatively high profitability, and the possibility, although unsubstantiated, that the profitability would improve with future CD activities. These can be surmised to be the cause of not commencing procedures to record a provision for contract loss.

Later, although it became evident that achievement of profit improvement measures was becoming difficult, the fact that Hideo Kitamura CP had not approved the recording of a provision for contract loss even for Project E, which was in a worse situation than Project F regarding profitability, as stated above, had led the sales department personnel at the Thermal Power Plant Division (same as the Division handling Project E) to believe that approval of CP would not be granted, even if approval was sought for the recording of a provision for contract loss for Project F. This also can be surmised to be the cause of not commencing procedures to record a provision for contract loss.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

The audit report for the audit conducted by the Corporate Audit Division in February 2009 on the Thermal & Hydro Power Systems & Services Division did report that “there is a possibility of losses being generated in Project F and Project E,” but on this point, as stated in regard to Project E, it cannot be identified that Atsutoshi Nishida P was aware of the amount of possible loss for Project F, the outlook thereof, and whether a provision for contract loss would be recorded in relation thereto.

(b) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project F.

a. Internal control in the Company

The Accounting Division of the Company was expected to provide a checks and balances function to conduct appropriate accounting treatment and was responsible for contributing to internal control. The reason that the General Manager of the Accounting Division of the Company was a participating member of the Power Supply Company Order Policy Meetings and the BRF Meetings can be surmised to be to guarantee the adequacy of accounting treatment in important CP Approval Projects.

The General Manager of the Accounting Division of the Company attended the BRF

Meeting for Project F and was aware of the possibility of a contract loss for Project F, and therefore should have pointed out the issue or given instruction to revise the total estimated cost of contract work and to commence the procedures to identify Loss-Making Projects that would have led to the recording of a provision for contract loss. However, there was no evidence of such indication or instructions being made, and as a result, the function to guarantee the appropriateness of accounting treatment was not fulfilled.

Therefore, internal control by the Accounting Division was not functioning sufficiently with respect to Project F.

b. Audit by the Corporate Audit Division

As mentioned earlier, an audit of the Thermal & Hydro Power Systems & Services Division was conducted by the Corporate Audit Division in February 2009. However, in its audit report, although it pointed out that “there is a possibility of loss being generated in Project F and Project E,” as stated in regard to Project E, no indications or the like were made by the Corporate Audit Division based on the awareness of “possible generation of loss,” and it can be recognized that internal control by the Corporate Audit Division was not functioning appropriately.

c. Other

No facts were found indicating that the Audit Committee or the accounting auditor pointed out any issue regarding Project F.

(8) Project G

(A) Outline of Project G

This is a project where WEC,¹⁸ which is a consolidated Subsidiary of Toshiba, received orders during the period from 2007 to 2009 (with a total contract amount of USD 7.6 billion as of the period ended March 2009) to build, etc. Power Plant G with (initial) delivery dates from 2013 to 2019.

(B) Accounting treatment in question and appropriateness thereof

With respect to the increased estimated amount of the total estimated cost of contract

¹⁸ WEC is a Limited Liability Company under U.S. Law with its headquarters in Pennsylvania, USA and with a principal business of designing, manufacturing, and maintaining nuclear fuel and nuclear power generating facilities. WEC is a consolidated Subsidiary of Toshiba, with all of its equity effectively held by Toshiba Nuclear Energy Holdings (US) Inc. (“TNEH”), and Toshiba holding 87% of the voting rights of TNEH.

work¹⁹ due to factors such as design changes and delayed construction work in Project G, WEC reported additional recognized risks of USD 385 million (impact on profit and loss was negative USD 276 million) and USD 401 million (impact on profit and loss was negative USD 332 million) in the second quarter and the third quarter of FY 2013, respectively. As a result of further evaluation by Toshiba, the accounting records reflected USD 69 million (impact on profit and loss was negative USD 50 million) and USD 293 million (impact on profit and loss was negative USD 225 million), respectively.

With respect to the fourth quarter of FY 2013, Toshiba and WEC agreed to reflect USD 401 million in the accounting records.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	8,369	8,576	8,676	8,819	8,931	9,165
Total estimated cost of contract work	-	7,768	8,035	8,134	8,498	9,082	9,347
Net profit and loss	-	601	542	542	321	(151)	(182)
FY profit and loss							
Sales	-	1,575	1,245	1,367	1,163	699	589
Gross profit	-	117	72	84	(81)	(355)	(20)
Cumulative profit							
Sales	-	1,575	2,820	4,187	5,350	6,049	6,638
Gross profit	-	117	189	273	192	(163)	(182)

However, there are not sufficient grounds for the reduction evaluation of the increased estimate amount of the total estimated cost of contract work undertaken by Toshiba in the second quarter of FY 2013, so the figure of USD 385 million reported by

¹⁹ The estimated increase in the total estimated cost of contract work in Project G was discussed by the people involved basically based on an amount net of the estimated increase in SP. Accordingly, with respect to Project G, the term “estimated increase in the total estimated cost of contract work” is used as the estimated amount net of that estimated increase in SP. Also, the above figures are discussed on a fiscal year basis (quarterly accumulated basis) rather than as single quarterly figures, so the figures for Project G are set out on a fiscal year basis (quarterly accumulated basis).

WEC should have been reflected.

In the third quarter, Ernst & Young ShinNihon, the accounting auditor, insisted that with respect to the increased estimate amount of the total estimated cost of contract work, the amount of USD 401 million (impact on profit and loss was negative USD 332 million) reported by WEC should be recorded, but Toshiba adopted USD 293 million (impact on profit and loss was negative USD 225 million). However, there were no specific grounds for the figure adopted by Toshiba, so the figure of USD 401 million reported by WEC should have been adopted. A discrepancy in impact on profit and loss of negative USD 107 million arose in those amounts, but Ernst & Young ShinNihon eventually treated this discrepancy as an uncorrected misstatement (each of those adjustment were made on a quarterly basis and they do not impact year end financial statements, thus the table for adjustment amounts is omitted. But profit and loss will be affected when converting a foreign currency into Japanese yen).²⁰

The impact on profit and loss is negative USD 225 million for the second quarter, USD 123 million for the third quarter, and USD 102 million for the fourth quarter (each of those is an impact on profit and loss, and due to the negative correction of the second quarter, the corrections for the third quarter and the fourth quarter consequently became positive corrections).

(C) Facts identified by the Independent Investigation Committee

(a) Background leading to the final settlement of the FY 2013 second quarter financial statements

a. Circumstances up to September 2013

At the end of August 2013, Yasuharu Igarashi CP of the Power Systems Company received a report from WEC that an increase of USD 86.1 million was expected as an estimated increase in the total estimated cost of contract work in the second quarter of FY 2013 for Project G.

Upon receiving that report, Yasuharu Igarashi CP sent an expert team from Toshiba to WEC to review the contents of the above estimated increase of USD 86.1 million. As a result, the estimated increase as of the end of September 2013 was reduced to USD 69 million, and the consolidated financial data incorporating that amount was submitted by WEC to Toshiba for the preparation of Toshiba's consolidated financial statements.

b. Circumstances from October 2013

²⁰ "Uncorrected misstatement" means a misstatement that was discovered in a financial statement audit (difference between an amount in a financial statement item to be recorded and an amount of a financial statement item requested based on the framework of a financial report to be applied). The purpose of a financial statement audit is not to discover all misstatements, but it is to obtain reasonable assurance that there is no material misstatement on the whole, so even if an uncorrected misstatement is discovered in the process of an audit, the financial statement does not necessarily need to be corrected if that uncorrected misstatement is not material.

As mentioned above, as of the end of September 2013, the estimated increase in the total estimated cost of contract work reported by WEC to Toshiba for Project G was USD 69 million.

Then, in October 2013, WEC reported to Toshiba that it believed the amount of USD 69 million to be incorporated as the estimated increase in the total estimated cost of contract work of Project G in the second quarter of WEC was insufficient, which was WEC's view in light of comments made by Ernst & Young LLP ("EY USA"), which was in charge of accounting audits of WEC. Further, by October 24 at the latest, WEC reported to Toshiba that the estimated increase in the total estimated cost of contract work was evaluated to be USD 385 million, creating a discrepancy of USD 316 million with the estimated increase of USD 69 million that had been submitted to Toshiba.

Faced with those situations, Toshiba had discussions, mainly by the Corporate Finance & Accounting Division, the Accounting Division of the Power Systems Company, and Japanese Officers and Employees seconded to WEC from the Power Systems Company ("WEC **Secondees**"), with EY USA and Ernst & Young ShinNihon on measures to be taken.

c. Final settlement of the FY 2013 second quarter consolidated financial statements

As a result of the above discussions, at the end of October 2013, it was decided that the amount to be incorporated in the FY 2013 second quarter financial statements as the estimated increase in the total estimated cost of contract work of Project G at both Toshiba and WEC would be USD 69 million.

While the amount to be incorporated into the financial statements had been determined as such, WEC had evaluated that USD 385 million was the best estimate, so in the process of the quarterly review of Toshiba's consolidated financial statements for the second quarter of FY 2013, which was conducted by EY USA against WEC on that basis, it was pointed out that the additional total estimated cost of contract work to be recognized with respect to the total estimated cost of contract work was USD 316 million (an amount of impact to profit and loss of negative USD 225 million). In spite of that, Toshiba did not change the estimated increase in the total estimated cost of contract work of USD 69 million based on an evaluation that recovery was possible (cost reductions were possible). Toshiba's evaluation that recovery was possible was formed based on an assumption that, mainly with respect to additional costs incurred from delays in the contract work process, it was possible to reduce costs by shortening the contract work period and to recover costs for reasons attributable to the customer. However, in the process of the Investigation conducted by the Committee, neither specific work schedules incorporating a shortened contract work period, in relation to the master work schedule which incorporated delays in contract work process at WEC, nor sufficient evidence that would allow a judgment that there was a reason attributable to the customer was found. Furthermore, although it turned out eventually, when a further review was conducted by Toshiba and WEC for the third quarter and at the end of the fiscal year with respect to items that were judged to be recoverable in the second quarter, very few of those items were judged to be still recoverable, while further additional costs were incurred.

After that was pointed out, taking into consideration the results of an examination

conducted by Toshiba on a consolidated basis, Ernst & Young ShinNihon conducted a quarterly review of the second quarter of FY 2013, and as a result, judged that it was necessary for USD 167 million (an amount of impact to profit and loss of negative USD 114 million) to be reflected in the calculation by the percentage-of-completion method as an additional cost, in addition to the above USD 69 million estimated increase in the total estimated cost of contract work (an amount of impact to profit and loss of negative USD 50 million). Consequently, an uncorrected misstatement occurred in the form of an amount of impact to profit and loss of negative USD 114 million.

The reason why, as stated above, there was an uncorrected misstatement at Toshiba of an amount of impact to profit and loss of negative USD 114 million (estimated increase in the total estimated cost of contract work of USD 167 million) while it was pointed out at WEC that there was a recognized difference in an amount of impact to profit and loss of negative USD 225 million (estimated increase in the total estimated cost of contract work of USD 316 million) in the process of the quarterly review conducted by EY USA, was that Ernst & Young ShinNihon judged that the estimated increase in the total estimated cost of contract work by WEC was recoverable within the range of USD 149 million by additionally taking into account Toshiba's knowledge about the construction of nuclear power plants.

d. Reports to Hisao Tanaka P and others

While events progressed as described above, reports separate from the reports stating the aforementioned USD 86.1 million, concerning the estimated increase in the total estimated cost of contract work of Project G were made from around August to September 2013 by G of WEC's management to Vice President G1 who was the Vice President of the WEC Division of the Power Systems Company and WEC Chairperson, that there was a possibility of increases in the total estimated cost of contract work of USD 1.0 billion in total, if all potential risks are taken into account. After receiving those reports, Vice President G1 reported the contents of those reports to Yasuharu Igarashi CP and Hisao Tanaka P.

Further, from October 2013, the possibility of an increase in the total estimated cost of contract work for Project G was reported by Vice President G1 and others to Hisao Tanaka P. In addition, Makoto Kubo CFO received reports from the WEC Secondees on the background leading to USD 69 million being incorporated as an estimated increase in the total estimated cost of contract work of Project G in the FY 2013 second quarter financial statements and reports showing specific amounts that there was an evaluation of USD 1.6 billion as potential risk of increase in the total estimated cost of contract work in the future.

After receiving those reports, Hisao Tanaka P and Makoto Kubo CFO told Vice President G1 and the WEC Secondees to review and improve the estimated amounts to ensure that there would be no further increases from the estimated increase of USD 69 million already submitted.

Given those circumstances, under the direction of Yasuharu Igarashi CP, even after October 2013, Toshiba hired outside experts, dispatched teams of experts to WEC and continued to review the numbers in order to examine the estimated increase in the total estimated cost of contract work of Project G by WEC.

(b) Background leading to the final settlement of the FY 2013 third quarter financial statements

a. Status of the review as of the beginning of January 2014

Based on the review of the estimated increase in the total estimated cost of contract work conducted by Toshiba and WEC described above, a meeting of Toshiba and WEC concerning Project G was held on January 6, 2014, with Makoto Kubo CFO and others in attendance from Toshiba. At that meeting, Vice President G1 reported that, among other things, in light of the above review, the WEC side had evaluated the estimated increase in the total estimated cost of contract work to be incorporated for the third quarter of FY 2013 was an amount of impact to profit and loss of negative USD 400 million²¹ and that it was expected that Toshiba and WEC would continue to further review that.

b. Instructions to Yasuharu Igarashi CP and others

On January 7, the following day, Makoto Kubo CFO informed Yasuharu Igarashi CP and others of an instruction from Hisao Tanaka P that the estimated increase in the total estimated cost of contract work with a profit and loss impact of negative USD 400 million, which was the amount evaluated by WEC, could not be adopted for the third quarter of FY 2013 of Toshiba considering the future business development of Project G, and that the estimated increase within the range of a profit and loss impact of negative USD 114 million, which was judged to be an uncorrected misstatement by Ernst & Young ShinNihon in the second quarter, was acceptable (meaning that amount would be accepted to be incorporated in the FY 2013 third quarter consolidated financial statements).

Further, on January 14, it was also stated by Makoto Kubo CFO to Yasuharu Igarashi CP and others that there was an instruction by Hisao Tanaka P regarding an increase in the total estimated cost of contract work of Project G to “reconsider postponing the treatment until the fourth quarter,” and it was instructed that, to achieve that, it was necessary to review and improve the estimated increase for Toshiba to a profit and loss impact of zero, and to have WEC state that “it is possible as a target value” with respect to that review and improvement.

c. Further review of WEC’s estimate by Toshiba

Given the above instructions, with the aim of announcing the financial results for the

²¹ Regarding the estimated increase in the total estimated cost of contract work of Project G, from January 2014, the related parties had discussions not using the “estimated increase in the total estimated cost of contract work” itself, but using figures of the “impact to profit and loss” based on that estimated increase. Hence, if the figures indicating the amount of impact to profit and loss are shown below rather than the estimated increase in the total estimated cost of the contract work itself, the “profit and loss impact” will be set out preceding those figures. Furthermore, that profit and loss impact is indicated on an annual basis (aggregate of the quarterly amounts).

third quarter on January 30, 2014, Toshiba established a special team and further examined the estimated increase in the total estimated cost of contract work by WEC, and as a result, on around January 17, concluded that the estimated increase by Toshiba would be a profit and loss impact ranging from negative USD 75 million to negative USD 189 million (profit and loss impact of negative USD 75 million in the best case). However, to begin with, Toshiba's estimate with a profit and loss of negative USD 75 million was calculated without consulting with WEC, and its contents did not fully reflect the actual operations at WEC and commercial customs in the United States, so it could not be said that its feasibility was high.

Meanwhile, parallel with the review by Toshiba, a review of the estimate was also being repeated by WEC. As a result, the estimated increase in the total estimated cost of contract work by WEC was reduced from the initial profit and loss impact of negative USD 400 million to a profit and loss impact of negative USD 396 million, and finally, as of January 29, 2014, it was determined that the profit and loss impact could not be reduced lower than negative USD 332 million.

d. Working towards announcing the financial results on January 30, 2014

From the beginning of January 2014, Makoto Kubo CFO and the General Manager of the Corporate Finance & Accounting Division continued to discuss and study the accounting treatment of Project G in the third quarter with Ernst & Young ShinNihon while receiving reports on the status of the review of the estimated increase from the Power Systems Company.

However, as of January 28, Makoto Kubo CFO and others were informed by Ernst & Young ShinNihon of its opinion that, given that the difference in opinion regarding the estimate of the profit and loss impact by Toshiba of negative USD 75 million and the estimate of the profit and loss impact by WEC of negative USD 396 million as of the same date did not narrow, a profit and loss impact of negative USD 396 million by WEC should be incorporated into Toshiba's third quarter consolidated financial statements. Meanwhile, on the same day, Hisao Tanaka P informed Yasuharu Igarashi CP that "it would be catastrophic if that was 39.6 billion"²² for the third quarter of FY 2013.

Under those circumstances, on January 29, Makoto Kubo CFO had further discussions with Ernst & Young ShinNihon on measures based on a profit and loss impact of negative USD 332 million, which was the estimated increase by WEC obtained at that time, under tight circumstances with the announcement of the financial results scheduled for the next day.

In light of the discussions at that meeting, Makoto Kubo CFO devised a plan to make the estimated increase in the total estimated cost of contract work of Project G to be incorporated for Toshiba's third quarter of FY 2013 a profit and loss impact of negative USD 225 million by adding negative USD 150 million to negative USD 75 million (profit and loss impact of negative USD 107 million (negative USD 332 million -

²² It seems that this amount refers to a profit and loss impact of negative USD 396 million, which is the estimated increase in the total estimated cost of contract work by WEC, in the course of reviewing the estimates from January 2014.

negative USD 225 million) as an uncorrected misstatement), and, between the afternoon of that day and the morning of the following day, he reported that plan to Hisao Tanaka P and obtained his approval and reported to Atsutoshi Nishida C that the third quarter financial statements would be prepared based on that plan. However, there was no detailed statement on which that estimate of a profit and loss impact of negative USD 225 million was based and that estimate was totally unsubstantiated.

Further, as explained above, regarding the background that led to the decision to incorporate a profit and loss impact of negative USD 225 million on January 29, Makoto Kubo CFO has explained that, in discussions with Ernst & Young ShinNihon on that day, Ernst & Young ShinNihon made a statement to the effect that the amount of around JPY 10.0 billion (around USD 100 million) could be treated as an uncorrected misstatement as a special case in the third quarter of FY 2013 on the condition that the estimated increase in the total estimated cost of contract work could definitely be reduced and recovered to a profit and loss impact of negative USD 75 million, which was Toshiba's estimate, by the end of FY 2013. However, on this point, Ernst & Young ShinNihon has explicitly denied that it made such a statement, and the details of the above background could not be identified. However, given that Ernst & Young ShinNihon has explained that they cannot deny the possibility that Makoto Kubo CFO guessed the allowable amount of the uncorrected misstatement during repeated discussions regarding quarterly reviews up to that time (and in fact, it was dealt as an uncorrected misstatement in the third quarter of FY 2013), and in light of the above explanation by Makoto Kubo CFO himself, it cannot be avoided saying that the profit and loss impact of negative USD 225 million was an amount that was calculated back from the expected allowable amount as an uncorrected misstatement.

e. Determination of the amount to be incorporated in the FY 2013 third quarter consolidated financial statements

With that background, at Toshiba, the FY 2013 third quarter consolidated financial statements, which incorporated a profit and loss impact of negative USD 225 million as an estimated increase in the total estimated cost of contract work for Project G, were reported at the meeting of the Board of Directors held on January 30, 2014. The minutes of the Board of Directors meeting on that date indicated that there were questions and answers among the directors regarding "measures for improvement of management accuracy of nuclear power plant construction costs of WEC," but their specific contents are unknown.

With respect to Toshiba's third quarter of FY 2013, incorporating the above profit and loss impact of negative USD 225 million, Ernst & Young ShinNihon, which is Toshiba's accounting auditor, treated the difference of USD 107 million from the estimated profit and loss impact of negative USD 332 million by WEC as an uncorrected misstatement.

(c) Subsequent events

a. Working towards the FY 2013 financial statements

Even after the FY 2013 third quarter financial statements were confirmed, reductions with respect to the estimated increase in the total estimated cost of contract work of Project G were to continue to be considered at Toshiba towards the end of FY 2013.

On January 31, 2014, Vice President G2 and others of the WEC Division were requested by the General Manager of the Corporate Finance & Accounting Division stating that “the difference (USD 107 million) between the estimated amount at WEC (USD 332 million) and the additional cost incorporated in the financial statements at Toshiba (USD 225 million) has been deferred, and unless the estimate at WEC falls below USD 225 million, it will be necessary to recognize additional losses in the fiscal year financial statements. Please immediately implement measures for reduction to the original USD 75 million, before the end of the fiscal year, and please regularly report on the progress in cooperation with the Power Systems Company,” and that request was made known to Hisao Tanaka P, Makoto Kubo CFO, and Yasuharu Igarashi CP.

b. FY 2013 financial statements

However, following that in March 2014, WEC filed a lawsuit claiming expenses related to the cancellation of contract work due to the customer’s circumstances in other projects related to Project G, and the allocation of expenses among each project of Project G was revised in accordance with that, reducing the total estimated cost of contract work and the recognized costs for Project G, with an expected improvement in profitability of more than USD 100 million. In light of those circumstances, in Toshiba’s FY 2013 financial statements, the profit and loss impact of negative USD 332 million, which was the estimated increase by WEC as of end of January 2014, was incorporated without being adjusted for the estimated increase in the total estimated cost of contract work of Project G, which resolved the discrepancy in the evaluation of estimates between Toshiba and WEC that arose in the third quarter of FY 2013.

(D) Causes of inappropriate accounting treatment

(a) Regarding the second quarter of FY 2013

In the second quarter of FY 2013, the estimated increase in the total estimated cost of contract work of USD 385 million reported by WEC anew in October 2013 was an amount that was evaluated as being the best estimate by WEC itself, which was the business operator of Project G, and in principle, Toshiba should have incorporated USD 385 million as the estimated increase in the total estimated cost of contract work for Project G in the second quarter financial statements.

However, Toshiba did not adopt that amount based on a judgment that an evaluation of recognizing additional cost had not been adequately conducted and that a cost reduction was possible given Toshiba’s knowledge and it instead prepared the second quarter financial statements by incorporating USD 69 million, which was submitted by WEC at the end of September 2013, as the estimated increase in the total estimated cost of contract work.

a. Company

Yasuharu Igarashi CP gave instructions in the Power Systems Company regarding a review of the estimated increase in the total estimated cost of contract work reported by WEC, and the Accounting Division requested the WEC Secondees and others to take measures to prepare the second quarter financial statements based on USD 69 million, and it can be recognized that Yasuharu Igarashi CP and the Accounting Division were aware that WEC expected an increase in the total estimated cost of contract work of more than USD 69 million and that there was a need to incorporate that into Toshiba's second quarter financial statements.

In spite of that, the Accounting Division did not accept an additional estimated increase in the total estimated cost of contract work for Project G by WEC of USD 316 million, and it prepared the financial statements on the assumption that only USD 69 million would be incorporated. Yasuharu Igarashi CP did not attempt to correct such treatment by the Accounting Division.

It can be surmised that it is likely that the reason for such inappropriate accounting treatment was that Yasuharu Igarashi CP and the Accounting Division intended to avoid recording losses in that quarter and to postpone that until a subsequent fiscal period.

b. Corporate

Hisao Tanaka P, Makoto Kubo CFO, and personnel at the Corporate Finance & Accounting Division also received reports between September and October 2013 regarding the fact that it was expected there would be an increase in the total estimated cost of contract work for Project G by WEC, so it can be recognized that they were also aware that it was necessary to incorporate the estimated increase in the total estimated cost of contract work by WEC in the second quarter financial statements.

It can be surmised that the possibility cannot be denied that the reason why Hisao Tanaka P and others on the Corporate side failed to give instructions, etc., to the Company Accounting Division in spite of the above was that they intended to avoid and postpone until a subsequent fiscal period the negative impact on performance by recording a loss for that quarter based on a significant increase in the total estimated cost of contract work of Project G (the operating profit and loss for the first half of FY 2013 was negative JPY 1.6 billion (the budget was JPY 8.5 billion) for the WEC Division of the Power Systems Company, where the profit and loss of WEC were to be incorporated, JPY 13.6 billion (the budget was JPY 16.2 billion) for the Power Systems Company as a whole and a significant shortfall from the budget was expected, especially for the WEC Division).

(b) Regarding the third quarter of FY 2013

Considering that the profit and loss impact of negative USD 332 million, which was the estimated increase in the total estimated cost of contract work of WEC in the third quarter of FY 2013, had gone through a review conducted jointly by Toshiba and WEC using outside experts since the second quarter, it should be said that that was an estimate with a certain degree of reasonableness and Toshiba should have incorporated the profit and loss impact of negative USD 332 million as the estimated increase in the total

estimated cost of contract work of Project G in the third quarter financial statements.

However, Toshiba did not accept that and prepared the third quarter financial statements by incorporating a profit and loss impact of negative USD 225 million as the estimated increase in the total estimated cost of contract work of Toshiba.

a. Company

Yasuharu Igarashi CP and the Accounting Division received instructions by email, telephone, etc. from Hisao Tanaka P and Makoto Kubo CFO and were involved in a review of the estimated increase in the total estimated cost of contract work reported by WEC towards the third quarter financial statements, and it can be recognized that Yasuharu Igarashi CP and the Accounting Division were aware of the specific details of Toshiba's estimate and WEC's estimate.

It can be surmised that the reason why Yasuhisa Igarashi CP and the Accounting Division did not, in spite of the above, attempt to prepare the third quarter financial statements on the basis of a profit and loss impact of negative USD 332 million which was the estimated increase in the total estimated cost of contract work by WEC was that, as explained below, Hisao Tanaka P and others on the Corporate side did not approve the third quarter financial statements on the premise of the estimated increase in the total estimated cost of contract work by WEC.

b. Corporate

Given the background described above, it can be recognized that Hideo Tanaka P gave instructions to consider postponing the reflection of the estimated increase in the total estimated cost of contract work by WEC in Toshiba's consolidated financial statements until the fourth quarter of FY 2013, or failing which, to record the minimum possible losses in the third quarter, and that Makoto Kubo CFO and personnel at the Corporate Finance & Accounting Division took action to carry out those instructions. In order to carry out those instructions, after having discussions with Ernst & Young ShinNihon on January 29, 2014, Makoto Kubo CFO planned the recording of an unsubstantiated profit and loss impact of negative USD 225 million as the estimated increase in the total estimated cost of contract work based on an amount that was expected to be permissible as an uncorrected misstatement, and he reported that plan to Hisao Tanaka P and obtained his approval and also reported to Atsutoshi Nishida C that the financial statements would be prepared based on that plan.

It is likely that those actions by Hisao Tanaka P and Makoto Kubo CFO were conducted with an intention to postpone the recording of losses until a subsequent fiscal period in order to avoid a significant negative impact on performance by recording a loss in that quarter based on a significant increase in the total estimated cost of contract work for Project G (the cumulative operating profit and loss up to the third quarter of FY 2013 was negative JPY 23.2 billion for the WEC Division, and even based on the profit and loss impact of negative USD 225 million adopted by Toshiba, the WEC Division recorded a huge operating loss of JPY 20.0 billion or more, and the performance of the Power Systems Company as a whole was also poor with an operating profit of JPY 400 million).

Besides, on that point, Hideo Tanaka P has explained that he does not recall receiving a report of the plan to incorporate the profit and loss impact of negative USD 225 million in the third quarter financial statements from Makoto Kubo CFO or giving approval for that plan. However, it can be recognized that Hisao Tanaka P received and approved the above report given that it is difficult to believe that Makoto Kubo CFO determined the contents of the financial statements based on the above plan at his own judgment in light of the fact that even on January 29, 2014, with the meeting of the Board of Directors at which the financial statements were to be reported and the announcement of the financial statements scheduled for the following day, there was still a gigantic gap of USD 257 million (USD 332 million minus USD 75 million) between the estimate of the Toshiba side and the WEC side, and as a result Toshiba's financial statements were not finalized, which was an extremely abnormal situation, and also in light of the magnitude of that amount, and given the behavior, etc. of Hisao Tanaka P concerning the increase in the total estimated cost of contract work for Project G in the course of events described above.

(c) Problems in internal control

In addition to the causes set out in (a) and (b) above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project G.

a. Company Accounting Division and Corporate Finance & Accounting Division

Originally, the role of the Company Accounting Division was to organize the financial statements based on consolidated financial data submitted by subsidiaries and check that there was no problem, and the role of the Corporate Finance & Accounting Division was to check the financial statements organized by the Company Accounting Division and correct them if there was any problem.

However, for projects such as Project G, where inappropriate accounting treatment was conducted with the intent of the top management, such as P and CFO, internal control was not functioning not only at the Company Accounting Division but even at the Corporate Finance & Accounting Division, and instead, those Divisions were themselves involved in inappropriate accounting treatments, so the internal control required to be performed by the Company Accounting Division and the Corporate Finance & Accounting Division was not functioning at all.

b. Audit by the Corporate Audit Division

The Corporate Audit Division audited the NPP Business of WEC in February 2014, and in that business audit report, although there were references to the state of profit and loss and the cost management method for Project G, there was no indication regarding the accounting treatment concerning the increase in the total estimated cost of contract work in the second and third quarters of FY 2013.

c. Audit by the Audit Committee

The following interviews were conducted by the Audit Committee from the second quarter of FY 2013, but for Hisao Tanaka P and Makoto Kubo CFO, there was no indication regarding the accounting treatment concerning the increase in the total estimated cost of contract work of Project G in the second and third quarters of FY 2013.

On the other hand, in the interview conducted by the Audit Committee on December 26, 2013, Yasuharu Igarashi CP was asked by an Audit Committee member “What is the state of (WEC) cost over-runs? Will a provision be recorded in the third and fourth quarters?” but Yasuharu Igarashi CP responded by stating that the necessity of that was being examined, and no further questions or comments were raised by the Audit Committee members in response to that answer, and no trace of a further investigation by the Audit Committee after that can be found. Given this point, it can be surmised that internal control by the Audit Committee was not functioning sufficiently.

Hisao Tanaka P: September 30, 2013, March 3, 2014, September 17, 2014

Makoto Kubo CFO: January 20, 2014

Yasuharu Igarashi CP: October 9, 2013, December 26, 2013

d. Audit by the accounting auditor

As a result of the review in the second quarter of FY 2013, Ernst & Young ShinNihon, the accounting auditor stated that, based on materials obtained and questions asked concerning the reduction of additional costs for Project G, USD 167 million, which was the estimated increase of USD 316 million (USD 385 million minus USD 69 million) in the total estimated cost of contract work on the WEC side less USD 149 million, should be reflected as an additional cost, and a profit and loss impact of negative USD 114 million was an uncorrected misstatement. However, as explained above, the cost reduction measures of USD 149 million lacked the presentation of detailed evidentiary materials, but there are such circumstances as that it was practically difficult for them to elucidate the appropriateness of specific estimates (cost reduction measures), considering the fact that Ernst & Young ShinNihon was provided with information on the above estimated increase of USD 316 million in the total estimated cost of contract work in the latter half of October 2013, which was immediately before the announcement of Toshiba’s financial statements on the last day of October, and the fact that the quarterly reviews were conducted by limited procedures as compared to the auditing of financial statements at the end of the fiscal year. The Committee is not evaluating the appropriateness of audits conducted by the accounting auditor on the whole, but in this instance, the aspect cannot be denied that, as a result, control by the accounting auditor did not sufficiently function.

3. SIS Company

(1) Overview of the SIS Company

The SIS Company (Social Infrastructure Systems Company) provides a wide range

of products in fields such as power distribution systems, railway and automotive systems, solutions and automation equipment, and radio wave systems. The SIS Company was established on April 1, 2011 following the merger of the Transmission Distribution & Industrial Systems Company (*Densansha*) and the Social Infrastructure Systems Company (*Shakaisha*)

The following is an overview of the SIS Company.

(A) Divisions, etc. in the Company

The SIS Company comprises five divisions²³ and four operations.²⁴

The Transmission & Distribution Systems Division is in charge of Project H, Project J, Project M, Project N, and Project O, which were the subject of the investigation by the Committee. This division provides equipment and systems relating to the supply of power in the fields of power transmission, power distribution, and solar power generation. The Railway Systems Division of the Railway & Automotive Systems Division, which is in charge of Project I, is responsible for providing urban transportation solutions such as railway carriage systems and information systems for railway transportation.

(B) Budget preparation and control

At the SIS Company, a three-year medium-term business plan is prepared each year, the part of which regarding the first year constitutes the budget for the following fiscal year. The medium-term business plan is prepared in accordance with the following process.

Each division prepares a three-year medium-term plan based on the “Medium-Term Plan Basic Policy” presented by Corporate every December, and reports those to the Company Medium-Term Plan Examination Committee the following January. The Company compiles the medium-term business plans submitted by each division and other organization and submits that collated plan to the SIS Company at the end of January. Based on this, Corporate and the SIS Company discuss concrete measures in February, and the SIS Company’s medium-term plan is finalized in March based on those discussions.

The SIS Company reports as follows to Corporate each month on the status of achieving the budget prepared through the above process.

The SIS Company reports to the Corporate Finance & Accounting Division at the

²³ The Transmission & Distribution Systems Division, the Railway & Automotive Systems Division, the Security & Automation Systems Division, the Defense & Electronic Systems Division, and the Landis+Gyr Division. Of these, the Railway & Automotive Systems Division is divided into the Railway Systems Division, the Automotive Systems Division, and the Industrial Systems & Components Division.

²⁴ The Fuchu Operations - Social Infrastructure Systems, the Hamakawasaki Operations, the Komukai Complex, and the Mie Operations.

beginning of each month on the actual performance for the previous month. After the SIS Company receives reports from each division on matters such as an overview of that division's business and a forecast for the current period, it examines those reports at internal meetings called monthly meetings in the SIS Company in around the middle of each month, and the SIS Company reports monthly forecasts to the Corporate Finance & Accounting Division based on the results of that examination. Those reports are delivered to the President of Corporate at CEO Monthly Meetings held during the last ten days of each month. (The meetings held each January and July are referred to as "quarterly reporting meetings," and the status of achieving quarterly budgets is reported and considered at those meetings.)

Just before each CEO Monthly Meeting, the SIS Company has prior meetings with the GCEO to explain to the GCEO the content of the report to be made at the CEO Monthly Meeting. After reviewing matters pointed out by the GCEO at the meeting with the GCEO, the report is made to the President (CEO) of Corporate at the CEO Monthly Meeting. After the CEO Monthly Meeting, a meeting to wrap up the CEO Monthly Meeting is held at the SIS Company to confirm and discuss matters pointed out at the CEO Monthly Meeting.

Position evaluation meetings are held around the same time as the CEO Monthly Meetings in the last month of each quarter (June, September, December and March) after the financial forecasts have been submitted. At these position evaluation meetings, matters such as the forecasts for the current period are reported by each division and matters such as whether there are deviations from the forecasts are considered. After the position evaluation meeting held before the CEO Monthly Meeting, the figures that the SIS Company will report at the CEO Monthly Meeting as the expectation for the current period are determined based on the results of that position evaluation meeting, and each division is issued a "Challenge" (instruction to improve performance) in order to achieve those figures. At the position evaluation meeting held after the CEO Monthly Meeting, figures for sales, operating profit, fund balance, and so on are compiled for the settlement of accounts for the quarter.

(C) Internal control for financial reporting in the Company and other matters

The internal control described below has been implemented in the SIS Company with respect to the receipt of orders, the treatment of projects in which the percentage-of-completion method is used, and handling Loss-Making Projects.

(a) Approval of the receipt of project orders

At the SIS Company, projects are classified according to importance, and there are two classifications: (1) projects requiring approval by the CP following consultations at the SIS Company order policy meeting (the "**SIS Company Order Policy Meeting**") and (2) projects requiring approval by the Vice President following consultation at the division order policy meeting (the "**Division Order Policy Meeting**").

a. Projects requiring approval by the CP following consultations at the SIS Company Order Policy Meeting

Projects, etc. requiring approval by the CP under the approval standards of each division²⁵ are discussed at the Order Policy Meeting.

The SIS Company Order Policy Meetings are attended by the CP, who is the approving party, and the Executive Vice President, Managing Director, the Vice President of the division, the General Manager of the Finance & Accounting Division, the General Manager of the Legal Division, and the General Manager of the Business Planning Division, who are the members (the CP may also call additional members when necessary). The personnel in charge in the Business Planning Division also attends in a secretariat capacity.

At the SIS Company Order Policy Meeting, the following matters are reported and the CP is asked to approve them: a summary of and background to the contract, the benefits of receiving the order, the business flow and the formation of the contract, profit and loss, the key terms of the contract, risks, uncertainties, and measures for addressing risks. The secretariat prepares minutes of the results of the deliberations at the SIS Company Order Policy Meeting.

b. Projects requiring approval by the Vice President following consultations at the Division Order Policy Meeting.

Projects, etc. requiring approval by the Vice President under the approval standards set out by each division are discussed at the Division Order Policy Meeting. The members of the Division Order Policy Meeting, the matters to be reported thereat, and so on are prescribed in the approval standards of each division.

(b) Handling projects in which the percentage-of-completion method is used

a. Applicable requirements for the percentage-of-completion method

Toshiba treats the following projects as projects in which the percentage-of-completion method is used if they fulfill the requirement that the total estimated income from contract work, the total estimated cost of contract work, and the extent of contract progress as of the fiscal year-end are capable of being reliably estimated.

- Long-term contracted construction where the total estimated income from contract work is JPY 1.0 billion or more and the contract work period is one year or more

²⁵ In addition to projects with SP that is equal to or greater than a certain amount set out by each division, projects where, regardless of the amount of the SP, the amount of the loss-making provision is JPY 100 million or more, etc., are included.

- Of contracted construction where the total estimated income from contract work is JPY 1.0 billion or more and the contract work period is for three months or more and less than one year, those for which the subject item is not delivered during the fiscal year in which the construction work starts

Even if the total estimated income from contract work is less than JPY 1.0 billion, the percentage-of-completion method can be used if the outcome of the construction activity is considered reliable.

b. Internal control for financial reporting on projects in which the percentage-of-completion method is used

In the Transmission & Distribution Systems Division,²⁶ internal control over financial reporting of projects in which the percentage-of-completion method is used is implemented through the following six work processes. Although most staff members of the divisions and departments related to those processes understood the following processes, it cannot be necessarily said that the SIS Company has thoroughly informed all staff members that they are required to comply with those work processes.

Note that the term “planning department” in these processes and the processes described in (c) “Handling of Loss-Making Projects” indicates the planning department in each division rather than the Company’s Business Planning Division.

(a) Registration as a project subject to the percentage-of-completion method

-A superior at the sales department or the planning department confirms that that is a project in which the percentage-of-completion method should be used based on materials that are the basis for the SP and the contract work period and gives approval for that project.

- In situations such as where a project number is issued for a project where the SP is JPY 1.0 billion or more, a confirmation message is displayed indicating whether that is a project in which the percentage-of-completion method should be used.

(b) Calculation of estimated costs

- Personnel at the operations accounting department or personnel at the engineering department calculate estimated costs, etc. and prepare an estimate cost sheet. A superior at the accounting department or the engineering department examines the contents of that estimate cost sheet closely and approves that form based on

²⁶ All of SIS Company’s projects subject to the percentage-of-completion method that were investigated by the Committee were undertaken at the Transmission & Distribution Systems Division. (The percentage-of-completion method was not applied to Project I.)

documentary evidence. The approved estimate cost sheet is circulated to the sales department.

- Personnel at the sales department prepare direct selling cost estimates, and the superior at the sales department examines the direct selling cost estimates closely and approves that estimate based on documentary evidence.

- A superior at the sales department confirms that the NET and direct selling cost entered in the system are consistent with the amount in the above estimate cost sheet and the above direct selling cost estimate, and then approves those amounts.

- Personnel at the sales department confirm with operations, the engineering departments, or the procurement departments on whether there has been any change in the estimated costs, and if there has, enters the changes into the system. A superior at the sales department confirms that the NET or the direct selling cost that has been changed and entered in the system is consistent with the amounts in that documentary evidence, and then gives their approval thereof. If the terms of a contract are amended, a change to the estimated cost and the SP is performed in the same manner.

(c) Calculation of the amount of sales to be recorded based on the percentage-of-completion method

- Toshiba's percentage-of-completion method system has a framework in which the amount of sales to be recorded and the amount of sales costs to be recorded are automatically calculated based on the percentage-of-completion method.

(d) Verification of the amount of sales to be recorded based on the percentage-of-completion method

- Personnel at the planning department and personnel at the accounting department verify the consistency of the original data (contract amounts, cumulative injection amounts, and estimated total costs) used in calculations made using the percentage-of-completion method.

(e) Recording of sales

(f) Reversing entries of recorded sales

(c) Handling Loss-Making Projects

At Toshiba, regardless of whether the percentage-of-completion method is applied, the expected losses from the next period are to be recorded as provisions for contract losses with respect to projects where (i) it is expected that losses of JPY 200 million or more will arise at the end of the current period and (ii) the amount of those losses can be reasonably estimated.

According to the Rules for Action on J-SOX used at the SIS Company, although the handling of Loss-Making Projects differs slightly from division to division, Loss-Making Projects are to be handled through the following process:

- (i) Identifying Loss-Making Projects
- (ii) Recording provisions for contract losses for each quarter
- (iii) Reversing provisions for contract losses for the previous quarter

Of the above, the process of internal control of (i) and (ii) pertaining to financial reporting related to the handling of Loss-Making Projects is as follows. (Note that the process of (iii) is a formal process to prevent a provision for contract losses being recorded twice in a particular quarter and the previous quarter.)

a. Identifying Loss-Making Projects

(a) Handling in the Transmission & Distribution Systems Division

At the Transmission & Distribution Systems Division, identifying Loss-Making Projects (i.e., projects for which a provision for contract losses needs to be recorded) is conducted by preparing a “Schedule for Provision for Contract Losses for Orders Received” through the following work process as internal control pertaining to financial reporting.

(i) Personnel at the sales department receive answer forms regarding actual estimated costs from the engineering department or operations when a large amount of loss is anticipated, and if, after confirming related documents such as order forms, the above answer forms, and direct selling cost estimates, the amount of losses will be JPY 200 million or more, the personnel will forward those related documents to the superior at the sales department.

(ii) The superior at the sales department will confirm the amount of losses based on those related documents, affix a seal of approval to each document, and send those documents to personnel at the planning department.

(iii) After checking the relevant documents, the personnel at the planning department informs personnel at the Company Finance & Accounting Division of the contracted amount, the expected amount of actual cost, the direct selling cost (if the percentage-of-completion method is applied, the aggregate sales and the aggregate sales cost are included), advances received, and the yen exchange rate on the monthly closing date.

(iv) Personnel at the Company Finance & Accounting Division prepare a “Schedule for Provision for Contract Losses for Orders Received” based on communications from

personnel at the planning department, and a superior at the Company Finance & Accounting Division will investigate each type of related document and then affix a seal of approval to the “Schedule for Provision for Contract Losses for Orders Received.”

* To ensure no Loss-Making Project is omitted when identifying Loss-Making Projects, personnel at the planning department send to the sales department or the administration department each quarter a “confirmation list of Loss-Making Projects” that lists projects where the SP is JPY 1.0 billion or more and the amount of losses is JPY 100 million or more from the list of backlog orders on the system, and will request that the sales department or the administration department confirms that list. In addition, personnel at the planning department will request personnel at the Company Finance & Accounting Division to prepare the latest “Schedule for Provision for Contract Losses for Orders Received” at the end of each quarter with respect to projects in which a provision for contract losses was recorded based on the above procedures for identifying Loss-Making Projects.

(b) Handling in the Railway Systems Division of the Railway & Automotive Systems Division

In the Railway Systems Division of the Railway & Automotive Systems Division, the identification of Loss-Making Projects is handled by preparing a Schedule for Provision for Contract Losses for Orders Received in accordance with the following process as part of internal control for financial reporting.

(i) At the beginning of the last month of each quarter, personnel at the Management Group (Management G) identifies (i) projects with an SP of JPY 100 million or more and an M Ratio²⁷ of less than 100% and (ii) projects with a gross loss of JPY 50 million or more, even if the SP is less than JPY 100 million, that are included in the list of received projects. This person then prepares a “Loss-Making Project Estimate Cost Sheet (Sales)” and a “Loss-Making Project Estimate Cost Sheet (Manufacturing).” After these sheets have been examined by the manager of the Management G, they are sent to the relevant sales department and operations manufacturing departments, which are asked to complete them.

(ii) Personnel at the sales departments examines gross profit, sales expenses, and commission going forward from the next period, enters the necessary information in the Loss-Making Project Estimate Response Sheet, attaches documentary evidence, and asks the sales GPM to approve it. Personnel in charge of production management at the operations department examines the profit and loss by project number going forward from the next period, enters the necessary information in the Loss-Making Project Estimate Response Sheet, attaches documentary evidence, and asks for approval from the production management GPM. Each GPM in charge carefully examines the

²⁷ Ratio of the total estimated profit from contract work divided by the total estimated cost of contract work.

estimate, affixes their seal of approval to the Loss-Making Estimate Project Response Sheet, and sends it to the personnel at the Management G.

(iii) The personnel at the Management G calculates the amount of provisions for Loss-Making Projects using the SP for the balance of received orders, the Loss-Making Project Estimate Response Sheet, and other material, and prepares a “List of Loss-Making Project Candidates. Furthermore, in the case of Loss-Making Projects where the anticipated losses are JPY 100 million or more, they prepare a Schedule for Provision for Contract Losses for Orders Received and submit it to the Operation Manager.

(iv) The Operation Manager confirms the content detailed on the List of Loss-Making Project Candidates and the Schedule for Provision for Contract Losses for Orders Received and approves them.

(v) The personnel at the Management G submits the approved List of Loss-Making Project Candidates and the Schedule for Provision for Contract Losses for Orders Received to the person in charge of accounting and finance.

(vi) The person in charge of accounting and finance affixes their seal to the Schedule for Provision for Contract Losses for Orders Received.

b. Recording provisions for contract losses for each quarter

At the SIS Company, provisions for contract losses for each quarter are recorded using the “Schedule for Provision for Contract Losses for Orders Received” and it is expected that provisions for contract losses for each quarter will be recorded by going through processes for identifying Loss-Making Projects described in a. above.

(d) De facto rules at the SIS Company

At the SIS Company, however, there were also de facto rules that were different from the rules for matters such as the handling of Loss-Making Projects described above.

Specifically, according to the Rules for Action on J-SOX, it is not necessary to report to or obtain a decision or approval from the CP or Corporate (P, GCEO, and CFO) in the recording of provisions for contract losses and procedures for registering in the system total estimated costs of contract work, which support the necessity for recording the provisions. However, as a de facto rule, except in the case of recording small provisions, without the approval of the CP and reporting to and approval by Corporate (P, GCEO and/or CFO), matters such as the recording of provisions for contract losses and the registration into the system of the total estimated cost of contract work, which supports the necessity to record such provisions, could not be performed.

(e) Responsibilities and roles of the Finance & Accounting Division

At the SIS Company, the Finance & Accounting Division is responsible for matters such as:

- Planning and proposing various accounting systems
- Implementing, providing guidance concerning, and managing the accounting systems
- Matters regarding preparing and managing nonconsolidated and consolidated monthly financial statements
- Managing and training related to recording profits, recording expenses, and calculating manufacturing and sales costs
- Compliance, audits and investigations regarding accounting
- Quality control of internal controls (J-SOX) regarding accounting

That is to say, it was expected that the Finance & Accounting Division would create a system in which the accounting treatment of the SIS Company is conducted appropriately and play a role in managing that system.

(2) Project H

(A) Outline of Project H

This is a project where the SIS Company received an order in September 2013, with a contract amount of JPY 31.9 billion²⁸ from client H to develop a communication system for Smart Meters (approximately 27 million units) to be installed within client H's premises, and to manufacture, install and maintain the Smart Meter equipment, with an (initial) delivery deadline of March 2024.

The manufacturing part of the Smart Meter equipment was recorded in accounting on an inspection basis (contract amount of JPY 17.8 billion), while the other parts (development, installation and maintenance) were recorded under the percentage-of-completion method (contract amount of JPY 14.1 billion).

(B) Accounting treatment in question and appropriateness thereof

With respect to Project H, the SIS Company already anticipated contract losses of at or around JPY 8.0 billion at the SIS Company Order Policy Meeting held in September 2013, even after considering an increased contract amount and additional cost reduction measures. Nonetheless, despite the absence of any reasonable grounds, no provision for contract losses was recorded at the time of the order receipt, and no provisions for contract losses were recorded in the third quarter of FY 2013 and thereafter.

The calculation using the percentage-of-completion method was carried out by using the total estimated income from contract work at JPY 14.1 billion and the total

²⁸ The substantiated amount of the order was JPY 31.9 billion; however, the estimate was submitted at JPY 39.9 billion, including JPY 8.0 billion for Smart Meter installation work to be undertaken by client H.

estimated cost of contract work was calculated using the percentage-of-completion method at JPY 14.1 billion, which was the same amount as the total estimated income from contract work. In addition, with regard to parts that were accounted for on an inspection basis, inspections of equipment commenced from FY 2014, and sales of equipment that were inspected by the third quarter of FY 2014 came to JPY 5.2 billion, and the amount of recorded losses came to JPY 1.0 billion.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	319	319
Total estimated cost of contract work	-	-	-	-	-	319	319
Net profit and loss	-	-	-	-	-	0	0
FY profit and loss							
Sales	-	-	-	-	-	58	103
Gross profit	-	-	-	-	-	0	(10)
Cumulative profit							
Sales	-	-	-	-	-	58	161
Gross profit	-	-	-	-	-	0	(10)

As a loss of JPY 8.0 billion (even after considering cost reduction measures) was anticipated at the time of the order receipt in September 2013, a provision for contract losses should have been recorded in the second quarter of FY 2013. In addition, as Project H was a new type of project for the SIS Company in which they had no experience, only robust cost reduction measures should have been reflected in the total estimated cost of contract work for each period.

The increase in the total estimated cost of contract work in the second quarter of FY 2013 was JPY 25.5 billion, with the impact on profit and loss also being negative JPY 25.5 billion.

In the case of this project, for reasons such as that the precision of estimates at the time was inadequate, the table indicates adjustments using estimates from subsequent

points in time.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	319	319
Total estimated cost of contract work	-	-	-	-	-	574	576
Net profit and loss	-	-	-	-	-	(255)	(257)
FY profit and loss							
Sales	-	-	-	-	-	22	71
Gross profit	-	-	-	-	-	(255)	(2)
Cumulative profit							
Sales	-	-	-	-	-	22	93
Gross profit	-	-	-	-	-	(255)	(257)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	-	-	-	-	255	257

Net profit and loss	-	-	-	-	-	(255)	(257)
FY profit and loss							
Sales	-	-	-	-	-	(36)	(32)
Gross profit	-	-	-	-	-	(255)	8
Cumulative profit							
Sales	-	-	-	-	-	(36)	(68)
Gross profit	-	-	-	-	-	(255)	(247)

(C) Facts identified by the Independent Investigation Committee

(a) Background to the receipt of the order

In November 2012, the SIS Company received an RFP (Request for Proposal) regarding Project H from client H, and began studying the project with a view to submitting a tender.

On February 28, 2013, an SIS Company Order Policy Meeting regarding Project H was held, and on the same date the SIS Company submitted, along with its proposal, an estimate of JPY 53.0 billion²⁹ to client H. According to materials from that SIS Company Order Policy Meeting, when the SIS Company was working on the first bid, the NET estimate was JPY 45.7 billion against the tender price of JPY 53.0 billion, which means a gross profit of around JPY 7.3 billion was expected.

However, on April 4, 2013, client H instructed the SIS Company that it only wanted to budget for JPY 31.5 billion. The SIS Company responded on April 18, 2013 by submitting an estimate of JPY 44.6 billion to client H. Client H responded by informing the SIS Company that it had decided to only continue negotiations with the SIS Company, but asked for the price to be reduced to JPY 39.9 billion. Although the SIS Company was aware that Project H was at very high risk of resulting in a deficit, on April 25, 2013 it submitted an estimate of JPY 39.9 billion to client H as it was considered to lead to achieving synergies with a subsidiary purchased by the SIS Company expecting that the projects for communication systems for Smart Meters would be awarded, and also to creation of a new business model and expansion of the scope of business by integrating energy and communications.

As a result, on May 1, 2013, the SIS Company received the letter of intent from

²⁹ Includes JPY 8 billion for the installation work, which client H would be performing. All amounts detailed in this section (a) below include the JPY 8 billion for the installation work to be performed by client H.

client H for Project H.

(b) The situation in the second quarter of FY 2013

Project H constituted a CP Approval Project, and a SIS Company Order Policy Meeting concerning Project H was held at the SIS Company on September 10, 2013. The materials prepared by the Transmission & Distribution Systems Division for that Meeting contained requests for “a provision of JPY 8.4 billion for the three years from FY 2013 to FY 2015” against the current estimated contract losses of JPY 13.6 billion and “a provision of JPY 6.7 billion for the three years from FY 2013 to FY 2015” should additional measures to improve profitability be achieved, in which case the estimated contract losses would be JPY 10.0 billion. The same requests were also included in the materials prepared for another SIS Company Order Policy Meeting held on September 12. Toshio Masaki CP considered the estimates presented in the materials dated September 10 and September 12 to be extremely unreasonable, but he believed that the total estimated cost of contract work could be further reduced if measures to that end were implemented in the future. However, because it would probably be impossible to implement all the measures, it was decided to ask Corporate to approve the recording of a provision of at or around JPY 4.2 billion and to explain that Project H was at high risk of falling into deficit.

From September 25 to September 26, 2013, Toshio Masaki CP, the General Manager of the Finance & Accounting Division of the SIS Company, and Vice President H of the Transmission & Distribution Systems Division asked Hideo Kitamura GCEO, Makoto Kubo CFO, and Hisao Tanaka P to approve the recording of a provision of JPY 4.2 billion in FY 2013. This request was made after explaining to each of them the circumstances surrounding the receipt of the order for Project H, and was based on the premise that common development expenses for Project H would be allocated to other contracts. According to the explanatory materials prepared by the Transmission & Distribution Systems Division, the current estimates, which excluded the JPY 8.0 billion to be borne by client H, were NET JPY 44.1 billion (which incorporated CD), SP JPY 31.9 billion, and a gross loss of JPY 12.2 billion. Although it was expected that the implementation of profit improvement measures in the future would reduce the gross loss to JPY 8.0 billion, and that the allocation of common development expenses for Project H to other contracts would also reduce it, a loss of JPY 4.2 billion was still anticipated, which is why the stated request was for “a provision of negative JPY 4.2 billion in FY 2013.”

However, Hisao Tanaka P and Hideo Kitamura GCEO did not give an approval to record the provision for contract losses on the ground that there was room to improve the estimates to some extent.

As a result, at the SIS Company Order Policy Meeting held on September 30, 2013, Toshio Masaki CP formally decided to receive the order for Project H and entered into a contract with client H to that effect (however, the formal contract entered into at this time was for the JPY 14.1 billion portion to which the percentage-of-completion method would be applied). The materials prepared by the Transmission & Distribution Systems Division for that meeting anticipated a gross loss of JPY 12.2 billion, even after the implementation of CD measures, and a target gross loss of JPY 8.0 billion after

the implementation of further improvement measures, which was the same as the explanatory material submitted to Corporate as detailed above. In the end, no provision for contract losses was recorded in the second quarter of FY 2013.

(c) The situation in the fourth quarter of FY 2013

At the CEO Monthly Meeting held on November 22, 2013, an explanation was provided for the high-risk projects that the SIS Company was engaged in. The materials used for this explanation presented an operating loss of “JPY 5.0 to 10.0 billion,” of which “JPY 1.1 billion” was the loss anticipated in the second half of FY 2013.

On November 27, 2013, the Transmission & Distribution Systems Division explained to Toshio Masaki CP that the current NET estimate for November 2013, against SP JPY 39.9 billion, was JPY 60.1 billion excluding the JPY 8.0 billion that client H was responsible for. The target NET estimate, meanwhile, which was contingent on the implementation of CD measures, was JPY 44.1 billion excluding the JPY 8.0 billion that client H was responsible for.

On December 25, 2013, the Audit Committee interviewed Toshio Masaki CP. During that interview, no direct mention was made of Project H, but the materials submitted by the SIS Company presented a figure of “JPY 1.1 billion” for the operating loss on Project H in the second half of FY 2013. There was also a comment that the “loss of JPY 5 to 10.0 billion will be presented as deferred assets to be amortized within the total amount.”

On January 9, 2014, the SIS Company (in attendance were Toshio Masaki CP, Vice President H, etc.) explained to Hideo Kitamura GCEO that the targets for both SP and NET were not being met and that various measures were going to be implemented to meet the target NET of JPY 41.5 billion (or JPY 37.7 billion if development expenses could be allocated to contracts other than Project H) excluding the JPY 8.0 billion that client H was responsible for. In addition, at the quarterly reporting meeting held on January 23, 2014 and the CEO Monthly Meeting held on February 20, 2014, similar explanations to the ones given at the aforementioned CEO Monthly Meeting in November 2013 were given regarding high-risk projects that the SIS Company was engaged in.

In a report made by the Transmission & Distribution Systems Division to Toshio Masaki on March 12, 2014, it was explained that at the present time the NET estimate was JPY 61.7 billion excluding the JPY 8.0 billion that client H was responsible for, that the targets for both SP and NET were not being met, and that various measures were going to be implemented to meet the target NET of JPY 41.5 billion (or JPY 37.7 billion if development expenses could be allocated to contracts other than Project H) excluding the JPY 8.0 billion that client H was responsible for.

According to the Finance & Accounting Division personnel at the time, at the SIS Company’s position evaluation meeting regarding the FY 2013 settlement of accounts (attended by Toshio Masaki CP, the General Manager of the Finance & Accounting Division, etc.), which was held in late March 2014, it was decided not to record a provision for contract losses on Project H.

Amid these circumstances, in the fourth quarter of FY 2013, the

percentage-of-completion method started being applied to Project H. However, despite the aforementioned report, etc. having been made, the percentage-of-completion method started being applied to an SP of JPY 14.1 billion, which corresponded to the portion for which a formal contract had been entered into, with the NET amount still registered on the internal system as JPY 14.1 billion. The procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses, were not commenced.

(d) The situation in the second quarter of FY 2014

At the quarterly reporting meeting held on July 23, 2014, the SIS Company presented a written report on Project H. The report stated that the risk level was high, that there would be an operating loss of JPY 7.5 billion, and that measures were being taken to charge for products/services and to reduce costs for the purpose of cutting down on the amount of provisions to be recorded for Loss-Making Projects. It stated that the impact of these measures would range from a loss of JPY 5.0 billion to JPY 10.0 billion. At this time, Hisao Tanaka P expressed his concern that he was unsure whether this would be the final result or things could get even worse for Project H.

On August 21, 2014, the General Manager of the Finance & Accounting Division of the SIS Company gave an explanation on Project H to Keizo Maeda CFO. The materials used for this explanation gave current forecasts for losses under the percentage-of-completion method of JPY 7.9 billion in 2014, JPY 7.5 billion in 2015, and JPY 7.5 billion in 2016, making for a total loss of JPY 22.9 billion. It also gave post-improvement forecasts for losses under the percentage-of-completion method of JPY 6.5 billion in 2014, JPY 5.0 billion in 2015, and JPY 5.2 billion in 2016, making for a total loss of JPY 16.7 billion.

At the CEO Monthly Meeting held on August 25, 2014, the SIS Company reported an “operating loss (tentative) of JPY 7.5 billion” for Project H.

On September 22, 2014, after an explanation had been given to Toshio Masaki GCEO, the SIS Company (attended by Takeshi Yokota CP, etc.) gave a report on Project H to Hisao Tanaka P. The materials used for this report gave an estimate as of that day of a gross loss of JPY 22.9 billion only for the portion subject to the percentage-of-completion method (the figure would have increased to JPY 27.3 billion if the portions subject to the inspection-based method had been included). The report also stated that even if profit improvement measures, such as CD, increasing the contract amount, and sharing development and other expenses with other projects, were successfully implemented, the gross loss would still be “JPY 6.5 billion (to be recorded as a Loss-Making Project in the second half of 2014).”

Despite the reports, etc. such as those described above having been made, in the second quarter of FY 2014 the NET amount of JPY 14.1 billion registered on the internal system against an SP of JPY 14.1 billion was not reviewed, and there was again no commencement of procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses.

(D) Causes of inappropriate accounting treatment

(a) Accounting treatment in the second quarter of FY 2013

a. Company

At the time of the order receipt, the SIS Company made estimates for amounts excluding the JPY 8.0 billion that client H was responsible for. The implementation of CD measures was incorporated into these estimates of NET JPY 44.1 billion, SP JPY 31.9 billion, and gross loss of JPY 12.2 billion, provided that, should further improvement measures be implemented, the gross loss would be JPY 8.0 billion, and if orders for other projects were also received and the development expenses for Project H could be allocated to these other projects, the gross loss would be JPY 4.2 billion. In the case of Project H, a large loss was anticipated from the time of the order receipt, so a provision for contract losses should have been recorded in the second quarter of FY 2013.

However, the estimates that the SIS Company made at the time the order was received included unsubstantiated CD. Even before CD was taken into account, the estimates were insufficiently precise and lacked reasonableness. As a result, when calculating the recorded amount of the provision for contract losses, reasonable estimates³⁰ should have been made, after which procedures for identifying Loss-Making Projects should have been commenced based on the amounts of those estimates. It can be surmised that the CP and other executives of the SIS Company were not aware of what the total estimated cost of contract work would be if the calculations were performed in a reasonable manner, and not properly aware of the amount of the provision for contract losses that should be recorded. (It is presumed that, although they knew that the project would make a loss when they received the order for it, they were probably aware that there was considerable potential for CD measures and the receipt of additional orders.) The CP and other people of the SIS Company were aware that at least around JPY 4.2 billion needed to be recorded as a provision for contract losses. Even so, at the SIS Company, procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses, were not commenced, and a provision for contract losses was not recorded.

There was a de facto rule at the SIS Company regarding the treatment of Loss-Making Projects; except in the case of recording of small provisions, reporting to and approval by Corporate (P and/or GCEO) was required when recording a provision for contract losses at the SIS Company. The reason why a provision for contract losses was not recorded for this project can be recognized that, even though the SIS Company asked, before the order was received, for a provision for contract losses of JPY 4.2 billion to be recorded in FY 2013, Hisao Tanaka P and Hideo Kitamura GCEO did not give their approval.

³⁰ Reasonable estimates of the total estimated cost of contract work would have been JPY 20.4 billion for the portion to which the inspection basis was applied (portion for the manufacture of the equipment) (gross loss JPY 2.6 billion) and JPY 36.8 billion for the portion to which the percentage-of-completion basis was applied (portion for development, installation, and maintenance not included in the portion for the manufacture of the equipment) (gross loss JPY 22.9 billion).

b. Corporate

As stated above, although the estimates that the SIS Company made at the time the order was received were not reasonable, the SIS Company explained to Hisao Tanaka P, Makoto Kubo CFO, and Hideo Kitamura GCEO that the estimated loss was JPY 4.2 billion. The SIS Company explained that although the current estimated gross loss was JPY 12.2 billion (the estimated loss at the time of receiving the order), factors such as the implementation of improvement initiative in the future would reduce the gross loss to JPY 8.0 billion, and that the allocation of common development expenses for Project H to other contracts would also reduce it to this amount. Based on this view, Hisao Tanaka P, Makoto Kubo CFO, and Hideo Kitamura GCEO were requested to approve a provision for contract losses of JPY 4.2 billion to be recorded in FY 2013.

In response, Hisao Tanaka P and Hideo Kitamura GCEO did not give their approval, and as a result, procedures for identifying Loss-Making Projects, which would have led to recording of a provision for contract losses with regard to Project H, were not commenced. Hideo Kitamura GCEO himself has stated that he never said a provision for contract losses should not be recorded. However, this is at odds with statements from several of the other people involved. In addition, the fact that Hideo Kitamura GCEO himself stated that it was possible to improve profitability further and has not stated that he approved the recording of a provision for contract losses indicates that Hideo Kitamura GCEO did not approve the recording of a provision for contract losses. Also, Hisao Tanaka P, even though he has no recollection of receiving an explanation of Project H from the SIS Company before the order was received, has stated that he did not say that a provision for contract losses should not be recorded. However, this is at odds with statements from several of the other people involved. In addition, it can be considered that, if Hisao Tanaka P had given his approval, a provision for contract losses would have been recorded regardless of the wishes of the other people involved, which indicates that Hisao Tanaka P did not approve the recording of a provision for contract losses.

Given that Hisao Tanaka P and Hideo Kitamura GCEO did not approve the recording of a provision for contract losses of JPY 4.2 billion when asked to do so by the Company, even in the absence of highly-implementable specific CD measures, it can be surmised that they intended to delay the recording of a provision for contract losses. (In the first half of FY 2013, the SIS Company recorded an operating loss of JPY 5.1 billion against the budgeted amount (loss) of JPY 4.4 billion, and if a provision for contract losses in relation to Project H had been recorded, the SIS Company's operating loss would have been much larger.)

(b) Accounting treatment in the fourth quarter of FY 2013

a. Company

From the events that occurred from November 2013 to March 2014 described above, it can be recognized that the CP and other related people at the SIS Company were aware that a loss of at least JPY 5.0 to 10.0 billion would be incurred in the fourth

quarter of FY 2013. Nevertheless, in that quarter the SIS Company carried out no procedures to make changes to the NET (JPY 14.1 billion) recorded on its internal system, and did not commence any procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses.

As stated above, when explanations were given on September 25 to 26, 2013, before the order was received, approval was not obtained from Corporate to record a provision for contract losses in FY 2013. (During the explanations it gave on those days, the SIS Company did not request an approval for a provision for contract losses to be recorded in the second quarter of FY 2013 specifically. It simply requested an approval for such a provision to be recorded before the end of FY 2013, but did not obtain such approval.) This can be surmised as the reason why a provision for contract losses was not recorded in the fourth quarter of FY 2013.

b. Corporate

In view of the explanations given at the CEO Monthly Meetings held in November 2013 and February 2014 and the explanation given to Hideo Kitamura GCEO on January 9, 2014, Hisao Tanaka P and Hideo Kitamura GCEO were aware that Project H was anticipated to incur a loss of at least several billion yen.³¹

However, no evidence was found that Hisao Tanaka P and Hideo Kitamura GCEO gave any suggestions, instructions, etc. to the SIS Company to review the NET on the internal system or carry out procedures for recording a provision for contract losses on the premise that this was a Loss-Making Project.

As stated earlier, it can be surmised that Hisao Tanaka P and Hideo Kitamura GCEO intended to delay the recording of a provision for contract losses in order to avoid a deterioration in the SIS Company's profitability in FY 2013, which would have occurred had the provision for contract losses been recorded. (In FY 2013, the SIS Company recorded an operating profit of JPY 28.7 billion, but the SIS Company's budgeted operating profit for that year had been JPY 41.0 billion. and if a provision for contract losses in relation to Project H had been recorded, the SIS Company, while not falling into deficit, would have missed the budget by an extremely wide margin.)

During the interviews with the people involved, quite a number of people cited a lack of reliability in the estimates made before the end of FY 2013 as the reason why a provision for contract losses was not recorded in that fiscal year. In the case of Project H, however, the percentage-of-completion method was applied from the fourth quarter of FY 2013, except to the portion to which the inspection basis was applied. However, the percentage-of-completion method should be applied on the premise that reliable estimates are made. (If reliable estimates are not made, the percentage-of-completion method cannot be applied.) It is unacceptable to continue to apply the

³¹ At the CEO Monthly Meeting held on November 22, 2013, the quarterly reporting meeting held on January 23, 2014, and the CEO Monthly Meeting held on February 20, 2014, the operating profit from Project H was stated as "JPY 5.0 to 10.0 billion," but questions remain about why there is no evidence of a discussion having occurred when it was explained that JPY 1.1 billion was being incorporated as a loss in FY 2013. Such a discussion would have addressed the issue of why only JPY 1.1 billion was being recorded at the end of FY 2013 when there was an operating profit of JPY 5.0 to 10.0 billion.

percentage-of-completion method while not recording a provision for contract losses on the grounds that the estimates lack reliability.

(c) Accounting treatment in the second quarter of FY 2014

a. Company

From the events that occurred from July to September 2014 described above, it has been recognized that the CP and other related people at the SIS Company were aware that even if all the improvement measures were successfully implemented, a loss of at least JPY 6.5 billion (if things stayed as they were, the loss would be JPY 20-something billion) would be incurred in the second quarter of FY 2014. Nevertheless, in that quarter the SIS Company did not carry out any procedures to change the NET (JPY 14.1 billion) recorded on its internal system, and did not commence procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses. It is surmised that the following reasons for this existed.

At the quarterly reporting meeting held in January 2015, the SIS Company reported that although the cost-increasing and profit-reducing components of Project H and other projects would be filled through the implementation of various improvement measures, there was a risk that the JPY 8.0 billion component would not be filled. In response, Corporate instructed the SIS Company to “not allow the second-half JPY 8.0 billion risk to become reality.” From the fact that this instruction was given at the quarterly reporting meeting, and from statements made previously by Hisao Tanaka P, it can be inferred that at that time the SIS Company was aware that to record a provision for contract losses, it would, from a budget-control perspective, be required by Corporate to increase its profits by an amount similar to the provision. It can be surmised that this awareness was the reason why a provision for contract losses in relation to Project H was not recorded in the second quarter of FY 2014. (In the second quarter of FY 2014, the Transmission & Distribution Systems Division earned an operating profit of JPY 2.2 billion, but if a provision for contract losses in relation to Project H had been recorded, the division would have fallen into deficit.)

b. Corporate

From the events that occurred from July to September 2014 described above, it has been recognized that Hisao Tanaka P and Toshio Masaki GCEO were aware that Project H was anticipated to incur a loss of between JPY 6.5 billion and JPY 20-something billion.

In this quarter, too, however, no evidence was found that Hisao Tanaka P and Toshio Masaki GCEO gave any suggestions, instructions, etc. to the SIS Company to revise the NET on the internal system or carry out procedures for recording a provision for contract losses on the premise that this was a Loss-Making Project. Regarding the reasons for them not taking such action, it can be surmised that Hisao Tanaka P and Toshio Masaki GCEO intended to delay the recording of a provision for contract losses in order to avoid a deterioration in the SIS Company’s profitability in the second quarter of FY 2014, which would have occurred had the provision been recorded. (In the

second quarter of FY 2014, the SIS Company earned an operating profit of JPY 4.9 billion, but if a provision for contract losses in relation to Project H had been recorded, the SIS Company would have fallen into deficit.)

(d) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project H.

a. Internal control in the Company

In order to perform appropriate accounting treatment, the Company's Finance & Accounting Division was expected to perform a checks and balances function as an organization that was independent of divisions, and was therefore responsible for contributing to internal control.

Regarding Project H, the General Manager of the Finance & Accounting Division had attended the SIS Company Order Policy Meetings since before the order was received. Moreover, after the order was received, the General Manager of the Finance & Accounting Division and other personnel at the Finance & Accounting Division made reports to the CP and attended meetings, etc. to check the cost situation. Therefore, the Finance & Accounting Division should have indicated that the total estimated cost of contract work from a figure based on the premise of profitability improvement measures, etc. that were unlikely to be realized (or were not being realized) should be revised to one based on the premise of reasonable estimates and procedures for identifying Loss-Making Projects should be commenced and have provided guidance in connection with these.

However, the de facto rule requiring the CP and Corporate to make decisions on whether to record provisions for contract losses and the amounts thereof crippled the checks and balances function of the Finance & Accounting Division. (In such situations, the Finance & Accounting Division was expected to exercise its checks and balances function by liaising with the Corporate Finance & Accounting Division, but in reality, the Corporate Finance & Accounting Division never played such a role.)

In addition, personnel at the Finance & Accounting Division had a strong tendency to place priority on managerial accounting over financial accounting. They felt that it could not be helped to prioritize improving the company's profitability in terms of accounting more than ensuring appropriate accounting treatment. It is therefore surmised that this was a reason not to indicate that a provision for contract losses should be appropriately recorded or provide guidance in connection with that. Therefore, it must be said that internal control by the Finance & Accounting Division was not functioning at all.

b. Internal control at Corporate

(a) Corporate Finance & Accounting Division

As the top of the Corporate Finance & Accounting Division, Makoto Kubo CFO was

aware that Project H was expected to incur a loss in each quarter, so regardless of the intents of Hisao Tanaka P and Hideo Kitamura GCEO, he should have instructed the SIS Company to record a provision for contract losses. In addition, as the top of the Corporate Finance & Accounting Division from the second quarter of FY 2014, Keizo Maeda CFO was aware that Project H was expected to incur a loss, and should have responded similarly.

However, Makoto Kubo CFO, Keizo Maeda CFO, and the Corporate Finance & Accounting Division did not give instructions to the SIS Company. It can therefore be recognized that the checks and balances function of the Corporate Finance & Accounting Division was not functioning at all. Like the Company Finance & Accounting Division, the Corporate Finance & Accounting Division had a strong tendency to prioritize managerial accounting over financial accounting. The people in the division felt that it could not be helped to prioritize improving the company's profitability in terms of accounting more than ensuring appropriate accounting treatment. It can therefore be surmised that this was a reason they did not give instructions for a provision for contract losses to be appropriately recorded. Therefore, it must be said that internal control by the Corporate Finance & Accounting Division was not functioning at all with respect to Project H.

(b) Corporate Audit Division

No audit of the Transmission & Distribution Systems Division was conducted by the Corporate Audit Division after September 2013, when the order for Project H was received, and no fact could be found showing that the Corporate Audit Division had conducted any investigation of Project H.

c. Other

(a) Audit Committee

Members of the Audit Committee who are not outside directors are supposed to attend quarterly reporting meetings, so they attended the quarterly reporting meetings held in January and July 2014. Regarding Project H, the materials from the quarterly reporting meeting held in January 2014 stated an operating loss of "JPY 5.0 – 10.0 billion," while the materials from the quarterly reporting meeting held in July 2014 stated an operating loss of "JPY 7.5 billion."

In addition, on December 22, 2014 the Audit Committee interviewed Takemi Adachi, the EVPI, Senior Vice President of the SIS Company. During this interview, the fact that Project H was making a loss was mentioned.

Furthermore, on the 25th of the same month, the Audit Committee members Makoto Kubo and Seiya Shimaoka received an explanation of Loss-Making Projects relating to large contracts from the Corporate Finance & Accounting Division. Both Audit Committee members received an explanation of Project H, and the explanatory materials used contained this statement: "This fiscal year the gross margin will be negative JPY 6.5 billion on the master agreement (completion basis) due to the SP being JPY 14.1 billion and the total estimated cost of contract work being JPY 20.6 billion,

and the key issue is whether any doubts from the auditors can be eliminated.” It also stated that the costs would be cut through the implementation of “improvement measures (master agreement: JPY 14.6 billion),” but that “specific measures have not been confirmed.”

In addition to these facts, even though Makoto Kubo, who became the Chairman of the Audit Committee in June 2014, had previously been the CFO and was aware that Project H was expected to incur large losses, no evidence was found that the Audit Committee raised the issue of reviewing the NET in the internal system or recording a provision for contract losses with the SIS Company or engaged in any deliberations concerning this issue.

Therefore, the Audit Committee cannot be evaluated to have been performing its appropriate internal control function.

(b) Accounting auditor

During the audit for the fourth quarter of FY 2013, the SIS Company presented the accounting auditor with the order item numbering list for Project H and the agreement entered into with client H. These materials were submitted so that the accounting auditor could confirm the contract amount and the total estimated cost of contract work, but the accounting auditor did not probe particularly deeply into whether the NET amount recorded on the order item numbering list was valid or whether it was necessary to record a provision for contract loss.

However, as explained above, in the case of projects to which the percentage-of-completion method is applied, personnel from the operations accounting department or engineering department prepares estimates, which are first approved by an accounting department or engineering department superior, and then approved by a sales department superior. Provided that the order item numbering list has been prepared after approval has been given by persons with expert abilities concerning these estimates, the accounting auditor will normally assume that the NET amount presented on the order item numbering list is correct. In the case of Project H, the big discrepancy between the correct NET amount and the NET amount presented on the order issuance sheet could not be corrected, and the result was that the control function of the accounting auditor did not cover it, but it can be considered that this was unavoidable.

(3) Project I

(A) Outline of Project I

This is a project where TIC America, a U.S.-based Subsidiary of Toshiba, received an order in December 2010, with a contract amount of USD 129 million from client I subsidiary, a U.S.-based subsidiary of client I, to provide electric equipment used for the subway trains for customers of client I subsidiary), with an (initial) delivery period of

July 2013 through July 2015.³²

The SIS Company undertook the design and a certain part of the manufacturing of the electric equipment from TIC America, while TIC America undertook the assembly. The contract between TIC America and client I subsidiary sets forth the obligation of TIC America to deliver the electric equipment for 364 cars for the price of USD 129 million (the “**Base Contract**”) as described above, with a further option by client I subsidiary to order additional electric equipment for up to 384 cars for the price of USD 122 million (the “**Option Contract**”).

The SIS Company applied inspection basis accounting to Project I, with sales recorded at the time of inspection of the electric equipment.³³ Project I was nonetheless included in the scope of the Investigation, considering the importance placed on the estimation of the total cost of contract work, just the same as under the percentage-of-completion method.³⁴

(B) Accounting treatment in question and appropriateness thereof

With respect to Project I, as of March 2012, the SIS Company was planning to hold a final meeting on specifications called a “Final Design Review” in the following month, such that the specifications had been largely determined and a reasonable estimate was able to be prepared. Also, the possibility of a loss, such as the total estimated cost of USD 207 million exceeding the amount of the order of USD 129 million regarding the Base Contract, was recognized at that time. However, despite the absence of any reasonable grounds, no provision for loss-making contracts³⁵ was recorded at the time of the order receipt.

Thereafter, JPY 2.5 billion was recorded as provisions for loss-making contracts in the second quarter of FY 2013, but overall losses were anticipated to be JPY 3.9 million in the fourth quarter of FY 2013, and expanded to JPY 6.4 billion in the second quarter of 2014, resulting in the recording of additional provisions for loss-making contracts.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

³² The initial delivery period is for mass produced rolling stock (360 cars). The initial delivery period for prototype rolling stock (1 car) was January 2012, and that for pilot type rolling stock (4 cars) was October 2012.

³³ Projects subject to the percentage-of-completion method are construction contracts (of service contracts under which consideration is paid for completion of work, contracts under which standard specifications and work content such as civil engineering, construction, shipbuilding, and manufacturing of fixed machinery and equipment is carried out in accordance with customer directions) and software development projects. Project I is neither of these project types.

³⁴ Project I is not a construction contract under the accounting rule. Therefore, expressions such as the total cost of contract work and the total income on contract work do not strictly apply. That said, this report has not differentiated between these expressions.

³⁵ Because accounting standards for construction contracts do not apply to this project, the account titles also differ from other transactions, and the title for provisions for contract losses is not used.

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	50	26
Total estimated cost of contract work	-	-	-	-	-	88	90
Net profit and loss	-	-	-	-	-	(39)	(64)
FY profit and loss							
Sales	-	-	-	-	-	1	3
Gross profit	-	-	-	-	-	(39)	(25)
Cumulative profit							
Sales	-	-	-	-	-	1	4
Gross profit	-	-	-	-	-	(39)	(64)

According to the “Report Material Regarding Profit and Loss Improvement for Project I” dated February 7, 2012, a cost of USD 207 million was expected to be incurred for the contract amount of USD 129 million. The SIS Company did not record provisions for loss-making contracts, taking into consideration the effect of cost reductions. However, the terms of the cost reduction measures included matters for which there were no specific measures at that time. Therefore, a quotation should have been prepared excluding cost reduction amounts with low feasibility, and provisions for loss-making contracts should have been recorded in the fourth quarter of FY 2011.

As a result of the review based on the above matters, the total estimated cost of contract work for FY 2011 was JPY 16.3 billion in the fourth quarter, and the amount of the impact on profit and loss was negative JPY 5.7 billion.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013 ³⁶	FY 2014 Q3
Total estimated income from contract work	-	-	-	106	121	25	26
Total estimated cost of contract work	-	-	-	163	187	99	98
Net profit and loss	-	-	-	(57)	(66)	(74)	(73)
FY profit and loss							
Sales	-	-	-	-	-	1	3
Gross profit	-	-	-	(57)	(8)	(8)	1
Cumulative profit							
Sales	-	-	-	-	-	1	4
Gross profit	-	-	-	(57)	(66)	(74)	(73)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	106	121	(24)	-
Total estimated cost of contract work	-	-	-	163	187	11	9
Net profit and loss	-	-	-	(57)	(66)	(35)	(9)

³⁶ From 2013, Toshiba separated the business between the U.S. Subsidiary and Toshiba, at which stage Toshiba only recognized the section that it was in charge of, resulting in extensive fluctuations in the total estimated income from contract work and the total estimated cost of contract work.

FY profit and loss							
Sales	-	-	-	-	-	-	0
Gross profit	-	-	-	(57)	(8)	31	26
Cumulative profit							
Sales	-	-	-	-	-	-	0
Gross profit	-	-	-	(57)	(66)	(35)	(9)

(C) Facts identified by the Independent Investigation Committee

(a) Events from the receipt of the order to the end of FY 2011

On December 10, 2010, TIC America received the order for Project I (the “**Base Contract**”) for a price of USD 129 million from client I subsidiary. The SIS Company undertook from TIC America the design and part of the manufacturing of the electric equipment. Although it was estimated since the time of the order receipt that Project I would incur a loss (of JPY 4.2 billion), the SIS Company decided to receive the order for strategic reasons, and set a cost target of breaking even, including the option contract. At the SIS Company, under the rules concerning the approval of the receipt of orders, CP Approval Projects had to be referred to the SIS Company Order Policy Meeting. However, as a matter of fact, Project I was approved by the CP without having been deliberated on at the Order Policy Meeting.

Because detailed specifications had not been determined at the time of the order receipt, it was necessary for the SIS Company to conduct a design review with client I and client I’s subsidiary to cause them to decide the specifications. A preliminary design review was conducted in July 2011, and at around the end of FY 2011 at the latest, just before the final design review, which needed to be performed in April 2012, it was possible to make a reasonable estimate of the total estimated cost of contract work for Project I.

On January 26, 2012, the Vice President I of the Railway & Automotive Systems Division, which was in charge of Project I, apologized to Norio Sasaki P for the delay in providing a report on their progress regarding profitability improvement. They then explained that, as of November 2011, the estimated loss would be USD 85 million, but that if they implemented profitability improvement measures, the loss could be reduced to USD 26 million, which would be their target. However, Norio Sasaki P instructed them to prepare and provide an explanation of a profitability improvement plan that would put the project into the black.

In addition, at the quarterly reporting meeting held on the same day, Norio Sasaki P stated that if a provision was made for Project I, the operating profit for the second-half of the year of the Railway Systems Division which was in charge of Project I, JPY 5.9

billion, could be completely wiped out.

On February 20, 2012, the Railway Systems Division, which was in charge of Project I, reported to Norio Sasaki P that the loss would be USD 85 million if nothing was done, and that several profit targets had been set based on the potential of the measures to be implemented successfully. According to the report, these were Target Step 1 (negative USD 55 million), Target Step 2 (negative USD 26 million), and ultimately, Target Step 3, which was to break even, would be aimed in the future. On February 24, the Railway Systems Division reported to Norio Sasaki P on the profit and loss forecast of the Base Contract. If things remained as they were (in February 2012), the loss would be USD 78 million, but the target was for a loss of USD 26 million. At the CEO Monthly Meeting held on the same day, the SIS Company reported that, given the latest information on the cost situation (Total Contract Cost), the gross loss would be USD 78 million, but that CD measures were being implemented as aggressively as possible and that a careful consideration would be performed by March 9. It received the comment from Norio Sasaki P that “(while anticipated operating profit is JPY 8.4 billion for the whole SIS Company excluding the L+G Division in FY 2011), if the Loss-Making Project with client I, which carries a loss of JPY 6.4 billion, was received, operating profit would be JPY 2.0 billion for the fiscal year: i.e., almost zero.”

Norio Sasaki P, during the important measures review meeting on February 15, 2012, said, “Isn’t Project I the key project? Doesn’t incurring a loss of as much as JPY 8.9 billion make it the key project? Having an order that’s going to lose JPY 8.9 billion, and how is this going to be resolved?” In addition, at a meeting of the medium-term plan/budget examination meeting held on March 5, 2012, when General Manager I said, with reference to Project I, that he wanted to “discuss a strategy that would ensure this Project makes a profit,” Norio Sasaki P replied, “Impossible. How is it possible to make a project with a sale price of JPY 12.3 billion and an anticipated gross loss of JPY 8.9 billion profitable?”

At around the beginning of February 2012, the General Manager of the Corporate Finance & Accounting Division instructed the General Manger of the SIS Company Finance & Accounting Division and the Division GPM I to avoid losses arising and to determine the accounting treatment for the fourth quarter of FY 2011 with respect to Project I. On February 3, 2012, the General Manger of the SIS Company Finance & Accounting Division and the Division GPM I gave an explanation of Project I to Makoto Kubo CFO and the General Manager of the Corporate Finance & Accounting Division. Makoto Kubo CFO asked what the actual profit forecast was while the target profitability was negative USD 26.0 million. The response was a loss of between USD 26.0 million and USD 55.0 million, and Makoto Kubo CFO instructed them to settle on an amount and report it to the CEO by the next CEO Monthly Meeting.

On the other hand, on March 1, 2012, in the Corporate Finance & Accounting Division and the SIS Company Finance & Accounting Division, (i) General Manager I of a department in charge of implementation of new accounting systems, (ii) I1, who was in charge of implementation of J-SOX rules in the same department, (iii) I2, the GPM in charge of administration in the Corporate Finance & Accounting Division, (iv) the General Manager of the SIS Company Finance & Accounting Division, and (v) I, the GPM of the SIS Company Finance & Accounting Division, held a meeting concerning internal controls for Loss-Making Projects, based on the materials prepared

by the SIS Company Finance & Accounting Division. In these materials, a subsection entitled “Current analysis and issues” in the “Case: Client I project” section, contained the statement, “Toshiba and TIC America should have discussed their awareness of the Loss-Making Project at an early stage.” From this statement, it can be surmised that this meeting was held because of regrets that recording a provision for contract losses in relation to Project I had not been considered until that time, even though such consideration had been necessary. It can also be surmised that the meeting was held for the purpose of reviewing internal controls relating to financial reporting. Later, on March 14, 2012, Makoto Kubo CFO had a discussion about Project I with General Manager I, the General Manager of the SIS Company Finance & Accounting Division, and the Division GPM I, at which similar things were discussed.

On March 16, 2012, General Manager I and others from the Railway Systems Division gave Hideo Kitamura GCEO, Makoto Kubo CFO, and the General Manager of the Corporate Finance & Accounting Division an explanation of CD measures and measures to increase SP that were being implemented with the aim of getting Project I into the black. After receiving this explanation, Hideo Kitamura GCEO and Makoto Kubo CFO decided “not to record a provision for contract losses in that period on the grounds that the CD measures and measures to increase SP were not yet determined.” Hideo Kitamura GCEO also strongly urged the SIS Company to successfully implement the measures that had been explained to him that day and to get the Project into the black. If it didn’t, he warned that they should be prepared to see the likely collapse of the Railway Systems Division.

On the same day, General Manager I and others [from the Railway Systems Division] reported the above decision to Toshio Masaki CP.

The SIS Company Finance & Accounting Division included the following statement in the margin (outside the scope of that printed out) in its list of forecasts for the second half of FY 2011, which was dated March 23, 2012, under “Risk information (figures not included):” “Project I: a provision for contract losses approx. JPY 4.0 billion → implement measures to improve profitability.”

(b) FY 2012

On September 7, 2012, Toshio Masaki CP and others gave an explanation to Hideo Kitamura GCEO, Makoto Kubo CFO, and the General Manager of the Corporate Finance & Accounting Division concerning the situation with the implementation of measures to improve the profitability of Project I, and explained that the current profit forecast was negative USD 41 million. On the premise that they would meet the target through additional CR activities, they asked for approval for a provision for contract losses to not be recorded in the first half of FY 2012. At the same meeting, they explained that future negotiations to increase the SP were expected to be difficult, but that there had not been any items broken down in the negotiations so far. In response, Hideo Kitamura GCEO and others approved the non-recording of a provision for contract losses.

On March 7, 2013, at a top-management medium-term plan and budget meeting (Norio Sasaki P, Hideo Kitamura GCEO, and Kubo CFO were all in attendance), Toshio Masaki CP reported that, while there were a few projects that required provisions for contract losses or were experiencing delays in getting off to start, it was only Project I

that was expected to incur a large loss. During the Investigation by this Committee, Toshiba responded that there were no report materials concerning Project I submitted by the SIS Company to Corporate at the end of FY 2012.

(c) End of the first half of FY 2013

On July 5, 2013, one of the personnel at the SIS Company Finance & Accounting Division explained to Toshio Masaki CP that the current total profit forecast for the Base Contract was “negative USD 59.5 million.” He also explained that simulations involving various exchange rates and assumptions (worst case, realizable case, minimum case) put the loss in yen terms in the range of JPY 5.28 billion to JPY 2.0 billion. During that explanation, Toshio Masaki CP mentioned; “Is it possible to minimize the loss for the current period by identifying components of the initial costs (development elements) that can be deferred,” “I want the division to provide a target CR amount that was genuinely realizable.” After receiving this report, Toshio Masaki CP and the General Manager of the SIS Company Finance & Accounting Division decided to partially record a provision for contract losses in relation to Project I.

On July 8, 2013, Toshio Masaki CP and the General Manager of the SIS Company Finance & Accounting Division gave a report to Hideo Kitamura GCEO and Makoto Kubo CFO. They explained that negotiations to increase the SP had been rejected by client I, that cost reductions would be difficult because the design and specifications were already fixed and reducing procurement costs would be difficult, that the project met the criteria for a Loss-Making Project, that simulations involving various exchange rates and assumptions (original-contract worst case,³⁷ original-contract realizable case,³⁸ minimum case based on an SP increase³⁹) put the loss in yen terms in the range of JPY 5.28 billion to JPY 2.0 billion. Approval was then granted to record a provision for contract losses for the smallest amount in the range, JPY 2.0 billion. On July 10, Toshio Masaki CP and the General Manager of the SIS Company Finance & Accounting Division gave the same report to Hisao Tanaka P.

Following these reports and approval, it was decided to record a provision for contract losses of JPY 2.0 billion in the first half of FY 2013.

On the other hand, on September 4, 2013, the Railway & Automotive Systems Division reported to Toshio Masaki CP that the total loss was currently expected to be approximately JPY 6.0 billion, and that taking into account the measures to reduce the loss to JPY 2.0 billion and those with low feasibility thereof, the loss would be JPY 4.0 billion. In the same report, the Finance & Accounting Division GPM I reported to Toshio Masaki CP that from the accounting side the loss would be JPY 5.3 billion (or JPY 5.9 billion if a revision to the assumed exchange rate were incorporated), and that there was a risk that the accounting auditor would point out as an issue with a provision for contract losses of JPY 2.0 billion in recording the order for this Project, due to an

³⁷ Did not take into account the possibility of an SP increase and reflected only highly-realizable CD measures.

³⁸ Did not take into account the possibility of an SP increase and reflects only CD measures that the Finance & Accounting Division expected to be successfully implemented.

³⁹ Took into account the possibility of an SP increase and reflected all CD measures except those that at that time were known to be impossible to implement.

absence of concrete measures to ensure its profitability.

Toshio Masaki CP, meanwhile, decided to increase the provision for contract losses in relation to Project I on the grounds that the profit of the Railways Systems Division in the second quarter of FY 2013 was anticipated to rise by JPY 0.3 billion from cost-variance adjustments and JPY 0.3 billion from unrealized gains on inventory. As a result, the amount of the provision ultimately recorded at the end of the first half of FY 2013 was JPY 2.5 billion.

(d) End of FY 2013

The materials used by the SIS Company for the explanation it gave at the CEO Monthly Meeting held on November 22, 2013 stated that it was engaged in a Challenge to achieve a further reduction in the amount of impact on profit or loss with respect to Project I, which was negative JPY 6.0 to 5.0 billion. The materials also stated that a provision for a loss of JPY 2.5 billion had already been recorded for the first half of FY 2013. In addition, the materials used by the SIS Company for the explanation it gave at the CEO Monthly Meeting held on December 19, 2013, the quarterly reporting meeting held on January 23, 2014, and the CEO Monthly Meeting held on February 20, 2014 contained similar statements.

In addition, the CR activity reporting material dated March 13, 2014 informed Toshio Masaki CP that the anticipated total loss for the fiscal year was “USD 63.8 million.”

Further, when the budget for the next fiscal year was being put together at the end of FY 2013, provisions for the risk of deterioration in various projects, including Project I, were incorporated into it, and a provision for contract losses of JPY 2.2 billion in relation to Project I was incorporated into the budget for the first half of FY 2014.

(D) Causes of inappropriate accounting treatment

(a) Accounting treatment at the end of FY 2011

a. Company

Looking at the events described above, Project I was anticipated to incur a loss of at or around JPY 6.0 billion as at the end of FY 2011 and it was likely that Toshio Masaki CP and other people involved at the Company were aware of this. Company personnel should have recorded provisions for contract losses in accordance with the process for the treatment of Loss-Making Projects.

In spite of this, at the end of FY 2011, Project I had not been identified as a Loss-Making Project in accordance with the process for the treatment of Loss-Making Projects, and a provision for contract losses was not recorded. The following can be considered to be causes of such situation.

Under the de facto rule that the SIS Company had concerning the treatment of Loss-Making Projects set forth above, provisions for contract losses could not be recorded without the approval not only of the CP and others within the Company but also of Corporate (P and/or GCEO), and on March 16, 2012, Hideo Kitamura GCEO, along with Makoto Kubo CFO, decided not to record a provision for contract losses in

relation to Project I, and conveyed this decision to the General Manager of the Railway Systems Division. As a result, it can be considered that the people involved at the SIS Company, in accordance with the decision made by Hideo Kitamura GCEO and Makoto Kubo CFO, did not commence procedures for identifying Loss-Making Projects, which would have led to the recording of a provision for contract losses.

b. Corporate

As stated above, Hideo Kitamura GCEO, along with Kubo CFO, decided on March 16, 2012 not to record a provision for contract losses in relation to Project I. This can be considered to have been a direct cause of the fact that Project I was not identified as a Loss-Making Project and that a provision for contract losses was not recorded at the end of FY 2011.

Hideo Kitamura GCEO has stated that he believed that, in the case of projects for which provisions for contract losses had been recorded, the persons in charge of the project might consider that it is acceptable to incur losses up to the amount of the provision, and that this may give them less incentive to take CR measures etc., and that this thinking led to him adopting a policy of not easily approving the recording of provisions for contract losses. Although it cannot be denied altogether that such a reason did exist, as stated above, it was explained at the quarterly reporting meeting held on January 26, 2012 that a loss of USD 85 million was anticipated. In addition, the target operating profit for the SIS Company in FY 2011 was JPY 50.8 billion, but even if a provision for contract losses on Project I was not recorded, operating profit would still have only been JPY 6.6 billion. Given factors such as this, it can be surmised that Hideo Kitamura GCEO intended to delay the recording of losses in the current period.

Given the reports made on January 26, 2012 and February 24 of the same year, the statements made at the important measures review meeting on the 15th of the same month and at the medium-term plan and budget meeting held on March 5 of the same year, and the results of the audit conducted by the Corporate Audit Division in November 2011, it can be considered that Norio Sasaki P was aware that Project I was anticipated to incur a loss of several billion JPY. He should therefore have encouraged, instructed, etc. a provision for contract losses to be recorded; yet no evidence was found that he issued any such suggestions or instructions (however, also no evidence was found that Norio Sasaki P decided himself not to record a provision for contract losses in relation to Project I). With regard to this point, Norio Sasaki P made these statements: “I constantly say that improprieties are unacceptable, and ask them to comply with the law.” “The finance & accounting people are supposed to ensure that accounting treatment is appropriate.” “P does not make the final decision on whether provisions for contract losses will be recorded with respect to individual projects; I just receive a financial report in April. And I never gave any instruction not to record a provision for contract losses in relation to Project I in the fourth quarter of FY 2011.” “I was also not aware that a provision for contract losses in relation to Project I had not been recorded in the fourth quarter of FY 2011.” However, at events such as the aforementioned reporting meetings, Norio Sasaki P repeatedly mentioned the impact that recording a provision for contract losses in relation to Project I would have on the financial results of the Railway Systems Division and the SIS Company (i.e., expressed

concerns that doing so would wipe out the operating profit altogether). Given these statements, it can also be surmised that he was aware that a provision for contract losses in relation to Project I was not going to be recorded and that he did not give suggestions, instructions, etc. for such a provision to be recorded in order to avoid recording losses in the current period.

(b) Accounting treatment in FY 2012

a. Company

In the first half of FY 2012, Toshio Masaki CP asked Hideo Kitamura GCEO, Makoto Kubo CFO and others to approve the non-recording of a provision for contract losses in relation to Project I. It cannot be altogether denied that the reasons why Toshio Masaki CP decided, as the SIS Company's position, that a provision should not be recorded (to request the approval of such non-recording from Hideo Kitamura GCEO) was that he felt that the implementation of further CR activities left room to achieve CR, but it can be surmised that it was because recording it would mean that the SIS Company was itself acknowledging that Project I was a loss-making order at the time of order receipt, and that the SIS Company would be held responsible for accepting this loss-making order (in fact, in March 2012, Hideo Kitamura GCEO warned that they should be prepared to see the likely collapse of the Railway Systems Division if Project I could not be brought into the black), and that therefore he intended to avoid recording a provision for contract losses.

b. Corporate

When asked by Toshio Masaki CP to approve the non-recording of a provision for contract losses in the first half of FY 2012, both Hideo Kitamura GCEO and Makoto Kubo CFO decided to give their approval. It can be surmised that the reason Hideo Kitamura GCEO approved the non-recording of a provision for contract losses at the end of the first half of FY 2012 was that he intended, like he had done at the end of FY 2011, to delay the recording of losses in the current period.

In the second half of FY 2012, at a top-management medium-term plan and budget meeting attended by Norio Sasaki P, Hideo Kitamura GCEO, Makoto Kubo CFO and others, suggestions, instructions, etc. should have been given to record a provision for contract losses because there was an awareness that Project I was likely to incur a large loss. However, no evidence was found of such suggestions, instructions, etc. having been given (however, also no evidence was found that these people decided themselves not to record a provision for contract losses in relation to Project I). With regard to this point, Norio Sasaki P has stated that he was not aware that a provision for contract losses in relation to Project I had not been recorded. However, Project I was a high-risk project regarding which it was possible to incur a large loss, and if a provision for contract losses had been recorded, an explanation would at least have been given at the CEO Monthly Meeting, etc. (otherwise, accounting figures such as operating profit, etc. could not have been explained). As a result, the doubt remains that Norio Sasaki P and Hideo Kitamura GCEO were aware that a provision for contract losses had not been

recorded in relation to Project I and that they did not give any suggestions, instructions, etc. to do so in order to avoid recording a loss in the current period. (The SIS Company's operating-profit target for FY 2012 was JPY 32.0 billion, and even though a provision for contract losses in relation to Project I was not recorded, actual operating profit for the fiscal year was only JPY 24.8 billion.)

(c) Accounting treatment at the end of the first half of FY 2013

a. Company

Looking at the events that occurred at the end of the first half of FY 2013, which were described above, as of September 2013, client I was refusing to enter into negotiations to increase the SP, and there was little room for CR in the procurement department as the design and specifications were already fixed and mass production had already begun.⁴⁰ Given this situation, it can be recognized that Toshio Masaki CP and the other people involved at the SIS Company were aware that it was impossible to prevent Project I from incurring a loss, and that a reasonable estimate for the loss was approximately around JPY 6.0 billion. The people involved at the SIS Company should therefore have commenced the procedures that would have led to the recording of a provision for contract losses of approximately at or around JPY 6.0 billion.

However, the actual provision for contract losses recorded was only JPY 2.5 billion. The following can be considered as the causes of this situation.

At the SIS Company, Toshio Masaki CP decided to record a provision for contract losses, but decided the amount of that provision would ultimately be JPY 2.5 billion, not the amount of the anticipated loss of approximately JPY 6.0 billion. The reasons for this can be surmised as follows: Under the aforementioned de facto rule at the SIS Company, provisions for contract losses could not be recorded without the approval of Corporate (P and/or GCEO), and Corporate had adopted a strict attitude until that time concerning the recording of a provision for contract losses in relation to Project I. In addition, based on the previous statements, etc. made by P and others, the SIS Company recognized that the recording of a provision for contract losses would lead Corporate to demand the profit increase by an amount that matched that provision from a budgetary control perspective, and because the performance outlook for the Railway & Automotive Systems Division was bleak for the first half of FY 2013, they intended to avoid recording losses in the current period and to delay the recording of those losses. (The budget for an operating profit and loss for the Railway & Automotive Systems Division in the first half of FY 2013 was negative JPY 3.4 billion, and even though the provision for contract losses in relation to Project I was limited to JPY 2.5 billion, the Railway & Automotive Systems Division's actual operating loss in the first half the same fiscal year was JPY 5.5 billion.)

b. Corporate

⁴⁰ The equipment for mass-produced rolling stock was initially supposed to be delivered between July 2013 and July 2015, but delivery was later rescheduled to between January 2014 and January 2016.

On July 8 and 10, 2013, it was explained to Hisao Tanaka P and Hideo Kitamura GCEO that a provision for contract losses in relation to Project I needed to be recorded, and based on these explanations, they approved the recording of a provision for contract losses of JPY 2.0 billion. With regard to this point, Hisao Tanaka P has stated that he looked at the materials on the assumption that the people from the finance & accounting departments had examined them carefully, and that he did not give any instructions, etc. concerning provisions. However, based on the facts that reporting materials provided to Hisao Tanaka P contained statements such as “meets the criteria for a Loss-Making Project,” which constitutes a suggestion to record a provision for contract losses and that it can be recognized that the SIS Company had an intent to propose the partial recording of a provision for contract losses to Corporate, it is likely that the SIS Company gave Hisao Tanaka P an explanation concerning the recording of a provision for contract losses and that Hisao Tanaka P had at least tolerated it.

Because the figure of JPY 2.0 billion was the amount of loss expected to be incurred in the “minimum case,” which took into account SP increase and reflects all CR measures except those that at that time were known to be impossible to implement, Hisao Tanaka P and Hideo Kitamura GCEO could have been aware that such an amount was inadequate as the loss reasonably expected to be incurred for Project I. Nevertheless, given that Hisao Tanaka P and Hideo Kitamura GCEO approved (or at least tolerated) JPY 2.0 billion as the amount that would be recorded as a provision for contract losses, it can be surmised that both of them intended to avoid recording losses in the current period and to delay the recording of those losses. (The target operating profit and loss for the SIS Company in the first half of FY 2013 was negative JPY 4.4 billion, and even though the provision for contract losses in relation to Project I was ultimately limited to JPY 2.5 billion, the SIS Company’s operating loss in the first half of the same fiscal year was JPY 5.1 billion.)

(d) Accounting treatment at the end of FY 2013

a. Company

The events described above indicate that, at the end of FY 2013, it was reasonably anticipated that Project I would incur a loss at or around JPY 6.0 billion, so an additional provision for contract losses of around JPY 3.0 billion would need to be added to the JPY 2.5 billion provision already recorded at that time. While it can be recognized that Toshio Masaki CP and the other people involved at the SIS Company were aware of this, only an additional provision for contract losses of JPY 0.6 billion was actually recorded (JPY 0.6 billion was recorded as a loss for the current period), with a provision for contract losses in relation to Project I of JPY 2.2 billion was incorporated into the budget for the first half of FY 2014.

It can be surmised that the causes of this were as follows: Given the previous statements, etc. from P and others, there was recognition that in order to record a loss, it would, from a budgetary control perspective, be requested to increase profits by an amount that matched that loss. It can be surmised that, because the forecast for FY

2013 for the Railway & Automotive Systems Division of the SIS Company was bleak (while the target operating profit and loss for the Railway & Automotive Systems Division in FY 2013 was negative JPY 0.6 billion, even though a provision for contract losses in relation to Project I had not been ultimately recorded, the operating loss of the SIS Company's Railway & Automotive Systems Division in FY 2013 was JPY 1.9 billion), there was an intention to avoid recording losses in the current period and to delay the recording of those losses.

b. Corporate

At the CEO Monthly Meetings held on November 22 and December 19, 2013 and February 20, 2014, and at the quarterly reporting meeting held on January 23, 2014, it was reported to Hisao Tanaka P and Hideo Kitamura GCEO that a provision for contract losses in relation to Project I of only JPY 2.5 billion had been recorded in the first half of FY 2013, even though the amount of impact on operating profit and loss in FY 2013 was at risk of being as high as negative JPY 6.0 billion. With regard to this point, Hisao Tanaka P has stated that he has no recollection of a discussion taking place based on such report materials. However, Hisao Tanaka P, at the quarterly reporting meeting held on January 23, 2014, said, "You haven't forgotten about Project I and GIS, have you?" In other words, he made a statement referring to the recording of provisions for contract losses in relation to Project I, from which it can be surmised that it is likely that Hisao Tanaka P was aware of the report.

Hisao Tanaka P and Hideo Kitamura GCEO should have given suggestions, instructions, etc. for a provision for contract losses to be recorded at the end of FY 2013. However, no evidence was found that Hisao Tanaka P and Hideo Kitamura GCEO gave any such suggestions, instructions, etc. (However, also no evidence was found that they decided themselves not to record a provision for contract losses in relation to Project I.) It can be surmised that it is likely that the cause of this was that Hisao Tanaka P and Hideo Kitamura GCEO also intended to avoid recording losses in the current period and to delay the recording of those losses (as mentioned earlier, although the SIS Company's actual operating profit in FY 2013 was JPY 28.7 billion, its target for that fiscal year had been JPY 41.0 billion).

(e) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project I.

a. Internal control in the Company

In order to perform appropriate accounting treatment, the Company Finance & Accounting Division was expected to perform a checks and balances function as an organization independent of divisions, and was therefore responsible for contributing to internal control.

However, de facto rules requiring the CP and Corporate to make decisions on whether to record provisions for contract losses and the amounts thereof crippled the

checks and balances function of the Company Finance & Accounting Division. (In such situations, the Company Finance & Accounting Division was supposed to exercise its checks and balances function by liaising with the Corporate Finance & Accounting Division, but in reality, the Corporate Finance & Accounting Division did not play such a role.) In addition, the Company Finance & Accounting Division personnel had a strong tendency to place priority on managerial accounting over financial accounting. They felt that it could not be helped to prioritize improving the company's profitability in terms of accounting more than ensuring appropriate accounting treatment. It can therefore be surmised that this was a reason that instructions were not given to appropriately record a provision for contract losses.

Regarding Project I, as was mentioned earlier, it can be recognized as likely that at the end of FY 2011, the SIS Company Finance & Accounting Division personnel and personnel at the Corporate Finance & Accounting Division discussed the project as an example of a Loss-Making Project, and that they reported to the CP and others a specific amount for the provision for contract losses that the Company Finance & Accounting Division considered reasonable. However, regardless of these reports, the decision on whether to record a provision for contract losses and the amount thereof was made by the CP (and the GCEO from Corporate) and others. Based on this fact, it must be said that internal control by the Finance & Accounting Division was not functioning sufficiently.

b. Internal control at Corporate

(a) Corporate Finance & Accounting Division

From the events described above, as the top in the Corporate Finance & Accounting Division, Makoto Kubo CFO was aware that Project I was expected to incur a loss in each quarter, so regardless of the intents of the CP and the GCEO, he should have instructed the SIS Company to record a provision for contract losses. However, Makoto Kubo CFO, together with Hideo Kitamura GCEO, proactively made the decision not to record a provision for contract losses. It can therefore be surmised that not only did he fail to sufficiently perform his professional responsibilities, but he also, in making such a decision, intended to avoid and delay the recording of losses.

In addition, given that around the beginning of February 2012, the General Manager of the Corporate Finance & Accounting Division instructed the SIS Company Finance & Accounting Division to avoid Loss-Making Contracts and to determine the accounting treatment for the fourth quarter of FY 2011, not only was the checks and balances function of the Corporate Finance & Accounting Division failing to function, but the doubt remains that the Corporate Finance & Accounting Division intended to cripple the checks and balance function of the SIS Company Finance & Accounting Division and to avoid and delay the recording of losses. Even though the General Manager of the Corporate Finance & Accounting Division and Corporate Finance & Accounting Division personnel had, along with the SIS Company Finance & Accounting Division, discussed Project I as an example of a Loss-Making Project, no evidence was found that any action was ultimately taken concerning the recording of contract losses in relation to Project I. At the Corporate Finance & Accounting Division as well, there was a strong tendency to place priority on managerial accounting

over financial accounting, and awareness that it could not be helped to prioritize improving the company's profitability in terms of accounting more than ensuring appropriate accounting treatment. It can therefore be surmised that this was a reason that instructions were not given to appropriately record a provision for contract losses.

Therefore, it must be said that internal control by the Corporate Finance & Accounting Division was not functioning at all with respect to Project I.

(b) Corporate Audit Division

In November 2011, the Corporate Audit Division conducted an audit of the Railway Systems Division, which was in charge of Project I, and prepared an audit report on December 5 of the same year. Although this audit report stated that at the time of the audit Project I was expected to incur a loss of USD 86 million, no comment was made about the need to record a provision for contract losses.

Although it cannot be considered that there was a reasonable estimate leading the recording of provisions for contract losses as of the third quarter of FY 2011 as the specifications had not yet been determined as at December 2011, it was expected that a provision for contract losses would need to be recorded sooner or later, and so it should have been indicated that such a provision would be required and that appropriate accounting treatment should be implemented.

Therefore, it cannot be said that internal control by the Corporate Audit Division was functioning sufficiently with respect to Project I.

c. Other

(a) Audit Committee

On February 3, 2012, during an interview with Toshio Masaki CP, concerns about the deteriorating profitability of Project I were reported to the Audit Committee.

In addition, on March 19 of the same year, during an interview with Hideo Kitamura GCEO, the Audit Committee was reported that stemming the bleeding from a project that was expected to result in deficit from the order receipt was a task that should be tackled.

Furthermore, on March 29 of the same year, the General Manager of the SIS Company Finance & Accounting Division and others explained to Director Fumio Muraoka (Chairman of the Audit Committee) and Director Hiroshi Horioka (a member of the Audit Committee) the action that the division was taking to minimize the loss and told them that a provision for contract losses in relation to Project I would not be recorded at that time. During this explanation, Director Fumio Muraoka said that the plan to wipe out the anticipated loss of JPY 8.3 billion on the portion of the order already received by raising the sale price to JPY 4.3 billion and making up the difference through cost reductions was probably impossible to achieve, and asked how the amount of loss was incorporated into the budget for FY 2012. The General Manger of the SIS Company Finance & Accounting Division responded by saying that

he was looking at the figures for after the measures had been implemented.⁴¹ From these exchanges, it can be recognized that Director Fumio Muraoka (Chairman of the Audit Committee) and Director Hiroshi Horioka (a member of the Audit Committee) were aware, from the explanation provided by the SIS Company Finance & Accounting Division, that a provision for contract losses in relation to Project I had not been recorded even though recording such a provision was necessary. Even so, only a general comment urging caution concerning high-risk projects was made to the Corporate Finance & Accounting Division, and no indication was found that anything more than that was done.

In addition, on November 7 of the same year, the Audit Committee, during an interview with Takemi Adachi EVP, was informed that it was proving difficult to negotiate a higher sale price for Project I (through negotiations to increase SP), and on December 13 of the same year, during an interview with Toshio Masaki CP, it was reported that strengthening Project I (minimizing the loss and getting into the black after the exercise of the option) had been positioned as a key task for management and important measures.

Despite this situation, no evidence was found that any discussion of Project I occurred at meetings of the Audit Committee. In addition, no facts were found indicating that the Audit Committee made a report or pointed out any issue, etc. concerning the fact that a provision for contract losses in relation to Project I had not been recorded.

Furthermore, on December 25, 2013, the Audit Committee held an interview with Toshio Masaki CP, and the materials that Toshio Masaki CP used for his explanation stated that Project I, which was anticipated to incur an operating loss of JPY 6.0 billion, and that, as a high-risk project, a provision of JPY 2.5 billion had been recorded in the first half of 2013. However, the Audit Committee did not take any action concerning Project I even after this date.

Given this situation, it must be said that internal control by the Audit Committee was not functioning sufficiently.

(b) Audit by accounting auditor

At the end of FY 2013 and FY 2014, the accounting auditor, in the course of conducting their audits, received an explanation from I3, the SIS Company Finance & Accounting Division member, concerning the appropriateness of recording a provision for contract losses in relation to Project I.⁴² The SIS Company used materials to explain measures to increase the SP as well as CD measures, but these measures included ones that were unlikely to be realizable. However, because the accounting auditor did not notice that the measures included ones that were unlikely to be realizable,

⁴¹ As of FY 2012, nothing had been done to incorporate the provision into the budget, so it can be surmised that this response meant that because the figures after the measures were implemented would not constitute a loss, a provision for contract losses had not been incorporated into the FY 2012 budget.

⁴² Besides this, at the end of the first half of FY 2013, they received an explanation concerning provisions in relation to Project I during the quarterly review process.

the result was that the accounting auditor failed to function as a control.

In this regard, because it cannot be denied that it is difficult for an accounting auditor to scrutinize the feasibility of measures, it was in a sense unavoidable that the accounting auditor did not function as a control.

(4) Project J

(A) Outline of Project J

This is a project where the SIS Company received an order in October 2008 with a contract amount of JPY 11.8 billion from client J for construction work on a power plant for an overseas electric power company with the (initial) delivery date of October 2013.

(B) Accounting treatment in question and appropriateness thereof

The SIS Company reviewed the total estimated cost of contract work for Project J, incorporating the cost reduction measures of JPY 1.7 billion, and the reduction of the total estimated cost of contract from JPY 13.5 billion to JPY 11.7 billion resulted in profits of JPY 1.7 billion in the second quarter of FY 2013.

The cost injection ratio was an anomaly of 100% in the fourth quarter of FY 2013 despite the fact that construction was not complete, but the total estimated cost of contract work was not reviewed. In addition, the additional contract cost incurred was not recorded before the third quarter of FY 2014.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	112	110	107	149	142	144	144
Total estimated cost of contract work	107	102	104	138	135	117	112
Net profit and loss	5	7	4	10	8	27	32
FY profit and loss							
Sales	49	9	9	8	23	45	0
Gross profit	2	2	(1)	3	(0)	21	5
Cumulative profit							

Sales	49	58	67	75	99	144	144
Gross profit	2	4	2	5	5	27	32

The cost reduction was not based on the substantiated action plans and the amount of cost which was actually reduced was only JPY 0.1 billion. Thus, the incorporation of cost reduction measures cannot be considered reasonable and the SIS Company should have recognized the initial estimated cost of contract work based on the estimate before such reduction was made.

The increase in the total estimated cost of contract work for FY 2013 was JPY 1.7 billion in the second quarter, and the amount of impact on the profit and loss was negative JPY 1.7 billion.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	112	110	107	149	142	144	145
Total estimated cost of contract work	107	102	104	138	135	134	134
Net profit and loss	5	7	4	10	8	9	11
FY profit and loss							
Sales	49	9	9	8	23	27	19
Gross profit	2	2	(1)	3	(0)	3	3
Cumulative profit							
Sales	49	58	67	75	99	125	145
Gross profit	2	4	2	5	5	8	11

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3

Total estimated income from contract work	-	-	-	-	-	(0)	1
Total estimated cost of contract work	-	-	-	-	-	17	21
Net profit and loss	-	-	-	-	-	(17)	(20)
FY profit and loss							
Sales	-	-	-	-	-	(19)	19
Gross profit	-	-	-	-	-	(19)	(2)
Cumulative profit							
Sales	-	-	-	-	-	(19)	1
Gross profit	-	-	-	-	-	(19)	(20)

(C) Facts identified by the Independent Investigation Committee

(a) Events from the receipt of the order to the second quarter of FY 2013

In October 2008, the SIS Company received an order for Project J with a contract amount of JPY 11.8 billion from client J, and began recording sales from the project in the first quarter of 2009.

At around the beginning of September 2013, a meeting was held in the Transmission & Distribution Systems Division to check on progress in achieving budget targets for the second quarter of FY 2013. At this meeting, because it was expected that the internal targets for the Transmission & Distribution Systems Division would not be achieved, J, the Vice President of the Division, demanded improvements from each business unit (BU)⁴³ to ensure that the targets would be met. This was because at the time Corporate was putting heavy pressure on the SIS Company to meet budget targets, and in response to this, Toshio Masaki CP in turn put a lot of pressure on the Transmission & Distribution Systems Division, and the pressure of this demand for improvements was considerable.

⁴³ The Transmission & Distribution Systems Division contains a number of engineering departments, and each engineering department has a corresponding sales department, which two departments together form a business unit (BU), and profit and loss in the Transmission & Distribution Systems Division was managed at the BU level.

As a result, in the Transmission & Distribution Systems Division, the Planning & Administration Department put together improvement measures for each BU and compiled data on the results. During this process, in the Transmission BU, the idea came up to revise and reduce the total estimated cost of contract work for Project J, to which the percentage-of-completion method was being applied, in order to record a profit for the second quarter of FY 2013, and this was looked into specifically.

In response, for the procedures for revising the total estimated cost of contract work, the Transmission & Distribution Systems Division's International Operation Department asked the Transmission & Distribution Systems Division's Overseas Substation Project Engineering Department to consider the purpose of use of and look into the possibility of reducing the NET (certain items only) of Project J. As a result, the Overseas Substation Project Engineering Department responded by saying that the total estimated cost of contract work could be reduced by approximately JPY 0.4 billion.

However, faced with the pressure from the Division described above, the International Operation Department felt that it was necessary to record a larger profit, and began procedures to reduce the total estimated cost of contract work by JPY 1.7 billion on the grounds that a reduction of JPY 1.7 billion was achievable. However, it did this without properly investigating the feasibility of this reduction, and without reasonable grounds.

(b) Fourth quarter of FY 2013

At the end of the fourth quarter of FY 2013, another six months remained until the completion of the contract work for Project J and additional construction costs were expected to be incurred. However, the cost injection ratio (actual costs incurred as percentage of NET), which was based on the total estimated cost of contract work after it had been reduced in the manner described in (a) above, had already reached 100%.

As a result, even though the reduction in the total estimated cost of contract work described in (a) had been inappropriate, if it was assumed that this reduction had been made, the personnel of the Transmission & Distribution Systems Division's International Operation Department needed to commence procedures for revising the total estimated cost of contract work.

(D) Causes of inappropriate accounting treatment

(a) Accounting treatment in the second quarter of FY 2013

a. Company

Obviously, it is unacceptable to reduce, without reasonable grounds, the total estimated cost of contract work with the intention of inflating current-term profit.

The reduction that took place in the second quarter of FY 2013 was based on a decision made by the Transmission & Distribution Systems Division's International Operation Department, but it can be recognized that, with a background that this Department's motive for doing this stemmed from the immense pressure that Corporate was putting on the SIS Company and that the SIS Company (CP) was in turn putting on

each division to meet budget targets, the International Operation Department therefore devised the plan as a way of improving profitability in terms of accounting, even though it was not appropriate. (In the first half of FY 2013, the Transmission & Distribution Systems Division earned an operating profit of JPY 5.7 billion against a target of JPY 5.4 billion. As a result, operating profit would have fallen short of the FY 2013 first-half target had it not been inflated by reducing the total estimated cost of contract work for Project J.) It is beyond dispute that this approach was due to a lack of awareness of the appropriate accounting treatment (i.e., a lack of awareness of compliance).

Although it can be surmised that it was likely that the fact that the International Operation Department had reduced the total estimated cost of contract work was reported to the Vice President J of the Division via the Planning & Administration Department, no fact was found that the Vice President was aware that a reduction of JPY 1.7 billion had been performed without reasonable grounds.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(b) Accounting treatment in the fourth quarter of FY 2013

a. Company

With the cost injection ratio exceeding 100% and further costs expected to be incurred, the sales department personnel needed to revise the total estimated cost of contract work in order to increase it. Nevertheless, they did not do so. Regarding the cause of such situation, the International Operation Department of the Transmission & Distribution Systems Division (General Manager J of the Sales & Marketing Department and other personnel in the department) has stated that it had not noticed that the cost injection ratio had reached 100%. However, in the case of projects to which the percentage-of-completion method is applied, sales are recorded in accordance with the cost injection ratio (construction progress ratio) at the end of each quarter, so the amount of sales recorded is of great interest to sales department personnel. Looking at these facts, they could have easily noticed when the cost injection ratio had reached 100% (meaning when the amount of the recorded sales has reached the maximum amount of SP). On the other hand, sales department personnel could easily find out whether costs were expected to be incurred in the future.

From the above, doubts remains that the fact that the total estimated cost of contract work was not revised even though the cost injection ratio had reached 100% could mean that there was an intention to avoid recording losses in the current period and to delay the recording of those losses. (In FY 2014, the Transmission & Distribution Systems Division earned an operating profit of JPY 15.2 billion against a target of JPY 19.7 billion. As a result, operating profit would have fallen even further short of the target if the total estimated cost of contract work for Project J had been increased.)

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(c) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project J.

a. Internal control in the Company

In order to perform appropriate accounting treatment, the Company's Finance & Accounting Division was expected to perform a checks and balances function, and was therefore responsible for contributing to internal control.

However, the sales department was allowed to make decisions (i.e., had authority) to revise the total estimated cost of contract work, and the Finance & Accounting Division was not in a position to be aware of whether revisions had been made or whether they were necessary. As a result, the Finance & Accounting Division was unable to notice that the inappropriate accounting treatment described above had occurred.

As a result, internal control by the Finance & Accounting Division was not functioning sufficiently.

b. Other

No facts were found indicating that the Corporate Audit Division or the Audit Committee pointed out any issue. However, during the audit it conducted in the second quarter of FY 2013, the accounting auditor was shown the order item numbering list issued at the time of the reduction of JPY 1.7 billion in the total estimated cost of contract work as well as materials regarding a breakdown of this JPY 1.7 billion reduction. They asked for these documents so that they could confirm that an appropriate process had been followed to reduce the total estimated cost of contract work. They then asked the SIS Company for a detailed explanation of the breakdown, and the SIS Company responded as if the reduction in the total estimated cost of contract work was sound.

From the above, it can be recognized that the accounting auditor took concrete action to confirm the reliability of the reduction in the total estimated cost of contract work. Accounting auditors do not necessarily possess technical knowledge, so it is considered that it would have been extremely difficult for them to judge that a reduction actually lacked reliability even though they had received a detailed explanation from the SIS Company of why the reduction was reliable. As a result, it can be surmised that it was unavoidable that the control functions of the accounting auditor did not extend to Project J.

4. CS Company

(1) Overview of the CS Company

The main business area of the CS Company is to realize a smart community (the purpose of which is to develop smart solutions society as a whole, by using information and communications technology and promoting the use of renewable energies, while realizing integrated management and optimized controls for infrastructure in all fields, including electric power, heat, water, traffic, healthcare, and lifestyle information).

The CS Company was established in October 2013 through the succession of business areas including those operated by the Automation Products & Facility Solution Division⁴⁴ of the SIS Company.

The following is an overview of the CS Company. A supplementary explanation will be given regarding the situation surrounding the Automation Products & Facility Solution Division of the SIS Company (meaning the division before it was succeeded by the CS Company in October 2013; hereinafter the same), which was in charge of Project K, as necessary.

(A) Divisions, etc. in the Company

The CS Company comprises three divisions⁴⁵ and one operation.⁴⁶ The Community Solutions Division (in charge of Project K, which is subject to the Investigation by the Committee) is a division with its main area of business lying in the provision of total solutions using information and communications technology and cloud computing, with energy conservation and ecology at its core, for all kinds of facilities (broadcasting and telecommunications systems, disaster prevention systems, road systems, etc.) for the town and community.

(B) Budget preparation and control

At the CS Company, a three-year medium-term business plan is prepared each year, the part of which regarding the first year constitutes the budget for the following fiscal year. The medium-term business plan is prepared in accordance with the following process.

Each division prepares a three-year medium-term plan based on the “Medium-Term Plan Basic Policy” presented by Corporate every December, and reports those to the Company Medium-Term Plan Examination Committee the following January. The CS Company compiles the medium-term business plans submitted by each division and

⁴⁴ Specifically, (i) business to provide total solutions centered around energy conservation and ecology utilizing information and communication technology for all facilities related to towns and communities, (ii) business to provide traffic management systems to sense and manage road traffic conditions and electronic toll collection (ETC) systems, video monitoring and information systems for disaster prevention, large-sized LED display systems for ballparks, etc., (iii) business to provide broadcasting systems and transmission networks for further progress into the digital broadband era in the area of broadcasting and telecommunications, and (iv) water treatment related business.

⁴⁵ Namely, Community Solutions Division, Water & Environmental Systems Division, and Building & Facility Solutions Division.

⁴⁶ Fuchu Operations - Community Solutions

submits that collated plan to Corporate at the end of January. Based on this, Corporate and the CS Company discuss concrete measures in February, and the CS Company's medium-term plan is finalized in March based on those discussions.

The CS Company reports as follows to Corporate each month on the status of achieving the budget prepared through the above process.

The CS Company reports to the Corporate Finance & Accounting Division at the beginning of each month on the actual performance for the previous month. After the CS Company receives reports from each division on matters such as an overview of that division's business and a forecast for the current period, it examines those reports at internal meetings called monthly meetings in the CS Company in around the middle of each month, and the CS Company reports monthly forecasts to the Corporate Finance & Accounting Division based on the results of that examination. Those reports are delivered to the President of Corporate at CEO Monthly Meetings held during the last ten days of each month. (The meetings held each January and July are referred to as "quarterly reporting meetings," and the status of achieving quarterly budgets are reported and considered at those meetings.) Immediately before each CEO Monthly Meeting, the CS Company has prior meetings with the GCEO to explain to the GCEO the content of the report to be made at the CEO Monthly Meeting. After reviewing matters pointed out by the GCEO at the prior meeting with the GCEO, the report is made to the CEO of Corporate at the CEO Monthly Meeting. After the CEO Monthly Meeting, a meeting to wrap up the CEO Monthly Meeting is held at the CS Company to confirm and discuss matters pointed out at the CEO Monthly Meeting.

Meetings referred to as "position evaluation meetings" are held around the same time as the CEO Monthly Meetings in the last month of each quarter (June, September, December and March) after the financial forecasts have been submitted. At these position evaluation meetings, matters such as the forecasts for the current period are reported by each division and matters such as whether there are deviations from the forecasts are considered at those meetings. After the position evaluation meeting held before the CEO Monthly Meeting, the figures that the CS Company will report at the CEO Monthly Meeting as the projection for the current period are determined based on the results of that position evaluation meeting, and each division is issued a "Challenge" (an instruction to improve performance) in order to achieve those figures. At the position evaluation meeting held after the CEO Monthly Meeting, figures for sales, operating profit, cash flow, and so on are compiled for the settlement of accounts for the quarter.

(C) Internal control for financial reporting in the Company and other matters

The CS Company implemented the following internal control regarding the receipt of orders for projects, the treatment of projects subject to the application of the percentage-of-completion method, and the handling of Loss-Making Projects.

(a) Approval of the receipt for project orders

As it was the SIS Company that received the order for Project K, the procedures for approvals of the receipt of project orders are the same as the procedures for approvals of

the receipt of orders regarding the SIS Company.

(b) Handling projects in which the percentage-of-completion method is used

a. Applicable requirements for the percentage-of-completion method

Toshiba treats the following projects as projects in which the percentage-of-completion method is used if they fulfill the requirement that the total estimated income from contract work, the total estimated cost of contract work, and the extent of contract progress as of the fiscal year-end are capable of being reliably estimated.

- Long-term contracted construction where the total estimated income from contract work is JPY 1.0 billion or more and the contract work period is one year or more

- Of contracted construction where the total estimated income from contract work is JPY 1.0 billion or more and the contract work period is for three months or more and less than one year, those for which the subject item is not delivered during the fiscal year in which the construction work starts

Even if the total estimated income from contract work is less than JPY 1.0 billion, the percentage-of-completion method can be used if the outcome of the construction activity is considered reliable.

At the CS Company, specific conditions have been established regarding the abovementioned case where “even if the total estimated income from contract work is less than JPY 1.0 billion, if the outcome is deemed to be a certainty” from FY 2014, and the percentage-of-completion method is applied to the following.

- Long-term contracted work where the total estimated income from contract work is JPY 500 million or more and the contract work period is one year or more

- Of contract work where the total estimated income from contract work is JPY 500 million or more and the contract work period is three months or more but less than one year, contracted work in which the deliverable will not be handed over during the fiscal year in which the work starts

b. Internal control for financial reporting on projects in which the percentage-of-completion method is used

At the CS Company (including the Automation Products & Facility Solution Division of the SIS Company), internal control over financial reporting of projects in which the percentage-of-completion method is used is implemented within the Company through the following six work processes. Although most staff members of the divisions and departments related to those processes understood the following processes, it cannot be necessarily said that the CS Company has thoroughly informed all staff members that they are required to comply with those work processes.

(a) Registration as a project subject to the percentage-of-completion method

- The sales department determines the projects under which sales are subject to the percentage-of-completion method, based on the received order data (customer, contract amount, contract work period, etc.) and registers it into the system when the project number is issued.

- The personnel at the planning department of the Division confirms whether there are any registration omissions or errors in the list of backlog orders list and affixes their seal to the list.

(b) Calculation and confirmation of estimated costs

- The engineering department personnel calculates the NET for the issued project number based on the content of the order, upon request by the sales department personnel, and the person with approval authority (GPM) at the engineering department or the sales department verifies the correctness of the calculation by checking it against the cost estimation basis and approve that calculation. The project number is issued based on the draft circulated after approval. This sequence of processes will be repeated if the issued project number NET is changed at the stage of making the decision to change the content of the contract and the specifications after the contract has been entered into.

- Every month, the GPM of the engineering department or the sales department confirms with regard to project numbers subject to the percentage-of-completion method that the issued project number NET is the latest NET, and that it matches the control table.

- A superior at the sales department confirms that the NET and direct selling cost entered in the system are consistent with the amount in the above estimate cost sheet and the above direct selling cost estimate, and then approves those amounts.

- Personnel at the sales department confirm with operations, the engineering departments, or the procurement departments on whether there has been any change in the estimated costs, and if there has, enters the changes into the system. A superior at the sales department confirms that the NET or the direct selling cost that has been changed and entered in the system is consistent with the amounts in that documentary evidence, and then gives their approval thereof. If the terms of contract are amended, a change to the estimated cost and the SP is performed in the same manner.

(c) Calculation of the amount of sales to be recorded based on the percentage-of-completion method

- Toshiba's percentage-of-completion method system has a framework in which the amount of sales to be recorded and the amount of sales costs to be recorded are automatically calculated based on the percentage-of-completion method.

(d) Verification of data used for the calculation of the amount of sales to be recorded based on the percentage-of-completion method

- Personnel at the planning department and personnel at the accounting department

verify the consistency of the original data (contract amounts, cumulative injection amounts, and estimated total costs) used in calculations made using the percentage-of-completion method.

- (e) Recording of sales
- (f) Reversing entries of recorded sales

(c) Handling of Loss-Making Projects

At Toshiba, regardless of whether the percentage-of-completion method is applied, the expected losses from the next period are to be recorded as “provisions for contract losses for orders received” with respect to projects where (i) it is expected that losses of JPY 200 million or more will arise at the end of the current period and (ii) the amount of those losses can be reasonably estimated.

According to the Rules for Action on J-SOX used at the CS Company (including the Automation Products & Facility Solution Division of the SIS Company), although the handling of Loss-Making Projects differs slightly from division to division, Loss-Making Projects are to be handled through the following process:

- (i) Identifying Loss-Making Projects
- (ii) Recording provisions for contract losses for each quarter
- (iii) Reversing provisions for contract losses for the previous quarter

Of the above, the process of internal control of (i) and (ii) pertaining to financial reporting related to the handling of Loss-Making Projects is as follows. (Note that the process of (iii) is a formal process to prevent a provision for contract losses being recorded twice in a particular quarter and the previous quarter.)

a. Identifying Loss-Making Projects

At the CS Company (including the Automation Products & Facility Solution Division of the SIS Company), Loss-Making Projects are identified by preparing a “Schedule for Provisions for Contract Losses for Orders Received” in accordance with the following processes, which serve as an internal control for financial reporting.

(a) Identification of Loss-Making Projects subject to recording

(i) Each quarter, the Finance & Accounting Division sends a Schedule for Provisions for Contract Losses on Orders Received to the planning department of the Division requesting the identification of Loss-Making Projects subject to recording (subject Loss-Making Projects are identified based on the TOV of project numbers with a backlog in orders and manufacturing profit and loss for each project number) and the calculation of the amount of the provision for Loss-Making Projects.

(ii) At the beginning of the month after the end of the accounting period of each quarter, the administration personnel in the planning department of the Division identify

the project number data for backlogged orders from the system, identify the project numbers of Loss-Making Projects in excess of JPY 100 million in units of backlog orders by project number, and prepare a Loss-Making Project number list.

(iii) The person with approval authority of the planning department of the Division confirms that there are no identification oversights by examining the Loss-Making Project number list and verifies that project numbers of Loss-Making Projects with losses of JPY 100 million or more have been correctly identified by referring to the gross profit amount by project, and then affixes their seal to the Loss-Making Project number list.

(b) Preparation and response to Schedule for Provisions for Contract Losses for Orders Received

(i) If there is a backlog order project number with a loss of JPY 100 million or more, the planning department of the Division requests the division in charge to prepare the Schedule for Provision for Contract Losses on Orders Received mandated by the Finance & Accounting Division.

(ii) The sales department personnel who receive the request then request the engineering department to confirm that the NET for that project number is the latest NET.

(iii) The engineering department personnel who receive the request confirm whether the issued project number NET is the latest or not, and if not, calculate the latest issued project number NET. The person with approval authority of the engineering department confirms the accuracy of the NET, obtains approval, forwards the latest issued project number draft that has been calculated (NET) to the sales department personnel, and changes the issued project number NET by electronic approval by the person with approval authority of the sales department.

(iv) Every quarter, the person with approval authority of the engineering department confirms that and approves the total estimated contract cost for issued project numbers on the sales system is the latest NET for the project numbers of Loss-Making Projects, by checking that it matches the latest NET control table.

(v) The sales department personnel who received the latest NET⁴⁷ from the engineering department confirm the contract amount in the contract document or the purchase order and prepare the Schedule for Provisions for Contract Losses on Orders Received.

(vi) The sales department superior confirms that the contract amount and the total cost of contract work listed in the Schedule for Provisions for Contract Losses on Orders Received match the contract amount in the contract document or the purchase order, and the final NET on the sales system for that quarter as approved by the person with approval authority of the engineering department or materials used to calculate the NET incorporating the amount to be generated in the future, affixes its seal to the Schedule for Provisions for Contract Losses on Orders Received, and submits that

⁴⁷ At CS Company, this includes materials in which the estimated total cost is calculated, incorporating the amount to be generated in the future, affixed with the seal of the engineering department superior. The same applies in Item (vi).

Schedule to the planning department of the Division.

(vii) The Division summarizes the Schedule for Provisions for Contract Losses on Orders Received for the divisions and notifies the Finance & Accounting Division. If there are no projects subject to loss, the Division gives notification thereof.

b. Recording of provisions for contract losses each quarter

At the CS Company (including the Automation Products & Facility Solution Division of the SIS Company), provisions for contract losses on received orders for each quarter are recorded according to the following procedure and using the Schedule for Provisions for Contract Losses on Orders Received and the process of identifying Loss-Making Projects detailed in Paragraph a. above is expected to be applied to the recording of provisions for contract losses on received orders for each quarter.

(D) De facto rules at CS Company (Perception of Shinichiro Akiba CP)

According to the Rules for Action on J-SOX, it is not necessary to report to or obtain a decision or approval from the CP or Corporate (P, GCEO, and CFO) for the recording of provisions for contract losses and procedures for registering in the system total estimated costs of contract work, which support the necessity for recording the provisions.

However, Shinichiro Akiba CP believed that approval by the CP, reporting to Corporate (P, GCEO, and/or CFO), and approval from those parties was required for risks that may have significant effects on the performance of the CS Company, in keeping with Principles of Business Communication applied to Subsidiaries, etc. In particular, as stated later, Project K was a project that certainly had risks that had a significant impact on the performance of the CS Company and incorporated provisions for contract losses of as much as JPY 3.5 billion in the budget from the time that the CS Company was established. Furthermore, based on the de facto rules at the time of the SIS Company, various procedures were already promoted based on the assumption that reports to Corporate of the recording of contract losses and approvals from Corporate were required. This being the case, the recording of Contract Loss was handled differently to rules concerning the handling of Loss-Making Projects as stated earlier, and handled as requiring the approval of the CP, reports to Corporate (P, GCEO and/or CFO), and their approvals every time.

(E) Checks and balances function of the Finance & Accounting Division

At the CS Company, the Finance & Accounting Division is responsible for matters such as:

- Planning and proposing various accounting systems
- Implementing, providing guidance concerning, and managing the accounting systems
- Matters regarding preparing and managing nonconsolidated and consolidated monthly financial statements
- Managing and training related to recording profits, recording expenses, and

calculating manufacturing and sales costs

- Compliance, audits and investigations regarding accounting
- Quality control of internal controls (J-SOX) regarding accounting

That is to say, it was expected that the Finance & Accounting Division would create a system in which the accounting treatment of the CS Company is conducted appropriately and play a role in managing that system.

(2) Project K

(A) Outline of Project K

This is a project where the SIS Company received an order in November 2012 with a contract amount of JPY 9.7 billion from client K to update the aged ETC facility, with an (initial) delivery date in March 2016.

(B) Accounting treatment in question and appropriateness thereof

Project K was a technically challenging project from the outset, given the need to change over from the concurrent operations with the existing system, the complex toll structure, large-scale construction of 472 lanes amidst a large volume of traffic, and unique specification adjustments such as zoning. Project K also experienced significant cost escalations after commencement of construction by the SIS Company due to delays in specifications approval, staff shortages, and system troubles, such that the Total Contract Cost continued to mount, resulting in recording of a Contract Loss of JPY 3.5 billion for FY 2013, and a provision for contract losses of JPY 1.1 billion.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	97	104	121	121
Total estimated cost of contract work	-	-	-	88	104	156	156
Net profit and loss	-	-	-	9	0	(35)	(35)
FY profit and loss							
Sales	-	-	-	2	30	50	32

Gross profit	-	-	-	0	(0)	(35)	-
Cumulative profit							
Sales	-	-	-	2	32	82	114
Gross profit	-	-	-	0	0	(35)	(35)

The SIS Company⁴⁸ commenced application of the percentage-of-completion method for Project K from the fourth quarter of FY 2011. However, as they could not actually make a reliable estimate given delays in preparing detailed specifications subsequent to receiving the order, the percentage-of-completion method should not have been applied for that period such that sales of JPY 200 million and gross profits of JPY 20 million recorded for the fourth quarter of FY 2011 should not have been recorded.

The creation of detailed specifications gave rise to a situation where cost increases were inevitable, with the sales manager for Project K reporting an anticipated NET of JPY 11.2 billion exceeding the SP of JPY 9.7 billion at the steering meeting held in the first quarter of FY 2012. According to this report, after increasing the amount of the NET on the internal system a provision for contract losses (JPY 1.5 billion) should also have been recorded at that time.

Moreover, while the aforementioned issues led to further increases in costs for the fourth quarter of FY 2012 after commencement of construction, this was only partially offset by an increase in SP, and the total increased amount in costs could not be absorbed. As such, after increasing the total estimated income from contract work and the total estimated cost of contract work in that quarter, a provision for additional contract losses (JPY 14.1 billion) should have been recorded.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	104	121	121
Total estimated cost of contract work	-	-	-	-	260	300	319
Net profit and loss	-	-	-	-	(156)	(179)	(198)

⁴⁸ This project was part of projects that the SIS Company was in charge of at the time of the order receipt. Following the subsequent establishment of the CS Company, the project was transferred to the CS Company.

FY profit and loss							
Sales	-	-	-	-	-	43	13
Gross profit	-	-	-	-	(156)	(23)	(19)
Cumulative profit							
Sales	-	-	-	-	-	43	56
Gross profit	-	-	-	-	(156)	(179)	(198)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	(97)	-	-	-
Total estimated cost of contract work	-	-	-	(88)	156	144	163
Net profit and loss	-	-	-	(9)	(156)	(144)	(163)
FY profit and loss							
Sales	-	-	-	(2)	(30)	(7)	(19)
Gross profit	-	-	-	(0)	(156)	12	(19)
Cumulative profit							
Sales	-	-	-	(2)	(32)	(39)	(58)

(C) Facts identified by the Independent Investigation Committee

(a) Background to receiving orders (SIS Company era)

On November 14, 2011, the SIS Company lost bids conducted by client K for the renewal of ETC equipment in the area which K1 branch and K2 branch were in charge of.

On November 21, 2011, the SIS Company held an SIS Company Order Policy Meeting to consider the pros and cons of tendering a bid for the renewal of ETC equipment under the control of client K. At the meeting, the Automation Products & Facility Solution Division personnel proposed a tender amount of JPY 8.9 billion for the

renewal of ETC equipment in the area which K3 branch was in charge of, based on the estimated NET of JPY 8.8 billion, obtained by adding the cost calculated based on the estimation at the time of the K1 branch bid (JPY 7.6 billion) and JPY 1.2 billion (i.e., the costs corresponding to the risks inherent to the area which the K3 branch was in charge of),⁴⁹ and with the M Ratio estimated to be almost 100%. However, Toshio Masaki CP decided to submit the tender to the amount in excess of a 110% M Ratio (JPY 9.7 billion), so that gross profits would not result in a negative value, even after considering the risks.

On November 22, 2011, the SIS Company submitted a tender amount of JPY 9.7 billion, which is the amount that satisfies the conditions determined at the SIS Company Order Policy Meeting.

On November 29, 2011, Toshiba entered into a construction contract with client K for a contract price of JPY 9.7 billion.

Based on the construction contract and the estimate at the time of the order receipt, the SIS Company registered the SP at JPY 9.7 billion and NET at JPY 8.8 billion (in other words, the M Ratio of 109.9%) from the fourth quarter of FY 2011 for Project K into the internal system, and commenced the application of the percentage-of-completion method and the recording of contract income and contract cost. However, it took some time to detail the specifications, stemming from the misinterpretation by the SIS Company of specifications and standards⁵⁰ required by client K, and the SIS Company was not in a position to establish a reliable estimate. (However, such conditions were only discovered later during the negotiation process for the acceptance of specifications.)

In spite of that, the SIS Company applied the percentage-of-completion method and recorded the sales (JPY 200 million) and the gross profit from sales (JPY 20 million).

(b) First quarter of FY 2012

Later, in the first quarter of FY 2012, negotiations for acceptance of specifications were facing difficulties and the situation arose where it was inevitable to assume cost increase to be incurred in the process of detailing the specifications. As a result of estimating the new NET based on the conditions at the time, a report was made at the steering meeting within the Automation Products & Facility Solution Division held on June 19, 2012, that a reasonable NET forecast excluding additional design changes yet to be determined as of such date would amount to JPY 11.2 billion.

On the other hand, although at that meeting a report was made that the SP (JPY 9.9

⁴⁹ It was estimated JPY 770 million for equipment development risk (unattained risk for expected CD for equipment, development risk for specifications particular to certain regions), and JPY 470 million for construction risk (cost increase risk accompanying work process fluctuation owing to heavy traffic).

⁵⁰ The SIS Company had believed, during discussions with the K3 branch of client K, that most of the specifications would be fixed according to a proposal by the SIS Company (as was the case from previous experience). However, in reality, at client K, an across-the-board cost management organization was established around April 2012 to establish consolidated specifications among K1, K2, K3, and K4 branches, and the SIS Company was required to discuss with this organization, resulting in many specifications proposed by the SIS Company being rejected.

billion) was expected to exceed the contract price under the agreement (JPY 9.7 billion), there was no rational forecast at the time for obtaining the SP in excess of the contract price under the agreement.

In spite of that, no revision was made to the SP of JPY 9.7 billion or the NET of JPY 8.8 billion registered initially (fourth quarter of FY 2011) in the internal system and no procedures for the identification of Loss-Making Projects leading to the recording of provisions for contract losses were commenced.

(c) From fourth quarter, FY 2012 to second quarter, FY 2013

On March 26, 2013, a report was made by the Automation Products & Facility Solution Division personnel to Toshio Masaki CP of the SIS Company that the SP would be JPY 10.4 billion, and the NET would be JPY 12.9 billion in the worst case (true figure), the figure incorporating the improvement plan (effort amount) would be JPY 12.2 billion, and the confirmed cost would be JPY 10.4 billion. Toshio Masaki CP responded by instructing to calculate an accurate estimate after the creation of a cost management structure that would make it possible to accurately estimate the total estimated cost of contract work, and to formulate cost improvement plans classified into four ranks from A through D,⁵¹ in accordance with the feasibility thereof, and to prepare a new report.

As a result, in the fourth quarter of FY 2012, the NET was also registered as JPY 10.4 billion against the SP of JPY 10.4 billion in the internal system, and no procedures were taken for identification of Loss-Making Projects leading to the recording of provisions for contract losses.

After that, the project team, which was formed on June 27, 2013 to continuously carry out the cost management for Project K (the “**ETC Cost Management Project Team**”), took on the instructions from Toshio Masaki CP and reported to Toshio Masaki CP and the executives of the SIS Company on the results of their study. The report was centered around two NET figures, one where rank A through rank C cost reduction initiatives were realized, and the other where rank A through rank D cost reduction initiatives were realized. The report forecasted contract loss of JPY 3.6 billion if cost reduction initiatives of ranks A through D were realized, and Contract Loss of JPY 10.1 billion if cost reduction initiatives of ranks A through C were realized. However, objectively speaking, the feasibility of these cost reduction initiatives, not only of rank D, but also classified into ranks B and C, could not be said to be high, and should not have been included in a reliable estimate in terms of accounting. Toshio Masaki CP, in response to this report, stated (i) that provisions should be made for a loss of a minimum of JPY 3.6 billion for the current period, (ii) that consideration should be given to the situation in which further losses were incurred later, (iii) that (if this degree of loss was going to be incurred) the project should be shelved through making provisions for the Loss-Making Project and (iv) that, assuming the loss amounted to JPY 10.0 billion, terminating the contract would mean a smaller loss. Furthermore, other executives also mentioned that, based on the explanatory document, a loss of JPY 10.0 billion was

⁵¹ Cost reduction initiatives that are classified as rank A are those that can be reliably implemented, rank B and C have a relatively high degree of accuracy, and rank D require efforts to be realized.

the true figure and achieving a loss of JPY 3.6 billion would be a very high hurdle to clear.

However, even in the first quarter of FY 2013, the NET of JPY 10.4 billion remained registered in the internal system and no review was made, and no procedures were carried out for the identification of Loss-Making Projects leading to the recording of provisions for contract losses.

On July 8, 2013, Toshio Masaki CP and others reported to Hideo Kitamura GCEO and Makoto Kubo CFO that, as one of the projects with large risk at the SIS Company, Project K faced the risk of Contract Loss between JPY 3.6 and JPY 10.1 billion, even if cost reduction initiatives were incorporated, and they reported the same details to Hisao Tanaka P on July 10, 2013.

Also on July 10, a report was made by the ETC Cost Management Project Team to Toshio Masaki CP and the executives of the SIS Company that Contract Loss of from JPY 3.6 to JPY 7.4 billion was expected. In response to this, Toshio Masaki CP stated that although it should be required to consider a provision for contract losses amounting between JPY 3.6 and JPY 10.0 billion in the second quarter under normal circumstances, this would allow no room for the operation of the business, and that a logic for segmenting this loss should be thought about.

Based on the above details, on August 22, 2013, Toshio Masaki CP and others made a report to Hideo Kitamura GCEO, Makoto Kubo CFO, and Hisao Tanaka P to obtain approval to provide contract losses of JPY 4.5 billion in the second half of FY 2013. Although Hideo Kitamura GCEO responded with instructions to maintain the provision at a low amount within the range of forecast contract losses, Hisao Tanaka P and Makoto Kubo CFO gave no specific opinion or instruction on the provisions. Consequently, Toshio Masaki CP and the General Manager of the SIS Company Finance & Accounting Division decided to incorporate a provision for contract losses in the budget for the second half of FY 2013 of JPY 3.5 billion, which was the result of rounding up the lowest estimated contract loss of JPY 3.3 billion forecasted by the ETC Cost Management Project Team at the time.

In the top management budget meeting held on August 28, 2013, the decision was made to incorporate a provision for contract losses of JPY 3.5 billion for the risk of Project K in the budget for the second half of FY 2013.

As detailed above, since the decision was made to make a provision for contract losses of JPY 3.5 billion in the second half of FY 2013 (the fourth quarter), no review of NET was conducted on the internal system, even at the end of the second quarter of FY 2013, and no identification procedures for Loss-Making Projects were carried out to record a provision for contract losses.

(d) Third quarter and fourth quarter of FY 2013 (CS Company era)

The CS Company was launched in October 2013 and Project K was transferred from the SIS Company to the CS Company.

On November 15, 2013, Shinichiro Akiba CP and the General Manager of the CS Company Finance & Accounting Division reported to Makoto Kubo CFO and the General Manager of the Corporate Finance & Accounting Division that the anticipated amount of contract losses appeared as though they would increase from JPY 4.5 billion,

as previously reported, to JPY 11.5 billion, but the aim was to contain this amount to JPY 8.7 billion. This amount of JPY 8.7 billion was no more than a target amount set as a goal that incorporated improvement initiatives with relatively low feasibility (including JPY 1.9 billion from negotiations to increase the SP) in order to make an appeal to Corporate that a target had been established for the CS Company to strive for, even though the realistic estimated amount of contract losses was JPY 11.5 billion. The decision to report this amount of JPY 8.7 billion to Corporate was made by Shinichiro Akiba CP. In response to this report, Makoto Kubo CFO commented that the amount was too large to give any comment on and he would like to consider provisions bearing in mind various factors including shareholder lawsuits, and the General Manager of the Corporate Finance & Accounting Division stated that he wished to consider whether to make provisions in full in the third quarter of FY 2013 or not, in view of the profit and loss of the entire company.⁵²

On that same day, a report was made by Makoto Kubo CFO to Hisao Tanaka P that the anticipated contract loss of Project K was JPY 8.7 billion. Based on the above, a judgment was indicated by the Corporate Finance & Accounting Division to the General Manager of the CS Company Finance & Accounting Division that only JPY 8.7 billion of contract loss was admissible; however, the timing of recording a provision for contract losses would be determined later. Furthermore, Hisao Tanaka P contacted Shinichiro Akiba CP and asked to try to record the contract losses for ETC in the fourth quarter rather than in the third quarter.

Thereafter, on several occasions until December 9, 2013, Shinichiro Akiba CP and others continued to report to Hisao Tanaka P, Hideo Kitamura GCEO, Makoto Kubo CFO, and the Corporate Finance & Accounting Division personnel and others that the current anticipated contract loss of Project K was expected to increase from JPY 4.5 billion which was previously reported (the amount reported on August 22) to JPY 11.5 billion, while the target amount incorporating the negotiation to increase the SP and cost reduction initiatives was for contract loss of JPY 8.7 billion, and asked for approval to record a provision for contract losses in the third quarter of FY 2013.

In response to this, with the approval of Hisao Tanaka P and the Corporate Finance & Accounting Division, Contract Loss of JPY 3.5 billion only was finally recorded in the fourth quarter, not in the third quarter, of FY 2013, and the remaining balance of JPY 5.2 billion (out of the JPY 8.7 billion) was incorporated into the budget for FY 2014. (Hisao Tanaka P stated that this did not mean that the Contract Loss of JPY 5.2 billion had been authorized, and instructed to make every effort to minimize this amount.)

On December 11, 2013, Shinichiro Akiba CP explained to Hisao Tanaka P that the profit and loss for the third quarter of FY 2013 would have been JPY 2.9 billion shortfall in the budget, incorporating a further deterioration of JPY 1.0 billion to the amount reported in November (JPY 1.9 billion shortfall in budget); however with the improvement of JPY 3.5 billion from shifting the provision of JPY 3.5 billion for Project K incorporated in the amount reported in November to the fourth quarter of FY 2013, there will be a budget surplus of JPY 600 million. To this, Hisao Tanaka P

⁵² As of November 15, 2013, the forecast for entire company's profit and loss was a budget shortfall of JPY 11 billion on the operating profit and a budget shortfall of JPY 86.8 billion on the fund balance.

instructed to immediately decide on and implement measures to recover the postponed JPY 3.5 billion and the additional amount of deterioration during the fourth quarter.

In the CEO Monthly Meeting on December 18, Hisao Tanaka P mentioned that even after postponing the provision for Project K, non-consolidated results for the third quarter would still result in deficit.⁵³

Based on the above details, no revision of NET in the internal system was carried out in the third quarter of FY 2013 based on the anticipated contract loss mentioned earlier (JPY 8.7 billion) and no identification procedures for the Loss-Making Project leading to the recording of a provision for contract losses were commenced. In the fourth quarter of FY 2013, NET was revised to show only JPY 3.5 billion as contract loss,⁵⁴ and as a result, provision for contract loss of JPY 1.1 billion⁵⁵ was recorded.

Furthermore, a medium-term business plan incorporating Contract Loss of JPY 5.2 billion for Project K in the FY 2014 budget was confirmed under prescribed procedures.

(e) Subsequent details

Thereafter, between the first quarter and the third quarter of FY 2014, no review of the NET or recording of contract losses was made based on the above anticipated amount.

On the other hand, on January 28, 2015, a report was made to Hisao Tanaka P that the current anticipated amount of contract losses was JPY 14.8 billion, indicating a further deterioration of JPY 6.1 billion from the target amount (JPY 8.7 billion) established in November 2013. To this, Hisao Tanaka P instructed that although a provision for JPY 5.2 billion was budgeted in FY 2014, this should be minimized.

On March 18, 2015, a report was made by the General Manager of the CS Company Finance & Accounting Division to the General Manager of the Corporate Finance & Accounting Division, stating (i) that work had been carried out for the provision of a total of JPY 8.7 billion for a Contract Loss for Project K (JPY 3.5 billion in the second half of FY 2013 and JPY 5.2 billion in the second half of FY 2014), but (ii) that the actual situation had further deteriorated by around JPY 6.1 billion and was anticipated to reach JPY 14.8 billion, (iii) that they were in discussions with the person in charge of accounting at the Corporate Finance & Accounting Division about the explanation to the accountant to the effect that the provision for the second half of FY 2014 would be contained at JPY 5.2 billion, (iv) that, in spite of this, the person in charge of accounting at the Corporate Financing & Accounting Division considered that there was no way that this would hold up in the explanation to the accountant, (v) while it may have been possible to explain somehow if the provision could be further increased by or around JPY 4.0 billion, increasing the provision by JPY 4.0 billion at this stage would have a

⁵³ It is surmised that he made this comment in the context of the CS Company alone (the Community Solutions Division and the Water & Environmental Systems Division), excluding subsidiaries under the CS Company.

⁵⁴ The NET was reviewed to be JPY 15.6 billion against the SP of JPY 12.1 billion and a total contract loss of JPY 3.5 billion was recorded.

⁵⁵ As a result of the review of the NET, a realized loss of JPY 2.4 billion was to be recorded on the premise of the SP as at such point of time under accounting procedures, and as a result, the amount of a provision for contract losses was recorded at JPY 1.1 billion.

large impact on the entire company's profit and loss, and (vi) that this was the reason why they wished to consult with the General Manager of the Corporate Finance & Accounting Division. Based on this report, discussions were made by the Corporate Finance & Accounting Division and the CS Company Finance & Accounting Division, and as a result, it was decided that Contract Loss of JPY 9.2 billion (an additional JPY 4.0 billion onto the JPY 5.2 billion already budgeted) would be recorded in the fourth quarter of FY 2014, which seemed to be the amount in the range that could be held up in the explanation to the accountant.

(D) Causes of inappropriate accounting treatment

(a) Accounting treatment for fourth quarter, FY 2011

a. Company (SIS Company era)

At the time of the order receipt, the estimate made by the SIS Company was SP of JPY 9.7 billion and NET of JPY 8.8 billion, and the SIS Company applied the percentage-of-completion method from the fourth quarter of FY 2011, on the assumption of this estimate being reliable, and recorded sales and gross profit from sales.

However, as mentioned earlier, the SIS Company was in no state to carry out a reliable estimate and the estimate at the time, on which the application of the percentage-of-completion method was based, lacked reliability and the percentage-of-completion method should not have been applied, in the first place.

Accordingly, it can be recognized that the cause for this inappropriate accounting treatment was that the related parties including the sales personnel in the Automation Products & Facility Solution Division at the time and others failed to recognize that the estimate by the SIS Company was unreliable because the details of the specification had not been settled and an estimate had been prepared based on a misunderstanding of the specification criteria.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(b) Accounting treatment for first quarter, FY 2012

a. Company (SIS Company era)

Based on the details mentioned earlier, in the first quarter of FY 2012, at the very least, the participants of the steering meeting at the Automation Products & Facility Solution Division, including the Vice President K of the Automation Products & Facility Solution Division received a report that NET was anticipated at JPY 11.2 billion, but on the other hand, they must have known that no confirmation had been made yet that the SP would exceed the contract price of JPY 9.7 billion stipulated under the

contract. Therefore, they should have reviewed the NET in the internal system, and commenced the procedures to identify Loss-Making Projects leading to the recording of provisions for contract losses for JPY 1.5 billion, which was the difference between JPY 9.7 billion and 11.2 billion.

In spite of this, no revision of NET was carried out in the internal system, and no procedures were commenced to identify the Loss-Making Projects. The following can be considered as the cause for not taking such measures.

According to the de facto rules of the SIS Company, a provision for contract losses cannot be recorded unless approval has been obtained at least from the CP.

However, taking into account the details that, during the SIS Company Order Policy Meeting held on November 21, 2011, Toshio Masaki CP approved that provision on condition of achieving an M Ratio of 110% so that the gross profit would not fall into negative even if the risks were considered, the doubt remains that the Automation Products & Facility Solution Division recognized that further approval from Toshio Masaki CP for a provision for contract losses in that period would not be given at a stage where only six months had passed from the time of the order receipt and intended to avoid and postpone recording a provision for contract losses for that period.

On this point, K, the Vice President of the Division, has stated that, at that time, he was negotiating to obtain acceptance of the specifications proposed by the SIS Company and whether to anticipate contract loss or not was dependent on the outcome of the negotiations and the cost reduction initiatives to be made in the future, and that, as he did not recognize the possibility of contract loss at the time, he did not review the NET nor did he carry out any recording of provisions for contract loss. However, the percentage-of-completion method had been applied to Project K from the fourth quarter of FY 2011, and since the percentage-of-completion method is applied on the assumption that a reliable estimate can be made, the Automation Products & Facility Solution Division must have acknowledged that a reliable estimate could be made for Project K. It cannot be recognized that a provision for contract was not recorded for the reasons given by Vice President K of the Division.

b. Corporate

No facts were found indicating that Corporate was involved in this matter.

(c) Accounting treatment from fourth quarter, FY 2012 to second quarter, FY 2013

a. Company (SIS Company era)

As mentioned earlier, in March 2013, Toshio Masaki CP instructed the Automation Products & Facility Solution Division to establish a cost management structure to enable the accurate estimation of the total estimated contract cost of contract work and to carry out an accurate estimate, and in June 2013,⁵⁶ the result of the estimation

⁵⁶ The reason why the estimate by the ETC Cost Management Project Team was delayed until June 2013 was that the main personnel in the Automation Products & Facility Solution Division was fully

conducted by the ETC Cost Management Project Team after receiving that instruction found that, even if cost reduction initiatives ranked A through C were realized, the anticipated contract loss would still amount to JPY 10.1 billion. Furthermore, in reality, cost reduction initiatives ranked B and C were not those that would realize cost reduction if a reasonable estimation was conducted.

In light of this situation, the same results as the estimate made by the ETC Cost Management Project Team would have been obtained in June if a reasonable estimate was made in March 2013,⁵⁷ and based on that estimate, it would have been anticipated that Contract Loss of JPY 15.6 billion in total would be incurred, on the assumption that only rank A cost reduction initiatives could be realized, but not those ranked B, C, and D. It can be surmised that, as an appropriate accounting treatment, the revision of the total estimated cost of contract work and the recording of a provision for contract losses in fourth quarter of FY 2012 should have been carried out.

In reality, as mentioned earlier, no review of NET in the internal system based on the anticipated amount of contract loss was conducted in the period until the second quarter of FY 2013, and procedures to identify Loss-Making Projects leading to the recording of a provision for contract losses were not commenced. The cause for such inappropriate accounting treatment can be surmised as follows.

Toshio Masaki CP and related parties at the SIS Company in positions below him were aware that Contract Loss between JPY 3.6 and JPY 10.1 billion was anticipated in the first quarter of FY 2013 at the latest. Therefore, the SIS Company should have revised the NET in the internal system in the first quarter of FY 2013 and commenced procedures for the identification of Loss-Making Projects leading to the recording of a provision for contract losses, but failed to carry out those procedures.

The related parties at the SIS Company, including Toshio Masaki CP, have stated that the reason for not taking such action was that they believed that there still was possible room for improvement, and they wanted to take a wait-and-see attitude.

However, as a result of the estimate conducted by the ETC Cost Management Project Team established under the instructions of Toshio Masaki CP, even if all cost reduction initiatives, including those of which the implementation would have been difficult, were realized, it was still anticipated that Contract Loss of JPY 3.6 billion would be incurred. Looking at that Toshio Masaki CP himself stated (on July 10, 2013) that a provision for contract losses in excess of JPY 3.6 billion must be made in the second quarter of FY 2013, and requested Hisao Tanaka P for an approval for the recording of contract losses in the third quarter of FY 2013 on August 22, 2013, Toshio Masaki CP should have been aware, in the second quarter of FY 2013 at the latest, that contract losses should be recorded.

In spite of this, it can be surmised that the reason for not recording the Contract Loss in the second quarter of FY 2013 was that it was likely that there was intent to avoid and postpone the recording of Contract Loss in the current period by deferring to the third

involved in responding to issues at the work site, and there were a number of public holidays such as Golden Week ["Golden Week" refers to a series of public holidays around the end of April and beginning of May each year], so it was only in June that the ETC Cost Management Project Team was formed and started on the estimate.

⁵⁷ Acceptance of specifications was obtained and site construction work commenced during the third quarter of FY 2012.

quarter of FY 2013 or later. (The anticipated operating profit and loss of the SIS Company for the first half of FY 2013 was negative JPY 7.4 billion (budget shortfall of JPY 3.0 billion) and negative JPY 1.0 billion (± 0 against the budget) for the Automation Products & Facility Solution Division. Therefore, if Contract Loss for Project K was recorded, the gap with the budget for operating profit and loss of the SIS Company would increase, which may have caused the Automation Products & Facility Solution Division in not achieving its budget.)

b. Corporate

Hisao Tanaka P and Hideo Kitamura GCEO received a report from Toshio Masaki CP and others between July 8 and July 10 of 2013, that Contract Loss of between JPY 3.6 and JPY 10.1 billion was anticipated for Project K, and on August 22, 2013, were asked for an approval for a provision for Contract Loss amounting to JPY 4.5 billion in or after the third quarter of FY 2013. Therefore, it can be said that, in the second quarter of FY 2013, Hisao Tanaka P and Hideo Kitamura GCEO were both aware of the necessity to record a provision for contract losses for Project K. In spite of this, no evidence was found to indicate that Hisao Tanaka P or Hideo Kitamura GCEO gave any suggestions or instructions to the SIS Company to record a provision for contract losses in the second quarter of FY 2013. (Furthermore, Hideo Kitamura GCEO had instructed to lower the provision for Contract Loss smaller than JPY 4.5 billion, for which amount an approval was requested.) It can be surmised that the reason why no suggestions or instructions were made was the presence of intent on the part of Hisao Tanaka P and Hideo Kitamura GCEO to avoid and postpone the recording of Contract Loss. (As mentioned earlier, based on the anticipated operating profit and loss of the SIS Company for the first half of FY 2013, if Contract Loss for Project K was recorded, the gap between operating profit and loss and the budget of the SIS Company would have widened and the Solution & Automation Products Division could have fallen into deficit against the budget.)

Regarding this point, Hisao Tanaka P has stated that the provision for Contract Loss had been already discussed beforehand between the General Manager of the CS Company Finance & Accounting Division and the General Manager of the Corporate Finance & Accounting Division, and since he was listening to the report on the premise that either or both of the Finance & Accounting Divisions of the CS Company and Corporate had confirmed that there were no problems (accounting wise), he paid little attention to any problems of the timing of recording provisions for contract losses. However, the need to record provisions for contract losses in a timely manner when any Contract Loss was anticipated should have been easily understood even without any professional accounting knowledge, and it is difficult to consider that Hisao Tanaka P was not aware of the need to record provisions for contract losses in the second quarter of FY 2013.

(d) Accounting treatment from third quarter to fourth quarter, FY 2013

a. Company (CS Company era)

Judging from the fact that, in the third quarter of FY 2013, the CS Company was aware that Contract Loss of at least JPY 11.5 billion had been anticipated and they even reported to Corporate that the target contract loss was JPY 8.7 billion after incorporating various cost reduction initiatives with relatively low feasibility, they should have reviewed the NET in the internal system based on the amount reasonably estimated at the time and should have commenced procedures to identify Loss-Making Projects leading to the recording of provisions for contract loss in the third quarter of FY 2013 at the latest.

In spite of this, it can be recognized that the reasons for these required procedures not being carried out in the third quarter of FY 2013 at the CS Company were that, to begin with, regarding the issue of timing, a policy was indicated by Hisao Tanaka P and the Corporate Finance & Accounting Division that the contract losses were to be recorded in the fourth quarter of FY 2013 but not in third quarter.

Second, regarding the amount to be recorded, the amount of Contract Loss recorded by the CS Company in the fourth quarter in FY 2013 remained at JPY 3.5 billion. But when the request was made for an approval for incorporating the Contract Loss in the budget for the second half of FY 2013 during the top management budget meeting on August 28, 2013, and also when the discussions took place with Corporate between the third and fourth quarter of FY 2013, the amount of provision was presumed to be JPY 3.5 billion, and the remaining balance of JPY 5.2 billion (the balance after deduction of JPY 3.5 billion from the target goal of JPY 8.7 billion) was only considered to be incorporated into the budget as a provision in FY 2014. It is likely that the reason for this situation is that there was an intent to avoid and postpone the recording of a provision for contract losses in the current period for the portion in excess of JPY 3.5 billion (that was incorporated into the budget for FY 2013), because, while there was an awareness that a matching profit had to be made from the viewpoint of budget control in order for the CS Company to record Contract Loss that was not incorporated in the budget, the performance of the CS Company for FY 2013 was anticipated to be very tight (it was facing a budgetary shortfall of JPY 12.5 billion, even after excluding the contract loss of JPY 3.5 billion from Project K).

b. Corporate

In light of the details for July through December 2013 mentioned earlier, it can be recognized that Hisao Tanaka P was aware that even after incorporating cost reduction initiatives with relatively low feasibility, Project K was anticipated to still generate a contract loss of JPY 8.7 billion.

However, no evidence was found to suggest that Hisao Tanaka P gave any appropriate suggestions or instructions to the SIS Company or the CS Company for conducting a review of the NET in the internal system or recording a provision for contract losses. Rather, it can be recognized that Hisao Tanaka P indicated a policy to recognize the Contract Loss in the fourth quarter, not in the third quarter, and approved limiting the amount of the provision for contract losses to be recorded only to a part of the loss anticipated at the time.

On these points, Hisao Tanaka P has stated that either the Corporate Finance & Accounting Division or the Company Finance & Accounting Division should have rejected postponing the recording of a provision from the third quarter to the fourth

quarter, if it was not acceptable. Furthermore, with regard to the approval to limit the amount of a provision for contract losses to be recorded only to a part of the loss anticipated at the time, he has stated that he believed that he could have gone to the client to negotiate CD by himself or believed that there was still room for further CD. But, he has not denied the fact that necessary procedures were not taken in the third quarter and also the fact that, in the fourth quarter, he had approved limiting the amount of a provision for contract losses to be recorded only to a part of the loss anticipated at the time.

It can be surmised that, in the end, the reason why Hisao Tanaka P took the responses mentioned earlier was rooted in the fact that the recording of a provision for contract losses for Project K would have made the CS Company's operating profit target for third quarter of FY 2013 fall short of budget, a situation that led him to the intent to avoid and postpone the recording of a provision for contract losses for the current period.

In other words, not only Hisao Tanaka P, but Toshiba in general, were not highly aware of the importance of timely accounting treatment in the quarterly settlement, which indicates a tendency that, even if the accounting treatment that should have been carried out in the current quarter was shifted to the next quarter, it was not a big issue if it was processed during that fiscal year. Taking such tendency as a background, and looking at the fact that the CS Company would have to record a substantial budget shortfall if Contract Loss of JPY 3.5 billion was recorded for Project K in the third quarter of FY 2013 (the operating profit was expected to be JPY 2.9 billion shortfall of budget if contract loss of JPY 3.5 billion was recorded for Project K), and the contents of communications and statements made by Hisao Tanaka P on December 11 and December 18, 2013 (there were discussions that it would result in a profit of JPY 600 million against the budget if a Contract Loss of JPY 3.5 billion was not recorded for Project K), it can be surmised that Hisao Tanaka P had an intent to avoid and postpone the recording of a provision for contract losses in the third quarter since the situation could result in the budget not being achieved in the third quarter (and as a consequence, the intent to turn the third quarter results into profit against the budget).

Furthermore, regarding the fact that the amount of Contract Loss to be recorded was limited to a part of the anticipated loss at the time, it is difficult to believe that Hisao Tanaka P had thought that further CD was possible (i.e., that the Contract Loss could be reduced from JPY 8.7 billion) even though a report was received from the CS Company that a loss of JPY 8.7 billion was expected even after incorporating the improvement initiatives with significantly low feasibility. As mentioned above, it can be surmised that, rather than recording contract loss in full (that would deteriorate the profit and loss of Toshiba), he intended to limit the amount of the provision for contract losses to be recorded for that period to only a part of the losses, and to postpone the recording of the balance of the losses.

(e) Problems in internal control

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment in Project K.

a. Internal control in the Company

In order to conduct appropriate accounting treatment, the Company Finance & Accounting Division was expected to provide a checks and balances function from a standpoint independent of the divisions, and played a part in internal control.

Since March 2012, the General Managers of the Finance & Accounting Divisions of the SIS Company and the CS Company had received reports on the anticipated amount of contract losses for Project K, from time to time. Therefore, by all rights, the Finance & Accounting Divisions, which should exercise their function for internal control related to financial reporting, should have pointed out or instructed to review the NET in the internal system based on a reasonable estimate, as well as to commence procedures to identify Loss-Making Projects.⁵⁸

However, no evidence was found to indicate that these indications or instructions were made by the Finance & Accounting Divisions, and internal control by the Finance & Accounting Divisions was not functioning at all with respect to Project K.

b. Internal control at Corporate

(a) Corporate Finance & Accounting Division

As the top of the Corporate Finance & Accounting Division, Makoto Kubo CFO received a report that a loss was anticipated to be incurred as at July 2013, and in August 2013, he received a report requesting the recording of a provision for contract losses in the second half of FY 2013. Therefore, in spite of the intent of P and GCEO, he should have taken appropriate measures, such as suggesting or instructing the revision of the NET in the SIS Company internal system and the commencement of procedures for identification of Loss-Making Projects during the first half of FY 2013 at the latest. However, no such suggestions or instructions were made by Makoto Kubo CFO to the SIS Company.

Furthermore, Makoto Kubo CFO and the General Manager of the Corporate Finance & Accounting Division had received the report in November 2013 that the anticipated Contract Losses for Project K would be at least JPY 8.7 billion, and therefore, they should have taken appropriate measures, such as suggesting or instructing the review of the NET in the CS Company internal system and the commencement of the procedures

⁵⁸ At the SIS Company and the CS Company, regarding the amount of the provision for contract losses, there were discussions of anticipated contract loss, from beginning to end, based on the premise of rank A through rank D measures (in other words, all assumed profit and loss improvement initiatives) being realized. However, from the accounting point of view, initiatives that could be incorporated in the consideration of the amount of the provision for contract loss (in other words, initiatives that can be considered reliable estimates) were only those classified as rank A. However, no evidence was found to indicate that discussions had been conducted on this point. (No reports on the anticipated contract loss had been made to Corporate, based on the assumption that only rank A measures could be realized.) This being the case, even if the anticipated contract loss for Project K recognized by the SIS Company, the CS Company, or Corporate (the anticipated amount reported by the SIS Company or the CS Company in the case of Corporate) had been recorded at an appropriate timing based on the aforementioned details, it can be considered that the contract loss amount would not have been sufficiently recorded.

for identification of Loss-Making Projects in the third quarter of FY 2013 at the latest. However, no such suggestions or instructions were made by Makoto Kubo CFO or by the Corporate Finance & Accounting Division. Rather, at the time of the report made by the CS Company in November 2013, Makoto Kubo CFO stated that the amount was too large to give any comments and he would like to consider provisions bearing various factors in mind, including shareholder lawsuits, while the General Manager of the Corporate Finance & Accounting Division stated that he wished to consider whether to set aside provisions for the full amount in third quarter, in view of the profit and loss of the entire company. These statements suggest that, rather than recording a contract loss of an appropriate amount at an appropriate time in accordance with the accounting principles, the top management at the Corporate Finance & Accounting Division were more concerned about the trend of pursuing responsibility to executives and about the impact on the company's overall profit and loss in case a large amount of provisions were recorded.

In addition, as mentioned later, when the Company was subject to an audit for impairment test, etc. by an accounting auditor in the recording of a provision for contract losses for Project K, the personnel in charge of budget control and the budget examiner in the Corporate Finance & Accounting Division, being aware that the Company Finance & Accounting Division was preparing documents to make a plausible story that was different from the actual situation to be used as an explanation to the accounting auditor, failed to stop this from taking place, and tolerated such action.

Based on the above findings, it can be surmised that internal control by the Corporate Finance & Accounting Division was not functioning at all with respect to Project K.

(b) Corporate Audit Division

In September to October of 2013, an audit of the road and disaster prevention business, including Project K, was conducted by the Corporate Audit Division, and a report was compiled on December 5, 2013. The report detailed that a possible Contract Loss had occurred in Project K and even though efforts to improve profit and loss were being conducted, there was no prospect of achieving the target (loss of JPY 2.8 billion), and the summary which was used for reporting to P detailed that the target was a loss of JPY 8.7 billion, indicating that the Corporate Audit Division was aware that a large loss was anticipated for Project K. However, there were no indications concerning the accounting treatment.

In addition, no appropriate measures were taken at an appropriate time regarding the accounting treatment for Project K by Hisao Tanaka P or others who received the report from the Corporate Audit Division.

Therefore, it can be surmised that internal control by the Corporate Audit Division was not functioning with respect to Project K.

c. Other

(a) Audit by Audit Committee

An interview with Shinichiro Akiba CP from the CS Company was conducted in July

2014 by the Audit Committee in which it was reported by Shinichiro Akiba CP that a provision of JPY 3.5 billion had been recorded for FY 2013 and a loss of JPY 5.2 billion had been incorporated into the budget for FY 2014 with regard to Project K.

This was followed by a report by K, General Manager of the Company Finance & Accounting Division to Makoto Kubo, Chairman of the Audit Committee, on February 23, 2015 that the current anticipated Contract Loss of Project K was JPY 14.8 billion, reporting a further deterioration of JPY 6.1 billion from the target amount (JPY 8.7 billion) established in November 2013. In addition, regarding the interview by the Audit Committee with Hidejiro Shimomitsu GCEO scheduled for February 27, Makoto Kubo, Chairman of the Audit Committee, suggested not to question Hidejiro Shimomitsu GCEO very much about Project K on that day, and also stated that he would pretend that he had no idea of the additional loss of JPY 6.1 billion. During the interview with Hidejiro Shimomitsu GCEO by the Audit Committee held on February 27, Hidejiro Shimomitsu GCEO reported that the anticipated amount of Contract Loss for Project K was JPY 8.7 billion and no special questions were raised by the Audit Committee, including the Chairman of the Audit Committee Makoto Kubo.

Furthermore, the Audit Committee received a report on the audit results made by the Corporate Audit Division mentioned previously.

Even with this background, no evidence was found that the Audit Committee pointed out any issue or made any report concerning the inappropriate accounting treatment for Project K. Rather, it can be perceived that the Chairman of the Audit Committee Makoto Kubo had an attitude to intentionally avoid discussing the Contract Loss of Project K and the issues related to accounting treatment. Therefore, it can be surmised that internal control by the Audit Committee was not functioning at all with respect to Project K.

(b) Audit by the accounting auditor

During the period from FY 2011 to the third quarter of FY 2014, no special indication was made in the audit by the accounting auditor regarding Project K.

However, as mentioned earlier, since the provision for contract loss amounting to JPY 3.5 billion was to be recorded in the fourth quarter of FY 2013 for Project K at the CS Company, they had to deal with the accounting auditor from the end of February to April of 2014.

Therefore, employees of the CS Company discussed with the person in charge of financial control and the person in charge of accounting in the Corporate Finance & Accounting Division to prepare documents that made the amount of anticipated Contract Loss JPY 3.5 billion, making the amount coherent to the accounting auditor. (However, the actual amount of the injection was in line with the actual situation, and only the anticipated figures were adjusted to fit to that planned amount.) They then reported the contents to the accounting auditor by submitting those documents. As the accounting auditor was given an explanation based on documents that were made up to be coherent, it was not possible for the accounting auditor to understand the problems regarding the amount of provision for contract losses recorded for Project K.

Based on the above details, it can be surmised that for Project K, control by the accounting auditor was not sufficiently functioning.

5. Other projects

(1) Projects where adjustments would amount to approximately less than JPY 1.0 billion

(A) Project L

(a) Outline of the project and details of adjustments

In 2011, the SIS Company received an additional order (the “**Additional Contract**”) with the contract amount of JPY 0.5 billion from client L for construction to address specification changes regarding construction for which orders had already been received (the “**Main Contract**”), with a delivery date (initial) of March 2014.

The SIS Company was planning to enter into a separate contract with client L for the Additional Contract aside from the Main Contract, and the Additional Contract was actually independent of the Main Contract, such that the SIS Company recognized the Additional Contract as a different lot of construction work from the Main Contract for accounting purposes as well.

While the SIS Company applied the percentage-of-completion method to the Main Contract, it did not apply that method to the Additional Contract as it was below the monetary threshold (JPY 1.0 billion) for applying the percentage-of-completion method based on internal rules. After application of the completed contracts method, sales of JPY 0.5 billion and a loss of JPY 1.0 billion were recorded as of the completion of the contract.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	5	5	5	-
Total estimated cost of contract work	-	-	-	6	6	15	-
Net profit and loss	-	-	-	(1)	(1)	(10)	-
FY profit and loss							
Sales	-	-	-	-	-	5	-
Gross profit	-	-	-	-	-	(10)	-

Cumulative profit							
Sales	-	-	-	-	-	5	-
Gross profit	-	-	-	-	-	(10)	-

However, the SIS Company was in a position to be able to estimate the total estimated cost of contract work of JPY 1.6 billion as of the second quarter of FY 2012 for the Additional Contract, such that a provision for contract losses of JPY 1.0 billion should have been recorded at that juncture.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	5	5	5	-
Total estimated cost of contract work	-	-	-	6	16	15	-
Net profit and loss	-	-	-	(1)	(10)	(10)	-
FY profit and loss							
Sales	-	-	-	-	-	5	-
Gross profit	-	-	-	-	(10)	0	-
Cumulative profit							
Sales	-	-	-	-	-	5	-
Gross profit	-	-	-	-	(10)	(10)	-

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-

Total estimated cost of contract work	-	-	-	-	9	-	-
Net profit and loss	-	-	-	-	(9)	-	-
FY profit and loss							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	(10)	10	-
Cumulative profit							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	(10)	-	-

(b) Main causes of inappropriate accounting treatment

The SIS Company received an unofficial announcement on August 10, 2011 to increase the contract amount of JPY 500 million with regard to the Additional Contract (which had been negotiated with client L as the items for change or addition to the specifications) before the same day. The Finance & Accounting Division at the SIS Company recognized that the Main Contract and the Additional Contract involved different lots of construction work, and carried out accounting treatment after separating the Additional Contract from the Main Contract. Accordingly, the SIS Company was required to consider whether the Additional Contract itself fell within the Loss-Making Projects or not, and to carry out procedures of recording provisions for contract losses as necessary. However, the senior manager in charge of Project L from the Sales & Marketing Department 2 of the Transmission & Distribution Systems Division did not carry out procedures at the end of the first half of FY 2012 to indicate the Additional Contract as a Loss-Making Project that was linked to recording provisions, even though he was aware that losses were anticipated for a portion of the Additional Contract. The reason for this was that there was a misunderstanding by the senior manager and others that there was no need to handle the Additional Contract independently as a Loss-Making Project as they were not aware that the Main Contract and the Additional Contract involved different construction lots, that the Main Contract and the Additional Contract involved a series of construction for the same customer, and that there would be no loss if the Main Contract and the Additional Contract were totaled.

It can be found that the main cause of inappropriate accounting treatment in this project was due to a lack of requisite accounting knowledge of the sales personnel.

(B) Project M

(a) Outline of the project and details of adjustments

This is a project where *Densansha* (now the SIS Company) received an order in January 2010 with a contract amount of JPY 3.3 billion from client M, to install a power generation system, with an (initial) delivery date of October 2010.

In Project M, even though the SIS Company considered a bid on the condition that a loss of at least around JPY 1.1 billion would occur at the time of the order receipt, the SIS Company did not record any provision for contract losses at the time of the order receipt or at the end of the period. In addition, the SIS Company did not reflect in the total estimated cost of contract work the JPY 600 million increase of the total estimated cost of contract work that arose following the subsequent specification change and the sudden rise in the price of materials. In the second quarter of FY 2010, the SIS Company recorded a provision for contract losses of JPY 400 million.

Change in profit and loss before adjustment (Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	33	40	-	-	-	-
Total estimated cost of contract work	-	33	57	-	-	-	-
Net profit and loss	-	-	(17)	-	-	-	-
FY profit and loss							
Sales	-	8	32	-	-	-	-
Gross profit	-	-	(17)	-	-	-	-
Cumulative profit							
Sales	-	8	40	-	-	-	-
Gross profit	-	-	(17)	-	-	-	-

At the time of commencing construction in the fourth quarter of FY 2009, the SIS Company should have recorded a provision for contract losses (of JPY 1.1 billion) for the reasonably anticipated Contract Loss. In addition, an additional provision for contract losses (of JPY 600 million) should have been recorded at the time of the increase in the total estimated cost of contract work based on the specification changes and the increase in the price of materials that was identified in the second quarter of FY 2010.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	33	40	-	-	-	-
Total estimated cost of contract work	-	43	57	-	-	-	-
Net profit and loss	-	(11)	(17)	-	-	-	-
FY profit and loss							
Sales	-	6	34	-	-	-	-
Gross profit	-	(11)	(6)	-	-	-	-
Cumulative profit							
Sales	-	6	40	-	-	-	-
Gross profit	-	(11)	(17)	-	-	-	-

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	11	-	-	-	-	-
Net profit and loss	-	(11)	-	-	-	-	-
FY profit and loss							
Sales	-	(2)	2	-	-	-	-
Gross profit	-	(11)	11	-	-	-	-

Cumulative profit							
Sales	-	(2)	-	-	-	-	-
Gross profit	-	(11)	-	-	-	-	-

(b) Main causes of inappropriate accounting treatment

On December 4, 2009, the SIS Company received a request for a quotation from M Company regarding Project M. On December 14, the Transmission & Distribution Systems Division held an Order Policy Meeting regarding this request for a quotation. As a result of discussions based on the meeting materials that included the words “submit bid for JPY 3,400 million” and “negative gross margin of JPY 550 million,” M, the Vice President of the Transmission & Distribution Systems Division decided to try to receive the order with a “bid of JPY 2,800 million,” “current NET JPY 4,390 million” and “negative gross margin of JPY 1,590 million.” Upon making that decision, Vice President M indicated his request that Project M should be made to break even, and instructed to consider how to accomplish this.

Besides, Hideo Kitamura GCEO was conducting business activities aimed at winning the order for Project M.

On December 17, the SIS Company submitted a quotation stating a “quotation of JPY 2,800 million” to client M. On the same day, Ryuichi Nakata CP was briefed about Project M based on the materials that included the terms “quotation of JPY 2,800 million” and “negative gross margin of JPY 820 million.”

On January 12, 2010, the SIS Company received the order for Project M with the contract amount of JPY 3,250 million. The amount varied from the quotation because of slight additions made to the specifications upon receiving the formal order. On the same day, in response to this, the SIS Company produced “internal kickoff materials” related to Project M. These materials contained the words “SP 3,250,” “NET 4,310” and “negative 1,060 → must become zero.”

Based on the above, when the order for Project M was received in the fourth quarter of FY 2009, there was a reasonable expectation that there would be a loss of approximately JPY 1.1 billion and that Ryuichi Nakata CP and other personnel from the SIS Company were aware of it. (Further, Hideo Kitamura GCEO was also aware that there would be a loss and the possibility cannot be excluded that he was also aware that this loss would be approximately JPY 1.1 billion). Despite this, considering that it was generally not acceptable to record provisions for contract losses at the time of the order receipt (or in the initial stages of construction), the personnel of the Sales & Marketing Department of the Transmission & Distribution Systems Division registered NET of the same amounts as the estimated total income from contract work in the internal system on the basis that there was a possibility to avoid recording a loss with an expectations⁵⁹ of profitability improvement through future cost reductions, etc. In addition, they did not identify Project M as a Loss-Making Project or commence procedures to record

⁵⁹ However, according to the Committee’s Investigations, the expectations of future cost reductions could not be considered reasonable.

provisions for contract losses. Further, based on a similar thinking, the total estimated cost of contract work was not revised, and no procedures were commenced to identify Loss-Making Projects leading to the recording of provisions for contract loss after that until just before construction was completed in the second quarter of FY 2010.

Also, no evidence was found that Ryuichi Nakata CP, Vice President M, or others made any suggestions or instructions regarding the fact that the personnel from the Sales & Marketing Department of the Transmission & Distribution Systems Division had failed to conduct necessary procedures to address the issue. Regarding this situation, Ryuichi Nakata CP, Vice President M, and others have stated that this was because, as was the case for the personnel, there was a possibility to avoid recording losses as future cost reductions and other measures could be expected to improve the profitability.⁶⁰

However, despite the fact that reasonable cost reductions could not objectively be expected, Ryuichi Nakata CP and Vice President M and others did not make any detailed investigation into the expected future cost reductions. It could not be identified that there was any objective basis to believe the recording of losses could be avoided, while Vice President M had an optimistic understanding regarding expected cost reductions, or Ryuichi Nakata CP was too credulous of the reports from the Vice President and others. Thus, the doubt remains that there was an intention to defer the recording of losses.

As such, the doubt remains that the reason why Ryuichi Nakata CP, Vice President M, and other persons involved at the SIS Company did not take procedures to record provisions for contract losses, etc. (and did not correct the situation) as noted above despite the fact that losses were anticipated to arise, was that the persons involved at the SIS Company intended to defer the recording of losses.

(C) Project N

(a) Outline of the project and details of adjustments

This is a project where the SIS Company received an order in March 2013 with a contract amount of USD 20 million (JPY 2.0 billion) from client N for work regarding overseas electrical substation facilities and related equipment, with an (initial) delivery date of May 2014. The content of the agreement is primarily the production and sale of equipment, and excludes installation work on the project site.

The percentage-of-completion method was applied to Project N, but based on the completion of shipment of the main components in September 2014 (before the end of construction), sales up until completion of construction were recorded.

⁶⁰ No evidence was found that Hideo Kitamura GCEO took any particular measures. Regarding the reason for this, Hideo Kitamura GCEO has stated that he was not aware that no provisions had been recorded. (Regarding the fact that NET and SP were registered with the same amounts in the internal system, it could be considered that Hideo Kitamura GCEO was not aware, as no one was aware of this fact other than the sales department personnel who conducted the procedures himself or herself.) No fact to the contrary was found.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	21	21
Total estimated cost of contract work	-	-	-	-	-	16	25
Net profit and loss	-	-	-	-	-	5	(4)
FY profit and loss							
Sales	-	-	-	-	-	7	14
Gross profit	-	-	-	-	-	1	(6)
Cumulative profit							
Sales	-	-	-	-	-	7	21
Gross profit	-	-	-	-	-	1	(4)

As not all work had been completed as of the end of September in FY 2014, and only the shipment of the main components had been completed, a certain portion of the sales recorded in the second quarter of FY 2014 before completion of construction should have been recorded as sales in the third quarter of FY 2014, upon actual completion of all work.

Also, the profitability deterioration for Project N was recognized in August 2014, and by including this, Contract Loss was being anticipated in the second quarter of FY 2014, such that a provision for contract losses should have been recorded then by revising the total estimated cost of contract work.

The increase in the total estimated cost of contract work in FY 2014 was JPY 500 million in the second quarter, and the amount of the impact on profit and loss was negative JPY 400 million in the second quarter and JPY 400 million in the third quarter.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
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Total estimated income from contract work	-	-	-	-	-	21	21
Total estimated cost of contract work	-	-	-	-	-	16	26
Net profit and loss	-	-	-	-	-	5	(5)
FY profit and loss							
Sales	-	-	-	-	-	7	15
Gross profit	-	-	-	-	-	1	(6)
Cumulative profit							
Sales	-	-	-	-	-	7	21
Gross profit	-	-	-	-	-	1	(5)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	0
Total estimated cost of contract work	-	-	-	-	-	-	1
Net profit and loss	-	-	-	-	-	-	(0)
FY profit and loss							
Sales	-	-	-	-	-	-	0
Gross profit	-	-	-	-	-	-	(0)
Cumulative profit							
Sales	-	-	-	-	-	-	0
Gross profit	-	-	-	-	-	-	(0)

(b) Main causes of inappropriate accounting treatment

Project N entailed the production at and supply from Toshiba's Hamakawasaki Operation, but, partly because the project involved supplying equipment to Country N in the Middle East after a long interlude, there were major delays in the plans during the design phase. Furthermore, following the 2011 Great East Japan Earthquake, the Operation's production capacity was scaled down, and the number of workers was reduced to two-thirds or less of the previous level to the maximum; however, from the second half of 2012, when the order for Project N was received, through 2013, orders for the Middle East became increased and production did not proceed as planned. Production was disrupted, with the disruption peaking in 2014.

Due to the production disruptions, it became impossible to meet the initial delivery deadline of May 2014. Following negotiations with client N, it was decided to deliver the equipment as soon as it became ready in batches to the final destination, with delivery ultimately taken place in nine batches.

Also, due to the production disruptions, the Operation in question was not able to exercise sufficient cost control, and through around July 2014, it was not possible to estimate what costs would be incurred, and accurate information regarding estimates of future costs likely to be incurred was not shared with the division in charge of Project N, the International Operation Department Group 2 of the Transmission & Distribution Systems Division (the "**International Operation Department**"). Subsequently in August of the same year, it became clear within the Operation that there would likely be large cost increases, far more than initially expected, and the Operation requested the International Operation Department to take procedures to increase the NET amount in September that year.

However, the personnel at the International Operation Department, while aware of the possibility that costs exceeding the initial quotation amount would be incurred, did not take any procedures to change the NET amount, nor did he or she take procedures to identify Loss-Making Projects leading to the recording of a provision for contract losses. This was because he or she believed that large cost increases were unlikely due to the nature of the project of production and sale of equipment in the absence of specification changes, that, therefore, there would basically be no need to change the NET figures, and also had an awareness that the cost estimates from this Operation did not always have clear grounds.

Furthermore, based on the fact that the main products had been shipped in early September, the personnel at the International Operation Department processed the contract completion in the second quarter of FY 2014, even though the manufacturing processes remained unfinished. The reason why he processed the contract completion even though manufacturing was still underway can be surmised that, while it was unusual for equipment to be delivered in batches, he mistakenly thought that it was appropriate to process the project completion if the main products had been shipped.

Based on the events above, it can be surmised that the main cause of inappropriate accounting treatment with regards to Project N is that the personnel at the sales department had a misunderstanding about the process for the contract completion, and that he neglected to conduct the necessary accounting treatment based on his or her own understanding of the recording of provisions for contract losses.

Meanwhile, regarding the recording of the sales based on the processing of contract completion for the second quarter of FY 2014, the accounting auditor requested submission of materials to confirm the validation of the recording of sales based on the project being treated as completed in October in the same year. At that time the SIS Company Finance & Accounting Division judged that there was no issue in the timing of the recording of sales because in the second quarter of FY 2014 the main products had been completed shipping and the cumulative value of equipment shipped was approximately over 80% of SP. The Finance & Accounting Division submitted to the accounting auditor the contract for Project N, the bills of lading and materials that described the shipping (ship loading) schedule by item and explained these matters as such. Subsequently the accounting auditor did not express any doubts, but given that this was a materials-based quarterly review performed in a limited time frame, it cannot be surmised that the accounting auditor failed to carry out the auditing or quarterly review appropriately.

(D) Project O

(a) Outline of the project and details of adjustments

This is a project where the SIS Company received an order in September 2012 with an (initial) delivery date of January 2014 and the contract amount of JPY 14.1 billion (converted to Japanese yen) from government office O, for the production and installation of transformers and other equipment for electrical substation facilities, and construction and civil engineering works for associated buildings.

With respect to Project O, while an increase in the total estimated cost of contract work was reasonably anticipated in the first quarter and the second quarter of FY 2014, it was not reflected in the total estimated cost of contract work.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	121	137	156
Total estimated cost of contract work	-	-	-	-	103	111	133
Net profit and loss	-	-	-	-	18	27	23
FY profit and loss							
Sales	-	-	-	-	3	98	55

Gross profit	-	-	-	-	0	19	3
Cumulative profit							
Sales	-	-	-	-	3	101	156
Gross profit	-	-	-	-	0	20	23

The SIS Company should have adjusted those amounts in the first quarter of FY 2014 based on the total estimated cost of contract work reasonably expected. The increase in the total estimated cost of contract work in FY 2014 was JPY 1.4 billion in the first quarter of FY 2014, and the impact on profit and loss was negative JPY 1.3 billion in the first quarter, negative JPY 800 million in the second quarter, and JPY 900 million in the third quarter.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	121	137	157
Total estimated cost of contract work	-	-	-	-	103	111	145
Net profit and loss	-	-	-	-	18	27	12
FY profit and loss							
Sales	-	-	-	-	3	98	43
Gross profit	-	-	-	-	0	19	(9)
Cumulative profit							
Sales	-	-	-	-	3	101	144
Gross profit	-	-	-	-	0	20	11

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
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Total estimated income from contract work	-	-	-	-	-	-	1
Total estimated cost of contract work	-	-	-	-	-	-	12
Net profit and loss	-	-	-	-	-	-	(11)
FY profit and loss							
Sales	-	-	-	-	-	-	(12)
Gross profit	-	-	-	-	-	-	(12)
Cumulative profit							
Sales	-	-	-	-	-	-	(12)
Gross profit	-	-	-	-	-	-	(12)

(b) Main causes of inappropriate accounting treatment

At the time, the SIS Company applied the percentage-of-completion method on the basis that NET would be JPY 12.4 billion for both the first quarter and the second quarter of FY 2014.

However, the Power Systems Engineering Department of the Transmission & Distribution Systems Division, which was in charge of cost control for Project O, estimated the total estimated cost of contract work at approximately JPY 13.8 billion as of the end of the first quarter of FY 2014, and approximately JPY 14.3 billion as of the end of the second quarter of FY 2014, and reported to that effect to the personnel at the International Operation Department of that Division, which was in charge of sales for Project O. Also, in the second quarter of FY 2014, the actual costs injected had exceeded the NET amount, and the cost injection ratio was nearly over 100%.

Notwithstanding this, the personnel from the International Operation Department thought that there was basically no need to change the NET, other than for cost increases that were fully substantiated at that time, including costs already incurred, foreign-exchange losses and cost increases due to variation orders (which means changes to specifications: the “VOs”). In addition, access to electricity for Project O was expected to be completed by the end of December, 2014, so they thought that it would be sufficient if costs other than those already confirmed were accounted for during FY 2014, even if they were not accounted for during every quarter. Subsequently, while they took procedures to revise the NET amount for the impact from foreign-exchange fluctuations and the VOs, they did not further revise the NET amount based on the report from the Power Systems Engineering Department.

Based on the above, it can be surmised that the main cause of inappropriate accounting treatment for Project O was that the personnel from the sales department had

insufficient awareness of appropriate accounting treatments.

With regard to the above accounting treatments, in the second quarter of FY 2014, the SIS Company Finance & Accounting Division personnel were aware that actual cost injection amount was greater than the NET, but did not conduct a revision of the total estimated cost of contract work even at that point of time; so it can be recognized that the internal control function of the Finance & Accounting Division was not functioning.

(2) Projects that Toshiba has informed it will adjust

The projects that Toshiba has informed it will revise are shown in the following.

These are projects that Toshiba told the Committee that it would revise of its own volition based on the results of self-checks, etc. Therefore, the Committee has not carried out an investigation, but has set out overviews of the projects below.

(A) Project P

This is a project where the CS Company received an order in July 2014 from client P to deliver ●● system equipment with an (initial) delivery date in March 2019, with a contract amount of JPY 5.9 billion.

At the Order Policy Meeting in June 2014, the CS Company estimated for Project P an initial total estimated cost for contract work of approximately JPY 6.9 billion (contract amount of JPY 5.9 billion), so was aware of the possibility of losses from the time of the order receipt, but until the third quarter of FY 2014 it had not recorded provisions for contract losses.

However, provisions for contract losses should have originally been recorded in the second quarter of FY 2014, when the order for the project was received.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	59
Total estimated cost of contract work	-	-	-	-	-	-	56
Net profit or loss	-	-	-	-	-	-	3
FY profit or loss							
Sales	-	-	-	-	-	-	1

Gross profit	-	-	-	-	-	-	0
Cumulative profit							
Sales	-	-	-	-	-	-	1
Gross profit	-	-	-	-	-	-	0

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	59
Total estimated cost of contract work	-	-	-	-	-	-	65
Net profit or loss	-	-	-	-	-	-	(6)
FY profit or loss							
Sales	-	-	-	-	-	-	1
Gross profit	-	-	-	-	-	-	(6)
Cumulative profit							
Sales	-	-	-	-	-	-	1
Gross profit	-	-	-	-	-	-	(6)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	-	-	-	-	-	9
Net profit or loss	-	-	-	-	-	-	(9)
FY profit or loss							

Sales	-	-	-	-	-	-	(0)
Gross profit	-	-	-	-	-	-	(7)
Cumulative profit							
Sales	-	-	-	-	-	-	(0)
Gross profit	-	-	-	-	-	-	(7)

(B) Project Q

This is a project where the Power Systems Company received an order in August 2004 from client Q to install power generation equipment at Power Plant Q with an (initial) delivery date in March 2015, with a contract amount of JPY 2.5 billion.

In Project Q, after concluding the contract in August 2004, when re-estimating the total estimated cost of contract work as in August 2014, the Power Systems Company forecasted extensive increases in the total estimated cost of contract work from the initial estimate as a result of changes to specifications and delays due to the impact of the Great East Japan Earthquake, and was aware that there would possibly be a Contract Loss of around JPY 600 million, which exceeded the total estimated income from contract work. Nonetheless, despite the lack of any reasonable basis, the Power Systems Company judged that it would be able to obtain additional SP or realize expected CDs, and in the period until the third quarter of FY 2014, no provisions for contract losses were recorded. However, the Power Systems Company should have originally recorded provisions for contract losses for the JPY 600 million, total estimated cost of contract work that exceeded the total estimated income from contract work in the second quarter of FY 2014.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	25	25	25	25	25	25	25
Total estimated cost of contract work	22	22	22	22	22	22	22
Net profit or loss	3	3	3	3	3	3	3
FY profit or loss							

Sales	0	0	1	0	0	0	2
Gross profit	0	0	0	0	0	0	0
Cumulative profit							
Sales	0	0	1	1	2	2	4
Gross profit	0	0	0	0	0	0	0

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	25	25	25	25	25	25	30
Total estimated cost of contract work	22	22	22	22	22	22	36
Net profit or loss	3	3	3	3	3	3	(6)
FY profit or loss							
Sales	0	0	1	0	0	0	1
Gross profit	0	0	0	0	0	0	(6)
Cumulative profit							
Sales	0	0	1	1	2	2	3
Gross profit	0	0	0	0	0	0	(6)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	5
Total estimated cost of contract work	-	-	-	-	-	-	14

Net profit or loss	-	-	-	-	-	-	(9)
FY profit or loss							
Sales	-	-	-	-	-	-	(1)
Gross profit	-	-	-	-	-	-	(7)
Cumulative profit							
Sales	-	-	-	-	-	-	(1)
Gross profit	-	-	-	-	-	-	(7)

(C) Project R

This is a project where the Power Systems Company received orders in March 2014 from client R to install power generation equipment at a thermal power plant with an (initial) delivery date in June 2020, with a contract amount of JPY 14.4 billion.

In September 2014, a Contract Loss on Project R was anticipated, but unsubstantiated cost reduction measures were incorporated so that ultimately the estimates showed the total estimated cost of contract work to be lower than the total estimated income from contract work, and no provision for contract losses was recorded. However, a provision for contract losses (JPY 1.0 billion) should have originally been recorded in the second quarter of FY 2014.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	144
Total estimated cost of contract work	-	-	-	-	-	-	137
Net profit or loss	-	-	-	-	-	-	7
FY profit or loss							
Sales	-	-	-	-	-	-	0

Gross profit	-	-	-	-	-	-	0
Cumulative profit							
Sales	-	-	-	-	-	-	0
Gross profit	-	-	-	-	-	-	0

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	144
Total estimated cost of contract work	-	-	-	-	-	-	154
Net profit or loss	-	-	-	-	-	-	(10)
FY profit or loss							
Sales	-	-	-	-	-	-	0
Gross profit	-	-	-	-	-	-	(10)
Cumulative profit							
Sales	-	-	-	-	-	-	0
Gross profit	-	-	-	-	-	-	(10)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	-	-	-	-	-	17
Net profit or loss	-	-	-	-	-	-	(17)

FY profit or loss							
Sales	-	-	-	-	-	-	(0)
Gross profit	-	-	-	-	-	-	(10)
Cumulative profit							
Sales	-	-	-	-	-	-	(0)
Gross profit	-	-	-	-	-	-	(10)

(D) Project S

This is a project where the CS Company received an order in February 2014 from client S to supply machinery equipment with an (initial) delivery date in October 2014, with a contract amount of JPY 400 million.

Project S applied the completed contracts method so that before the third quarter of FY 2014, no sales had been recorded, but at that time, a Contract Loss of JPY 400 million was already expected to arise, and provisions for contract losses should have been recorded.

The impact on the financial statements of the failure to conduct the above accounting treatment is described below.

Change in profit and loss before adjustment

(Unit: JPY 100 million)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	4	4
Total estimated cost of contract work	-	-	-	-	-	4	7
Net profit or loss	-	-	-	-	-	0	(3)
FY profit or loss							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	-	-	-
Accumulated profit or loss							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	-	-	-

Change in profit and loss after adjustment

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	4	4

Total estimated cost of contract work	-	-	-	-	-	4	8
Net profit or loss	-	-	-	-	-	0	(4)
FY profit or loss							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	-	-	(4)
Cumulative profit							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	-	-	(4)

Adjustment amounts

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Total estimated income from contract work	-	-	-	-	-	-	-
Total estimated cost of contract work	-	-	-	-	-	-	1
Net profit or loss	-	-	-	-	-	-	(1)
FY profit or loss							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	-	-	(4)
Cumulative profit							
Sales	-	-	-	-	-	-	-
Gross profit	-	-	-	-	-	-	(4)

Chapter 4. Accounting Treatment in relation to Recording Operating Expenses in the Visual Products Business

I. Scope of Investigation

1. Subject period of investigation

The Investigation covered the period from FY 2008 to the third quarter of FY 2014 in principle. The fourth quarter of FY 2014 was excluded from the Investigation because it was covered by the annual audit conducted by the accounting auditor concurrently with the Investigation. However, the Investigation covered other periods as well to the extent necessary to explore the causes of inappropriate accounting treatment.

2. Scope of matters

In light of “II. Delegated matters (scope of the Investigation),” “Chapter 1. Overview of the Investigation,” the main focus on the Investigation was on the appropriateness of accounting treatment related to the timing of recording operating expenses (particularly in relation to items called C/O or Carry-Over, which will be discussed later) in the Visual Products Business of Toshiba and its consolidated Subsidiaries.

II. Investigation method and procedures

1. Basic policy of the investigation method

The population for the Investigation was the C/O on the C/O monitoring chart managed by the Visual Products Business (material in which divisions collect and manage information related to C/O Balances by region). The Committee obtained the “C/O Evaluation Table” in which TLSC evaluated each of the items under C/O Balances to be “Requiring Adjustment” or “Not Requiring Adjustment,” conducted interviews with the people involved, and scrutinized and analyzed relevant documents in regard to, the evaluation criteria and results and transaction details by type of C/O, thus investigating the appropriateness of accounting treatment, the background and causes of inappropriate accounting treatment, etc.

2. Investigation procedures

From May 22 to July 20, 2015, the Committee investigated the accounting treatment mainly using the following procedures, within the scope of the Investigation set forth above:

(1) Obtaining a complete set of C/O-related materials (including relevant meeting minutes and materials).

(2) Investigation and examination of the background and method of preparation and method of management of the complete set of C/O-related materials.

(3) Obtaining the C/O Evaluation Table and examined evaluation results of accounting treatment.

(4) Examination of the appropriateness of the timing by the content of C/O based on the results of (1) through (3) above.

(5) Examination of whether any inappropriate timing of recording operating expenses other than those included in the aforementioned C/O-related materials existed.

(6) Interviews with the Officers and Employees involved.

(7) Digital forensic investigation into the PCs used for work by Officers and Employees.

III. Limitations and reservations of the Investigation

While the Investigation covered the period from FY 2008 to the third quarter of FY 2014, for the period before FY 2010 (from FY 2008 to FY 2010), the lack of information to identify the details of C/O, etc.,⁶¹ rendered a thorough examination by individual items of C/O impossible. As a result, it was possible to determine only the total amount of C/O Balances⁶² for FY 2008 and FY 2009, and only the total amount of C/O Balances by region for FY 2010.

Further, the Company did not provide the Committee with detailed information to identify the details of certain of the C/O Balances from FY 2011 to FY 2014.

C/O Balances for which the details were unknown and about which detailed information was not provided are treated as “Requiring Adjustment” for convenience in this Investigation Report, in view of the fact that there was no satisfactory explanation given as to why they were “Not Requiring Adjustment” and that most of the C/O with identified details could lead to inappropriate accounting treatment.

IV. Facts identified in the Investigation

1. Outline of Visual Products Business

Toshiba, which adopts an in-house companies system, has repeatedly restructured and reorganized the Visual Products Business (manufacturing and sale of television sets). Since FY 2008, the following Companies and Subsidiaries (the Visual Products Business was spun off in FY 2014; collectively, the “**Visual Products Company, etc.**”) have been engaged in the Visual Products Business.

⁶¹ For FY 2010 and earlier, materials used for managing C/O by item and minutes and materials of major meetings were no longer available, making it impossible to check such materials. In addition, the Committee could not interview some of the personnel involved in the period subject to the Investigation or carry out a digital forensic investigation into their emails because they had resigned.

⁶² In the Visual Products Business, the amount of C/O performed at the end of a fiscal period was called “Balance.”

FY 2008 to FY 2009: Digital Media Network Company (DM Company)
FY 2010: Visual Products Company (VP Company)
FY 2011 to FY 2013: Digital Products & Services Company (DS Company)
FY 2014 onward: (Spin-off) Toshiba Lifestyle Company (TLSC)

Further, at the Visual Products Company, etc., the Visual Products Business was conducted by the following divisions (collectively, the “**Business Unit**” in this Chapter 4).

FY 2008 to first half of FY 2009: TV & Visual Media Equipment Division
Second half of FY 2009 to first half of FY 2010: Visual Products Marketing Division
Second half of FY 2010: Visual Products Divisions 1 and 2
FY 2011 to first half of FY 2013: Digital Products & Services Divisions 1 to 4
(Digital Products & Services Division 5 created in July 2012)
Second half of FY 2013: Visual Solutions Division
FY 2014 to date: Visual Solutions Business Group

The Visual Products Business of Toshiba and TLSC (collectively “**Toshiba**” in this Chapter 4) does not just consist of Toshiba itself, but also a global business network that includes a large number of affiliates inside and outside Japan that act as sales locations and Toshiba has worked in close collaboration with such affiliates. These affiliates outside Japan were called “**Overseas Affiliated Companies.**” (The departments and personnel responsible for collaboration with sales affiliates in the Business Unit are collectively referred to as the “**Regional Department.**”)⁶³

2. Appropriateness of accounting treatment in relation to recording operating expenses

(1) Accounting treatment in question and appropriateness thereof

In an attempt to meet profit and loss target amounts, the Business Unit of the Visual Products Business adjusted profits using so-called C/O (Carry-Over) that is to overstate the apparent current profit by failing to record a provision that should be recorded in the current period or deferring the recording of operating expenses until the next or a later fiscal period. While it was the Business Unit’s practice to aggregate their profit forecast by region from mid-period to the end of the period and to formulate and carry out improvement initiatives for the purpose of adjusting any gap with target profits, they used C/O to adjust such gap if it could not be covered through the usual improvement initiatives, such as increasing sales and CD.

Further, from FY 2011 at the latest, the Business Unit of the Visual Products Business gathered and managed data on C/O Balances by quarter. Some of these C/O Balances that were gathered and managed, however, represented no more than a risk of

⁶³ The Regional Departments are divided by region, e.g., Japan, Europe, Asia, and North America.

deterioration of operating performance that was not a profit and loss adjustment leading to inappropriate accounting treatment.

In the Investigation, the Committee examined the details of C/Os based on the C/O data that was gathered and managed by Toshiba, and as a result, identified the following inappropriate accounting treatment made for profit and loss adjustment:

(A) Main C/Os involving inappropriate accounting treatment

(a) C/Os related to provisions

- a. Inappropriate accounting treatment of promotion fees, rebates, and other expenses at distributors

Some of the promotion fees, rebates, and other expenses incurred by overseas distributors for China, Asia, India, and Russia were not accounted for on an accrual basis in the relevant accounting period in Toshiba's consolidated accounts.

- b. Failure to record rebates at the distributors for Europe

The distributors in Europe failed to record an adequate level of provisions for rebates in the third quarter of FY 2014.

- c. Inappropriate accounting treatment related to ecology subsidy at the distributors for China

The distributors in China recorded profits by accounting for the ecology subsidy they expected to receive from the government as an account receivable. Subsequently, however, the conditions for receiving the ecology subsidy were tightened. In the third quarter of FY 2013 at the latest, the distributor was aware that they could not receive the subsidy because they did not meet the annual unit sales target that was part of the conditions to receive the ecology subsidy. Despite this, they did not withdraw the receivable.

- d. Failure to record rebates at the distributors for the U.S.

The sales personnel of the distributor in the U.S. gave an oral promise to pay a rebate to a mass retailer, but resigned in the fourth quarter of FY 2013 without any handover to his successor. (The distributor became aware of the rebate when contacted by the retail customer in April 2014 and reached an agreement with the customer about the rebate before April 23, 2014.) The distributor should have recorded the operating expenses incurred for the incident that occurred in FY 2013.

(b) C/Os related to postponement of the timing of recording operating expenses

In Japan, Europe, the Middle East, Asia, etc., some of the expenses for advertising, logistics, and other services rendered by the end of a quarter were not recorded on the grounds that the invoices did not arrive or by requesting the payees to issue invoices in the following quarter. These operating expenses should have been recorded on an accrual basis in the period in which the services were rendered.

(c) C/Os related to inventory valuation

With respect to products sold by Toshiba to Overseas Affiliated Companies, Toshiba intentionally applied a temporary increase (UP) in the product prices (FOB prices) to Overseas Affiliated Companies at the end of the quarter. This means that on a non-consolidated basis, Toshiba recorded sales at the intentionally increased prices. As a result, sales and profits were overstated in regard to the difference between the original product prices (FOB prices) and the increased prices, while the inventories at Overseas Affiliated Companies were also overstated.

In such case, the overstated inventories at Overseas Affiliated Companies indicate the existence of unrealized profits since they are not sold outside the Toshiba Group; therefore, they should be eliminated in full from Toshiba's consolidated financial statements.

However, Toshiba did not eliminate the unrealized profits, in whole or in part, to make profit and loss adjustments on a consolidated basis (to overstate apparent profits) by using a practice of employing the non-consolidated profit rate of the divisions of Toshiba as a uniform elimination ratio for consolidated accounting for convenience (with which practice, unrealized profit and loss would not be eliminated on consolidated basis on its accounting system in cases where Toshiba's gross margins are negative in transactions with consolidated group companies).

(d) C/Os related to early recording of CR

In the Visual Products Business, Toshiba negotiated with panel manufacturers and ODM/OEM manufacturers that are parts and TV product suppliers about CR (Cost Reduction: requesting panel makers and ODM/OEM manufacturers to reduce their selling prices to Toshiba) ("CR" throughout this chapter) on the assumption that the procurement cost from the following fiscal period would be adjusted or increased. Therefore, even if an agreement was reached with them about CR in the current period, practically no CR would be actually achieved since a sizable procurement cost increase was anticipated from the following fiscal period. Notwithstanding this, Toshiba recorded purchase discounts.

(e) Other C/Os

As stated in "III. Limitations and reservations of the Investigation," C/O Balances for which the details were unknown are treated as "Requiring Adjustment" for convenience in this Investigation Report, in view of the fact that there was no satisfactory explanation given as to why they were "Not Requiring Adjustment" and that most of the

C/Os with identified details could lead to inappropriate accounting treatment.

For the above C/Os, adjustment amounts for accounting treatment are as follows.⁶⁴

Breakdown of required adjustment

(JPY 100 million)

Item		FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
A. C/Os related to provisions (total)		-	-	-	20	20	23	37
a. China, etc.	Failure to record promotion fees and rebates	-	-	-	16	16	12	16
b. Europe	Failure to record rebates	-	-	-	-	-	-	19
c. China	Failure to record ecology subsidy	-	-	-	-	-	9	-
d. U.S.	Failure to record rebates	-	-	-	-	-	2	-
	Other	-	-	-	4	3	1	2
B. C/Os related to delayed timing of recording operating expenses (total)		-	-	-	9	4	8	7
Japan, Europe, Middle East, Asia, etc.	Failure to record advertising, logistics, and other expenses	-	-	-	9	4	8	7
C. C/Os related to inventory valuation (total)		-	-	-	32	39	9	3
Japan, Europe, U.S.	Intentional increase of product selling prices to overseas distributors	-	-	-	28	38	7	-
	Other	-	-	-	4	1	2	3
D. C/Os related to early recording of CR		-	-	-	-	24	38	11
Japan etc.	Early recording of CR to panel					-	6	3
U.S., Europe, etc.	Early recording of CR to ODMs/OEMs	-	-	-	-	24	32	9
E. Other (details unknown)		53	131	196	21	31	27	
C/O Balances (total)		53	131	196	81	118	105	58

⁶⁴ As stated later, inappropriate accounting treatment was used from FY 2008 at the latest, and therefore, the amount of impact on profit and loss for FY 2008 was estimated on the assumption that C/O Balances in and before FY 2007 were zero.

Amount of impact on profit and loss	(53)	(78)	(65)	115	(37)	13	47
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3. Facts Identified by the Independent Investigation Committee

(1) Details of inappropriate accounting treatment carried out for the profit and loss adjustment

The Business Unit of the Visual Products Business did not have any internal rules expressly providing in writing for details, implementation methods, or management methods, etc., relating to C/Os, but broadly speaking they use the term “C/O” to refer to a variety of measures taken for the purpose of adjusting profit and loss (overstating apparent profits). Then when a profit and loss adjustment is made for the purpose of overstating apparent profit, it causes deterioration in profit and loss in subsequent periods by the amount of the adjustment. Therefore, in order to recognize the risk of deterioration in subsequent periods, the divisions aggregated all amounts that it had recognized as C/Os and managed them as C/O Balances every quarter.

It has been recognized, though, that among the C/Os the Business Unit of the Visual Products Business recognized as C/O Balances, there were in reality a very small number of them that ultimately could not be assessed as instances of inappropriate accounting treatment, such as a C/O that was judged to be the kind of error made where, despite the fact that an amount had already been recognized as a debt in one period, it was carried over as an amount treated for recognition in subsequent periods, and another that was conducted as a profit and loss adjustment at the time but for which, as a result of subsequent circumstances, an accounting revision became ultimately unnecessary.⁶⁵

However, whatever the case may be, it was recognized that the C/Os the Business Unit of the Visual Products Business recognized as C/O Balances were conducted as measures for the purpose of adjusting profit and loss, and that almost all of the C/Os recognized as C/O Balances were also in reality instances of inappropriate accounting treatment. In fact, in July 2011, General Manager A of the Finance & Accounting Division of the DS Company, upon consultation with the Corporate Finance & Accounting Division, attempted a definition of C/O between Masaaki Oosumi CP and the DS Company Finance & Accounting Division, and in this instance their discussions proceeded based on the premise that a C/O is a treatment that meets the two conditions of being (i) a treatment that affects profit and loss in a subsequent period by deferring expenses or recording profits early and (ii) an inappropriate treatment from an accounting perspective—in other words, that, whatever the case may be, it was an inappropriate treatment from an accounting perspective.

Set out below is a description of the facts and causes of those C/Os the Business Unit of the Visual Products Business recognized as C/O Balances that can be judged to be

⁶⁵ This case relates to the early recording of CR described below, and there was a case where, because prices ultimately did not increase in the following period, it was possible to end up achieving a CR effect in the current period, and as a result an accounting revision became unnecessary.

instances of inappropriate accounting treatment (“**Inappropriate C/O(s)**”).

(A) Methods of profit and loss adjustments that led to inappropriate accounting treatments in the Visual Products Business

Since around 2008 at the latest,⁶⁶ Toshiba’s Visual Products Business has continued to make Inappropriate C/Os as measures to achieve profit and loss target amounts.

The methods by which it did this (the items) can be broadly classified into the four types indicated below. As described above, these four types of items are instances of inappropriate accounting treatment.

⁶⁶ However, as described above, because, among other reasons, there is no information for understanding the details of C/Os in and before FY 2010, although it can be recognized that Inappropriate C/Os had been conducted since FY 2008, it was not until FY 2011 that it could be recognized that Inappropriate C/Os were being conducted with the authorization of the CP in the Companies engaged in the Visual Products Business.

	Item	Main method	Characteristics
A	Methods related to provisions	For purposes of Toshiba's consolidated accounting, using the cash-based method even though the accrual-based method should be used	<ul style="list-style-type: none"> - Often used as an accounting practice in Regional Departments in China, Asia, India, and Russia, where accounting treatments that are in substance close to cash-based methods are accepted - Little chance of being discovered in an accounting audit.
B	Methods related to delayed timing of recording operating expense	Where services that involve advertising or logistics expenses have already been provided, requesting vendors to delay the issuance of invoices until the next quarter to record expenses in the next quarter	<ul style="list-style-type: none"> - Often used in Regional Departments in Japan, Europe, and the Middle Eastern Asia, where accrual-based methods are applied under their accounting standards. - Little chance of being discovered in an accounting audit, as the evidence comes out in the next quarter.
C	Methods related to inventory valuation (mainly FOB-UP)	By utilizing the fact that on Toshiba's accounting systems unrealized profit and loss are not eliminated where Toshiba's gross margins are negative in transactions with consolidated group companies, increasing (UP) the product price (FOB price) to Overseas Affiliated Companies (to the extent that still maintains Toshiba's negative gross margin) at the end of the relevant period	<ul style="list-style-type: none"> - Often used in transactions with Regional Department in Europe, which has a large volume of transactions (the greater the negative amount of Toshiba's gross profit was, the more possible it was to make a large amount of profit and loss adjustments). - The effects of the profit and loss adjustment are greater with this item than with other items.

D	Methods related to early recording of CR	CR to be reflected in the purchase prices even in cases where there is low possibility of achieving CR	- In Toshiba's procurement department, it was possible to make profit and loss adjustments in large amounts collectively across all regions.
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Based on the characteristics of each item, the Business Unit of the Visual Products Business used these four types of items selectively at their discretion, comprehensively considering the profit and loss adjustment amounts which are necessary for the purpose of achieving profit and loss target amounts, and the timing of accounting audits (whether conducted during a quarter or at the end of a quarter), etc.

(B) Status of the Visual Products Division at the time inappropriate C/Os were conducted

(a) Circumstances surrounding the Visual Products Business

The table below shows changes in sales volume (number of products sold), sales revenue, operating profits, and other statistics for Toshiba's Visual Products Business since FY 2007:

(Sales Volume: 1,000 units; Monetary Unit: JPY 100 million)

FY	2007	2008	2009	2010	2011	2012	2013	2014
Sales Volume	4,714	6,384	9,246	12,974	13,724	9,941	7,498	5,334
Sales	6,131	5,330	5,301	6,155	4,627	3,006	2,692	2,165
Operating Profit	(135)	13	38	32	(535)	(481)	(261)	(354)
Group Profit and Loss	(120)	(106)	(59)	(40)	(682)	(720)	(484)	(706)

Toshiba's Visual Products Business had continued to stagnate in its overseas operations. Since FY 2007, Toshiba's business profit and loss had continued to struggle due to the economic recession triggered by the financial crisis, and since FY 2011 in particular, Toshiba's Visual Products Business had been performing extremely severely. Specifically, it achieved and maintained operating profits from FY 2008 to FY 2010, largely due to a temporary increase in sales in domestic businesses where replacement demand was high as a result of the introduction of points for eco-friendly products and the suspension of analogue waves (conversion to digital ground waves). However, in July 2011, when the replacement demand subsided following the completion of the switch over to digital ground waves, consumers stopped buying, and the domestic market scale shrunk rapidly to approximately one fifth of its previous size and sales plunged dramatically. This was accompanied by a drop in the product unit price as well as an

increase in repair costs for guaranteed products sold in FY 2010. These and other factors led to a substantial operating loss of as much as JPY 53.5 billion in FY 2011, and the Visual Products Business continued to record enormous operating losses in subsequent fiscal years, amounting to JPY 48.1 billion in FY 2012, JPY 26.1 billion in FY 2013, and JPY 35.4 billion in FY 2014.

These circumstances forced the Visual Products Business to take a variety of measures for structural reform. From FY 2012 through to FY 2013, Toshiba reduced or suspended its business operations in unprofitable regions such as Central and South America and Australia, reduced the number of domestic employees, split off part of its business (for integration into the home electrical appliances business), and closed (in Fukaya, Japan, and Dalian, China) and sold (in Poland) Operations that were manufacturing bases. In FY 2014, Toshiba reduced or suspended more business operations in unprofitable regions, let go more domestic employees, reorganized overseas sales offices, and created a brand licensing business for its North America businesses.

(b) Intensification of pressure from Corporate to achieve challenges

Even before FY 2010, at Toshiba, there were relentless demands from Corporate to the CP, the Vice President, the General Manager of the Company Finance & Accounting Division, and other executives of the Visual Products Company, etc., at the CEO Monthly Meetings to achieve the profit and loss required under the budget and the profit and loss improvement demands (these were referred to in Toshiba as “**Challenges**”) during the period. In particular, because the Visual Products Business was continuing to record operating losses, the Challenges set by Corporate became particularly difficult to be met, as described below. Starting in FY 2011 at the latest, executives of the Visual Products Company, etc., were often chastised severely by Corporate President and the Challenges were set at the meeting venue of the CEO Monthly Meetings and in individual communications.

In the beginning of 2013 in particular, the top management at Corporate demanded that the Visual Products Business achieve improvements in profit and loss while suggesting that Toshiba might have to withdraw from the Visual Products Business.

The Specific examples of the demands to achieve these severe Challenges that are noteworthy are as follows:

- In September 2012, at a CEO Monthly Meeting, Norio Sasaki P stated that “An explanation of measures to generate JPY 9.2 billion in sales to meet the targets submitted on September 10 is completely meaningless. That is not an answer to the Challenge to improve profits. Regarding this Challenge, if there is a Company that does not achieve its targets, Toshiba as a whole will fail to achieve the budget. Despite that, all you say is that you will meet your submitted figures. ... [A]bsolutely unacceptable. Do it again.”

- In August 2013, Hisao Tanaka P told Masahiko Fukakushi GCEO, Shigenori Tokumitsu CP, Vice President A of the Visual Products Division, and others that “The entire reason for this is an unexpected deterioration in profit and loss in our PC, TV, and home electrical appliances. If the state of second quarter profit and loss remains the same as the first quarter profit and loss, I will have no choice but to change our conventional position and consider completely withdrawing from the TV, PC, and home electrical appliance businesses, not only in Japan but everywhere in the world. This is

not in any way intended as a threat.”

- In September 2013, Hisao Tanaka P told Shigenori Tokumitsu GCEO and Masahiko Fukakushi CP that “I have publicly announced that we will bring our TV business back into the black in the latter half of this fiscal year. It is a public commitment. We must follow through on this by using every conceivable means.”

- In February 2014, at a CEO Monthly Meeting, Hisao Tanaka P stated that “Visual Products broke even in the third quarter, but then in the fourth quarter fell back into deficit again. This is pointless. We must by all means ensure that it breaks even. After all that structural reform we went through, we cannot say that we are still with JPY 4.6 billion in deficit. Up to what amount does it seem we can attain?” Vice President C of the Visual Products Division of the DS Company replied that “It is JPY 2.3 billion short as our attainable amount, and it is difficult to take measures to respond to Europe’s negative JPY 4.6 billion. We would like a little more time.” Hisao Tanaka P then instructed that “whatever it takes, bring it down to JPY 2.0 billion. ... [T]he Challenge is to improve cash flow by the amount of the deterioration last time plus JPY 10.0 billion.”

- In March 2014, at a CEO Monthly Meeting, Hisao Tanaka P asked “What is this mess with the TV business? There is still a risk of a JPY 2.0 billion loss. You have taken on the Challenge of JPY 1.9 billion in profit but cannot expect to achieve it. At worst, this means we could end up with a JPY 8.5 billion loss. If that happens, we will withdraw from the TV business. If it’s in deficit, we’re out. We promised the market that we would bring it back into the black. If we can’t do that, we will withdraw.” “The profit and loss for the Visual Products must recover at least JPY 1.9 billion from the JPY 6.5 billion loss.”

- In June 2014, Hisao Tanaka P chastised TLSC CEO as follows: “What is happening with the Visual Products Business? I cannot possibly approve anything like a loss of JPY 5.3 billion in the first quarter. I would be betraying the promise I made in the latter half of FY 2013 to the market that the business would record a profit. And I would be betraying the announcement I made that there was a firm forecast for a profit. The market will not trust whatever I promise, no matter what I say. Do you realize how badly this will affect our other businesses? As for any business recording a loss of over JPY 20.0 billion on an annual basis, we will have no choice but to withdraw completely. How many more years are we expected to put up with this? There will be no choice but to let go of all of the employees at the Overseas Affiliated Companies and withdraw from the business altogether. Substantial improvements have not been achieved at all, is that right? At the meeting for inspecting the business problems held the other day, Vice President C of the Visual Products Division was against even the idea of withdrawing just from the U.S. despite the current situation, do you remember that? You have to get serious, that’s all I can say.”

(c) Course of events that led to Inappropriate C/Os being conducted in each company

a. The DM Company era (up to FY 2009): commencement of Inappropriate C/Os

Around 2007, as per the instruction of Atsutoshi Nishida P, and in conjunction with the

DM Company's being in deficit and the switch over from analogue TVs to digital TVs, the DM Company decided to strengthen its Finance & Accounting Division with the aim of achieving structural transformation into a profitable business model and bringing the operating profits of the Visual Products Business back into the black. Namely, in order to undertake the switch from the analogue-TV-era business model of local production for local consumption to a centralized business model managed by the Tokyo Head Office and to strengthen control over Overseas Affiliated Companies, the position of chief financial officer was established in the DM Company, and the Finance & Accounting Division was strengthened by, for example, appointing personnel from the Semiconductor Business as the General Manager of the Finance & Accounting Division and as the Group Manager. Efforts were made to unify accounting standards, which were inconsistent across regions, so as to enable the Finance & Accounting Division to exert better control.

Further, because there was a possibility that information relating to performance forecasts and budgets collected from Overseas Affiliated Companies, etc. might contain expected amounts or effort amounts calculated based on inconsistent standards, the DM Company decided to first collect the total amount without taking into account expected amounts or effort amounts, so as to unify the management of profit and loss. As a result, the DM Company became aware of the possibility that provisions for sales promotion expenses and the like might have been substantially overstated. Given its business conditions and under circumstances where it was difficult to make profit, reducing (releasing) the provisions that had been substantially overstated was an easy and highly achievable measure for bringing operating profit back into the black. It was at this point, around 2008 at the latest, that the Finance & Accounting Division had discussions with Regional Departments over measures, referred to as "Challenges To Go," to improve profit and loss that would fill the gap between profit and loss target amounts and the Total Amounts for the purpose of profit and loss improvements aimed at profit and loss target amounts. And as one of those measures, the DM Company started to reduce the amounts of provisions that had been (were judged to have been) substantially overstated at overseas subsidiaries.

According to a member of the Finance & Accounting Division personnel at the time, inspection was made at a level recognized as appropriate accounting standards at the time (a level which would be approved by local accountants) and they attempted to normalize (reduce to the minimum extent necessary) the provisions that had been substantially overstated at Overseas Affiliated Companies to the extent permitted under the relevant accounting standards. However, based on the fact that it was difficult for someone in the Finance & Accounting Division to have a complete awareness of these treatments at Overseas Affiliated Companies, etc., and the fact that, even if there were provisions that had been substantially overstated, there was a limit to the amount that could be assessed to be an overstatement, it can be considered that there should also have been a limit to improving profit and loss by normalizing these provisions. Given these circumstances, it can be considered that there is a high possibility that Inappropriate C/Os began to be conducted by means of Item A mentioned above (methods related to provisions) around this time period under the guise of normalizing provisions. (There is also a member of personnel who has stated that they aggressively came to reduce the provisions in order to realize a positive balance in accordance with the intent of the CFO of the DM Company.)

In FY 2008, the DM Company did in fact come out of deficit and record positive operating profits, possibly because of the measures discussed above.

However, because there is a limit to the effectiveness of only reducing provisions, etc., as a measure for improving profit and loss, it can be considered that there is a high possibility that, at around this time period, Inappropriate C/Os by means of Item B mentioned above (methods related to delayed timing of the recording of operating expenses) also started to be conducted between the Business Unit of the Visual Products Business and the Overseas Affiliated Companies, etc., based on the idea of profit and loss improvements to achieve profit and loss target amounts (there is also a member of personnel who has stated that in FY 2009 Inappropriate C/Os were already conducted by means of Item B mentioned above).

b. The VP Company era (FY 2010): normalization of Inappropriate C/Os and background of commencement of FOB-UP

In FY 2010, which was the VP Company era, the accounting department was reformed and reorganized into a new structure. Around this time, the Business Unit was leading an initiative, with the cooperation of the accounting department, to examine, item by item, measures to improve profit and loss by way of Challenge To Go or “reaping,” and they noticed that Inappropriate C/Os in the form of Item A and Item B mentioned above were included in the items they were examining. Given the success of these items in temporarily achieving a positive balance, the overstating of apparent profit continued to be carried out through the conducting of Inappropriate C/Os by means of Item A and Item B mentioned above according to the instruction of the Business Unit in the Overseas Affiliated Companies whose results were worse off compared to the domestic subsidiaries, for the purpose of avoiding a loss in the Visual Products Business going forward, in case where it seemed like measures for improvement through ordinary measures such as sales increases and CDs (these ordinary measures were called “fresh-water measures” within the Visual Products Company, etc.) were not going to achieve the profit and loss target amount.

In such circumstances, in the first half of FY 2010, instructions were given from the Corporate Finance & Accounting Division to the VP Company to improve Toshiba’s non-consolidated profit and loss, on the grounds that the need had arisen to improve profit and loss at Toshiba on a non-consolidated basis. In response to this, because the situation was such that the ordinary measures were not improving Toshiba’s non-consolidated profit and loss as much as was desired, the Business Unit of the VP Company’s Visual Products Business started to conduct FOB-UP under Item C (methods related to inventory valuation) as a measure to resolve the problem in one all-encompassing act.⁶⁷ This treatment then led to Item C above being added to the

⁶⁷ According to a member of Finance & Accounting Division personnel at the VP Company at the time, FOB-UP was initially envisaged as a method to improve Toshiba’s non-consolidated profit and loss to the extent doing so would not adjust profit and loss on a consolidated basis (there would not be an adjustment to profit and loss on a consolidated basis because, in accordance with the accounting treatment, unrealized profits would be deleted in transactions with consolidated group companies). In reality, however, because there were times when, if FOB-UP was conducted, unrealized profits were not deleted on Toshiba’s accounting system, as discussed earlier, this led to instances of inappropriate accounting treatment on a consolidated basis. It can be surmised that the personnel at the VP Company who became aware of this loophole on conducting FOB-UP then

types of Inappropriate C/Os that were used in the VP Company for the purpose of adjusting profit and loss in Toshiba's consolidated accounts. As a result of a large amount of Inappropriate C/Os being conducted through Item C above in Europe during FY 2010, the C/O Balances that the VP Company actually recognized at the beginning of FY 2011 was more than JPY 10.0 billion.

However, at this time at the latest, the Business Unit of the Visual Products Business was, upon consultation with Overseas Affiliated Companies, etc., considering up to what amount they would use each of Items A, B, and C above taking into account the characteristics and regional nature of each means of Inappropriate C/O, while keeping in mind the profit and loss adjustment amount that was necessary in light of the Challenge amount and the state of profit and loss, etc. (i.e., the amount by which the profit and loss target cannot be improved by fresh-water measures). The extent to which C/Os, including Inappropriate C/Os, were scheduled to be conducted was then reported to the CP at the monthly meetings of the Visual Products Company, etc., and the Inappropriate C/Os were then conducted with the consent of the CP.

c. DS Company era (FY 2011 to FY 2013): managing C/Os and establishment of the Corporate reporting system

(a) Preparation of C/O monitoring chart and commencement of early recordings of CR

In April 2011, the VP Company, which had been carrying out the Visual Products Business, was amalgamated with the DN Company, which had been carrying out the PC Business, to form a brand new company, the DS Company. Following the amalgamation of the PC Business and the subdivision of the divisions by region, the need arose to manage the C/O Balances, including Inappropriate C/Os, by business and region. This need prompted the Visual Products Business to prepare a C/O monitoring chart.⁶⁸

Since FY 2012, Item D mentioned above (methods related to early recordings of CR) of Inappropriate C/Os started to be carried out. The reason why Item D was carried out for adjustments of profit and loss was to meet the heightened need to adjust the profit and loss because of further aggravation of performance in FY 2012 and of an increasing difficulty in negotiating sourcing costs, which was one of the measures the DS Company normally took.

Around this time, the Company had forecast submission amounts determination meetings held by the Business Unit where they discussed and determined mainly the anticipated amounts for sales and profit and loss, etc. to be submitted to the Corporate CEO Monthly Meetings held each month. At these meetings, the initial proposal of

subsequently started to intentionally conduct FOB-UP for the purpose of improving profit and loss on Toshiba's consolidated accounts.

⁶⁸ The DS Company had meetings to determine the forecast submission amount of C/Os that were attended by the Business Unit and the accounting departments, and totaled the results of C/Os settled at such meetings. The Business Unit instructed each Regional Department to give them a quarterly report on the C/O Balances, and totaled the Balance and recorded in the C/O monitoring chart. The information contained in the chart was then shared with the accounting department.

Inappropriate C/Os that had been discussed and formulated by the Regional Department in consultation with the Overseas Affiliated Companies was submitted, and the execution program for each item of the Inappropriate C/Os was decided upon discussion between the General Manager of the Business Strategy & Planning Division, the General Manager of the Finance & Accounting Division, and the Vice President. Then, these execution programs of Inappropriate C/Os were reported to the CP at the monthly meetings of the Visual Product Company, etc., and Inappropriate C/Os were executed with the consent of the CP. In order to understand the substantial operations profit and loss for the Visual Products Business, the DS Company began to use a double standard to manage the profit and loss status, where they referred to the performance figures after implementing Inappropriate C/Os (disclosed amounts) as well as the attainable amounts (close to normalized figures⁶⁹) of the performance figures after removing the profit and loss improvement effects caused by implementing C/Os including Inappropriate C/Os.⁷⁰

As detailed above, Inappropriate C/Os were executed with the consent of the CP, or, from time to time, through direct instruction by the CP himself. Among those concrete communications, what are noteworthy are as follows.

- On April 28, 2011, Masaaki Oosumi CP contacted General Manager A of the Finance & Accounting Division, and stated as follows: “As I am going to visit Toshiba Television Central Europe Sp. z o.o. on Friday, I will check the details of the C/Os for Europe. I will verify how much of the JPY 18.0 billion is the actual amount of Debt.⁷¹ We should call a meeting to authorize the C/Os. What are the details of the JPY 10.0 billion for Asia?” In response, General Manager A of the Finance & Accounting Division reported a breakdown of the content of their Debt (i.e., the C/O Balances) for Asia.

- On April 27, 2012, Masaaki Oosumi CP contacted the Vice President of each division and stated as follows: “We don’t have enough sales. I want you to increase the sales at least by JPY 5.0 billion. The quota for each division is JPY 2.0 billion. I want you to instruct our distributors to take resolute measures to increase sales by the end of this month by altering the timing of payment⁷² for the C/Os, for example.” In effect, Oosumi CP gave instructions to continue using C/Os to overstate apparent profits in the event that fresh-water measures would not be able enough to achieve the profit

⁶⁹ Normalized figures were used from time to time in order to indicate the profit and loss for a given fiscal year, by averaging out the quarterly profit and loss which could fluctuate considerably in each quarter.

⁷⁰ Previously, the C/Os proposed by the Regional Department included cases where they conservatively reported future sales shortfalls and cases where provisions were not recorded for rebates on the ground that they did not fulfill the accounting requirements for recording provisions because of uncertain factors in the future. However, from 2011, C/Os proposed by the Business Unit consisted of Inappropriate C/Os executed for the purpose of improving losses and profits.

⁷¹ The C/O Balance was referred to as “Debt,” since it could cause negative effects on profit and loss for the following accounting period.

⁷² At the Visual Products Company, etc., C/Os needed to be continuously implemented in order to improve the profit and loss for the following periods as the C/O Balance leads to deterioration in profit and loss in the following or subsequent periods. The reduction of the C/O amount implemented in a period using the C/O Balance from the previous period is called “repayment” of the C/O Balance (i.e., Debt).

and loss target amounts.

- On August 20, 2012, the procurement department personnel reported to Masahiko Fukakushi CP as follows: “The amount submitted by procurement department is JPY 92.5 billion, but this figure incorporated the FOB adjustment of plus JPY 5.5 billion. So, the actual figure is JPY 87.0 billion, excluding the profit and loss improvement.” As seen here, it was officially reported that FOB-UP was carried out as a profit and loss adjustment.

(b) Reports of C/O to Corporate top management as measures of profit and loss adjustment

At the CEO Monthly Meeting in June 2011, Makoto Kubo EV made a request to the DS Company as follows: “Please tell us the balance of sales, purchases and C/Os sorted by TVs and PCs.” In response to this request, after July 2011, the DS Company began reporting on the C/O Balances, including Inappropriate C/O Balances, and the increase and decrease thereof, in the Visual Products Business at the quarterly reporting meetings or CEO Monthly Meetings. Specifically, they reported the attainable amount of performance figures after removing the C/O Balances and the effects of profit and loss improvement plans by implementing C/Os. Those matters were reported in a way indicating that C/Os had been implemented at least for the purpose of adjusting profit and loss.

Among the materials for the above reports, there could be found those that clearly indicated that some of the C/Os need to be compatible with accountants, and that Item C above (FOB-UP) was included in the reports.

Regarding the C/O reports directed to the top management of Corporate, what are noteworthy are the following.

- The materials prepared for the CEO Monthly Meeting in November 2011, as well as those for the business measure follow-up meetings included a heading, “Buy-Sell, C/O Payment Plans,” under which “Priority of Payments” were identified as “1. C/Os compatible with accountants; 2. Buy Sell; and 3. C/Os.”

- The materials prepared for the Corporate monthly meeting in December 2011, as well as those for the business measure follow-up meetings contained the following statements: “Aggravation of the submitted amount (Finance) with negative JPY 14.3 billion, due to the increase in repayment of C/Os (of JPY 4.9 billion);” “Due to the decrease in sales volumes, the amount of C/Os has dropped more than anticipated;” and “Measures were not implemented because of the judgment of ‘black’ (negative 15), and not implemented because it was identified in prior audits at TIU (negative10).”

- The materials prepared for the CEO Monthly Meeting in February 2012 contained the following statements, which classified the “increased FOB (UP)” as “special inventory”: “We will aim to reduce ‘poor inventory’ as well as ‘special inventory’ even further.”

- The materials prepared for the CEO countermeasure follow-up meeting in July 2012 contained a table titled “Balance of C/Os, Buy Sell: The First Half of FY 2012,” in which the following statement was made: “Buy Sell, and FOB-UP are gray close to black, and the rest is recognized as gray.”

(c) Movement toward eliminating Inappropriate C/Os

In January 2014, Corporate began to instruct the DS Company to try not to increase the C/O Balances.

At the same time, however, Corporate put pressures onto the DS Company regarding the profit and loss improvement, which kept the DS Company from immediately eliminating the C/O Balances. As we discuss below, the C/O Balances remained not eliminated until the end of FY 2014.

d. TLSC era (FY 2014): Elimination of Inappropriate C/Os

In April 2014, TLSC was formed as a spin-off company to deal with the Visual Products Business, etc., through an absorption-type company split where the Visual Products Business and other related business run by the DS Company were transferred to THA (Toshiba Home Appliances, Inc.), which was another spin-off company running the home electrical appliances business.

At the time of the transfer, the General Manager of TLSC's Finance & Accounting Division at that time made a request to the Corporate Finance & Accounting Division that the large C/O Balances be left with Corporate. However, because the DS Company's statement of accounts had already been finalized, the C/O Balances including Inappropriate C/Os were succeeded to TLSC as they were. For instance, in TLSC's internal report for June 2014, with respect to the business improvement plan for the Visual Products Business in North America for the first quarter of FY 2014, improvement items were classified into attainable improvements and C/Os and also each item of the C/Os was then ranked into either "Rank B: Possible to eliminate, but requires careful deliberation with Overseas Affiliated Companies" or "Rank C: High risk of not clearing the audit; requires deliberation with Overseas Affiliated Companies and TLSC Finance & Accounting Division." In addition to such classification, in the business improvement plan for the Visual Products Business in Europe for the first quarter of FY 2014, the following statement was contained and C/Os remained carried out: "Will discuss with our Overseas Affiliated Companies and discover new C/O items."

However, due to subsequent circumstances, the TLSC business policy changed and TLSC decided to eliminate all C/Os, including Inappropriate C/Os, by the end of FY 2014. Such circumstances included (i) that, as a spin-off company, it would involve tax-auditing risk for TLSC to continue C/Os including Inappropriate C/Os, (ii) that many items of Inappropriate C/Os would become difficult to be executed since Toshiba was planning a practical withdrawal from its overseas Visual Products Business (in turn, Toshiba was planning to move to brand licensing businesses and focus on the domestic businesses) by discontinuing the development, ●●●●, and sales in all of its overseas businesses in FY 2015, (iii) that the reduced size of its business would make it impossible to realize significant effect of profit and loss adjustment.

As a result, the C/O Balances, including Inappropriate C/Os, became zero at the end of FY 2014.

4. Causes of inappropriate accounting treatment

(1) Corporate pressure in business downturns

As stated earlier, at Toshiba, from even before FY 2010, there were relentless demands from Corporate to the Visual Products Company, etc. at CEO Monthly Meetings, etc. to achieve profit and loss required under the budget and the profit and loss improvement demands (Challenges) during the period. Therefore, apparent profits were intentionally overstated at the Visual Products Company, etc. through Inappropriate C/O to adjust profits, as the usual measures such as revenue increases and CD were insufficient to meet Challenges and B/E (break-even) for the purpose of avoiding recording losses for any fiscal period.

What was fundamentally merely an estimate to be seen as a budget or goal amount from Corporate to the Visual Products Company, etc. was transformed into a mandatory profit and loss figure that needed to be achieved within Toshiba at some stage, driving the Visual Products Company, etc. to be in the situation where it had no choice but to push forward and achieve those figures.

Furthermore, the profit target to be achieved was not derived from the long-term perspective of an earnings target or similar, but from an over-riding current-term profit policy to maximize profits for each quarter or fiscal year.

Under these circumstances, the Visual Products Company, etc. used any means available to prioritize financial achievement, resulting in prioritizing the figures for performance control based on overstated profits after conducting Inappropriate C/O, over financial accounting. More specifically, through the process in which Challenges from Corporate imposed upon CP and the Vice President were allocated to the relevant regional managers and the instructions from P were conveyed, a culture came to be established in the Visual Products Company, etc. of using every available means to meet Challenges or avoid recording losses.

From FY 2011 at the latest, with further deterioration in the performance of the Visual Products Business, the Vice President of the Business Unit commenced with instructions explicitly stating Inappropriate C/O amounts to the regional managers in conjunction with concrete improvement items and amounts, with authorization from CP, the top management of the Company.

As described above, it can be surmised that the root cause of the Inappropriate C/O stems from excessive demands to meet Challenges from certain top management at Corporate level. Certainly, management techniques such as demands to achieve the budget were also carried out at other companies, and this may not have been an issue when the economic situation surrounding the industry and the Visual Products Company, etc. was favorable, but when business deteriorated in the industry and the Visual Products Company, etc., there were many issues in continuing with such management techniques, and this cultivated a foundation for encouraging inappropriate accounting treatment by the Visual Products Company, etc.

It appears that, at the time of Hisao Tanaka P, there were no instructions regarding “Challenges,” but instead, there were instructions such as “Use every possible means to bring [business] into the black,” which can be assessed as being substantially no different to the Challenges.

(2) Omissions by the top management and others at Corporate (based on an over-riding current-term profit policy)

No evidence was found indicating that the top management from Corporate such as P gave any instructions on or had any involvement in the execution of the Inappropriate C/O.

However, according to C/O reports described earlier that were provided to Corporate, it can be recognized that Norio Sasaki P was aware that C/O was conducted to overstate the profit in the Visual Products Company, etc. by November 2011 at the latest, while Hisao Tanaka P was aware by either August 2013 or March 2014 at the latest. Therefore, even if the top management of Corporate was not aware of the detailed breakdown of the C/O or the clearly inappropriate nature of accounting, they should have checked the content of the Inappropriate C/O that was being conducted to overstate profits and given suggestions or instruction to improve, or at the very least confirm, the accounting appropriateness thereof.

Regarding this point, Norio Sasaki P stated, “I believe that the Visual Products Business’ C/O was recognized around the middle of the president’s term of office (June 2009 through June 2013), but I was not aware of the specific details thereof; I have no recollection of statements such as ‘C/O compatible with accountants’ or ‘FOB-UP is gray close to black,’ which was detailed in the material for the CEO Monthly Meetings, etc. that I attended; and I habitually said that inappropriate acts were not allowed, so I was not aware of the possibility of C/O which included matters that could lead to inappropriate accounting treatment.”

Indeed, it cannot be said that Ps were aware of, or paid attention to, all matters detailed in the significant volume of materials used at their meetings. However, in addition to the aforementioned matters, based on that (i) documents stating “Measures were not implemented because of the judgment of ‘black’,” “not implemented because it was identified in prior audits,” and “poor inventory” as stated earlier were repeatedly submitted to meetings that Norio Sasaki P attended, (ii) it was repeatedly explained that the disclosed amounts were the figures that included C/O in the attainable amounts, and (iii) exchanges⁷³ with the General Managers of the Finance & Accounting Division regarding C/O suggested that Norio Sasaki P showed interest in C/O itself, it can be surmised that Norio Sasaki P was aware that acts that were recognized as C/O were carried out to overstate the apparent profit.

In addition, Hisao Tanaka P stated that it was just recently when he became aware of the Visual Product’s C/O, and he has no recollection of (i) explanations at the CEO Monthly Meeting in November 2011 that he attended as senior vice president that “C/O compatible with accountants” were preferentially going to be repaid, or (ii) statement of “FOB-UP” in the materials for the CEO Monthly Meeting in July 2012.

However, it is clear that Hisao Tanaka P attended each CEO Monthly Meeting stated

⁷³ In January 2012, A, the accounting manager at the DS Company, contacted Masaaki Oosumi CP to the effect that there would be a report from the Finance & Accounting Division the next morning at the request of Norio Sasaki P, regarding the C/O balance by business unit as of March 2012 and the fourth quarter in FY 2011.

earlier when he was senior vice president. In addition, it can be recognized that Hisao Tanaka P received an explanation from the Corporate Finance & Accounting Division about the changes in the C/O balance of the DS Company by using the material in August 2013 after being appointed as president. It can be presumed that the specific details of the C/O were explained to a certain degree at this time, and accordingly it can be presumed that Hisao Tanaka P, at the very least, became aware of C/O being carried out as an improvement plan at that time.

In addition, Hisao Tanaka P subsequently demanded in March 2014 the president of TLSC, which carried out the Visual Products Business, to be sure to achieve the operating profit of HA (the division in charge of home electronics business) to result in a positive, because the operating profit of VS (the division in charge of the Visual Products Business), which was substantially budgeted at positive JPY 900 million (excluding C/O), but anticipated to be at negative JPY 900 million, resulting in negative JPY 9.5 billion (including C/O). At the very least, it can be identified that he recognized, at this point in time, that the C/O balance in the preceding period was the cause of the deterioration of the profit and loss in the current period, in other words, that the apparent profit in the preceding period was overstated more than reality through the implementation of C/O.

Based on the aforementioned matters, it can be surmised that Hisao Tanaka P was aware that C/O was carried out in order to adjust profit and loss from August 2013, or from March 2014, at the latest.

As such, it can be identified that both Norio Sasaki P and Hisao Tanaka P were aware that the C/O including Inappropriate C/O were conducted to adjust profit and loss (or to overstate the apparent profit), but took no action to address this issue.

Admittedly, it can be recognized that the top management from Corporate was of the basic view that the C/O was to be eliminated, and they did in fact make remarks to that effect. However, at the same time, Norio Sasaki P remarked⁷⁴ that the C/O should not be eliminated while the group financial situation showed a net loss, such that he did not have any intention to eliminate the C/O, including Inappropriate C/O, should this result in a loss.

On the other hand, as stated earlier, after Hisao Tanaka P assumed position as president, from around 2014, Corporate announced a policy not to further increase the C/O balance, and all C/O balances were eliminated at TLSC in the fourth quarter of FY 2014. As stated earlier, however, it can be surmised that one of the reasons for this lies in the fact that a large number of items of Inappropriate C/O would be difficult to continue because of the spin-off of the Visual Products Business causing an issue with respect to auditing and also because of the substantial withdrawal from overseas business (transition to a brand license business and specialization on domestic business) upon the

⁷⁴ At the CEO Monthly Meeting in May 2012, Norio Sasaki P told Masaaki Oosumi CP, “If you are in deficit, you cannot repay the Debt. Why can the Visual Products Business repay the Debt even though it is in deficit? Why is the PC [Business] not making repayments even though it is profitable in terms of actual performance figures? The way of thinking is completely opposite.” Masaaki Oosumi CP replied, “I will do it that way.” In addition, at the CEO Monthly Meeting in November 2012, Norio Sasaki P remarked, “The amount such as the disclosed amount in the third quarter in FY 2012 is not good. It is preferable to repay Debts, but if you have no profits, whose money will you repay the Debts with?”

cessation of development ●●●● and sales in all overseas Visual Products Business scheduled for FY 2015.

(3) Lack of awareness of appropriate accounting

The overstatement of profits through the use of Inappropriate C/O is an “overstatement” of current profits in excess of real attainability and it can generally be understood by anyone without any accounting expertise that this sort of treatment is a diversion from appropriate accounting practice. In spite of this, the fact that such activities were continued by a large number of people in charge and others involved with the actual acknowledgement from CP, the top management of the Visual Products Company, etc. is indicative of the lack of awareness about appropriate accounting treatment.

(4) Inadequacy of internal control functions in the Visual Products Company, etc.

(A) Finance & Accounting Division

In order to conduct appropriate accounting treatment, the Finance & Accounting Division of the Visual Products Company, etc. was expected to perform a checks and balances function independently from divisions, as part of the internal controls. However, the checking function of the accounting department did not function as envisaged with regard to Inappropriate C/O, and rather they gradually came to take on a proactive role. In other words, the C/O balances including the Inappropriate C/O managed by the Business Unit at the Visual Products Company, etc. was shared with the Finance & Accounting Division, which recognized that Inappropriate C/O was conducted, but no evidence indicates that the Finance & Accounting Division tried to stop or prevent the implementation of Inappropriate C/O. From 2012 at the latest, the Finance & Accounting Division itself played a proactive role by examining and proposing Inappropriate C/O items, assessing the possibility of Inappropriate C/O and communicating that to the accounting managers at overseas affiliated companies, or preparing explanations for audit corporations.

Within the above process, in addition to the methods regarding provisions and methods regarding postponement of the timing for recording expenses previously taken, new methods came to be added to adjust profit and loss, such as FOB-UP, which improperly used the concise system in the procedures for consolidated accounting.

Matters that are noteworthy with regard to specific involvement of the Finance & Accounting Division are as follows.

- In September 2012, personnel at the DS Company Finance & Accounting Division contacted the Senior Manager of the planning department of each division stating, “An explanation is required from the DS Company to the related departments such as Corporate regarding the C/O forecast for November. As such, please detail the items

that cannot undergo another C/O and the reasons therefor, and give a response as to why another C/O cannot be carried out in the third quarter if it is to be reverted in the fourth quarter.”

- In January 2013, B, the General Manager of the DS Company Finance & Accounting Division, contacted the General Manager of each division stating, “There are regions where the C/O cannot be carried out in January. Please re-examine to maximize C/O in January as much as possible on items other than FOB-UP.”

- In August 2013, C, the Vice President of the Visual Products Division, contacted the personnel at the planning department stating, “We cannot move on without cooperation from the accounting division, but as this is a sensitive topic, I just consulted with B, the General Manager of the DS Company Finance & Accounting Division. There are hidden amounts in addition to the C/O reported amounts. For example, what was EUR 33 million in the third quarter in Europe (including items that are bought and sold quickly for a profit every quarter) is now close to EUR 40 million.”

(B) TLSC’s Board of Company Auditors

From FY 2014, the Visual Products Company, etc. became TLSC following the spin-off of the Company, which was a company with a board of company auditors.

The two internal company auditors of TLSC attended the monthly meetings of TLSC from April 2014, and became aware in that same month, at the latest, that TLSC carried out C/O, which was for the purpose of overstating the apparent profit. Based on this, the company auditors came to see the implementation of C/O as a problem, and when they prompted the president of TLSC to swiftly eliminate the C/O, an explanation was given by the TLSC president that the policy at TLSC would be to eliminate all C/O in FY 2014. Strictly speaking, while all losses should have been recorded and C/O should have been eliminated in that quarter rather than within the fiscal year, the company auditors judged that if C/O was eliminated within that fiscal year, the company auditors would not be hindered in preparing the audit report at the closing of accounts. So the company auditors accepted the TLSC’s plan, and they came to monitor the situation regarding the elimination of C/O in the discussions with the president of TLSC each quarter thereafter. In the end, as stated earlier, all C/O were eliminated at TLSC within FY 2014.

Even though, based on the above facts, it should have been required to act so that all C/O were immediately eliminated in light of the fact that TLSC made a plan to eliminate all C/O within that fiscal year, that the company auditors carried out monitoring to bring about that elimination, and that all C/O were actually eliminated by the end of FY 2014, internal control by TLSC’s board of company auditors cannot be evaluated as not functioning.

(5) Inadequacy in internal control at Corporate

(A) Corporate Finance & Accounting Division

The Corporate Finance & Accounting Division was in the position where it gathered

and recognized actual and expected amounts produced by the Finance & Accounting Division of the Visual Products Company, etc., and conveyed to the Company's Finance & Accounting Division instructions from Corporate regarding financial matters, and it was expected to play the role of controlling the Company's Finance & Accounting Division.

However, not only did Corporate Finance & Accounting Division provide no such control, but also, as detailed below, it was in close contact with the Company's Finance & Accounting Division and gave advice with regard to Inappropriate C/O. As such, internal control by the Corporate Finance & Accounting Division was not functioning at all.

(a) Insufficient function of CFO and others

CFO and General Manager of Corporate Finance & Accounting Division were aware of the existence of C/O and the breakdown thereof through reports from CEO Monthly Meetings, etc. and the sharing of information with the Finance & Accounting Division of the Visual Products Company, etc.

In addition, there was an intention of them to eliminate C/O; in response to the statement by Norio Sasaki P at the CEO Monthly Meeting in November 2012, "The amount such as the disclosed amount in the third quarter in FY 2012 is not good. It is preferable to repay Debts, but if you have no profits, whose money will you repay the Debts with?," Makoto Kubo EV stated, "The Finance & Accounting Division would also like to repay Debts, and is making various requests to the president(s). But the business prospects for the fourth quarter for the Visual Products Business and the PC Business is zero. With that, we cannot ask the president(s) to make repayments." However, the plan for the elimination of C/O was a gradual decrease, taking into consideration the performance of the Company, and it was hard to resist Norio Sasaki P's plan not to eliminate C/O in a situation where the business was experiencing losses.

(b) Involvement of Corporate Finance & Account Division

The Corporate Finance & Accounting Division knew the figures to be submitted by the Visual Products Company, etc. in a report to the CEO Monthly Meetings in advance, and was aware that C/O, including Inappropriate C/O, was being carried out in order to adjust profit and loss. In addition, the person in charge of the Company at the Corporate Finance & Accounting Division was in close contact with the Company's Finance & Accounting Division for implementing C/O at the Visual Products Company, etc., and it is there that the intent of Corporate top management, especially the intent of the CFO, was communicated.

Matters that are noteworthy with regard to specific exchanges that took place are as follows.

- As stated earlier, in July 2011, the Corporate Finance & Accounting Division clarified the definition of C/O with the Company's Finance & Accounting Division, and

discussed about the necessity of a common understanding about the amount of C/O.⁷⁵

- In November 2012, the personnel at the Corporate Finance & Accounting Division contacted B, the General Manager of the DS Company Finance & Accounting Division stating, “I will make sure to understand the monthly profit and loss. I am wondering if the monthly fluctuation in Ome’s manufacturing profit and loss (including buy-sell, etc.), sales expansion costs on the domestic and international sale side, C/O increases and decreases, and fixed-cost fluctuation costs are crucial points.”

- In December 2012, the personnel at the Corporate Finance & Accounting Division contacted B, the General Manager of the DS Company Finance & Accounting Division stating, “I spoke with General Manager of Corporate Finance & Accounting Division about DS Company’s forecast for the third quarter. I was instructed to convey the following to you; (1) You are required to make sure to make a repayment of C/O to the amount of approximately negative JPY 5.0 billion; and (2) we are anxious about the situation where the performance of the DS Company will be worse at around negative JPY 5.0 billion. You should submit the amount, not with an attainable profit and loss that will not at all be realized, but with an anticipated profit and loss that is feasible. If that is not the case, we will fall into our usual pattern of filling in deficits for any loose parts using C/O (C/O will not decrease).”

(B) Corporate Audit Division

At the time of the Company before TLSC, the audit of the Visual Products Company, etc. by the Corporate Audit Division had been carried out once a year, but audit reports by the Corporate Audit Division made no reference to C/O. In addition, TLSC was not included in the audit by the Corporate Audit Division in FY 2014 due to the period of audit.

Meanwhile, some people in charge of the corporate audit implemented from at least April through May 2012 for the Asia/Middle-East Africa Visual Products Business and in charge of the corporate audit implemented from November through December 2012 for domestic DS business stated that they were aware of the existence of the C/O practice in the process of their investigation.

However, those people in charge of Corporate Audit Division were given an explanation from the Company that the C/O was mere technical adjustments of gaps between different fiscal periods, and the amounts noted were not material enough to warrant any mention on specific C/O in the audit report. This situation is considered to have been influenced by the fact that the audit by the Corporate Audit Division used to put emphasis on advising how to improve the business performance, and it can be evaluated that internal control by the Corporate Audit Division was not functioning sufficiently.

(C) Audit Committee

⁷⁵ As stated earlier, the definition of C/O that was discussed was “(1) the postponement of recording the expenses or the taking ahead of profits, dealt with to affect profit and loss in the next period, and (2) satisfying two inappropriate conditions in accounting.”

No evidence was found to suggest that the Audit Committee reported or commented on the Inappropriate C/O.

The audit by the Audit Committee was performed mainly through interviews with CPs, and while information received at the time of the interviews included management reports, there were no descriptions implying the existence of the C/O, such as “attainable amount,” “disclosed amount” or “C/O” as included in the CEO Monthly Meeting materials. Also, the interviews conducted by the Audit Committee with CPs mainly focused on securing the effectiveness and efficiency of operations, and it seems difficult to say that checks of the appropriateness of the accounting and financial reports were sufficiently implemented.

Makoto Kubo, chairman of the Audit Committee, was CFO for a long period from June 2011 to June 2014, and can be recognized to have quite an amount of knowledge of the details of the C/O existing at the Visual Products Company, etc., but he never indicated Inappropriate C/O as an issue after becoming chairman of the Audit Committee in June 2014. It can be considered that this happened partly because it was substantially a self-audit, whereby Kubo had tacitly permitted the Inappropriate C/O as CFO, and thereafter audited the continuing situation regarding C/O (after him leaving that position as CFO).

Based on the above, it is difficult to say that internal control by the Audit Committee was functioning with respect to the Visual Products Business.

(D) Audit by the accounting auditors

In the course of the audit by accounting auditors, they performed a monthly P/L analysis, periodical comparison by Company and account items, sample-checks to verify the appropriateness of the assigned periods, and to verify the reasonableness based on those matters, but no responses were obtained to suggest existence of C/O. In past audits, they did not find materials indicating C/O monitoring charts or those indicating the existence of the concepts of “disclosed amounts” and “attainable amounts” in the Visual Products Company, etc., and did not discover C/O undertaken in the Visual Products Business.

This can be surmised to be attributable to the fact that the Visual Products Company, etc. did not disclose to the accounting auditors materials or information indicating the existence of C/O, and devised explanations so that the existence of C/O would not be revealed to the accounting auditors.

Matters that are noteworthy with regard to the handling of the accounting auditor of the Visual Products Company, etc. are as follows.

- In February 2012, the personnel at the Finance & Accounting Division of the DS Company explained to A, the General Manager of the DS Company Finance & Accounting Division, that in past audits, only existing products were subject to audit with regard to FOB-UP and that, if a new product name was used, it would be subject to exclusion from auditing based on the lower of cost or market value method; that, however, there is a risk that the accounting auditors would discover an abnormal price based on invoice information that is evidence of in-transit inventory, and would make them record a devaluation.

- In August 2013, C, the Vice President of the Visual Products Division, contacted the personnel at the planning department stating, “Debts managed in the Visual Products Company that management knew of amounted to JPY 8.4 billion in the first quarter, and it would be extremely helpful if the Visual Products Business could temporarily shed the Debts through extraordinary losses. However, we need a story and event that the accountants will agree to. Please consider whether the Visual Products Business can do something.”

5. Accounting treatment in relation to parts transactions in the Visual Products Business

During the course of the Investigation, it has been found that there was inappropriate accounting treatment related to parts transactions in the Visual Products Business falling into the scope of the Investigation, and they were examined as stated below.

(1) Accounting treatment in question in relation to parts transactions in the Visual Products Business and the impact thereof

(A) Overview of the parts transactions in the Visual Products Business, the accounting treatments in question and appropriateness thereof

The parts transactions (Buy-Sell Transactions) in the Visual Products Business are the same as those in the PC Business.⁷⁶ Therefore, an overview of the parts transactions and the accounting treatments in question and appropriateness thereof are as set forth in “2. Appropriateness of accounting treatment in relation to Parts Transactions,” “IV. Facts identified in the Investigation” of Chapter 5 below.

(B) The amount of impact resulting from the accounting treatment in question

(JPY 100 million)

Item	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
The amount of impact on profit and loss	5	(6)	7	5	(14)	(3)	8

⁷⁶ However, in the Parts Transactions, etc. in the PC Business, while the Masking Price was fixed, the Masking Ratio increased significantly every year and was eventually set at over five (5) times the procurement price.

In contrast, the Masking Price was not set in the Parts Transactions, etc. in the Visual Products Business; it was calculated by adding an amount equal to the procurement price multiplied by the Masking Ratio. (The Masking Ratios used for each year were as follows: FYs 2008- 2011: 30%, FY 2012: 20%, after FY 2013: 50%)

(Note)

The KCS (Keyparts Control Sheet) system was reformed as part of the changes made to SCM (Supply Chain Management) from FY 2012, but data prior to that time was not always managed properly, and it was explained that it is not very reliable, as there may be omissions and so forth. It was explained that the lack of reliability was particularly pronounced in volume data for FY 2009 and earlier and for price data for FY 2010 and earlier.

Therefore, for volumes, prices, and Masking Difference, a certain estimation calculation has been performed for each, and such estimation value has been used.

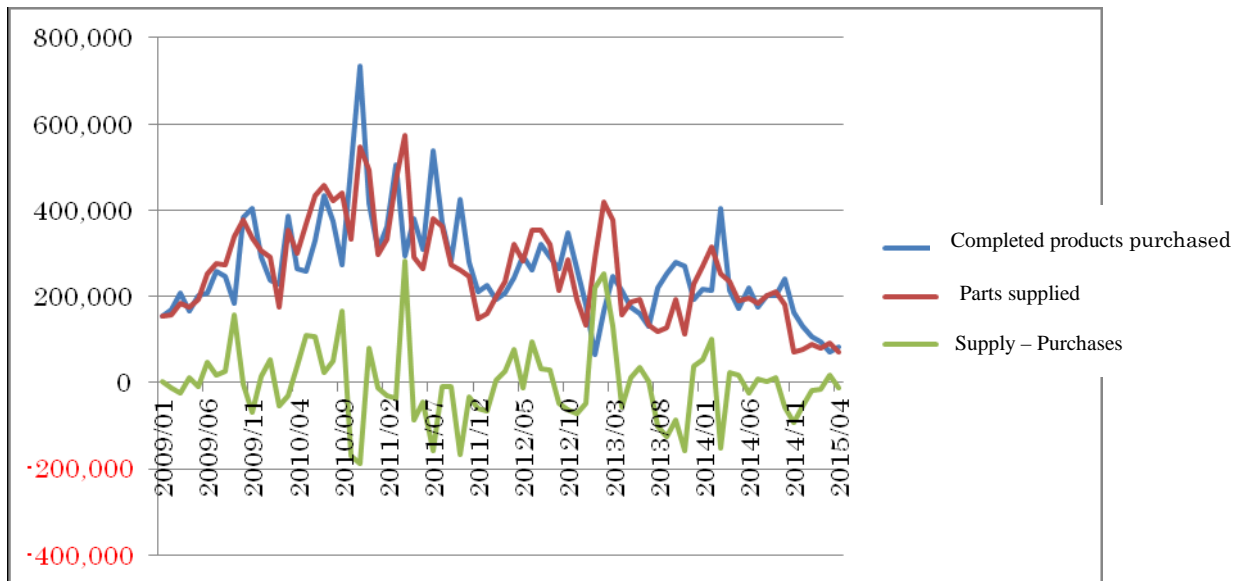
(2) Facts identified by the Independent Investigation Committee and causes of inappropriate accounting treatment

The inappropriate accounting treatments in the parts transactions (Buy-Sell Transactions) consist of two issues as follows: (1) the issue of the appropriateness of the accounting treatments to recognize the negative costs of manufactured goods as Masking Difference at Toshiba at the time when parts are supplied to ODMs in a normal parts transaction, and (2) the issue of misusing this accounting treatment in overstating the apparent current-term profit by Channel Stuffing of ODM Parts, as set forth below.

In Toshiba's Visual Products Business, parts transactions were introduced in FY 2007 (in January 2008), based on the method used in the PC Business (including for ODMs), in order to expand the production of televisions, and were undertaken to supplement the production volumes from self-manufacture, which was the main method. However, it was conducted depending on actual demand as described below. The following graph shows the shifts in parts supply volume and completed products volume purchased from FY 2008 onwards. This shows that, overall, it follows the same movement and is in conformance with actual demand,⁷⁷ with no circumstances found to suggest that Channel Stuffing of ODM Parts was intentionally conducted at the end of each period.

(Note: The numbers given are volumes.)

⁷⁷ The reason that the parts supply volume for the first quarter of FY 2011 is higher than the completed products volume purchased is that large volumes of parts were supplied to ODMs in advance, in order to prepare for the demand for last-minute purchases to switch to digital television in anticipation of the suspension of analog broadcasting planned for July of that year. Further, the excess supply volume in the fourth quarter of FY 2012 is due to repeated failures to realize the sales plan in the third quarter and the resulting temporary fluctuation in inventory balance (increased ODM inventory). Both of these can be recognized to be in conformance with actual demand.



One possible reason that, unlike the PC Business, parts transactions, etc. in the Visual Products Business were not used as a method of overstating apparent profit using methods such as intentionally increasing the amount of transactions (Channel Stuffing of ODM Parts) was that, at that time, there was excessive demand for low-price panels and it was difficult to procure panels in excess of actual demand, and since parts transactions were no more than secondary, used to supplement self-manufacture and transaction volumes were smaller compared to the PC Business, it would not have had a big enough impact if used for profit adjustment.

Therefore, the issue in the Visual Products Business is only (1) above, but the fact that the accounting treatment itself was inappropriate is the same as in the PC Business, and it can be surmised that the cause was lack of accounting knowledge.

Chapter 5. Accounting treatment in relation to parts transactions, etc. in the PC Business

I. Scope of the Investigation

1. Subject period of the Investigation

As a general rule, the Investigation covers the period from FY 2008 to the third quarter of FY 2014, and the fourth quarter of FY 2014 is not included within the scope of the Investigation because an audit is being conducted by the accounting auditor on this period in parallel with the Investigation. However, the Committee also investigated regarding other periods to the extent required to determine the causes of the inappropriate accounting treatment.

2. Scope of the Investigation

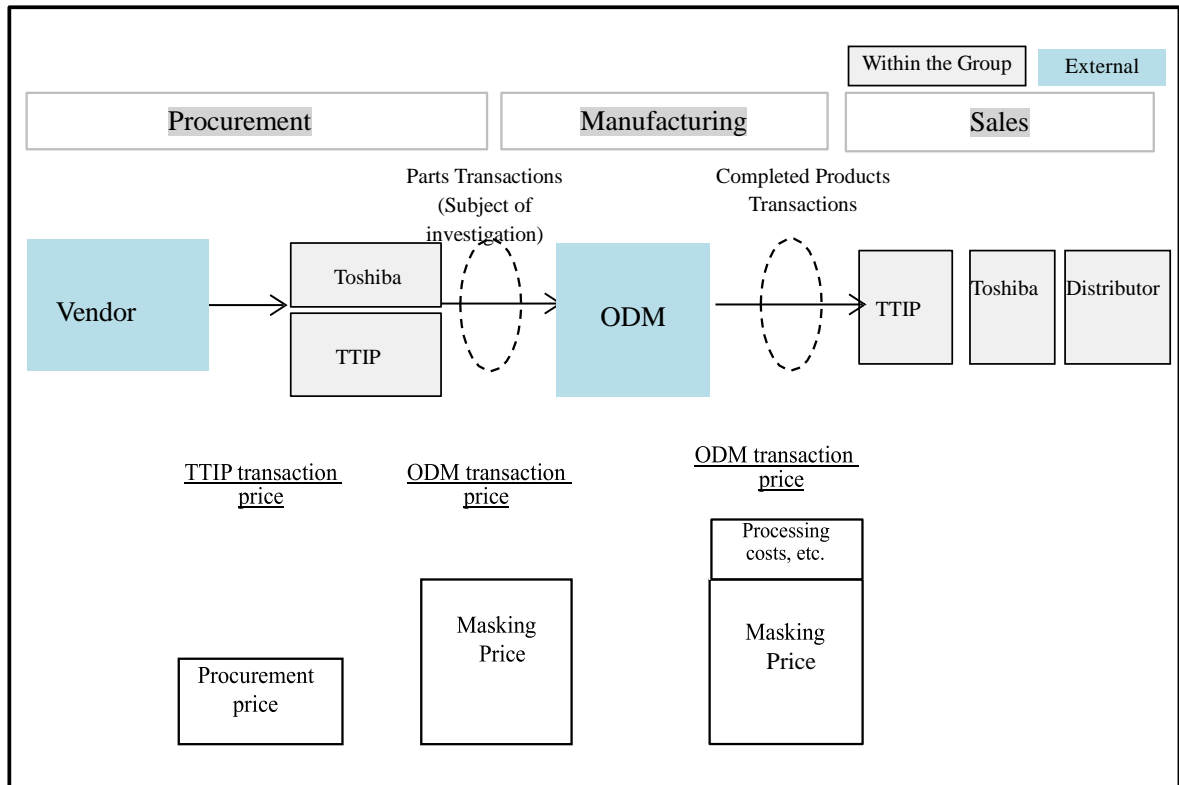
In the Investigation, the appropriateness of accounting treatment in relation to parts transactions, etc. in the personal computer (hereinafter, “PC”) business was delegated to the Committee for its investigation. The specific accounting treatments subject to the Investigation as confirmed by Toshiba and the Committee are as set forth below.

In the PC Business conducted by the PCS Company, the design, development, and production of PCs are outsourced to the ODM (original design manufacturing: designing, developing, and manufacturing of products to be sold with the brand of the contracting company) manufacturers in Taiwan. For key PC parts including CPU, HDD, memory, ODD, and LCD, after price negotiations with each parts vendor for all the parts to be supplied to each ODM are conducted, the parts are purchased by Toshiba or Toshiba’s wholly owned Subsidiary, TTIP, and then supplied for value to each ODM (the “**Parts Transactions**”). The price of these key parts other than CPUs supplied for value is the Masking Price, which is higher than the procurement price so as to prevent Toshiba’s procurement price from becoming clear to the ODMs that trade with competitors and from being leaked to competitors (the difference between the procurement price from vendors and the supply price to the ODMs is called the “**Masking Difference**”).

The ODMs that are supplied with parts produce PCs together with parts they procure themselves and deliver the completed PCs once again to TTIP (the purchase of these completed products by TTIP is referred to as the “**Completed Products Transactions**”). Subsequently, the products delivered to TTIP are sold in each region through Toshiba (the Parts Transactions and the Completed Products Transactions are referred to as “**Buy-Sell Transactions**”).

In this Investigation, the appropriateness of the accounting treatment in relation to the Parts Transactions using the Masking Price in these Buy-Sell Transactions was one of the matters delegated by Toshiba to the Committee, and therefore the appropriateness was examined.

Diagram 1: PC Production and Sales Process and the Scope of the Investigation



II. Investigation method and procedures

The Committee mainly carried out the following procedures regarding the subjects of the Investigation set forth above from May 22, 2015 to July 20, 2015.

1. The following materials were requested, investigated, and examined.
 - Materials including a summary, organization chart, and the business results for the PC Business
 - Materials and meeting minutes for meeting bodies in the Company conducting the PC Business and Corporate
 - Materials regarding sales channels in Buy-Sell Transactions, etc. (explanatory materials, contracts, etc.)
 - Tabulated materials (Excel administration tables stating quantity and price information) for the Masking Difference related to the ODM inventory (refers to the difference between the procurement price from vendors and the supply price to the ODMs; same below)
 - Inventory balance simulation sheets, etc.
2. Interviews with the Officers and Employees involved
3. Digital forensics of PCs used for work by Officers and Employees

III. Limitations and reservations of the Investigation

In the Investigation, because some data accurately indicating quantities, monetary amounts, etc., particularly for Buy-Sell Transactions, was missing from among the data for the above-mentioned period subject to the Investigation, the Committee carried out interviews and estimated the quantities and monetary amounts based on the materials currently remaining.

IV. Facts identified in the Investigation

1. Overview of the PC Business

Since 2002, Toshiba has conducted a PC manufacture and sale business including its mainstay notebook computer through the following in-house Companies.

Up to December 2003: Digital Media Network Company (DM Company)
From April 2004: PC & Network Company (PC Company)
From April 2010: Digital Products & Network Company (DN Company)
From April 2011: Digital Products & Service Company (DS Company)
From April 2014: Personal & Client Solutions Company (PCS Company)

The sales and operating profit (disclosed amount) for the PC Business conducted by each of these Companies is as follows.

(JPY 100 million)

FY	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Sales	7,679	8,527	9,718	10,404	9,553	8,881	9,160	8,229	7,051	7,339
Operating profit	82	34	69	412	145	(99)	73	114	82	(199)

2. Appropriateness of accounting treatment in relation to Parts Transactions

(1) Accounting treatment in question

(A) Accounting treatment in relation to Parts Transactions

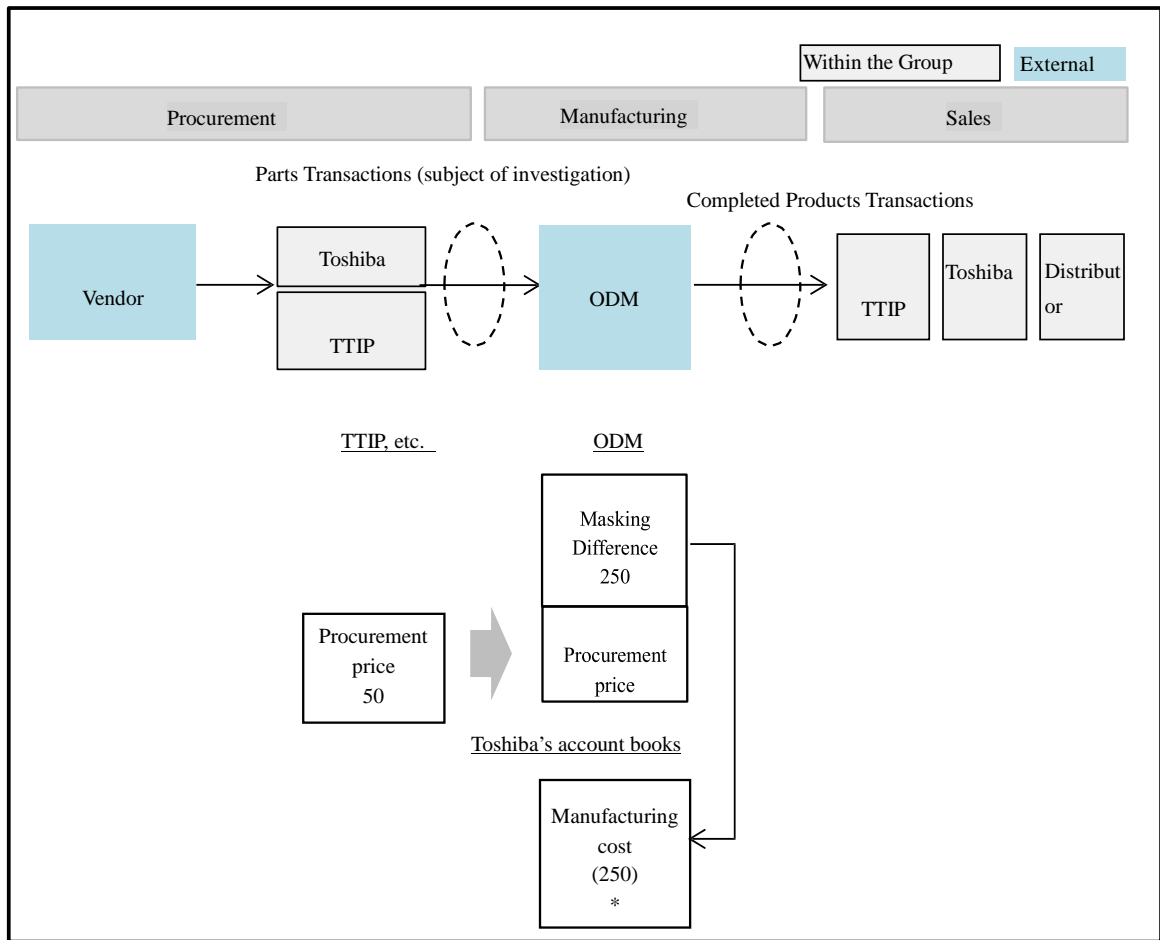
(a) Parts Transactions in general (TTIP→ ODM)

TTIP supplies the key parts purchased from parts vendors (LCD, HDD, memory, etc.) to ODMs at a Masking Price that is higher than the purchase price. Regarding the Masking Difference, which is the difference between the Masking Price and the

purchase price, while TTIP recognizes accounts receivable against ODMs and debts to Toshiba, TTIP does not recognize profits. Meanwhile, Toshiba records the amount equal to the Masking Difference as accounts receivable against TTIP so that the Masking Difference can be deducted from the product price when the PCs are delivered by TTIP in the future, and simultaneously records profits by reducing costs of manufactured goods. The concrete treatment for each company is as follows.

Diagram 2: Parts Transactions Example

TTIP procures the parts at 50 and supplies them to ODM at 300



* When parts are supplied to the ODM by TTIP, etc., Toshiba records the profit by deducting the amount of the Masking Difference from the costs of manufactured goods.

Accounting treatment by each company

Company name	Description	Debit	Amount	Credit	Amount
TTIP	Purchase from a vendor	Inventory	50	Accounts payable	50

	Supply to ODM and recognition of a debt to Toshiba	Accounts receivable (ODM)	300	Inventory Accounts payable (Toshiba)	50 250
Toshiba	Recognition of a claim against TTIP	Accounts receivable (TTIP)	250	Cost of manufactured goods	250
Consolidated	Elimination of consolidated intercompany transactions	Accounts payable (Toshiba)	250	Accounts receivable (TTIP)	250

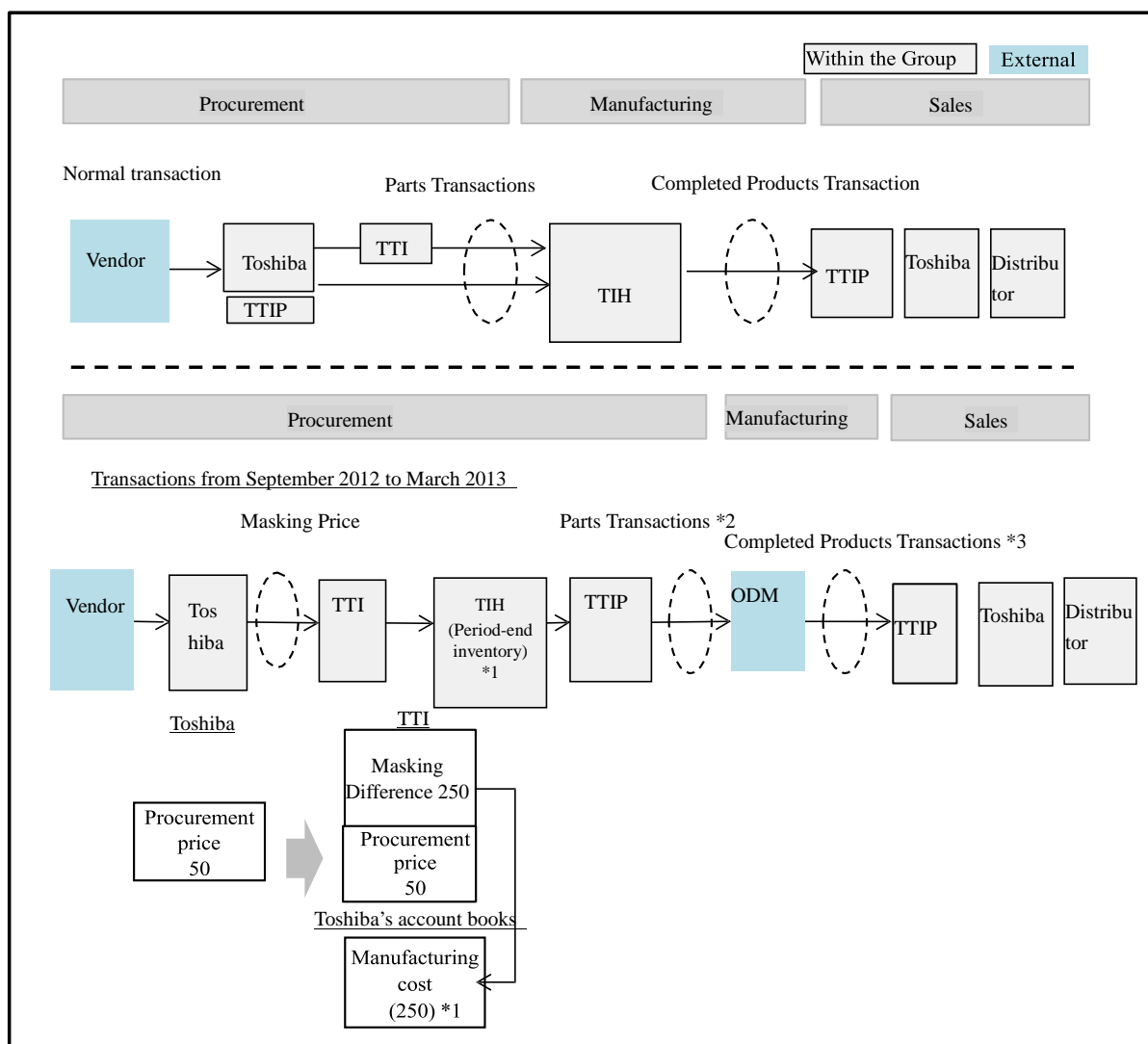
**(b) Transactions from September 2012 to March 2013
(Toshiba→TTI→TIH→TTIP→ODM)**

Toshiba manufactures PCs through TIH, its PC manufacturing Subsidiary. In order to supply parts to TIH, either TTIP purchases key parts (LCD, HDD, memory, etc.) from the vendors and supplies them to TIH, or Toshiba purchases the parts and supplies them to TIH via TTI.

Because TTI and TIH are Toshiba's Subsidiaries, parts are not supplied at the Masking Price. However, for some of the parts supplied in the last months of each quarter during the period from the second quarter through the fourth quarter of FY 2012, the parts were supplied by Toshiba to TTI at the Masking Price, which was four to eight times Toshiba's original procurement price. Toshiba recorded the Masking Difference for these transactions as accounts receivable against TTI and recorded profits by deducting costs of manufactured goods.

This inventory was supplied by TTI to TIH after adding a charge at the end of each quarter and then supplied to the ODMs via TTIP in the subsequent period (no masking is conducted here). The specific treatment for each company is as follows.

Diagram 3: Transaction Overview Diagram



*1: When parts are supplied to TTI by Toshiba, Toshiba records the profit by deducting the amount of the Masking Difference from the cost of manufactured goods.

*2: TTI purchases the parts at the Masking Price and transfers them to TIH by adding a charge to that amount, and TIH retains these inventories at period end.

*3: TIH transfers the parts to TTIP at the same price in the subsequent period, and TTIP supplies them to ODMs (no additional masking).

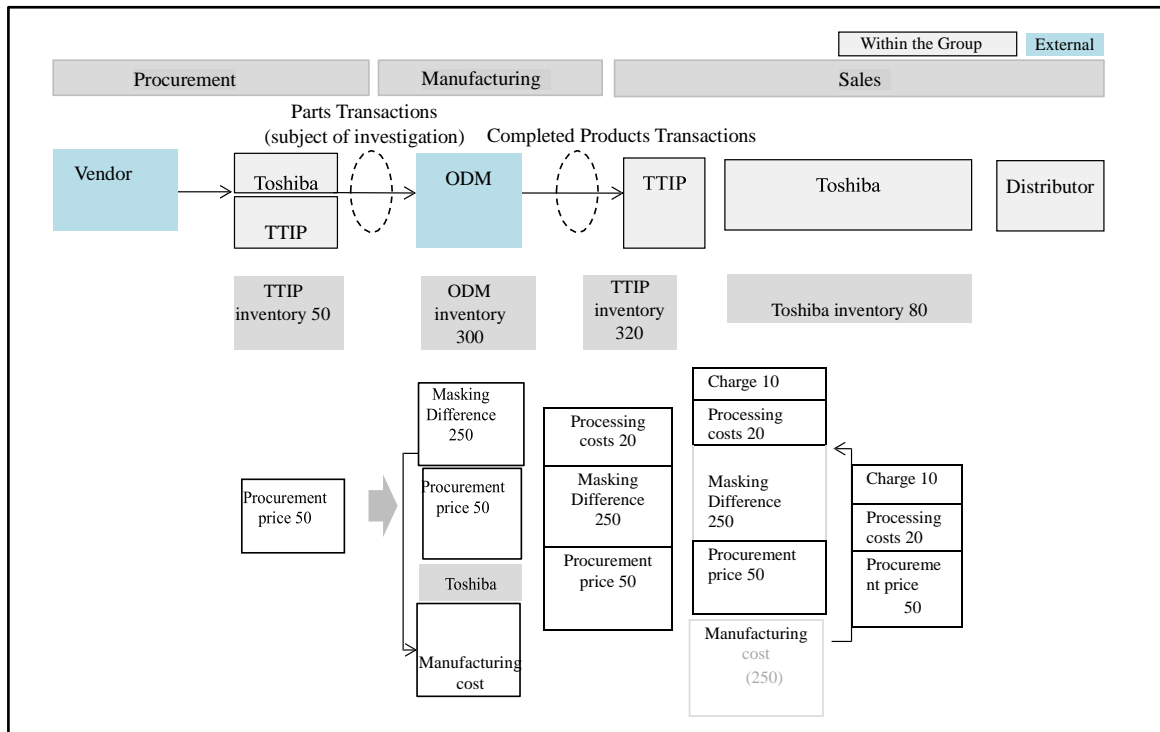
(B) Accounting treatment in relation to Completed Products Transactions

The ODMs that purchased parts at the Masking Price from TTIP use those parts to manufacture PCs and sell them to TTIP, and TTIP sells the purchased PCs to Toshiba. (The actual products are directly shipped to each region by the ODMs.) When Toshiba subsequently purchases the completed PCs from TTIP, the Masking Difference added

by TTIP (the factor of an increase in costs of manufactured goods) is offset with the negative amount of costs of manufactured goods recorded at the time of the Parts Transaction. As a result, the purchased product price becomes the figure from which the Masking Difference was deducted. Note that TTIP only records the charge related to this transaction as income. The specific accounting treatment for each company is as follows.

Diagram 4: Flow for Completed Products Transactions

ODM procures the parts at 300 and uses those parts to manufacture PCs, which are delivered to TTIP with an addition of processing costs of 20 incurred at the ODM (charge of 10 added upon delivery by TTIP to Toshiba)



Accounting treatment by each company

Company name	Description	Debit	Amount	Credit	Amount
TTIP	Purchase from ODM	Inventory	320	Accounts payable (ODM)	320
	Supply to Toshiba	Accounts receivable (Toshiba)	330	Inventory Charge income	320 10

Toshiba	Purchase from TTIP, etc.	Inventory	330	Accounts payable (TTIP)	330
	Transfer to cost of manufactured goods	Cost of manufactured goods (raw materials)	330	Inventory	330
Consolidated	Elimination of consolidated intercompany transactions	Accounts payable (TTIP)	330	Accounts receivable (Toshiba)	330

(C) Issues

(a) Parts Transactions in general (TTIP→ODM)

As Toshiba records profits by recording the negative costs of manufactured goods at the time of the Parts Transactions as in Diagram 2, the appropriateness of this accounting treatment becomes an issue (the appropriateness of the timing for recording profits in consideration of the actual state of the transactions). Note that in these Parts Transactions, the Masking Ratio increased significantly every year and was eventually set at over five times the procurement price for transactions with ODMs as displayed in Diagram 5, and accordingly the appropriateness needs to be reviewed in consideration of this point as well.

Diagram 5: Changes in the Masking Ratio

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Masking Ratio*	2.0 times	2.2 times	3.6 times	4.2 times	5.2 times	5.2 times

* The ratio of the Masking Difference divided by the procurement price from vendors with regard to parts subject to masking in Toshiba's standard model

**(b) Transactions from September 2012 to March 2013
(Toshiba→TTI→TIH→TTIP→ODM)**

From the second quarter through the fourth quarter of FY 2012, Toshiba recorded the profits by recording the negative costs of manufactured goods at the time of the Parts Transactions with TTI as in Diagram 3. While the profits were recorded as a transaction at the Masking Price with a group company in this transaction, because the goods are repurchased by Toshiba as completed products through an ODM in the same

manner as (a) above, the appropriateness of recording profits in this transaction becomes an issue.

(2) Review of accounting treatment

(A) Parts Transactions in general (TTIP→ODM)

As described above, Toshiba records the profits (the negative costs of manufactured goods) at the time of the Parts Transactions. However, taking into consideration the situation below, it can be reasonable to think of both transactions as actually being a series of transactions, and an accounting treatment assuming this may more appropriately express this transaction.

(a) Review from the actual state of the transactions

a. The estimates in the ODM production quotations submitted to Toshiba are conducted based on the Masking Price for parts supplied by TTIP, and Toshiba assumes that PCs are manufactured by using the parts supplied at the Masking Price, and subsequently Completed Products Transactions are conducted. (Accordingly, in the actual state of the transactions it is assumed that the supplied parts will be processed and returned as completed products.)

b. Under the General Purchase Terms Agreement with ODMs, Toshiba is obligated to purchase the completed products and works-in-progress of a planned production volume within a certain period from the production volume that the ODMs are instructed about. (Accordingly, the ODMs are effectively not exposed to inventory risks for procurement parts.)

c. As a general rule, the order quantity of parts from ODMs is linked to the order quantity of products from Toshiba, and in the past Toshiba has in fact repurchased inconvertible, extra inventories and paid the costs for their disposal as detailed below. (Accordingly, the ODMs are effectively not exposed to inventory risks for procurement parts.)

Buy-back of extra inventories of parts from ODMs

Item	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Buy-back amount (USD million)	2	8	11	7	14	27

Disposal payment ⁷⁸ (JPY 100 million)	2	6	5	-	3	-
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d. As a general rule, the prices for Parts Transactions are the prices stipulated by Toshiba, and there are no negotiations. (ODMs accepted an abnormally high Masking Price that was set at nearly five times the TTIP procurement price as displayed in Diagram 5. This can only be because it was assumed that Toshiba would purchase a quantity of products in line with the parts supply quantity at a price assuming that Masking Price. Accordingly, the ODMs are effectively not exposed to procurement price risks for parts.)

(b) Review in the view of Toshiba’s journalizing

a. While Toshiba records an amount equivalent to the Masking Difference as the negative costs of manufactured goods (profit) at the time of Parts Transactions, it does not record sales of the parts that are a precondition for recording profits. (There is no consistency as only profits are recorded without recording the sales of parts.)

b. After the Parts Transactions and before the Completed Products Transactions, only the negative costs of manufactured goods are recorded in advance, but the recording of negative costs is only a meaningful accounting entry when deductible costs of manufactured goods have been recorded, assuming that deductible costs of manufactured goods (Masking Difference) have been incurred. In addition, the purpose of recording the negative costs of manufactured goods is premised on appropriate calculation of cost of sales in the Completed Products Transactions by offsetting against the costs of product purchases (in some ways, the accounting treatment itself views the Parts Transactions and Completed Products Transactions as one unit).

(c) Summary

Because the Parts Transactions are premised on future Completed Products Transactions (Parts Transactions and Completed Products Transactions are effectively a series of transactions) and it can be considered that Toshiba was repurchasing the parts supplied to the ODMs as completed products after processing, it can be practically said that Parts Transactions were with repurchase conditions. Accordingly, recording the profits at the time that the parts are supplied does not appropriately represent the actual series of transactions, as the completion of the transfer of goods that is one requirement for revenue recognition is not effectively fulfilled. Therefore, at the settlement for

⁷⁸ Amount paid to ODMs as the disposal costs for extra inventories.

each period, it is necessary to delete the amount equivalent to the amount of the profits that were recognized at the time of the Parts Transaction (the negative costs of manufactured goods relating to the relevant Masking Difference) for the parts and completed inventories for which Completed Products Transactions have not been completed after the Parts Transactions, namely the ODM inventory.

As described above, the recording of profits at the time of Parts Transactions is coupled with the fact that there was a time when the Masking Difference for parts supplied from TTIP to the ODMs was set at an abnormally high level of nearly five times TTIP's procurement price (see Diagram 5); a framework in which large profits could be recorded by Toshiba by adjusting the volume of parts supplied to the ODMs.

**(B) Transactions between September 2012 and March 2013
(Toshiba→TTI→TIH→TTIP→ODM)**

As described above, Toshiba recorded profits (the negative costs of manufactured goods) at the time of Parts Transactions with TTI from the second quarter through the fourth quarter of FY 2012. However, because these transactions were conducted with the intention of recording profits using Subsidiaries and were transactions in which parts were supplied to the ODMs that were scheduled to be repurchased by Toshiba as completed products as in the transactions under (A) above, it was necessary to delete these profits.

(3) Calculation of the amount of impact on profit and loss

(A) Introduction

The amount of impact on profit and loss that should be adjusted for the accounting treatment in relation to the Parts Transactions, etc. in the PC Business is the difference between the total of (a) through (c) below and that of the previous period (quarter) end.

(a) Amount of profits recorded on unused Toshiba supplying parts inventories held by the ODMs at the end of each quarter

Parts supplied by TTIP to the ODMs that are held as is as unused parts

(b) Amount of profits recorded on Toshiba supplying parts contained in completed products inventories held by the ODMs at the end of each quarter

Parts supplied by TTIP to the ODMs that are used for production and held as PC completed products

(c) Amount of profits recorded on Toshiba supplying parts inventories held by TIH at the end of each quarter

Parts supplied by Toshiba at the Masking Price to TTI that are held as parts

inventories by TTI or TIH at the end of each period

Note that in order to accurately calculate the amount of impact on profit and loss, it is necessary to also add the amount of profit recorded on Toshiba supplying parts contained in work-in-progress inventories held by the ODMs at the end of each quarter, but this has not been added because it can be considered that this amount is generally a fixed amount with little impact on profit and loss and also because accurate data required for calculation of this amount was not provided.

In addition, as stated in “3. Limitations and reservations of the Investigation,” some past data was not available for the Investigation. In particular, it was explained that there was no inventory volume data from before the second quarter of FY 2010 for (a) the ODM unused parts inventories.

Further, it was explained that Toshiba did not have an understanding of data related to (b) the ODM completed products inventories. For this reason, the estimates calculated based on the set assumptions stated below have been used in calculating the adjustment amount of profit and loss in the Investigation.

(B) ODM unused parts inventories ((a))⁷⁹

(JPY 100 million)

Item	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Masking Difference	164	412	289	461	715	721	392
Amount of impact on profit and loss	(164)	(248)	123	(172)	(254)	(6)	329

(First quarter of FY 2008 to second quarter of FY 2010)

Estimates were calculated based on amounts tabulated as profits recorded on the ODM supplied parts recognized by Toshiba’s department or division responsible for procurement.

(Third quarter of FY 2010 to third quarter of FY 2014)

Based on the schedule of the ODM inventory amounts totaled from the inventory volume by part, the purchase unit price from vendors, and the Masking Difference, the estimate for the profits to be recorded is calculated by the inventory volume by part recognized by ODMs at the end of each quarter multiplied by the Masking Difference for each part.

⁷⁹ The amount of impact on profit and loss for FY 2008 was estimated based on a Masking Difference of zero for up to FY 2007.

(C) ODM completed products inventories ((b))

(JPY 100 million)

Item	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Masking Difference	34	72	88	83	98	121	199
Amount of impact on profit and loss	(34)	(38)	(16)	4	(14)	(23)	(78)

(First quarter of FY 2008 to fourth quarter of FY 2012)

Because volume data was not provided for the ODM completed products inventories, estimates have been used based on the following assumptions.

a. Volume: The number of units shipped during the first week of the month following the end of each quarter, from TTIP's data on the number of units shipped per week from ODMs, is assumed to be the completed products inventory volume for the end of the previous quarter. (Because there are some accounting periods in which the volume for the first week is zero, the number of units shipped during the second week is taken into consideration in some cases.)

*Took the lead time recognized through the interviews into consideration.

b. Masking Difference (unit price): The Masking Difference on the parts comprising the main sales models (completed products) for each quarter is used.

c. Masking Difference: The amount of a. above multiplied by b.

(D) Estimate of impact of Toshiba's Masking Difference on TTI ((c))

(JPY 100 million)

Item	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Masking Difference					29	0	
Amount of impact on profit and loss					(29)	29	

(Second quarter of FY 2012 to fourth quarter of FY 2012)

For the parts sold by Toshiba to TTI at the Masking Price, the sales volume is multiplied by the Masking Difference to calculate the estimates for the profits to be recorded.

(E) Summary

The amount of impact on profit and loss requiring adjustment regarding accounting treatment in relation to the PC Parts Transactions totaled above is as follows:

(JPY 100 million)

Item	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
The amount of impact on profit and loss	(198)	(286)	105	(166)	(296)	(1)	247

3. Facts identified by the Independent Investigation Committee

(1) The implementation of inappropriate accounting treatments in Parts Transactions (Buy-Sell Transactions)

The inappropriate accounting treatments in the Buy-Sell Transactions consist of two issues as follows: (1) the issue that the accounting treatments to recognize the negative costs of manufactured goods as Masking Difference at Toshiba at the time when parts are supplied to ODMs in a normal Parts Transaction are inappropriate, and (2) the issue that that accounting treatment was misused in overstating the apparent current-term profit by selling a higher volume of parts than the volume required for normal production to ODMs at the end of the quarter, which caused the ODM to hold the inventory, and recognizing the Masking Difference for those parts as the negative costs of manufactured goods for that quarter.

Below, relevant facts and causes of inappropriate accounting treatment will mainly concern issue (2), as issue (1) cannot be recognized to have been carried out in order to overstate the apparent current-term profit.

(2) Commencement of Buy-Sell Transactions (2004)

Toshiba's PC Business began to perform poorly around FY 2001, and operating losses of JPY 32.9 billion, JPY 7.1 billion, and JPY 32.8 billion were recorded in FY 2001, FY 2002, and the first half of FY 2003, respectively.

In response to this poor business performance, in January 2004, Toshiba spun off the PC Business from the Company that had conducted the PC Business up until then (the Digital Media Network Company), and established an in-house Company, the PC &

Network Company (the PC Company). With Atsutoshi Nishida appointed as the CP and the Manager of the PC Special Business Reform Project Team, “the PC Special Business Reform Project” were established and implemented. This project aimed to improve business performance over a short period of time and make the PC Business profitable by the second half of 2004 by focusing development resources and concentrating on differentiated products, migrating from in-house production to ODM production for standard products, strengthening procurement capabilities, reducing fixed costs, etc. As part of this project, the PC production and procurement framework was reformed by the Procurement Working Group (Leader: Hisao Tanaka, current P). Specifically, one of the initiatives was to effectively utilize the ODMs through means such as significantly increasing the ratio of ODM transactions for the purpose of improving the efficiency and reducing the cost of parts procurement and production.

With the aim of reducing procurement costs for PC parts in these ODM transactions, the framework in which the ODMs procured their own parts was changed, and Buy-Sell Transactions were introduced for five key PC parts (memory, HDD, LCD, etc.). The ODM transactions that are similar to these Buy-Sell Transactions per se have been a method generally implemented by major PC manufacturers from that time to the present day, including the use of the Masking Price.

The accounting treatment stated above was used as the accounting treatment for these Buy-Sell Transactions, and this accounting treatment has been conducted since September 2004 when these Buy-Sell Transactions were initially commenced.⁸⁰

(3) Commencement of inappropriate accounting treatment (President Nishida era: second quarter of FY 2008 to first quarter of FY 2009)

(A) Situation in the first quarter of FY 2008

Through the implementation of “the PC Special Business Reform Project” described above, under Hidejiro Shimomitsu CP, who was appointed on June 25, 2007, the PC Business of Toshiba achieved the highest sales and operating profit as ever as the sales of JPY 1,040,400,000,000 and the operating profit of JPY 41.2 billion for FY 2007. In response to this, sales of JPY 1,192,500,000,000 and operating profit of JPY 31.2 billion were set by the PC Company as the targets for the PC Business for FY 2008.

Under these circumstances, due to delays in product manufacture and shipment stemming from product manufacturing problems that occurred during April 2008 at the PC Company, an operating loss of JPY 5.3 billion (negative JPY 6.3 billion against the

⁸⁰ While an investigation was conducted into whether any investigations were conducted on the legality of accounting treatment when introducing and deciding on the accounting treatment for these new Buy-Sell Transactions as part of the Investigation, it was not clarified whether such investigations were implemented or what they consisted of. Considering that channel stuffing of ODM parts beyond the normal scope is not suggested from the PC Company’s operating profit by month from 2004 (when the transactions were commenced) to 2007, it cannot really be considered that there was any intent to conduct inappropriate accounting treatment, and it can be considered that mistaken accounting treatments were merely conducted as a result of giving insufficient consideration to accounting treatment.

budget) was recorded during that month. It was during that time that the global economy was going through a slowdown due in part to the sub-prime mortgage crisis, and there were increased concerns regarding a business downturn for Toshiba as a whole as well. In these circumstances, when the PC Company reported their operating profit projection for the first quarter as JPY 5.2 billion at the May CEO Monthly Meeting held on May 28 of the same year, Atsutoshi Nishida P stated (i) that the entire company was in a state of emergency and (ii) that he would like a minimum improvement of JPY 3.0 billion over the submitted value for the operating profit for the first quarter, (iii) that he would like an operating profit of JPY 20.0 billion to be achieved for the first half, and also (iv) that more could probably be achieved in terms of procurement CR. And he established the Challenge of achieving operating profits of JPY 8.2 billion for the first quarter, which was JPY 3.0 billion more than the submitted amount of JPY 5.2 billion.

In response to this, the PC Company looked into this in order to achieve the Challenge amount, and at the June CEO Monthly Meeting held on June 23, the PC Company stated that it aimed to achieve record-high level single month operating profit (JPY 7.8 billion) for June, including early recording measures for July,⁸¹ and set the operating profit forecast for the first quarter of FY 2008 at JPY 6.6 billion. However, this did not satisfy Atsutoshi Nishida P, who was in attendance at the meeting. He set forth the Challenge of “operating profit for the first quarter of the fiscal year + (plus) JPY 2.2 billion” against the submitted amount (Note: JPY 8.8 billion). He stated that he would really like the Challenge amount to be achieved, that he had high expectations, and strongly requested that profits be further improved because of the difficult conditions throughout the company in the first quarter.

In response to this, the PC Company improved operating profit for June to JPY 10.2 billion and achieved operating profit of JPY 9.0 billion for the first quarter of FY 2008, achieving Atsutoshi Nishida P’s Challenge value. At the July 2008 quarterly reporting meeting held on July 22, 2008, the PC Company reported regarding the operating profit for June of that year as follows: “achieved an improvement of JPY 2.4 billion through securing the early recording of CR in response to the Challenge amount of JPY 2.2 billion”; and “Achieved Nishida P’s Challenge by securing the early recording of CR.”⁸²

(B) Second quarter of FY 2008: commencement of inappropriate accounting (channel stuffing of ODM parts)

At the above-mentioned July quarterly reporting meeting, Hidejiro Shimomitsu CP and the PC Company anticipated operating profit for the first half of 2008 of JPY 14.8 billion, by incorporating profit improvement measures (improvement Challenges) of JPY 35.4 billion, which was considered as “currently being a large discrepancy,” while an operating profit and loss was anticipated to result in losses of JPY 20.6 billion on a

⁸¹ It is unclear whether channel stuffing of ODM parts using Buy-Sell Transactions was included in these “early recording measures for July” or not.

⁸² It could not be determined through the Investigation whether this “early recording of CR” was through the channel stuffing of ODM parts using Buy-Sell Transactions that will be described later or not.

simple total basis. However, Atsutoshi Nishida P made a strong request for further high-level improvement, stating that he would like to request a Challenge of “operating profit + (plus) JPY 5.0 billion” over the submitted amount.

However, as there were no prospects of achieving the Challenge by August 2008, at the August CEO Monthly Meeting held on August 25, 2008, the PC Company submitted a forecast of the profit and loss for the first half of FY 2008, with an operating profit of JPY 14.8 billion, which maintained the forecast from the July reporting meeting and was negative JPY 5.0 billion against Atsutoshi Nishida P’s Challenge. However, in light of the company-wide deterioration of profits at Toshiba due in part to the deceleration of the global economy as a result of the sub-prime mortgage crisis becoming more serious, at that CEO Monthly Meeting, Atsutoshi Nishida P strongly demanded further profit improvements regarding the operating profit, stating that a JPY 5.0 billion improvement was “a must” and that he wanted whatever was necessary to be done in order to achieve this target looking at the difficult conditions throughout the company.

Under these circumstances, the PC Company (Hidejiro Shimomitsu CP) conducted the “early recording of CR” of JPY 17.3 billion in September 2008 in order to achieve significant profit improvements. As a result, profits were improved by JPY 17.3 billion and operating profit of JPY 23.7 billion was recorded for the first half of FY 2008, achieving Atsutoshi Nishida P’s Challenge (JPY 19.8 billion).

(C) Method of channel stuffing of ODM parts

One method used in order to achieve these Challenges as part of this early recording of CR was the overstating of apparent profit through the channel stuffing of ODM parts⁸³ that was also conducted subsequently on an ongoing basis as described below (the act of overstating apparent profit through this method which was subsequently conducted on an ongoing basis is referred to as “Channel Stuffing of ODM Parts” hereinafter).

In other words, Toshiba (or TTIP), upon consulting with the ODMs, sold volumes of parts to ODMs in excess of the volume required for normal manufacturing activities and had the ODMs hold them as inventory at the end of the period. By doing this, Toshiba was able to recognize the difference between the purchase price for parts and the sales price based on the Masking Price (Masking Difference) as the negative costs of manufactured goods at the end of the period, and the apparent profit for only this amount was to be overstated. It can be noted that, according to Toshiba’s accounting treatment at the time stated in 2(1) above, this overstated apparent profit for the current period was recognized as a deduction from the profits when the completed products were purchased from the ODMs in the following month or beyond (the costs of manufactured goods to become higher by that amount). Therefore profits would deteriorate from the following month. (The overstated apparent profits for each

⁸³ The apparent profit recorded for the quarter through the Channel Stuffing of ODM Parts is of course not a profit for that period, nor is it a profit for the following period or beyond (it is only the Masking Difference that should not legitimately be recorded as profit for the following period or beyond either). For this reason, it does not constitute an “early recording of profit” for the following period or beyond.

quarter⁸⁴ were referred to as “Debt” by the parties involved because the amount of overstated apparent profits from the Channel Stuffing of ODM Parts could be a factor that causes the profits from the following month to decrease.) When it was not permissible for profits to deteriorate in the following quarter, it was possible to further avoid the deterioration of profits for the following quarter overall through further Channel Stuffing of ODM Parts in excess of the required volume at the end of the following quarter.

There were slight differences in the process of Channel Stuffing of ODM Parts depending on the timing, but in general, Channel Stuffing of ODM Parts was conducted through the following: (i) the CPs, top of the Companies, would make a decision to carry it out and decide the monetary amount of such treatment; (ii) based on such decision, the production and procurement departments of the Companies and Corporate’s procurement department (the Corporate Procurement Division), cooperating with TTIP, would negotiate with the ODMs concerning matters including the type and volume of goods to be sold to the ODMs and the monetary amount, and have ODMs purchase the ODM parts to complete the process of Channel Stuffing of ODM Parts.

As a result of Channel Stuffing of ODM Parts that was included in the early recording of CR in September 2008 described above, the total amount of the unused parts inventories supplied by Toshiba and held by the ODMs as of the end of September 2008 (including parts held based on normal Parts Transactions) multiplied by the respective Masking Difference (the cumulative of this amount at the end of each quarter is referred to as the “Balance of Recorded Buy-Sell Profit” hereinafter) was estimated to have reached JPY 14.3 billion. It can be presumed that most of this Balance of Recorded Buy-Sell Profit was overstated apparent profit achieved by Channel Stuffing of ODM Parts. Furthermore, from around this time, the term “early recording of CR” became used as a term that basically includes overstated apparent profit based on the recognition of the negative costs of manufactured goods accrued from the Masking Difference achieved through Channel Stuffing of ODM Parts using Buy-Sell Transactions.⁸⁵

(D) Third quarter of FY 2008 (Period-end Balance of Recorded Buy-Sell Profit of JPY 18.8 billion, increased by approximately JPY 4.5 billion from the end of the previous quarter)

⁸⁴ Normally, parts that are sold through channel stuffing to ODMs at the end of each quarter are processed and purchased by Toshiba as completed products in the following month or the month after that, and the Masking Difference is recognized as a deduction from profits. For this reason, the Masking Difference (debt) would revert back to zero if there was no new Channel Stuffing of ODM Parts during that period.

⁸⁵ “CR” was used by Toshiba as a term to mean cost reductions achieved through negotiations to lower prices from suppliers for parts, etc. On the other hand, the overstating of apparent profits for the period through the Channel Stuffing of ODM Parts does not constitute the early recording of future cost reductions. This means that the term “CR early recording” when used to refer to CR early recording including the Channel Stuffing of ODM Parts was used with a meaning that differed from the way the term was normally used at Toshiba.

At the October CEO Monthly Meeting held on October 27, 2008,⁸⁶ Hidejiro Shimomitsu CP of the PC Company reported to Atsutoshi Nishida P and others that “the effect of early recording of CR is JPY 17.3 billion, and if this is excluded, the attainable amount should be operating profit of JPY 6.4 billion,” explaining that the operating profit was being overstated through the early recording of CR, that was other than the actual capabilities. He also stated that “regarding the early recording of CR, early supply of parts was possible because of the Anniversary of the Founding of the People’s Republic of China in September, but obtaining agreement will be difficult in December because that’s the end of the accounting period for the ODMs,” explaining that the effect of early recording of CR was by means of “the early supply of parts” to the ODMs.

However, without really making any special mention of the “early recording of CR,” Atsutoshi Nishida P and Fumio Muraoka SEV made the following statements in relation to the PC Company’s operating profit forecast for the third quarter of FY 2008, regarding which the anticipated operating loss of JPY 14.0 billion was submitted due in part to the effect of the rebound of “early recording of CR”: Atsutoshi Nishida P stated “I want you to achieve the profit budget (Note: operating profit of JPY 10.1 billion) and Fumio Muraoka SEV stated “I want whatever can be done to avoid a loss for the third quarter to be done (loss of JPY 14.9 billion),” as they made strong demands for improvements.

However, due to factors including the influence of exchange rates and a decline in market demand stemming from the collapse of Lehman Brothers that occurred in September 2008, at the November CEO Monthly Meeting held on November 25, 2008, Hidejiro Shimomitsu CP reported the operating profit forecast for the third quarter of FY 2008 had deteriorated to negative JPY 18.4 billion. Nonetheless, Atsutoshi Nishida P, who was in attendance at the meeting, made strong demands for profit improvements once again, as he stated “It doesn’t matter how bad you say the exchange rates are,” and “In any case I would like you to achieve the budget (Note: operating profit of JPY 10.1 billion) because performance is poor for semiconductors.”

Also at the December CEO Monthly Meeting held on December 22, 2008, Hidejiro Shimomitsu CP stated that there was no improvement in the profit forecast and reported that the operating profit forecast for the third quarter of FY 2008 was negative JPY 18.4 billion; the same figure as the previous month. In response to this, Atsutoshi Nishida P stated things such as “I’m ashamed of these figures, so I can’t release them (in January).” Under these circumstances, the PC Company (Hidejiro Shimomitsu CP) conducted Channel Stuffing of ODM Parts in that quarter as well. As a result, the Balance of Recorded Buy-Sell Profit was estimated to be JPY 18.8 billion (an increase of approximately JPY 4.5 billion from the previous quarter). As a result, operating profit of JPY 20.7 billion was recorded just during December 2008, which enabled a dramatic improvement in operating profit by JPY 0.5 billion for the third quarter of FY 2008.

(E) Fourth quarter of FY 2008 (Period-end Balance of Recorded Buy-Sell Profit

⁸⁶ Participants in the reporting meeting included Atsutoshi Nishida P, Hisatsugu Nonaka GCEO, and Hidejiro Shimomitsu CP.

of JPY 16.4 billion, decreased by approximately JPY 2.4 billion from the end of the previous quarter)

The profit and loss situation for the third quarter of FY 2008 was reported at the January quarterly reporting meeting held on January 23, 2009. In response to the report that an operating loss of JPY 18.4 billion was anticipated for the second half of FY 2008, Atsutoshi Nishida P stated: “A minimum improvement in profit of JPY 10.0 billion is required,” “Do all that you can as if your life depends on it,” or “You will become a group subject to reconsideration⁸⁷ if you don’t do anything. There is no point in keeping this business. We are at the point of wondering whether we should even keep this business. You do not have to make the improvement of JPY 10.0 billion, if that is alright with you. However, this does mean that you will be sold off. If you want to protect your business, an improvement by JPY 10.0 billion is the minimum. Do your best,” as he made demands for increased operating profits.

In addition, at the February CEO Monthly Meeting held on February 23, 2009, in response to the report from the PC Company that the operating profit forecast for the second half of FY 2008 had further deteriorated to a negative JPY 23.7 billion, Atsutoshi Nishida P set forth a Challenge of a JPY 16.0 billion improvement in profits, and made strong demands for improvement, stating “Achieve a minimum annual profit of at least JPY 10.0 billion in the PC Business, with triple digits [when using the Japanese numbering system]” and “Make sure that the operating profit for the PC Business is in the triple digits.”

In response to this situation, the PC Company (Hidejiro Shimomitsu CP) conducted Channel Stuffing of ODM Parts, and as a result, the Balance of Recorded Buy-Sell Profit at the end of the fourth quarter of FY 2008 was estimated to be JPY 16.4 billion (decreased by JPY 2.4 billion from the previous quarter) and operating profit for the second half of FY 2008 was dramatically improved to negative JPY 9.2 billion.

(F) First quarter of FY 2009 (Period-end Balance of Recorded Buy-Sell Profit of JPY 27.3 billion, increased by approximately JPY 10.9 billion from the end of the previous quarter)

As described above, while it had been planned until the end of the quarter approached, on the premise that Channel Stuffing of ODM Parts would not be conducted again before the end of the fourth quarter of FY 2008, to record a loss of an amount of Channel Stuffing of ODM Parts at the end of the previous period, Channel Stuffing of ODM Parts was conducted once again in response to the pressure to achieve the budget as it became close to the end of the quarter.

However, considering that the plans for group profit and loss was set out as of April at the April CEO Monthly Meeting held on April 20, 2009 to be negative JPY 24.0 billion for April, negative JPY 4.9 billion for May, and positive JPY 27.8 billion for June, it can be considered that it was planned as in April to conduct Channel Stuffing of ODM Parts once again in June. In fact, Channel Stuffing of ODM Parts was conducted once again in June, and the Period-end Balance of Recorded Buy-Sell Profit

⁸⁷ It can be considered to mean being the scope of review including withdrawal from the business.

was estimated to amount to JPY 27.3 billion (increased by approximately JPY 10.9 billion from the end of the previous quarter) at the end of the first quarter of FY 2009 immediately after the resignation of Atsutoshi Nishida P as President.

(G) Summary

Based on the events above, during the era of Atsutoshi Nishida's service as Toshiba's President, the Balance of Recorded Buy-Sell Profit ⁸⁸ after Channel Stuffing of ODM Parts was shifted as follows.

	FY 2008 Q2	Q3	Q4	FY 2009 Q1
Balance of Recorded Buy-Sell Profit (estimate)	JPY 14.3 billion	JPY 18.8 billion	JPY 16.4 billion	JPY 27.3 billion
Comparison against the end of previous quarter (amount of impact on profit and loss)	Up JPY 12.3 billion	Up JPY 4.5 billion	Down JPY 2.4 billion	Up JPY 10.9 billion
Operating profit (after incorporating the amount of impact on profit and loss)	JPY 14.7 billion	JPY 0.5 billion	Negative JPY 9.7 billion	JPY 4.8 billion

(4) Expansion of inappropriate accounting (President Sasaki era: the second quarter of FY 2009 to the first quarter of FY 2013)

(A) From second quarter of FY 2009 to fourth quarter of FY 2010 (PC Company until the fourth quarter of FY 2009, DN Company from the first quarter of

⁸⁸ Note that the overstating of apparent profits was conducted at the end of each quarter and that overstatement would be settled once through the purchase of completed products by TTIP or Toshiba in the following month or the month after that. Accordingly, the Balance of Recorded Buy-Sell Profit for a given month consists of the total of the Masking Difference of parts supplied through normal Parts Transactions and that of parts from Channel Stuffing of ODM Parts conducted that month.

FY 2010: Sasaki and Fukakushi system)

On June 24, 2009, Atsutoshi Nishida resigned as Toshiba's President and was appointed as Toshiba's Chairman, while Norio Sasaki was appointed as Toshiba's President and Masahiko Fukakushi was appointed as the PC Company's President.

Immediately after appointment on July 21, 2009, Masahiko Fukakushi CP explained to Hisao Tanaka EV that he would like to report the operating profit forecast of the simple total amount for the second quarter of FY 2009 as negative JPY 55.7 billion, based on the assumption that there would be no Channel Stuffing of ODM Parts at that time. However, as it was said that the impact of this figure would be too big, it was decided to improve the forecast of negative JPY 55.7 billion through the implementation of Channel Stuffing of ODM Parts that had been recognized as "Debt" equivalent to JPY 29.5 billion. Then, at the July FY 2009 quarterly reporting meeting held on July 22, Masahiko Fukakushi CP reported an anticipated operating profit of JPY 3.6 billion, incorporating improvement measures of JPY 29.8 billion in the simple total amount of operating profit of negative JPY 26.2 billion. Then, due in part to a subsequent deterioration in business performance, Channel Stuffing of ODM Parts of JPY 32.5 billion (increased by JPY 5.2 billion from the end of the previous quarter) was conducted during the second quarter of FY 2009, and operating profit for that quarter was negative JPY 1.2 billion.

However, at the October 2009 CEO Monthly Meeting held on October 28, 2009, in discussing the forecast of profit and loss for the third quarter of FY 2009, Masahiko Fukakushi CP explained that an operating loss of JPY 24.7 billion would be recorded, incorporating a "settlement" of negative JPY 14.7 billion of the early recording of CR including the overstating of apparent profits through Channel Stuffing of ODM Parts. In response, Norio Sasaki P made the following statement: "You make the figures in the end only through Buy-Sell Transactions and cost reductions. It's strange to say that your company attainability is negative JPY 10.0 billion just because the amount of JPY 14.7 billion is something from a previous period. This is part of your company attainability. Because it is to offset the amount from previous periods, this is also part of your company attainability for the current period. It seems like you have been running on a shoestring because you always conduct things like Buy-Sell Transactions at the end of the period without learning from the past." In response to this, Masahiko Fukakushi CP replied by saying, "That is why we are going to repay a part of the early recorded amount this quarter and also during the fourth quarter, so that we can normalize the situation as much as possible." In response to this, Norio Sasaki P further replied, "Normalization may not be the best thing to do when the company is going through such a difficult phase. What you are talking about is a bit strange, and it may not be in the best interests of the PC Business or Toshiba."

Furthermore, following a management meeting on December 9, 2009, Norio Sasaki P made the following statement to Hisao Tanaka EV: "Improve the profit and loss for the PC Business. While I want them to pay back their Debts, in consideration of the state of our company as a whole, Debts are a necessary evil and there's nothing we can really do about it in the third quarter of this fiscal year. I want you to do something to improve the situation. If possible, I would like an improvement of around JPY 15.0 billion." As a result, the Balance of Buy-Sell Profit Recorded after Channel Stuffing

of ODM Parts for the third quarter of FY 2009 was estimated to be JPY 40.3 billion (increased by JPY 7.8 billion from the end of the previous quarter).

As can also be understood from this statement, it can be considered that by October 2009 at the latest, Norio Sasaki P understood the Buy-Sell Transactions system, an outline of the method of Channel Stuffing of ODM Parts, and the resulting increase in profit at the end of the quarter and the negative operating profit during the first month of the quarter being overstated as profits for the previous period.

However, Norio Sasaki P basically believed that this overstatement of profits should be reduced. This can be suggested from statements such as “The Buy-Sell System needs to be reviewed at some point” that was made at the above-mentioned October 2009 CEO Monthly Meeting held on October 28, 2009 and “For the repayment for the Debt for the third quarter, it should be not only JPY 4.2 billion, but more to the amount of JPY 6.0 billion or JPY 8.0 billion,” that was made at the above-mentioned November 2010 CEO Monthly Meeting held on November 29, 2010.

However, in terms of the method for reducing this overstatement of profits, he believed that they should only be reduced through profits from the PC Business and that the overstatement of profits should not be reduced when profit and loss in the PC Business are negative. This stance is reflected in the following statements by Norio Sasaki P that were made at the quarter reporting meeting for the second half of FY 2010 that was held on January 28, 2011: “It cannot be allowed not to record as much profit as you can in order to try to (excessively) reduce your Debt. What I mean is that you should ensure that we have a soft landing when repaying the Debt. You have a budget like that, and if you try to repay Debt in a manner that will cause you to fall short of the budget for the second half, you put yourself in a safe place but put our company at risk,” and “If you just repay the Debt and achieve your budget by using the profit from the third quarter to excessively repay the Debt like the last time, I will lower the bonus assessment by two levels.”

Furthermore, as can also be suggested from the statement by Norio Sasaki P following the above-mentioned management meeting held on December 9, 2009, doubt remains that Norio Sasaki P would have believed that in cases in which the deterioration of quarterly performance was foreseeable, the overstating of apparent profits through Channel Stuffing of ODM Parts in order to increase profits was something that was unavoidable. Influenced by this attitude by Norio Sasaki P, while the overstatement of apparent profits through Channel Stuffing of ODM Parts when the PC Business performed strongly in FY 2010 decreased, during other periods including FY 2009, FY 2011, and FY 2012 when the PC Business performed poorly, the Balance of Buy-Sell Profit Recorded including the overstatement of apparent profits increased.

The change in the estimated amount of the Balance of Buy-Sell Profit Recorded after Channel Stuffing of ODM Parts during this period was as follows.

	FY 2009 Q2	Q3	Q4
Balance of Buy-Sell Profit Recorded (estimate)	JPY 32.5 billion	JPY 40.3 billion	JPY 41.2 billion

Comparison to end of previous quarter (amount of impact on profit and loss)	Up JPY 5.2 billion	Up JPY 7.8 billion	Up JPY 0.9 billion
Operating profit (after incorporating the amount of impact on profit and loss)	Negative JPY 1.2 billion	Negative JPY 3.8 billion	Negative JPY 9.8 billion

	FY 2010 Q1	Q2	Q3	Q4
Balance of Buy-Sell Profit Recorded (estimate)	JPY 51.1 billion	JPY 38.7 billion	JPY 29.9 billion	JPY 28.9 billion
Comparison to end of previous quarter (amount of impact on profit and loss)	Up JPY 9.9 billion	Down JPY 12.4 billion	Down JPY 8.8 billion	Down JPY 1.0 billion
Operating profit (after incorporating the amount of impact on profit and loss)	JPY 0.9 billion	Negative JPY 0.3 billion	JPY 4.7 billion	JPY 1.9 billion

(B) From first quarter of FY 2011 to first quarter of FY 2012 (DS Company: Sasaki and Oosumi system)

On April 1, 2011, the DN Company, which had conducted the PC Business, and the VP Company, which had conducted the Visual Products Business, merged to form the reorganized Digital Products & Service Company (DS Company), which handles both businesses, and Masaaki Oosumi was appointed as the CP of the DS Company. Television sales suffered considerably in the Visual Products Business due to the termination of analog broadcasting and termination of the transition period to terrestrial digital broadcasting on July 24, 2011, and as a result operating losses of JPY 13.7 billion and JPY 39.8 billion were recorded in the first half and second half of FY 2011, respectively, and the survival of the Visual Products Business was put at risk.

Under these circumstances, because the DS Company (Masaaki Oosumi CP) was pressured to improve the profit and loss of the DS Company including the Visual Products Business in addition to the PC Business, the overstatement of apparent profits through Channel Stuffing of ODM Parts using Buy-Sell Transactions was maintained.

On the other hand, in response to Channel Stuffing of ODM Parts using Buy-Sell Transactions, during this period the DS Company's the Company production and procurement department and the Company Finance & Accounting Division, and the Corporate Finance & Accounting Division and CFO prepared a plan aimed at reducing the volume of channel stuffing products and the overstatement of profits in a planned matter in recognition of the fact that such transactions were unsound and should be resolved, but the impact on profit and loss for the accounting period would be massive if Channel Stuffing of ODM Parts was stopped all together.

For example, an improvement plan submitted by the DS Company (Masaaki Oosumi CP) on May 25, 2011 to the General Manager of the Corporate Audit Division in reply to the suggestion from that division contained the statement "The balance plan for the end of September is JPY 23.5 billion (JPY 33.5 billion at the end of March 2011), and the current plan is to achieve normalization over three years (by the end of March 2014)."

In addition, at the November Corporate monthly meeting and reporting meeting (1) for the business measure follow-up meeting held on November 26, 2011, the "Buy-Sell and C/O Repayment Plan" was established in order to "repay" the overstatement of apparent profits through the previously-described C/O and Buy-Sell Transactions (Channel Stuffing of ODM Parts). A plan was reported for the completion of repayment by the first half of FY 2015, through repayment of JPY 5.0 billion in the third quarter of FY 2011, JPY 5.5 billion in the fourth quarter of FY 2011, and JPY 10.0 billion in each half starting from FY 2012, meaning, JPY 20.0 billion each year.

However, as mentioned above, in face of the deterioration of profit and loss in the PC Business and the Visual Products Business at the DS Company, it was utterly impossible to use profits from the DS Company to compensate for losses from the provisional settlement of Channel Stuffing of ODM Parts, and the Balance of Buy-Sell Profit Recorded including amounts from Channel Stuffing of ODM Parts actually increased in order to cover the deterioration in profit and loss in the PC Business and the Visual Products Business.

As a result, the Balance of Buy-Sell Profit Recorded (estimated) following the Channel Stuffing of ODM Parts during each quarter of this period was as follows.

	FY 2011 Q1	Q2	Q3	Q4	FY 2012 Q1
Balance of Buy-Sell Profit Recorded (estimate)	JPY 34.9 billion	JPY 41.0 billion	JPY 36.1 billion	JPY 46.1 billion	JPY 45.1 billion

Comparison to end of previous quarter (amount of impact on profit and loss)	Up JPY 6.0 billion	Up JPY 6.1 billion	Down JPY 4.9 billion	Up JPY 10.0 billion	Down JPY 1.0 billion
PC Business operating profit (after incorporating the amount of impact on profit and loss)	JPY 5.1 billion	JPY 5.0 billion	JPY 0.2 billion	JPY 1.1 billion	JPY 3.6 billion
DS Company operating profit (after incorporating the amount of impact on profit and loss)	Negative JPY 2.3 billion	Negative JPY 2.3 billion	Negative JPY 16.7 billion	Negative JPY 23.3 billion	Negative JPY 6.1 billion

(C) From second quarter of FY 2012 to first quarter of FY 2013 (DS Company: Sasaki and Fukakushi system)

(a) Setback of the prompt overstatement reduction plan (second quarter of FY 2012)

On June 22, 2012, Masahiko Fukakushi was appointed as CP of the DS Company.

In the DS Company's medium-term business plan for FY 2012 that was formulated before his appointment, there were plans to reduce the overstated profit from Channel Stuffing of ODM Parts using Buy-Sell Transactions of JPY 49.6 billion recognized at the end of March 2012 by JPY 14.2 billion in FY 2012 (JPY 5.7 billion in the first half and JPY 8.5 billion in the second half), JPY 14.4 billion in FY 2013, and JPY 19.8 billion in FY 2014. However, at the Corporate monthly meeting held on April 26, 2012, Norio Sasaki P made the following statements concerning this plan: "While the PC Business has a positive disclosed amount through C/O⁸⁹ increases despite the attainable loss for FY 2011, the forecast for the first quarter of FY 2012 is negative due to C/O repayment despite the fact that the attainability was positive," "I don't understand your attitude regarding C/O repayment," and "We should conduct a proper

⁸⁹ It can be considered that the meaning of C/O here includes those of Channel Stuffing of ODM Parts.

review of our stance towards repayment.”

In response to this, at the July 2012 reporting meeting for the business follow-up meeting held on July 25, 2012 immediately following the appointment of Masahiko Fukakushi CP, in relation to the overstated profit from Channel Stuffing of ODM Parts using Buy-Sell Transactions of JPY 51.8 billion recognized at the end of June 2012, Masahiko Fukakushi CP stated that “we should conduct repayment after profitability in the PC Business becomes attainable.” Because the operating profit forecast for the PC Business for the second quarter of FY 2012 was only plus JPY 0.1 billion, it was decided to not make any reductions during that quarter. In this manner, there was a setback in the prompt implementation of the profit overstatement reduction plan.

(b) Demands for profit improvements of JPY 12.0 billion over three remaining days (second quarter of FY 2012)

On September 10, 2012, the DS Company (Fukakushi CP) reported its operating profit forecast for the first half of FY 2012 of negative JPY 14.9 billion (and second quarter operating profit of negative JPY 8.8 billion). At the September CEO Monthly Meeting held on September 20, in face of a significantly worse operating profit and loss forecast for the first half of negative JPY 20.1 billion (and the second quarter operating profit of negative JPY 14.0 billion), he also reported a Challenge target of an improvement of JPY 8.0 billion. In response to this, Norio Sasaki P stated “This is no good. Fix the plans,” partly due to the fact that the plans fell completely short of the operating profit Challenge amount of negative JPY 8.9 for the first half.

Based on this, while a CEO Monthly Meeting was held again on September 27, 2012, the DS Company reported an operating profit and loss forecast for the first half of negative JPY 24.8 billion (PC and Visual Products), a further deterioration from the previous reports. In response to this, Norio Sasaki P strongly demanded that the DS Company improve operating profit by JPY 12.0 billion over the remaining three days and requested that the results of the study be reported the following day, on September 28.

As a result, Masahiko Fukakushi CP of the DS Company and other DS Company members met from the evening of September 27 to review and develop emergency profit and loss improvement measures. On the following day, on September 28 at 12:10, Masahiko Fukakushi CP of the DS Company and other members of DS Company’s management explained the results of study for profit and loss improvement measures to Hidejiro Shimomitsu SEV, Hisao Tanaka SEV, Makoto Kubo EV, and the General Manager of the Corporate Finance & Accounting Division, and the results of study for profit improvement measures were reported to Norio Sasaki P along with those Corporate executives at 14:00. The DS Company explained that, as a result of their considerations, they would implement profit and loss improvement measures for an improvement of JPY 11.9 billion, which included JPY 3.9 billion of Buy-Sell and JPY 6.5 billion of C/O (JPY 5.8 billion for PC and JPY 0.7 billion for visual products) for a total of JPY 10.4 billion, by the end of September. The plan was accepted by Norio Sasaki P and the Corporate executives.⁹⁰

⁹⁰ However, how the Buy-Sell and C/O total of JPY 10.4 billion related to the total of JPY 11.9

Within this process, the Balance of Buy-Sell Profit Recorded after Channel Stuffing of ODM Parts for the second quarter of FY 2012 was estimated to be JPY 51.1 billion (up by JPY 6.0 billion from the end of the previous quarter).

The DS Company's profits did not improve subsequently and Channel Stuffing of ODM Parts was continued as described below, and as a result the Balance of Buy-Sell Profit Recorded after the Channel Stuffing of ODM Parts is follows.

	FY 2012 Q2	Q3	Q4	FY 2013 Q1
Balance of Buy-Sell Profit Recorded (estimated)	JPY 51.1 billion	JPY 55.6 billion	JPY 71.5 billion	JPY 65.4 billion
Comparison to end of previous quarter (amount of impact on profit and loss)	Up JPY 6.0 billion	Up JPY 4.5 billion	Up JPY 15.9 billion	Negative JPY 6.1 billion

(c) Overstatement of profits through Channel Stuffing to TIH (second quarter to fourth quarter of FY 2012)

The profit and loss improvement measures for an improvement of JPY 11.9 billion reported on September 28, 2012 included the overstatement of profits through Channel Stuffing to TIH.

In order to conduct Channel Stuffing of ODM Parts using standard Buy-Sell Transactions in general, negotiations with the ODMs are necessary. However, because business talks with the ODMs had already been completed as of September 28, 2012 and there was not enough time for new negotiations, it was not possible to conduct Channel Stuffing of ODM Parts. Instead, Toshiba sold parts held as inventory by Toshiba at the Masking Price to TTI and TIH, Toshiba's fully owned Subsidiaries to which there was no need to sell the parts at the Masking Price, and recorded the profits equivalent to the Masking Difference (the negative costs of manufactured goods). Specifically, following the above meeting on September 28, the DS Company procurement personnel issued instructions for TIH to immediately purchase approximately USD 4.2 million of memory and HDD products via TTI. As a result of these purchases by TIH, apparent profits of an estimated amount of JPY 2.9 billion were overstated in the second quarter of FY 2012. Note that this approach was also repeated in the third quarter of FY 2012. Specifically, on December 26, 2012, the DS Company procurement personnel issued instructions to the General Manager of TIH to purchase USD 4.8 million of memory and HDD products via TTI. In response to these instructions, the General Manager of TIH expressed reluctance, making statements such as "Does this request represent the intentions of the DS Company's top management?",

billion in profit and loss improvement measures (whether the latter includes all of the former or only a portion of the former) was not clear from the materials available.

“Are these instructions being made based on a sufficient understanding that of course this request is an abnormal one?”, “We are concerned that this transaction could cause the Group’s accounting treatment to be looked upon with suspicion”, and “Are these instructions being made with the preparedness to take on the associated risks (preparedness including the response should things go wrong)?” Nonetheless, the General Manager of the DS Company Finance & Accounting Division requested that TIH conduct the transaction, stating that the DS Company had explained to Makoto Kubo EV that these were audit risks. As a result, this transaction was conducted, and apparent profits were overstated by an estimated amount of JPY 3.4 billion for the third quarter of FY 2012 (moreover, because this profit overstatement was handled as a “loan” from the PC Business to the Visual Products Business that improved the profit and loss of the Visual Products Business by that amount, it became more difficult to understand the profit and loss of the PC Business and the Visual Products Business as a result).

In the same manner, the overstatement of profits through Channel Stuffing to TIH was also conducted in the fourth quarter of FY 2012, and during this quarter apparent profits were overstated by an estimated amount of JPY 2.9 billion.

Note that the overstatement of profits through Channel Stuffing to TIH was not conducted in the first quarter of FY 2013. This was because at the time Toshiba had a large amount of USD-denominated claims related to Channel Stuffing of ODM Parts and there was a foreign exchange profit of JPY 5.3 billion due to yen depreciation during that period, which enabled it to absorb the deterioration in profit and loss as a result of conducting Channel Stuffing to TIH at the beginning of the quarter by using the foreign exchange profit.

(d) Summary

As a result of the above, the Balance of Buy-Sell Profit Recorded including overstated profits through Channel Stuffing of ODM Parts and estimated overstated profits through Channel Stuffing to TIH during this period was as follows.

In this manner, the Balance of Buy-Sell Profit Recorded after the overstatement of apparent profits through Channel Stuffing of ODM Parts using the Buy-Sell Transaction grew to a huge amount as of the last day of the first quarter of FY 2013, immediately following the resignation of Norio Sasaki P, reaching an estimated amount of JPY 65.4 billion.

	FY 2012 Q2	Q3	Q4	FY 2013 Q1
Balance of Buy-Sell Profit Recorded (estimated)	JPY 51.1 billion	JPY 55.6 billion	JPY 71.5 billion	JPY 65.4 billion
Overstated profits through channel stuffing to TIH (estimated)	JPY 2.9 billion	JPY 3.4 billion	JPY 2.9 billion	—

Comparison to end of previous quarter (amount of impact on profit and loss)	Up JPY 8.9 billion	Up JPY 5.0 billion	Up JPY 15.4 billion	Down JPY 9.0 billion
PC Business operating profit (after incorporating the amount of impact on profit and loss)	JPY 4.1 billion	JPY 1.8 billion	Negative JPY 1.4 billion	Negative JPY 8.9 billion
DS Company operating profit (after incorporating the amount of impact on profit and loss)	Negative JPY 6.1 billion	Negative JPY 15.7 billion	Negative JPY 13.9 billion	Negative JPY 20.8 billion

(5) Enforcement of reduction of Inappropriate accounting (President Tanaka era: from second quarter of FY 2013)

On June 25, 2013, Norio Sasaki resigned as Toshiba's President and was appointed as Toshiba's Vice Chairman, while Hisao Tanaka was appointed as Toshiba's President and Shigenori Tokumitsu was appointed as the DS Company's President.

(A) From second quarter of FY 2013 to fourth quarter of FY 2013 (DS Company: Tanaka and Tokumitsu system)

As is described below, it can be considered that Hisao Tanaka P, who served many years as the Senior Manager of the PC Company's procurement department and Senior Manager of Corporate's procurement department and conducted talks and negotiations with the ODMs, was aware of the overstatement of apparent profits through Channel Stuffing of ODM Parts. On September 13, 2013, Hisao Tanaka P stated to Makoto Kubo SEV as "a confidential consultation": "In consideration of market expectations, perhaps the best scenario is for the DS Company's profit and loss to be half that of the first quarter (negative JPY 20.6 billion) so that it is two digits (negative JPY 9.9 billion), so that we can record profits of JPY 100.0 billion for the entire company," "There is something I would like to talk to you about. Although this differs a little from the policy up until now, I would like to increase the Buy-Sell Debt a bit and do whatever it takes to ensure that losses for the DS Company are no more than JPY 9.9 billion." This consultation proposed improving profit and loss through the overstatement of profits using Buy-Sell Transactions. In response to this, Makoto Kubo SEV replied "While I obey any decisions made by Hisao Tanaka P 100% and do my best, I am opposed to increasing Buy-Sell Transactions."

Against this backdrop, the overstatement of apparent profits through Channel Stuffing of ODM Parts was continued during 2013, and the estimated amounts of these overstatements are as follows.

	FY 2013 Q2	Q3	Q4
Balance of Buy-Sell Profit Recorded (estimated)	JPY 67.9 billion	JPY 66.8 billion	JPY 72.1 billion
Comparison to end of previous quarter (amount of impact on profit and loss)	Up JPY 2.5 billion	Down JPY 1.1 billion	Up JPY 5.3 billion
PC Business operating profit (after incorporating the amount of impact on profit and loss)	Negative JPY 3.5 billion	Negative JPY 4.7 billion	Negative JPY 2.8 billion
DS Company operating profit (after incorporating the amount of impact on profit and loss)	Negative JPY 10.3 billion	Negative JPY 4.7 billion	Negative JPY 11.1 billion

(B) From first quarter of FY 2014 to third quarter of FY 2014 (PCS Company: Tanaka and Tokumitsu/Murato system)

On April 1, 2014, the DS Company underwent an organizational change to become PCS Company that is only engaged in the PC Business.

Prior to that, starting from the end of 2013, the DS Company and Corporate including Makoto Kubo CFO identified items that should be eliminated as inflated amounts other than true attainable profits (referred to as the “PC Business improving remaining balance” at Toshiba) including the overstatement of apparent profits through the Channel Stuffing of ODM Parts (so-called “Debt”), and the elimination measures were reviewed. The contents were reported to Hisao Tanaka P in February 2014. These reviews were subsequently discussed in an integrated manner with the actual restructuring of the PC Business, and starting from May 12, 2014, these matters were discussed at the Emergency Meeting for Full Check of Underperforming Business for the PC Business including Hisao Tanaka P. At the Third Emergency Meeting for Full Check of Underperforming Business for the PC Business held on May 20, 2014, the thought that “The biggest priority is the improving remaining balance. I would like to reduce the costs involved with withdrawal as much as possible and increase the elimination amount for the improving remaining balance.” was indicated by Hisao Tanaka P, etc. There was further consideration based on this thought, and at the 8th meeting held on July 18, 2014, it was decided to record a loss of JPY 50.2 billion in FY 2014, and it was also decided that an amount of JPY 30.0 billion out of the JPY 45.0 billion to be recorded as operating expenses was the loss caused by the reduction of overstated profits from Channel Stuffing of ODM Parts.

Although this plan was approved through a resolution as the “PC Business structural reform issue” at the Toshiba’s Corporate Management Meeting held on September 16,

2014 and Toshiba's Board of Directors meeting held on September 18, 2014, it was only explained that, of the JPY 60.2 billion in expenses to be recorded during FY 2014, operating expenses of JPY 45.0 billion would be the costs for "sales and inventory measures, production adjustments, impairment, etc. related to the withdrawal."

While overstatement of apparent profits through Channel Stuffing of ODM Parts was continued after the first quarter of FY 2014, the Balance of Buy-Sell Profit Recorded decreased as follows as a result of implementation of the above plan.

	FY 2014 Q1	Q2	Q3	Q4 (provisional figures)
Balance of Buy-Sell Profit Recorded (estimated)	JPY 69.8 billion	JPY 62.6 billion	JPY 39.2 billion	JPY 39.7 billion
Comparison to end of previous quarter (amount of impact on profit and loss)	Negative JPY 2.3 billion	Negative JPY 7.2 billion	Negative JPY 23.4 billion	Up JPY 0.5 billion
PCS Company operating profit (after incorporating the amount of impact on profit and loss)	Negative JPY 0.1 billion	Negative JPY 20.4 billion	Negative JPY 25.3 billion	Negative JPY 6.6 billion

It was said that no Channel Stuffing of ODM Parts was conducted in June 2015, and as of now the overstatement of profits using Buy-Sell Transactions has resolved naturally.

(6) Summary

The actual figures of the sales and operating profit or loss by month for the PC Business from FY 2005 including the period from the second quarter of FY 2008 to FY 2014 when Channel Stuffing of ODM Parts was conducted, and graphs of these results are shown in Exhibit 3-2.

As shown here, there are intense deformations in the monthly profit and loss for the PC Business, and the impact of that can be seen from 2012 when the profit for the last month of the quarter nearly exceeds the sales for that month. From the monthly profits alone, the abnormality of this accounting treatment became clear at a glance.

4. Causes of inappropriate accounting treatment

- (1) There was an institutional behavior involving certain top management, and it was carried out for the purpose of intentionally "overstating the current-term**

profit (in excess of actual performance).”

(A) Awareness and tolerance by top management

In light of the events already explained, it can be recognized that the Company was forced to embark on Channel Stuffing of ODM Parts because Atsutoshi Nishida P and Norio Sasaki P demanded the Company to be sure to achieve the Challenge with high profit improvement. Moreover, it can also be recognized that, although Atsutoshi Nishida P and Hisao Tanaka P did not go so far as to acknowledge that they gave instructions to carry out Channel Stuffing of ODM Parts, they were aware that the profit was overstated by Channel Stuffing of ODM Parts, and they did not take action such as giving instructions to immediately correct this, and instead allowed the situation to continue.

Below, we examine the awareness and involvement of the three successive top management personnel regarding the overstating of profit by Channel Stuffing of ODM Parts.

(a) Former President, Nishida

As set forth above, it can be recognized that the Company was forced into a situation in which they had no choice but to implement Channel Stuffing of ODM Parts, due to the fact that Atsutoshi Nishida P imposed Challenges with high profit improvement on the Company and insisted that they should be achieved.

The investigation conducted by this Committee did not go so far as to recognize that Atsutoshi Nishida P was aware of and allowed the overstating of profits by Channel stuffing of ODM Parts.

Regarding this point, Atsutoshi Nishida P has thorough knowledge of the PC Business, the organization he used to belong to, and although it can be recognized that he understood how Buy-Sell Transactions work, in the interviews conducted by this Committee he stated, “I was not aware that the large amounts of profit arising at the end of each quarter were the result of Buy-Sell Transactions. If it had been explained to me in the reports at the CEO Monthly Meetings that the profit targets were met (and that operating profit was improved) by early recording of CR, I think I would have been aware that that early recording of CR meant early recording of cost reductions such as negotiations to reduce prices with vendors (parts suppliers),” and thereby denied that he was aware of the overstating of profit by Channel Stuffing of ODM Parts.

However, in the October 2008 Monthly CEO Meeting it was explained to Atsutoshi Nishida P that “With respect to early recording of CR, early recording of payment for parts was possible in September because of the Anniversary of the Founding of the People’s Republic of China, but it will be difficult to get agreement for December, because that is when the closing of accounts takes place for ODMs.” This explanation is based on the premise that “early recording of CR” can be realized by early recording of payment for parts with respect to ODMs, and therefore Atsutoshi Nishida P’s explanation as set forth above cannot be seemed to be reasonable.

Further, even after Atsutoshi Nishida P resigned from the position of President and Chief Executive Officer and assumed the position of Chairman of the Board, when

Hisao Tanaka EV, who was responsible for procurement at that time, told him that it would be possible to achieve the Challenge if they could have repayment of the “debt” deferred, he responded, “It can’t be helped this period, but next period you must repay at least some of the debt. It’s okay to be a little reckless this period, so make sure you contribute to Toshiba’s operating profit.” It can also be perceived that he received an explanation of the budget proposal for the PC Business through the materials in which the DS Company included the plan for reducing the amount of profits overstated by Buy-Sell Transactions (in other words, the debt repayment plan).

Based on these facts, the doubts remains that Atsutoshi Nishida P was aware of the use of Buy-Sell Transactions in overstating profits and did not correct that issue.

(b) Former President and Chief Executive Officer Sasaki

Norio Sasaki P has said, “I was aware that the majority of the large amounts of profit arising at the end of each quarter were the result of Buy-Sell Transactions. Soon after I assumed the position of President it was explained to me that Buy-Sell Transactions were not illegal, but I never gave instructions myself to overstate profits using Buy-Sell Transactions, and as it is unsound business, I kept on saying that the volume should be reduced.

However, based on the events set forth above, it is recognized that, while Norio Sasaki P told CPs to decrease the volume of Channel Stuffing by ODM Parts, he only said that it should be decreased by using the profits arising from the PC Business, and he showed reluctance when the CPs were going to decrease the volume when recording a loss.

In addition, Norio Sasaki P issued difficult Challenges to the CPs from the perspective of achieving the budget (and in many cases, as in the September 2012 example above, difficult Challenges were issued when there was only a short time remaining until the end of the quarter and when there was no longer enough time to institute revenue improvement initiatives using normal sales efforts), and demanded that they should be achieved, so that it can be recognized that the CPs were placed in a position in which they had no choice but to overstate profits using Buy-Sell Transactions, and that such practice continued.

(c) President and Chief Executive Officer Tanaka

Hisao Tanaka P has said, “I understood that selling parts to ODMs resulted in profit, but it was never raised as an issue by the auditor and I thought the accounting treatment was being implemented in accordance with the rules. I was aware that the volumes sold to the ODMs were increasing, but I thought that there were a number of reasons for that, such as that they had been implementing an expansion strategy before I became President, and I was not aware that they were having ODMs buy greater volumes than required in order to overstate profits.

However, Hisao Tanaka P led the start of Buy-Sell Transactions in 1994, and thereafter conducted talks and negotiations with each of the ODMs over many years in his successive positions as the Senior Manager of the procurement department of the PC Company and the Senior Manager of the procurement department for Corporate

procurement. In addition, in December 2009, when Hisao Tanaka P was an executive officer EV, Norio Sasaki P approached him saying, “We want repayment of debt (the balance resulting from Buy-Sell Transactions) to be made. Based on the situation of the entire company, it cannot be helped in the third quarter, but we would like to somehow improve profit for the PC Company. Would it be possible to do JPY 15.0 billion?” And it can be recognized that Hisao Tanaka notified Masahiko Fukakushi CP that he replied to the above mentioned Norio Sasaki’s comments to the effect that “The situation is difficult, but if we can have the debt repayment deferred it may be possible to make improvement of more than JPY 10.0 billion.” Also, in December 2013, after Hisao Tanaka P became President and Chief Executive Officer, he approached Makoto Kubo CFO for a “strictly confidential consultation” and suggested that, although it would be a little different from the policy up to that point (of decreasing Buy-Sell Transactions), he wanted to increase Buy-Sell Transactions slightly and stop the DS company’s operating loss for the second quarter of FY 2013 at minus JPY 9.9 billion, and in doing this he demonstrated that he was aware that PC Company’s profit and loss would be improved through the Buy-Sell Transactions.

Based on these facts, it can be recognized that Hisao Tanaka P was aware, from December 2009 at the latest, that profits were being overstated using Buy-Sell Transactions and that he did not correct this over a period of many years (however, it can also be found that from the beginning of FY 2014 he looked into reducing the balance of recorded profit from Buy-Sell Transactions in consultations with the PC[S] Company, and implemented some reductions from September of FY 2014 onward, causing a reduction in the balance of recorded profit from Buy-Sell Transactions).

(B) Institutional involvement by the CPs and the Company

As long as it was the Company conducting the PC Business that carried out the overstating of profit by Channel Stuffing of ODM Parts using Buy-Sell Transactions, the CP, as the top management of the Company, had made the decision to conduct Channel Stuffing of ODM Parts and the decision regarding the amounts of Channel Stuffing of ODM Parts. Even if the CP was subject to strong pressure from the Corporate P to improve profits, the decision of the CP to try to overstate profit by Channel Stuffing of ODM Parts was the direct cause behind the inappropriate accounting treatment being implemented.

Further, based on these decisions of the CP, the production and procurement department of the Company that conducts the PC Business and the procurement department of Corporate, together with TTIP, negotiated with ODMs to have them purchase the ODM parts and Channel Stuffing of ODM Parts was implemented in this way.

(C) Summary

As set forth above, it can be recognized that the overstating of profit by Channel Stuffing of ODM Parts has been carried out under the awareness and tolerance of the Ps that were part of the top management, and based on the decision made by the CP, who is the top management of the Company, and it was carried out and continued with the

institutional behavior involving the Company's and Corporate's related departments. Further, these acts can be considered to have been conducted for the purpose of intentionally "overstating the current-term profit (exceeding actual performance)."

This kind of institutional behavior involving some top management occurred, and was inappropriate accounting treatment based on acts intentionally carried out with the firm aim of overstating the current-term profit. As a result of this, Toshiba's internal control system had no force and Toshiba did not have a risk management structure that anticipated such inappropriate accounting treatment being carried out and continued in an institutional way involving top management, and, as described below, the supervisory functions of various bodies did not function sufficiently.

(2) The over-riding current-term profit policy and strong pressure to achieve the budget targets

As set forth above, among others, when Atsutoshi Nishida P and Norio Sasaki P were President and Chief Executive Officer, in the CEO Monthly Meetings, they demanded each of the CPs of the Company conducting the PC Business to be sure to achieve the budget (and even when the original budget was achieved, they would set a new target), and CPs were subjected to strong pressure under the name of "Challenge."

The Challenge was often set in the CEO Monthly Meetings, etc. held when there was only a short time left until the end of that quarter, as represented by the example set forth above, in which, in September 2012, as the DS Company's performance was deteriorating, it was repeatedly requested by the P to revise the prepared revenue improvement plans and ultimately strongly demanded to make a profit improvement of JPY 12.0 billion within the three days remaining until the end of the second quarter. Since it was difficult for the Company issued with the Challenge to achieve such large amounts of profit improvement during the short time remaining until the end of the quarter, even if they made every effort in sales, it can be surmised that they were often forced to use the inappropriate method of Channel Stuffing of ODM Parts in order to overstate profits as the only way available to them to achieve the Challenge.

In addition, the pressure of the Challenge was not aimed at securing long-term profit, and could be considered an over-riding current-term profit policy as it was set with the goal of maximizing profit for that period (quarter). Therefore, while Norio Sasaki P was CEO, even though the Company conducting the PC Business wanted to resolve the overstating of profits by Channel Stuffing of ODM Parts, the P clearly expressed that he would not approve doing so unless an operating profit in the PC Business was recorded, and if a profit was not recorded for that period he would not allow the resolution of overstated profits by Channel Stuffing of ODM Parts.

For these reasons, the inappropriate method of overstating profit by using Channel Stuffing of ODM Parts continued to be used for a long period of time.

(3) A weak awareness of appropriate accounting treatment (of compliance)

The overstating of profit by way of Channel Stuffing of ODM Parts was clearly an "overstating" of profit in excess of actual performance for that period. Despite this,

looking at the fact that such actions were implemented and continued under the involvement of certain top management, it cannot be avoided saying that there was a weak awareness among those in top management who were involved about the appropriate accounting treatment that must be implemented and also about the fact that compliance should take precedence over profit.

(4) Internal control function of internal control departments was not functioning

(A) Inadequacy of internal control function in the Company Finance & Accounting Division

The Finance & Accounting Division, which should have been responsible for ensuring appropriate accounting treatment in the Company, did want to resolve the overstating profit for a short time. However, under the situation that did not allow them to take such action due to the intentions of the CP and the P, the Company Finance & Accounting Division, as set forth later in this report, instead provided insufficient explanations contrary to the facts to the accounting auditors so that no issues would be raised by them, acted in ways that could be seen to conceal the inappropriate accounting treatments of Channel Stuffing of ODM Parts in an institutional manner. In this way, the internal control function of the Finance & Accounting Division was not functioning at all.

(B) Inadequacy of internal control function in Corporate

(a) CFO and the Finance & Accounting Division

It can be found that successive CFOs and the General Managers and people in charge in the Finance & Accounting Division were aware that the Company had recorded a large income at the end of every quarter since 2009 and that a large portion of such profit was overstated by using Channel Stuffing of ODM Parts, although they became aware at different times.

It can be recognized that, against this backdrop, some of them believed that the amount of overstated profit created by Channel Stuffing of ODM Parts should not be increased and should be decreased, and alerted this issue to the Company, and in some cases to the P when they had the opportunity. However, especially during the era when Norio Sasaki P was President, correction of the overstated profit was only allowed when there was profit from the PC Business (and, therefore, continuing overstating of profit by way of Channel Stuffing of ODM Parts in order to achieve the budget was tolerated). In these circumstances, the CFO and the Finance & Accounting Division were unable to exercise their internal control function and correct the situation, and they continued to “tolerate” the situation.

(b) Corporate Audit Division

On a total of three occasions, in FY 2009, FY 2011, and FY 2013, issues were raised

at the time of the audit by the Corporate Audit Division in relation to the overstating of profit by Channel Stuffing of ODM Parts. However, Channel Stuffing of ODM Parts using Buy-Sell Transactions was not stopped.

a. Issues raised in the FY 2009 corporate audit and failure to implement the requests for improvement

In the audit report dated August 26, 2009 regarding the PC China business, the following issues were raised: “Even if it is Buy & Sell, the business purpose is not the sale of major parts [of the PC Company], and actually this is supply for value.” “Buy & Sell Transactions are those in which the purchase price of the completed product purchased from the ODM is corrected through CR of the sale of the parts materials, and it must be synchronized within the same month. It is necessary to establish a system at [the PC Company] where appropriate internal controls work to ensure that arbitrary operations are not implemented.” Further, the requests for improvement stated “It is necessary to verify the situation regarding Buy & Sell parts held at the ODMs. And it is also necessary to establish a system at [the PC Company] where appropriate internal controls work to ensure that arbitrary operations are not implemented.”

However, even after that, at the PC Company “arbitrary operations” were implemented, and Channel Stuffing of ODM Parts using Buy-Sell Transactions continued to take place.

b. Issues raised in the FY 2011 corporate audit and failure to implement the improvement plan

The following issues were raised in the audit report dated March 23, 2011 regarding the DN Company’s PC Business: “The appropriate number of inventory days for inventory subject to Buy-Sell Transactions is five days, but the balance at the end of December 2010 was around the same as the procurement amount for that entire month, and equivalent to one month’s inventory.” “Increases and decreases in the masking amount balance (JPY 25.4 billion at the end of December 2010) have a large impact on profits for the period, and therefore it is necessary to keep a record of approvals regarding changes to the Masking Price. Further, it is desirable to decrease the Masking Price.” In response, the DS Company (Masaaki Oosumi CP) submitted an improvement plan to the General Manager of the Corporate Audit Division on May 25, 2011 stating that the planned balance for the end of September 2011 was JPY 23.5 billion (JPY 33.5 billion at the end of March 2011), and that the current plan was to normalize the situation over three years (by the end of March 2014). However, the “Improvement Plan and the Improvement Implementation Report” dated November 8, 2011 submitted to the General Manager of the Corporate Audit Division by the DS Company (Masaaki Oosumi CP) stated that “Inventory at the end of the quarter was JPY 41.7 billion according to the balance at the end of September, representing a massive increase compared to the JPY 18.2 billion budget.” and “The reduction plan from now on is to reduce that figure to JPY 29.0 billion at the end of December 2011, JPY 25.3 billion at the end of March 2012, and then to reduce the figure by JPY 15.0 billion annually.” These statements revealed that the improvement plan had not been implemented.

c. The FY 2013 corporate audit

In the audit report dated February 7, 2013 regarding the domestic DS business, the following issue was raised: “Under the accounting policies, the resale profit from Buy-Sell should not be realized until it becomes sales revenue after shifting to products. However, Buy-Sell parts held by the ODMs as inventory are ordinarily equivalent to three days’ worth of production. Therefore, it was explained to the auditor that the impact on unrealized profit and loss from this situation would be very limited and the approval for the current accounting treatment was obtained.”

However, the Corporate Audit Division did not indicate that the above issue was a matter regarding which improvement was requested, and the DS Company did not implement any particular response.

d. Summary

As set forth above, during the audits for FYs 2009, 2011, and 2013 conducted by the Corporate Audit Division, they noted that there was a possibility that Buy-Sell Transactions were being used to cause the ODMs to retain excess volumes of parts, but they did not go so far as to make any clear comment regarding the intentional Channel Stuffing of ODM Parts. Further, as in the FY 2011 corporate audit above, requests for improvements made by the Corporate Audit Division did not have any special compelling power, and when improvement plans such as the plan to reduce the ODM inventory were not implemented, no particular action was taken in response to that failure to act.

Therefore, Channel Stuffing of ODM Parts was not actually resolved and it can be evaluated that the Corporate Audit Division was not performing its internal control function.

(5) Internal control function of the Audit Committee was not functioning

Former CFO Mr. Tomio Muraoka was the chair of the Audit Committee from June 2011 to June 2014 and former CFO Mr. Makoto Kubo assumed the same position from June 2014. As former CFOs, they were both aware of the fact of Channel Stuffing of ODM Parts.

Further, the audit results of the Corporate Audit Division are regularly reported to the Audit Committee.

Despite this, there is no evidence that there was any discussion regarding Channel Stuffing of ODM Parts by the Audit Committee, nor was any evidence found to suggest that they took any action, such as making any kind of report regarding Channel Stuffing of ODM Parts by the Audit Committee. Further, no evidence was found to suggest that Mr. Tomio Muraoka, the chair of the Audit Committee, or Mr. Makoto Kubo, also the chair of the Audit Committee, exercised any of their individual authority as members of the Audit Committee regarding Channel Stuffing of ODM Parts.

Therefore, it cannot in any way be evaluated that the control function of the Audit

Committee was functioning sufficiently regarding Channel Stuffing of ODM Parts.

Further, on January 26, 2015, prior to the closing of accounts for the third quarter, the Audit Committee member Mr. Seiya Shimaoka suggested to Makoto Kubo, the chair of the Audit Committee, that a thorough examination should be conducted regarding the accounting treatment for the restructuring of the PC Business, which was resolved at the meeting of the Board of Directors on September 18, 2014 (the losses from reducing Channel Stuffing of ODM Parts were secretly included in this accounting treatment), in order to review whether or not there was inappropriate accounting treatment, and that it should be confirmed that there were no issues with the accounting treatment for the third quarter including seeking an opinion from legal and accounting experts. However, Makoto Kubo, the chair of the Audit Committee, did not take up this request, and no meeting of the Audit Committee was held. (Seiya Shimaoka made another request to Makoto Kubo, the chair of the Audit Committee to the same effect on March 19, 2014. In response, on April 1, Keizo Maeda CFO responded that there was nothing inappropriate included in the accounting treatment for the restructuring of the PC Business, and that with respect to Buy-Sell Transactions, the Parts Transactions and the Completed Products Transactions were independent transactions and their accounting treatment was conducted appropriately.)

In addition, when the Audit Committee member Mr. Seiya Shimaoka made a suggestion similar to the above to Makoto Kubo, the chair of the Audit Committee and the committee members on April 6, opinions were expressed to him such as that rocking the boat at that time would mean that there wouldn't be enough time left before the closing of accounts and would result in the worst outcome; and no specific action was taken at that time.

Taking into account these circumstances, it cannot be evaluated that, even looking this situation ex post facto, the Audit Committee was performing its control function sufficiently.

(6) The correction was not made by the control function of the accounting auditor

No evidence was found to suggest that the auditors raised any issues regarding the intentional Channel Stuffing of ODM Parts. It can be surmised that this would be one of the reasons why the overstating of profit resulting from Channel Stuffing of ODM Parts continued for a long period of time.

The accounting auditor confirmed that the costs of manufactured goods at the Ome Complex were reduced on the final day of the quarter, giving rise to a large gross profit margin, and that from FY 2012 that amount was higher than that for production, but received insufficient explanation that the reason the gross profit rate improved was because the production profit was secured by CR (cost reduction) which was given as a result of negotiations held every quarter. This can also be perceived from the fact that the following interactions took place, for example, among the persons in charge of accounting and finance at the DS Company regarding how to respond to the quarterly audit by the accounting auditor: "We can definitely not let them perceive that funds to cover manufacturing profit and loss are involved in the transactions with TTIP and TTI, and it is necessary to keep saying that TTIP sells parts materials to the ODMs as the

term ‘company-supplied’ requires picking up profit and loss. It is best to be careful and avoid touching on the issue as much as possible, and if you think it is even slightly risky you should consult your superiors.” and “We will be asked about the reason why the monthly profits improve at the end of each period at every audit with respect to the monthly movement in cost of sales and operating profit. We are responding by simply saying that it is a bundled CD at the end of the period, but with respect to the fluctuations in the amount, the values for FY 2012 are extremely abnormal. The operating profit for the single month of December FY 2012 is JPY 80.6 billion, which is the highest profit on record and is an amount that significantly exceeds the sales amount of JPY 63.7 billion.”

Compared to the aforementioned, the audit report by the Corporate Audit Division for FY 2013 states “Under the accounting policies, the resale profit from Buy-Sell should not be realized until it becomes sales revenue after shifting to products. However, Buy-Sell parts held by the ODMs as inventory are ordinarily equivalent to three days’ worth of production. Therefore, it was explained to the auditor that the impact on unrealized profit and loss from this situation would be very limited and the approval for the current accounting treatment was obtained,” but it could not be confirmed whether Toshiba and Ernst & Young ShinNihon actually did communicate to such effect.

Based on these events, it cannot be evaluated that control by the accounting auditor was functioning sufficiently.

5. Accounting treatment concerning recording of operating expenses in the PC Business

(1) Accounting treatment in question concerning recording of operating expenses in the PC Business and the amount of the impact

In the process of investigating the appropriateness of the accounting treatment concerning Parts Transactions in the PC Business, a situation was found where the accounting period attribution in the calculation of profit and loss was inappropriate in relation to C/O in the same manner as in the Visual Products Business.

For the PC Business, C/O has been recognized in the same manner as in the Visual Products Business, but they were in principle being carried out for the purpose of adjusting Toshiba’s profit and loss (overstating apparent profit). Also, the large part of the C/O that was being carried out for the purpose of profit and loss adjustment were inappropriate accounting treatment (hereinafter, “inappropriate C/O”).

Three kinds of inappropriate C/O for the PC Business were identified as follows.

(A) C/O used for the adjustment of profit and loss by delaying the timing of the recording of operating expenses

With respect to some of the domestic logistics expenses and advertising expenses,

there were instances where Toshiba has avoided recording operating expenses by requesting payees to delay the issuance of their invoices until subsequent quarters notwithstanding that the provision of services had been completed. Also, with respect to expenses the amounts for which were still being negotiated, there were instances where expenses have been recorded based not on the actual invoice amount but on the assumption a discount has been made.

(B) C/O used for the adjustment of profit and loss by intentionally increasing the price of products sold to overseas distributors

With respect to products sold by Toshiba to overseas group companies, such as Toshiba Europe GmbH (“**TEG**”), there were instances where Toshiba recognized profit and loss on such products as the profit or loss of the PCS Company by selling them to overseas sales companies at a temporarily inflated invoice price with the aim of recording a profit on a non-consolidated basis for the PCS Company at the end of the quarter. Because this would also lead to unrealized profit on the inventory of overseas companies in the consolidated accounts, all of those products needed to be eliminated. But in the consolidation procedures for Toshiba, the profit ratio of the entire divisions in Toshiba non-consolidated accounts was used as the elimination ratio for the elimination of unrealized profit, so there was still some unrealized profit that had not been eliminated on inventory sold at a sales price inappropriately increased immediately before the end of the period.

(C) C/O the details of which are unknown

The details-unknown C/O balance is included in the adjustment amount of profit and loss of each term for the same reason as mentioned in the Visual Products Business.

The amount of impact by these inappropriate C/O is as follows:

(Unit: JPY 100 million)

Item		FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Q3
(1) Matters related to delayed expense recognition (total)			-	-	2	5	10	9
Japan	Deferred invoice, recording of operating expenses using amount under negotiation	-	-	-	2	5	9	8
Asia	Amount of unrecorded operating expenses due to delayed arrival of invoice	-	-	-	-	-	1	1
(2) Inventory valuation (total)			-	-	43	26	3	-
Europe, Middle East, Africa, and Russia	Intentional increase of price of products sold to overseas distributors	-	-	-	43	26	3	-
(3) Others (unknown)		-	-	17	55	33	35	22
Total of C/O balance		-	-	17	100	64	47	31
The amount of impact on profit and loss		-	-	(17)	(83)	36	17	17

(2) Facts identified by the Independent Investigation Committee and the causes of inappropriate accounting treatments

(A) Facts identified by the Independent Investigation Committee

C/Os are various measures that were conducted by the Companies engaged in the Visual Products Business and the PC Business in order to adjust profit and loss (overstate current-term profits), and the majority of them were inappropriate accounting

measures (Inappropriate C/Os). For example, when attempting to define C/O in June 2011, the DS Company's General Manager of the Finance & Accounting Division stipulated that "'C/O' means (i) a treatment that affects profit and loss in a subsequent period by deferring expenses or recording profits early and (ii) an inappropriate treatment from an accounting perspective" and he gave the following as an example of a C/O: "the FOB price was increased for no legitimate reason and recorded as sales, and the profit and loss on the portion remaining in the inventory of the local subsidiary would not be realized."

In terms of the timing of when C/Os were commenced at the Companies engaged in the PC Business, while it was recognized that the term C/O was being used from around 2010 at the latest, the management of C/O by the Companies fully commenced in April 2011 when the DS Company was founded through the merger of the DN Company, which had been engaged in the PC Business, and the VP Company, which had been engaged in the Visual Products Business. This was due to the fact that, given that C/Os were already being widely used in the Visual Products Business, it was necessary to understand the status of C/Os within the same Company and properly understand the financial figures excluding the influence of C/Os, and due in addition to the fact that profit and loss measures through Inappropriate C/Os came to be conducted in an intentional and institutional manner in the PC Business as well based on decisions made by Masaaki Oosumi CP and others below him where it was necessary to improve profit and loss.

A background of each C/O measure in the PC Business is described below.

(a) Intentional delay of the timing of the recording of operating expenses

Divisions engaged in domestic businesses had conducted Inappropriate C/Os involving intentional delay of the timing of the recording of operating expenses in order to postpone the occurrence of losses since April 2011.

In other words, since April 2011 divisions engaged in domestic businesses had conducted the Inappropriate C/O of delaying the recording of operating expenses until the next quarter by such methods as having suppliers delay until the next quarter the issuance of invoices for operating expenses that should be recorded in the current quarter when the divisions were in a difficult position in terms of profit and loss. Specifically, expenses for advertising through catalogs, the Internet, and sales promotions, etc., expenses in the form of payments to contractors for call centers, repair services, and infrastructure repair services, and expenses for dispatching personnel to explain exclusive Internet sales models that were accrued by divisions engaged in domestic businesses were, among other such expenses, subject to a delay in being recorded until the next period through such methods as having suppliers delay the issuance of invoices until the next period.

Because the poor state of profit and loss continued for the DS Company and the PCS Company subsequent to that, the intentional delay of the timing of the recording of operating expenses was continually conducted each quarter up until the fourth quarter of FY 2014 at a scale of almost approximately less than JPY 1.0 billion per quarter.

(b) Intentionally increasing the price of products sold to overseas distributors (FOB-UP)

Around May 2011, it was decided that the FOB-UP that had been conducted for the Visual Products Business (division) in Europe up until then would not be conducted. The division decided to cover for the deterioration of profit and loss by conducting FOB-UP in the PC Business, and at the business forecast determination meeting held on June 14, 2011, it was reported that the C/O amount for the PC Business would be increased by JPY 3.0 billion, and that was subsequently implemented. It then became to be recognized that, as a result, during the first quarter of FY 2011, FOB-UPs equivalent to approximately JPY 3.1 billion were conducted in the Europe-related divisions, and FOB-UPs equivalent to approximately JPY 1.2 billion were conducted in the US-related divisions, and that the profit for that quarter was overstated by that amount.

Once profits were recognized at a sales price that had been increased through FOB-UP, when the overseas distributors sold that product in the following period (quarter), the cost of sales was increased by the amount of that price increase, so an amount equivalent to the amount of the overstatement of profits through the FOB-UP was to be recognized as a profit and loss deterioration in the following period. For this reason, if the situation at that time did not permit a deterioration in profit and loss, then the FOB-UP conducted once in one period (quarter) ended up being conducted in the following period (quarter) as well. Accordingly, FOB-UPs were subsequently continually conducted up until the second quarter of FY 2014 as follows in order to improve apparent profit and loss in the PC Business.

FY 2011				FY 2012				FY 2013				FY 2014	
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
43	53	45	43	43	49	30	28	34	34	47	3	4	3

*The Q1 of FY 2011 includes FOB-UPs on products for the US.

The Q2 of FY 2011 includes FOB-UPs on products for the Middle East, Africa, and Russia (handled by TEG). The Q4 of FY 2013, Q1 of FY 2014, and Q2 of FY 2014 consists only of FOB-UPs on products for the Middle East and Africa.

Although the FOB-UP method was mainly used for transactions with TEG, FOB-UP for TEG on products for Europe was terminated, the final quarter it was used being the third quarter of FY 2013. This was due to the fact that use of the FOB-UP method required TEG to continually purchase inventory at a high purchase price, and it became no longer able to do so due to the deterioration of its financial position to the extent that continuation of FOB-UP could have caused TEG to become insolvent. Subsequently, FOB-UP in the PC Business was terminated in the second quarter of FY 2014, with the FOB-UP transactions involving products for the Middle East and Africa.

(B) Cause of inappropriate accounting treatments

As described above, it can be recognized that Inappropriate C/Os in the PC Business were fully commenced in April 2011 when the DS Company was founded through the merger of the DN Company, which had been engaged in the PC Business, and the VP Company, which had been engaged in the Visual Products Business, and that they were conducted in an intentional and institutional manner on an ongoing basis. Therefore, it can be considered that the cause for the occurrence of Inappropriate C/Os in the PC Business is the same as that previously described in relation to the Visual Products Business in Chapter 4.

Chapter 6. Accounting Treatment in Relation to Valuation of Inventory in the Semiconductor Business Focusing on Discrete and System LSIs

I. Scope of the Investigation

1. Subject period of the Investigation

The Investigation covered the period from FY 2008 to the third quarter of 2014. The fourth quarter of FY 2014 was excluded from the scope of the Investigation because it was covered by the annual audit conducted by the accounting auditor concurrently with the Investigation.

2. Scope of the Investigation

The scope of the Investigation consisted of the appropriateness of accounting treatments related to the valuation of inventory in the Semiconductor Business. Specifically, the following three points were reviewed based on the specific matters delegated by Toshiba.

- The appropriateness of the timing of the recording of loss from an accounting perspective for ASIC inventory disposed of (approximately JPY 4.5 billion; hereinafter, “**ASIC Inventory**”) and ASIC inventory not disposed of (approximately JPY 0.6 billion; hereinafter, “**Non-disposed ASIC Inventory**”) in FY 2013
- The appropriateness of the timing of the recording of loss from an accounting perspective for SRPJ inventory disposed of (approximately JPY 3.4 billion; hereinafter, “**SRPJ Inventory**”) and SRPJ inventory not disposed of (approximately JPY 3.0 billion, hereinafter, “**Non-disposed SRPJ Inventory**”) in FY 2013
- The appropriateness of cost calculations based on the front-end TOV revisions conducted during the period from FY 2011

II. Investigation method and procedures

1. Basic policy of the Investigation method

(1) Appropriateness of the timing of the recording of loss for ASIC Inventory and Non-disposed ASIC Inventory and SRPJ Inventory and Non-disposed SRPJ Inventory

From an accounting perspective, with respect to retained inventory, losses should be recorded not at the time of the disposal of the goods in question, but in a timely manner

when it is expected that sales will no longer be possible or when the net sales price falls below the acquisition cost. At the S&S Company, however, for most of this inventory, losses were recognized for accounting purposes for the first time at the time of disposal, so the timing of the recording of the loss is an issue.

The Independent Investigation Committee identified the details of the circumstances leading to the occurrence of the retentions for the relevant inventory through interviews with related persons and viewing related documents, and it asked questions about the basis of the company's decisions that did not conduct a devaluation treatment for accounting purposes in any accounting period up until disposal.

(2) The appropriateness of cost calculations in association with the front-end TOV revisions conducted the during period

The manufacturing process of the S&S Company's Semiconductor Business is divided into two processes: front-end and back-end.

The S&S Company has adopted a cost accounting that uses standard cost ("TOV"), which is calculated based on the plant utilization rate, material costs, and labor costs, etc., set out in the budget. The TOV is determined for each process, and cost variances (difference between the TOV and cost actually accrued) are also incurred for each process.

However, in the cost variance allocation calculation carried out each quarter at the S&S Company, the calculation is undertaken not by allocating the cost variance to each process, but instead by simply allocating the total sum of accrued cost variance for the front-end and back-end processes in one lump sum to "front-end term-end inventory" (term-end intermediate products), "back-end term-end inventory" (term-end completed products) and "cost of sales" (cost of completed products).

Although TOV was regularly revised on a semi-annual basis, from FY 2011, given that the reduction in plant utilization was anticipated to be far less than that stipulated in the budget, TOV for the front-end process was irregularly revised upward during the period. Thereafter, up until FY 2014, the TOV was irregularly revised upward many times during the applicable period, but in all cases the revision was reflected only in the front-end TOV, and not in the back-end TOV (no revision was made to back-end TOV).

Although the S&S Company employs a method for the calculation of allocations of cost variance such that cost variances are not allocated separately to front-end and back-end processes, on the other hand, it is possible that because the TOV, which is the basis for this allocation calculation, was lacking continuity between the front-end and the back-end as a result of reflections not being made in back-end TOV, the book values of the front-end term-end inventory, the back-end term-end inventory, and the cost of sales ended up becoming amounts that could not be regarded as appropriate.

In the process of the Investigation, the impact of not revising the TOV for the back-end at the time of revision of TOV for the front-end on the cost of sales and inventory was reviewed. In calculating the impact, the Independent Investigation Committee adopted a method for recognizing the difference between the application of an accurate cost calculation through the allocation of the cost variance to each process and the method actually applied by the S&S Company.

2. Investigation procedures

Investigations were conducted on the subject of investigation above from May 22, 2015 to July 20, 2015, mainly using the following procedures.

(1) Appropriateness of the timing of the recording of loss for ASIC Inventory and Non-disposed ASIC Inventory and SRPJ Inventory and Non-disposed SRPJ Inventory

- Understanding of the inventory valuation rules applied by all Toshiba companies and the S&S Company

- Interviews with related persons and acquisition of related materials on the circumstances leading to the relevant inventories being retained

- Obtaining sales plans for the relevant inventories at the time of production and subsequently at the end of each accounting period

- Comparison of the above sales plans with the sales results

- Review of the status of devaluation treatments at the end of each accounting period for the relevant inventory

(2) The appropriateness of cost calculations in association with front-end TOV revisions conducted during the period

- Confirmation of the cost calculation method applied by all Toshiba companies and the S&S Company

- Interviews with related persons and obtaining related materials on the circumstances leading to only the front-end TOV being revised during the period starting from FY 2011

- Obtaining and reviewing simulation (starting from FY 2008) sheet on the impact of the difference between the application of an accurate cost calculation through the allocation of the cost variance to each process and the method actually applied by S&S

III. Limitations and reservations of the Investigation

For the review of the appropriateness of the timing of the recording of losses for ASIC Inventory and Non-disposed ASIC Inventory and SRPJ Inventory and Non-disposed SRPJ Inventory, some data was not available for the sales plans, sales results, and manufacturing dates of the relevant inventory (due to the migration of the inventory management system to a new system during the subject period). Accordingly, the impact amount attributable to the fact that appropriate accounting treatment had not been conducted was calculated on the basis of certain assumptions.

IV. Facts identified in the Investigation

1. Overview of the S&S Company

The S&S Company manufactures semiconductors, products using semiconductors (LED, integrated circuits, flash memory, etc.) and storage products (hard disk drives, etc.).

Specifically, it is composed of the following five divisions and development centers (Advanced Memory Development Center, Advanced Discrete Development Center, Center For Semiconductor Research & Development, and System & Software Solution Center).

(i) Memory Division (division that supplies NAND-type flash memory technology as its core product)

(ii) Discrete Semiconductor Division (division that supplies product mainly in the four product groups of power device, white LED, small-signal devices, and photocouplers)

(iii) Mixed Signal IC Division (division responsible for analog products such as motors, power supply, and communications and that supplies products involving communication and image recognition)

(iv) Logic LSI Division (division working to strengthen technologies such as data transmission technology and low-power consumption technology and that proposes solutions and supplies products in the multi-media and mobile device field)

(v) Storage Products Division (division that supplies high quality and differentiated products applying advanced technologies in response to increasingly diverse storage devices)

Note that the Logic LSI Division and Mixed Signal IC Division used to be one division in the form of the former System LSI Division. Specifically, in January 2011 the System LSI Division was split into the Logic LSI Division and the Analog Imaging Division, and subsequently in July 2013 the Analog Imaging Division became the Mixed Signal IC Division.

2. ASIC Inventory and Non-disposed ASIC Inventory disposed of in FY 2013

(1) Accounting treatment in question and appropriateness thereof and the facts constituting the premises thereto

(A) Overview of ASIC Inventory disposed of and Non-disposed ASIC Inventory in the period ended September 2013

Originally, the Logic LSI Division (System LSI Division) mainly manufactured ASIC products, which are products for specific uses and specific customers. However, ASIC products were retained as inventory in cases such as when a customer would

make changes to parts used in their own products.

Note that ASIC products were not manufactured based on the receipt of a formal order from a customer, but rather were manufactured based on assumptions of the prospect of an order in consideration of factors such as communications with customers. This is explained as follows.

First, the key items of ASIC Inventory are explained. Around the end of 2010 and the beginning of 2011, in association with, among other things, a change in the microprocessor for final product A manufactured and sold by the S&S Company's business partner Company A, an order for an ASIC product used in that microprocessor was suspended. Although that ASIC product had been a product for a specific use for a specific customer related to the manufacturer of that microprocessor, it could also be used for televisions and PCs, so sales activities were conducted to promote its use even after that order was suspended. However, in reality it was difficult to sell, and considerable numbers of the product remained in inventory (note that this inventory was one of the 18 key product types in (C) below and accounts for approximately one-third of ASIC Inventory (total of approximately JPY 4.5 billion)).

In addition, ASIC Inventories other than that were ASIC products that were for other companies but that were retained in inventory due to factors such as differences in demand expectations (for example, cases in which demand for big-screen TVs fell significantly below expectations) and switches from Toshiba products. (Note that, as stated in (B) below, a decision was made to shift from ASIC products to the ASSP products described below in March 2013, but this shift had been considered within the Logic LSI Division before that. For this reason, there were also circumstances where to some degree ASIC products were stockpiled in anticipation of this shift.)

(B) Disposal of inventory

At the S&S Company's FY 2013 Company budget review meeting held on March 11, 2013, a decision was made to shift from the former ASIC products to general purpose ASSP products for the products manufactured by the Logic LSI Division. Accordingly, in response to this decision, at the Top Management Liaison Meeting held on September 17, 2013, a decision was made to dispose of inventory consisting of approximately 7,000 of the ASIC product items that had been retained, and accounting treatment for this disposal (recording the entire book value amount as a disposal loss) was conducted during the second quarter of FY 2013 in connection with their disposal (the inventory disposed of based on this decision was ASIC Inventory, equivalent to a total of approximately JPY 4.5 billion).

Note that this disposal decision was reported at the CEO Monthly Meeting as well.

Furthermore, during the course of the Investigation, it was found that there is currently approximately JPY 0.6 billion of inventory that has not been disposed of (Non-disposed ASIC Inventory) despite the fact that it was being retained in the same manner as the ASIC Inventory (despite the fact that it was included in the scope of the approximately 7,000 types of applicable product).

Note that the ASIC Inventory and the Non-disposed ASIC Inventory included both inventory as manufacturing inventory and inventory as sales inventory.⁹¹

(C) State of changes in and sales of ASIC products

The changes in inventory relating to ASIC products (approximately 7,000 types of product) are as follows, and inventory barely decreased from FY 2009 to FY 2012, before disposal was carried out.

ASIC inventory changes (JPY 100 million)

Inventory amount	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
18 key product types	37	46	36	35	6
Others	15	15	15	15	-
ASIC inventory amount total	51	60	50	50	6

(D) Sales plans at the time for ASIC products

While there were sales plans created based on sales forecasts for customer products (final products) developed at the time of budgeting for each fiscal year for the ASIC products (approximately 7,000 types of product), sales results became to be zero or low and fell dramatically below the sales plans at the time because of factors such as a drop in the production volume of customer products or a switch to products other than Toshiba products.

The table below shows some of the sales plans and sales results for a key product.

Comparison of the sales plans and sales results for a key product (one of the 18 key product types (JT5CX2-AS))

Unit: JPY 100 million

Sales plan	Second half of FY 2009	FY 2010	FY 2011	FY 2012	FY 2013

⁹¹ (i) “Sales inventory” means inventory that is “Sales Managed Inventory”, in other words, inventory the quality inspection of which has been completed and that is in the warehouse and is therefore under the management of the sales department, and (ii) “manufacturing inventory” means “Factory Managed Inventory”, in other words, inventory for which the process above has not been completed and that is still under the management of Operations.

<u>Sales plan</u>					
FY 2009	56	88	29	-	-
FY 2010	-	72	160	-	-
FY 2011	-	-	82	32	-
FY 2012	-	-	-	-	-
<u>Sales results</u>	94	142	-	-	-

(E) Accounting treatment in question

Among the ASIC Inventory and the Non-disposed ASIC Inventory, while a majority of sales inventory⁹² was devalued in accordance with the S&S Company's devaluation rules (described in (2)(A)(a) below), the manufacturing inventory had not gone through any devaluation procedure whatsoever. Note that both the sales inventory and the manufacturing inventory portions of the ASIC Inventory were physically disposed of in the second quarter of FY 2013, and at that point a loss was recorded as structural reform costs (devalued down to zero).

As described in (2)(B)(a) below, according to generally accepted corporate accounting standards, for inventory retained outside of the normal operating cycle or inventory planned for disposal, etc., where it is difficult to derive a reasonably calculated value, instead of writing the inventory down to a net sales price, one of the following methods should be applied, depending on the situation:

- (1) A method of devaluing book value to the expected disposal value (including zero or a memorandum value); or
- (2) A method of regularly devaluing the book value where the turnover period exceeds a certain threshold level

Accordingly, the ASIC Inventory and the Non-disposed ASIC Inventory should have been devalued through either method (1) or (2) above, but for practical purposes, method (1) should have been used for inventory for which sales plans can be established (inventory for which it was reasonably possible to decide there was a possibility of being sold), in other words, the book value of such inventory should have been devalued to the expected disposal value (including zero or a memorandum value) once

⁹² While sales inventory accounted for approximately JPY 1.9 billion of the ASIC Inventory (approximately JPY 4.5 billion), JPY 1.85 billion of this was classified other than as "Active," as described below, and was devalued in accordance with the S&S Company's devaluation rules. In the same manner, while sales inventory accounted for approximately JPY 0.3 billion of the Non-disposed ASIC Inventory (approximately JPY 0.6 billion), JPY 0.25 billion of this was classified other than as "Active," as described below and was devalued in accordance with the S&S Company's devaluation rules.

sales could no longer be expected in consideration of sales plans, etc., and a valuation loss should have been recorded. Accordingly, the recording of loss by the S&S Company described above can be considered to be inappropriate.

Further details of this are described in the section on the causes of inappropriate accounting treatment in (2) below.

(F) The amount of impact resulting from the inappropriate accounting treatment

Because the inventory in question is inventory for which sales plans could be established (inventory for which it is reasonably possible to decide whether there is a possibility of being sold), the Independent Investigation Committee has made revisions through the method stated in (E) above (writing down the book value of the inventory to the expected disposal value (including zero or a memorandum value) once sales could no longer be expected in consideration of sales plans, etc.). The amounts of impact, set out below, were then calculated for the ASIC products (approximately 7,000 types of product) by comparing the ASIC inventory balance and sales results for each product at the end of each fiscal year in the past and devaluing inventory for which sales could no longer be expected to a book value of zero at the end of that fiscal year.

Unit: JPY 100 million

Profit and loss adjustment amount	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	Total
Valuation loss recorded (18 key product types)	(18)	(16)	(1)	(0)	(1)	(36)
Valuation loss recorded (Other)	(15)	-	-	-	-	(15)
Reversal of disposal loss	-	-	-	-	45	45
Total profit and loss adjustment amount	(32)	(16)	(1)	(0)	44	(6)

Note: Because there are approximately 7,000 types of the applicable ASIC products, it was difficult to aggregate the sales results data at the end of each past fiscal year

necessary for the calculation of the amount of impact due to a proper devaluation of all items. Therefore, in consideration of the fact that the valuation loss for the 18 key product types would have mostly been recorded in FY 2009 and FY 2010, for the ASIC inventory other than the 18 key product types (approximately JPY 1.5 billion), the amount of impact was calculated based on the assumption of bulk devaluation in FY 2009.

(2) Causes of inappropriate accounting treatments

(A) Assumptions (valuation loss recording rules at Toshiba)

As described above, the book value of inventory should have been devalued to expected disposal value (including zero or a memorandum value) once sales can no longer be expected in consideration of sales plans, etc., and as stated in (1)(F) above, ASIC Inventory and Non-disposed ASIC Inventory was not devalued despite the fact that it should have been.

Because Toshiba's accounting rules become relevant in relation to the analysis of the causes as to why devaluation was not appropriately conducted, the rules for recording valuation losses on inventory at Toshiba will firstly be reviewed below.

(a) Inventory devaluation rules

a. Devaluation rules for slow-moving inventory stipulated by the Corporate Finance & Accounting Division

Toshiba's Accounting Manual stipulate to the effect that if "slow-moving inventory, etc., outside of the normal operating cycle" must be held for a long period of time, it must be devalued to the "value calculated through multiplication by the devaluation rate for each of the number of years it is held" (Article 6 (3), Article 58 Paragraph 1 (3)), and based on these Accounting Manual the Corporate Finance & Accounting Division issued a notice on December 27, 2008 to the General Manager of each Company Finance & Accounting Division and the managers in the accounting department at each complex and operations, stating in relation to "inventory subject to devaluation" to the effect that "in comparison to mass production parts and inventory parts that are in the normal operating cycle, inventory (maintenance and service parts, etc.) that is managed under the name of maintenance parts, service spare parts, and warranty spare parts, etc., and held for maintenance and service purposes and that must be held over a long period of time due to relationships with clients and restraints on the performance of business, etc. (arrangements, etc. with the Ministry of Economy, Trade and Industry and industry organizations) can be considered to correspond to inventory such as slow-moving inventory outside of the normal operating cycle." That notice stipulated regarding maintenance and service parts, etc., that "for inventory with a retention period of two years or more, the amount of valuation loss should be calculated by multiplying that inventory by the devaluation rate for the number of years it has been held" and indicated the following devaluation rates for each number of years such inventory is held.

Item	Period held (retention period)					
	Less than 2 years	2 years or more	3 years or more	4 years or more	5 years or more	6 years or more
		Less than 3 years	Less than 4 years	Less than 5 years	Less than 6 years	
Devaluation rate	0%	20%	40%	60%	80%	100%

b. Devaluation rules for slow-moving inventories stipulated by the S&S Company

In response to the above-mentioned notice from the Corporate Finance & Accounting Division, the S&S Company Finance and Accounting Division stipulated, in a notice dated March 31, 2009, that “while manufacturing inventory and sales inventory is generally within the scope of valuation, for our Company and the companies under its umbrella, manufacturing inventory is outside the scope of revaluation, excluding special exceptions.” Placing manufacturing inventory outside the scope of the devaluation rules in this manner is a point unique to the S&S Company in contrast to other Companies, but as the background to this, there is the fact that (i) maintenance and service parts, etc., were held as sales inventory at the S&S Company as a general rule and (ii) while X maintenance and service parts, etc., were held exceptionally as manufacturing inventory, because they would almost certainly be purchased through normal commercial practice and the sales price at the time of sale was almost guaranteed, it was deemed that the circumstances would not directly lead to a decline in profitability

In addition, at the S&S Company, inventory for semiconductor parts was classified and managed under the classifications of “Discontinue,” “Phase-out,” “Obsolete,” and “Active,” and the first three of these classifications were regarded as corresponding to maintenance and service parts, etc.

For this reason, under the S&S Company’s rules, only sales inventory classified as “Discontinue,” “Phase-out,” or “Obsolete” were regarded as being subject to the devaluation rules (these rules are hereinafter referred to as the “S&S Company’s Devaluation Rules”).

c. Persons who determined the classification of inventory

As described in a and b above, ultimately whether or not devaluation was conducted based on the S&S Company’s Devaluation Rules was determined based on whether or not the inventory constituted sales inventory and whether or not it was classified other than as “Active” (with inventory first becoming subject to devaluation only if both of the above are affirmative).

According to this concept, whether or not inventory constitutes sales inventory is as a general rule determined based on objective criteria, rather than the judgment of personnel. On the other hand, whether or not inventory is classified as “Active” (specifically, semiconductor inventory is normally classified as “Active” when it is manufactured, so the question is whether or not it should be shifted from “Active” to “Discontinue”) is determined at EOL Meeting held once every three months. Specifically, applicable parts are proposed by the sales promotion departments in each division, and a decision is made by the S&S Company sales supervision department (Electronic Devices & Storage Sales Center) at those meetings.

(b) Valuation loss recording rules other than (a) above

At Toshiba, while in the event of the physical disposal of inventory, the entire book value is recorded as a loss, other than (a) above there were no accounting rules or de facto rules stipulating that the book value of inventory should be devalued to the expected disposal value (including zero or a memorandum value) once sales could no longer be expected in consideration of sales plans, etc.

(B) Direct causes of inappropriate accounting treatments

(a) Contents of the S&S Company’s Devaluation Rules

The ASIC Inventory and the Non-disposed ASIC Inventory included both manufacturing inventory and sales inventory. The majority of sales inventory fell under classifications other than “Active” and was devalued in accordance with the S&S Company’s Devaluation Rules, but on the other hand, because manufacturing inventory was not subject to the S&S Company’s Devaluation Rules, devaluation based on these rules was not conducted for manufacturing inventory (subsequently, a loss (book value devalued to zero) was recorded on both sales inventory and manufacturing inventory components with respect to the ASIC Inventory when it was physically disposed of in the second quarter of FY 2013).

However, the S&S Company’s Devaluation Rules differ from the general corporate accounting rules as described below, and this fact can be recognized as the direct cause of the inappropriate accounting relating to the ASIC Inventory and the Non-disposed ASIC Inventory. Specifically, although the valuation of slow-moving inventory is also provided for in general corporate accounting rules, under those rules, for slow-moving inventory outside of the normal operating cycle or inventory planned for disposal, etc., where it is difficult to derive a reasonably calculated value, instead of writing the inventory down to a net sales price, one of the following methods should be applied, depending on the situation:

- (1) A method of devaluing book value to the expected disposal value (including zero or a memorandum value); or
- (2) A method of regularly devaluing the book value where the turnover period exceeds a certain threshold level

On the other hand, the S&S Company's Devaluation Rules were not appropriate on the following points with respect to determining the assets subject to devaluation and the method for calculating the devaluation amount:

(i) Assets subject to devaluation

Under general corporate accounting rules, assets subject to devaluation (irrespective of whether manufacturing inventory or sales inventory) are regarded as "slow-moving inventory that is outside of the operating cycle or inventory planned for disposal," but under the S&S Company's Devaluation Rules, manufacturing inventory is excluded from the scope of devaluation, and on that point it can be considered to be not appropriate.

(ii) Method of calculating the devaluation amount

As a method for calculating the devaluation amount, the S&S Company's Devaluation Rules provide for only a method of calculation multiplication by the devaluation rate based on the number of years the asset is held (equivalent to (2) above), and they do not provide for a "method of devaluing book value to the expected disposal value (including zero or a memorandum value)" (equivalent to (1) above), which should be applied where there is almost no prospect for selling it, and it can be considered to be not appropriate in this respect.

For these reasons, it can be recognized that inappropriate accounting relating to the ASIC Inventory and the Non-disposed ASIC Inventory was conducted as follows.

(i) Manufacturing inventory

Manufacturing inventory was excluded from the scope of the S&S Company's Devaluation Rules, and for this reason manufacturing inventory was not devalued appropriately.

(ii) Sales inventory

While sales inventory was included in the scope of the S&S Company's Devaluation Rules, the rules did not provide for the "method of devaluing book value to the expected disposal value (including zero or a memorandum value)." For this reason, appropriate devaluation was not conducted.

(b) Whether or not the recording of valuation losses were intentionally postponed

As described above, there were problems with the contents of S&S Company's Devaluation Rules, but in theory, it is also possible to intentionally delay accounting treatment (the recording of valuation losses) using these problems. Specifically, it is possible to purposely not complete the quality inspection for inventory that should be classified as sales inventory and leave it as manufacturing inventory in order to remove it from the scope of devaluation, but in order to do so, it would be necessary to adjust the timing of the quality inspections and warehouse entry, and it can be considered to be extremely difficult to do so in consideration of the actual work in the manufacturing workplace.

Furthermore, no evidence was found which indicates that the problems in the S&S

Company's Devaluation Rules were used to intentionally delay accounting treatment (the recording of valuation losses).

(C) Indirect causes

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment for this case.

(a) Internal control in the Company

While the Finance and Accounting Division is in a position of being able to perform a checks and balances function independent from the divisions, no evidence was found indicating that the Division made indications, etc., to the effect that there were problems within the S&S Company's Devaluation Rules.

Furthermore, there was no particular internal audit department within the Company.⁹³ For this reason, internal control within the Company was not functioning sufficiently.

(b) Internal control at Corporate

While the Corporate Finance & Accounting Division should also be in an independent position capable of performing a checks and balances function, no evidence was found that the Division pointed out any issue, etc., to the effect that there were problems within the S&S Company's Devaluation Rules.

(c) Other

No facts were found indicating that the Corporate Audit Division, the Audit Committee, or the accounting auditor pointed out any issue regarding this matter.

3. SRPJ Inventory and Non-disposed SRPJ Inventory disposed of in FY 2013

(1) Accounting treatment in question and appropriateness thereof, and the facts constituting the premises thereto

(A) SRPJ Inventory and Non-disposed SRPJ Inventory disposed of in the period ended March 2014

⁹³ However, the Company Business Strategy & Planning Division provide support for the internal audits of related companies controlled by the Companies that are not included within the scope of the audit by the Corporate Audit Division.

At the management meeting held on December 22, 2008, Toshiba made a decision to close the Kitakyushu Operations (this closure constitutes one of the SRPJ).

At the Kitakyushu Operations, mainly X parts were manufactured by the System LSI Division and the Discrete Semiconductor Division, and the production of these parts was continued after transfer to the Oita Operations (however, the manufacturing of some parts was discontinued). Due to the nature of X parts being installed in final products B, it was essentially unacceptable for there to be a shortage of parts, while on the other hand it was contemplated that considerable time would be required for the transfer site, the Oita Operations, to receive the certification of the manufacturer of final products B (in accordance with the system at manufacturer of final products B, deliveries could only be accepted for parts manufactured at plants certified by the manufacturer of final products B as having appropriate quality control systems in place (certified operations)). Accordingly, the transfer of the manufacturing location would require the stockpiling of a considerable number of products (inventory), but this would normally entail holding discussions with the client, the B parts manufacturers (manufacturers that uses X parts delivered by Toshiba to manufacture parts used in final products B), estimating the required number of products, and stockpiling them. For this reason, from around February 2009, Toshiba requested clients to indicate the required number of products. However, because the manufacturer of final product B and the B parts manufacturer had a strong sense of distrust in response to the Operations closure, and because there was only a short period of time to respond, Toshiba was not able to receive clear instructions on the necessary number of parts. Therefore, stockpiling was conducted by deciding on the number of parts to be stockpiled after contemplating internally how many parts could probably be sold in the future based on factors such as the instincts of sales personnel that had conducted negotiations with the clients, past sales results, and the period until the closure of the Kitakyushu Operations (the production capacity of the Kitakyushu Operations). This stockpiling started from around February 2010 and was completed by May 2011 at the latest.

(B) Disposal of inventory

However, because the actual sales of X parts that were stockpiled fell significantly short of the number that the S&S Company was contemplating it would probably be able to sell, the inventory of these X parts became retained from May 2011 (note that the inventory of System LSI Division was taken over by the Mixed Signal IC Division through the Analog Imaging Division).

Due to the deterioration of the relationship with the client (B parts manufacturers) as described above, a situation continued in which it was not possible to sufficiently discuss with the client matters such as the number of X parts required and order plans. However, in FY 2013 Toshiba confirmed the necessity of each X part with clients (including whether or not inventory disposal would be possible). As a result, a decision was made to dispose of inventory for which written consent for disposal was received from clients and inventory that could be expected to be unnecessary (could be

disposed of without any problems) by sales personnel.

Specifically, at the Top Management Liaison Meeting held on March 31, 2014, a decision was made to dispose of a total of approximately JPY 3.4 billion⁹⁴ of the X parts (the SRPJ Inventory) described above that had been retained, and the accounting treatment was also conducted for this inventory (the recording of valuation losses).

Note that this decision to dispose of SRPJ Inventory was also reported at the CEO Monthly Meeting (although the disposal amount was inaccurate).

Furthermore, among the X parts stockpiled accompanying to the closure of the Kitakyushu Operations, there is currently approximately JPY 3.0 billion of inventory that has not been disposed of (the Non-disposed SRPJ Inventory).

Note that the SRPJ Inventory is all manufacturing inventory, and the Non-disposed SRPJ Inventory includes both manufacturing inventory and sales inventory.

(C) Changes in inventory of X parts that were stockpiled

The changes in the balance of inventory of X parts that were stockpiled accompanying to the closure of the Kitakyushu Operations is shown as follows, and disposal barely decreased until the inventory was disposed of.

Changes in Balance of SRPJ Inventory⁹⁵

Item	FY			
	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Inventory held				
Discontinued parts	33	29	24	20
Oita Operations replacement parts	14	12	11	10
Subtotal	47	41	35	30

⁹⁴ While the amount in the accounts was JPY 3.4 billion, this amount included inventory held by the Discrete Semiconductor Division and inventory held by the Mixed Signal IC Division, and there are discrepancies between the two because figures after the front-end TOV revisions conducted during the period had been used for the former and figures before the front-end TOV revisions conducted during the period had been used for the latter (the problematic nature of and accounting impact amount for front-end TOV revisions conducted during the period is described below). The amount is approximately JPY 3 billion if all figures are calculated before the TOV revisions.

⁹⁵ This amount excludes the impact of TOV revisions conducted during the period (it is an amount calculated based entirely on figures before the TOV revisions).

Disposal (disposed of in FY 2013)				
Discontinued parts	25	25	-	-
Oita Operations replacement parts	5	5	-	-
Subtotal	30	30	-	-
Total	77	70	35	30

(D) S&S Company’s Devaluation Rules for slow-moving inventories

As stated in 2(2)(A)(a) above, the S&S Company’s Devaluation Rules only apply for sales inventory, and manufacturing inventory was outside the scope of these rules.

(E) Accounting treatment in question

Among the Non-disposed SRPJ Inventory, while a majority of sales inventory⁹⁶ was devalued in accordance with the S&S Company’s Devaluation Rules, because all of the SRPJ Inventory was manufacturing inventory, it had not gone through any devaluation procedure at all. Note that the SRPJ Inventory was physically disposed of in the fourth quarter of FY 2013, and it was recorded a loss as non-operating expenses (devalued down to zero).

As described in 2(1)(E) above, in accordance with general corporate accounting rules and practice conducted based on such rules, slow-moving inventory that is outside of the operating cycle and is the sort of inventory for which sales plans can be established (inventory for which it is reasonably possible to decide there is a possibility of being sold) should be recorded as a valuation loss through the method of devaluing book value to expected disposal value (including zero or a memorandum value); in other words, the book value of this inventory should be devalued to the expected disposal value (including zero or a memorandum value) once sales could no longer be expected in consideration of sales plans, etc. However, if there are circumstances such as it not being possible to establish sales plans and sales expectations are unclear as a result (such cases as where it is not reasonably possible to decide there is a possibility of being sold), it can be allowed to regularly devalue to book value when the turnover period exceeds a certain threshold level.

For the SRPJ Inventory, revising (establishing) sales plans was extremely difficult due to the circumstances described above, and accordingly, it can be said that in some

⁹⁶ While sales inventory accounted for approximately JPY 0.9 billion of Non-disposed SRPJ Inventory (approximately JPY 3 billion), the majority of it was classified other than as “Active” (compared to JPY 24 billion classified as “Active”) and was devalued in accordance with S&S Company’s Devaluation Rules.

cases it was not possible to reasonably decide whether or not it was possible to sell the inventory. In other words, normally a reasonable estimate would be made of future sales expectations through discussions, etc. with customers and sales plans would be established (revised) based on these estimates. However, due to the deterioration of relationships with clients as a result of factors including a strong sense of distrust among clients (B parts manufacturers) in response to the closure of the Kitakyushu Operations, a situation continued in which it was not possible to sufficiently discuss with clients matters such as the number of X parts required and order plans, and this made it impossible to estimate sales volumes and establish (or revise) sales plans for the SRPJ Inventory and the Non-disposed SRPJ Inventory; in other words, it was not possible to reasonably decide whether or not it was possible to sell this inventory.

Therefore, a valuation loss should have been recorded on this SRPJ Inventory and the Non-disposed SRPJ Inventory using a method of regularly devaluing the book value where the turnover period exceeds a certain threshold level (method (2) of the general corporate accounting rules described above).

In response, in this case, for the majority of Non-disposed SRPJ Inventory that was sales inventory, devaluation in accordance with the S&S Company's Devaluation Rules (recording of valuation losses through a method of regularly devaluing the book value) was not conducted. Accordingly, it cannot be identified that inappropriate accounting treatment was conducted on sale inventory. On the other hand, the Non-disposed SRPJ Inventory that was manufacturing inventory and the SRPJ Inventory (all of which was manufacturing inventory) had not gone through any devaluation procedure. Accordingly, it can be said that appropriate accounting treatment was not conducted for this manufacturing inventory.

Specifically, the S&S Company should have applied inventory devaluation rules to manufacturing inventory as well in the same manner as other Companies (valuation losses should have been recorded through a method of regularly devaluing the book value)^{97 98}; in other words, the S&S Company's Devaluation Rules should have also applied by regarding manufacturing inventory as falling within their scope. Note that because the SRPJ Inventory and the Non-disposed SRPJ Inventory were stockpiled in light of the circumstances described above, it can be considered that it is possible to say that it would not have been completely appropriate for the S&S Company's Devaluation Rules, which did not contemplate this form of stockpiling, to have been applied by regarding manufacturing inventory as falling within their scope. However, as the very fact of not conducting any valuation whatsoever on the grounds that Toshiba had not developed devaluation rules that contemplated stockpiled inventory is also not appropriate, it can be recognized to have a degree of reasonableness in the application of the S&S Company's Devaluation Rules as that method.

⁹⁷ Although other Toshiba Companies adopt rules for regularly devaluing the book value depending on the retention period, in contrast to the S&S Company's Devaluation Rules, the rules of other Companies apply also to manufacturing inventory.

⁹⁸ As described above, the exclusion of X parts manufacturing inventory from the scope of the S&S Company's Devaluation Rules is based on the assumption that they would almost certainly be purchased through normal commercial practice and the sales price at the time of sale was almost guaranteed. However, the SRPJ Inventory was disposed of because there had ceased to be any prospect for selling them to clients, and this assumption had already ceased to hold.

This point will also be discussed in the section on the cause of inappropriate accounting treatment in (2) below.

(F) The amount of impact resulting from the inappropriate accounting treatment

If the S&S Company’s Devaluation Rules had also been applied to manufacturing inventory, the amount of impact resulting from the inappropriate accounting treatment⁹⁹ is as follows (note that as described above, while the amount of sales inventory classified as “Active” was extremely small, the S&S Company’s Devaluation Rules were not applied on this inventory).

Amount of impact on profit and loss of inventory held

Inventory held	FY			
	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Reversal of disposal	-	-	-	-
Reversal of existing valuation loss	-	(0)	1	1
Valuation loss recorded	-	(2)	(5)	(1)
Adjustment amount of profit and loss	-	(2)	(4)	(1)

⁹⁹ In order to avoid duplication with the accounting amount of impact due to issues with the front-end TOV revisions conducted during the period described below, the amounts of recorded valuation losses shown in the table have been calculated based on figures excluding the impact of TOV revisions conducted during the period.

Amount of impact on profit and loss of disposal

Disposal	FY			
	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Reversal of disposal loss	-	-	34	-
Reversal of existing valuation loss	-	-	-	-
Valuation loss recorded	-	(6)	(28)	-
Adjustment amount of profit and loss	-	(6)	6	-

Total amount of impact on profit and loss of inventory held and disposal

Total	FY			
	FY 2011	FY 2012	FY 2013	FY 2014 Q3
Reversal of disposal	-	-	34	-
Existing valuation loss adjustment	-	(0)	1	1
Valuation loss recorded	-	(8)	(32)	(1)
Adjustment amount of profit and loss	-	(8)	2	(1)

Note: In accordance with the S&S Company's Devaluation Rules, devaluation is conducted step by step based on the retention period, and this retention period is

calculated starting from the last time the product was transferred¹⁰⁰ or the manufacturing date, whichever date is more recent (note that such transfers also include not only transfer from the front-end inventory to the back-end but also transfers to other operations). However, for actual transfer records and manufacturing date of the Discrete Semiconductor Division, as a result of the impact of the migration to a new system, while it was possible to obtain information from October 2012, it was not possible to obtain information from before that. For this reason, it is assumed that all SRPJ inventory had been manufactured as of the end of September 2010, which was the timing for the completion of production for half of the total stockpiled lot volume in the production plan prepared in June 2010, and that there were no transfers for any products from the end of September 2010 to October 2012. In addition, for the Mixed Signal IC Division, as a result of the impact of the migration to a new system, while it was possible to obtain information from October 2012 for manufacturing dates and from October 2011 for transfer records, it was not possible to obtain information for these items from before that. For this reason, in the same manner as for the Discrete Semiconductor Division, it is assumed that all SRPJ inventory had been manufactured as of the end of September 2010, and that there were no transfers for any parts from the end of September 2010 to October 2011.

Note: Front-end TOV revisions were conducted during the period for both SRPJ Inventory and Non-disposed SRPJ Inventory, and as described below, there were accounting issues with these TOV revisions. Accordingly, the inventory valuation amount has been modified assuming the inventory valuation amount before such TOV revisions.

(2) Causes of inappropriate accounting treatments

(A) Direct causes

(a) Direct causes of inappropriate accounting treatments

The direct causes of inappropriate accounting treatments for the SRPJ Inventory and the Non-disposed SRPJ Inventory are similar to the case of the ASIC Inventory and the Non-disposed ASCI Inventory.

In other words, the Non-disposed SRPJ Inventory that was manufacturing inventory and the SRPJ Inventory (all of which was manufacturing inventory) had not gone through any devaluation procedure and therefore an appropriate accounting treatment

¹⁰⁰ Under the S&S Company's Devaluation Rules, the retention period is calculated starting from the final transfer date. Assuming this calculation method, even in cases of the holding of large volumes of surplus inventory requiring a long period of time for consumption, the possibility cannot be denied that the inventory is excluded from the scope of devaluation through the sale of small volumes of inventory, for example samples. It can be considered to be necessary to also consider revising the method for calculating the retention period in the future depending on the actual situation at the S&S Company.

had not been conducted. While manufacturing inventory was not devalued because it was excluded from the scope of the S&S Company's Devaluation Rules, the fact that manufacturing inventory was excluded from the scope of the S&S Company's Devaluation Rules, to begin with, was not appropriate in light of general corporate accounting rules, as described in 2(2)(A)(a) above.

(b) Intentional postponement of recording of valuation losses

As a result of the Investigation, no evidence was found to suggest an intent to postpone the recording of valuation losses.

(B) Indirect causes

In addition to the causes set out above, the following can be listed as indirect causes for the inappropriate accounting treatment for this case.

(a) Internal control in the Company

While the Finance & Accounting Division should be in a position of being able to perform a checks and balances function independent from the divisions, no evidence was found which indicates that the Division made indications, etc. to the effect that there were problems within the S&S Company's Devaluation Rules.

Furthermore, there was no particular internal audit department within the Company. For this reason, internal control in the Company was not functioning sufficiently.

(b) Internal control at Corporate

While the Corporate Finance & Accounting Division is also in an independent position capable of performing a checks and balances function, no evidence was found that the Division made any indications, etc. to the effect that there were problems within the S&S Company's Devaluation Rules.

(c) Others

No fact was found that any indication was made concerning this case by the Corporate Audit Division, the Audit Committee, or the accounting auditor.

4. Cost calculation associated with the front-end TOV revisions conducted during the period

(1) Accounting treatment in question and appropriateness thereof

(A) Cost calculation in the Semiconductor Business

For the Semiconductor Business, the S&S Company has adopted a cost calculation that uses TOV, which is calculated based on the plant utilization rate, material costs, and labor costs, etc., set out in the budget. On the other hand, the manufacturing process of the Semiconductor Business is divided into two processes, front-end and back-end, and TOV is determined for each process, and cost variances (difference between TOV and cost actually accrued) are also incurred for each process.

However, in the cost variance allocation calculation¹⁰¹ carried out each quarter at the S&S Company, the cost variance is not allocated to each process, but instead the total sum of the accrued cost variance for the front-end and back-end processes is simply allocated in one lump sum to “front-end term-end inventory” (term-end intermediate products), “back-end term-end inventory” (term-end completed products) and “cost of sales” (cost of completed products)¹⁰² (hereinafter, this method is referred to as the “Combined Allocation Method”).

Under the Combined Allocation Method, the accrued costs variances for the back-end process are allocated to front-end term-end inventory, which normally they should not be allocated to, and accordingly it is not a rigorous calculation method. More specifically, an example of a rigorous calculation method would be a method in which cost variances are classified according to either back-end process or front-end process and then allocated to its respective process (hereinafter, this method is referred to as the “Process-Specific Allocation Method”). However, the Combined Allocation Method can also be regarded as one of the cost calculation method that is acceptable as a simplified method when there are no abnormal circumstances such as significant changes in costs.

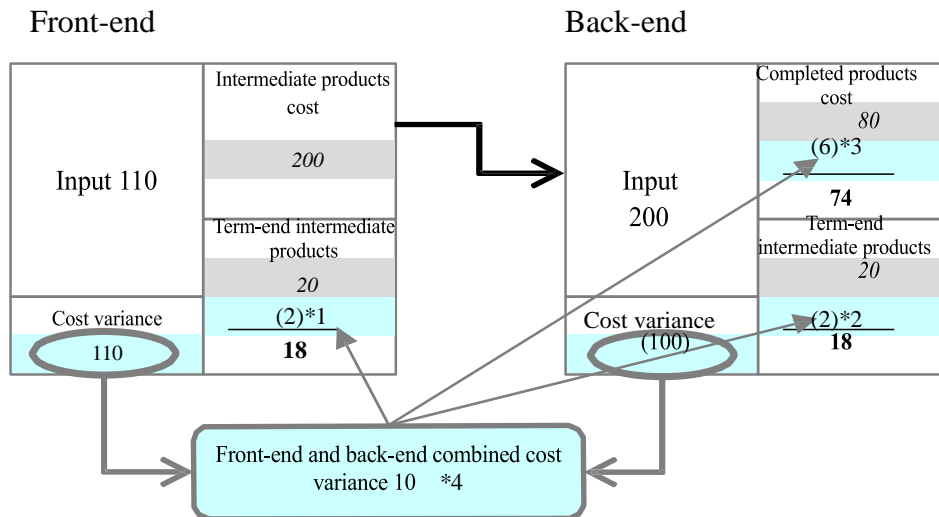
¹⁰¹ “Cost variance allocation calculation” means an accounting treatment where an adjustment is made from TOV to actual cost by allocating (distributing) the variance between the TOV calculated based on the budget and the costs actually accrued (cost variance) to cost of sales and inventory calculated based on TOV as of the closing of accounts.

¹⁰² The sums allocated to “front-end term-end inventory,” “back-end term-end inventory” and “cost of sales” are proportional to the amounts calculated based on the TOVs respectively (based on the proportions of each amount).

Calculation Method to Allocate Cost Variance

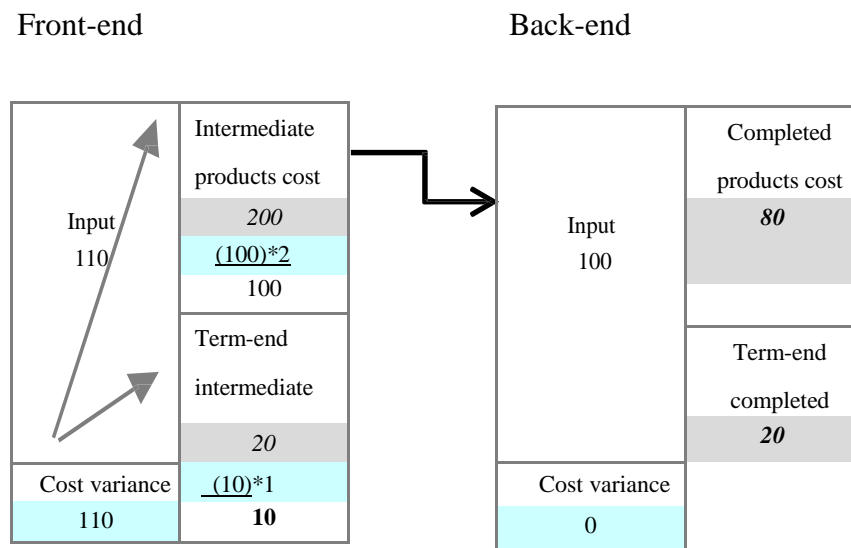
Standard cost is in italics

- Combined Allocation Method (the company's treatment)



- *1. Amount allocated for intermediate products (2) = front-end and back-end cost variance (10) / (intermediate products 20 + completed products cost 80) x intermediate products 20
- *2. Amount allocated for completed products (2) = front-end and back-end cost variance (10) / (intermediate products 20 + completed products 20 + completed products cost 80) x completed products 20
- *3. Amount allocated for completed products cost (6) = front-end and back-end cost variance (10) - amount allocated for intermediate products (2) - amount allocated for completed products (2)
- *4. Because this is the cost variance which is incurred due to standard cost being more than actual cost, it is a downwards adjustment in the allocation calculation (adjustment from standard cost to actual cost).

- Process-Specific Allocation Method (more elaborate method)



*1. Amount allocated for intermediate products (10) = cost variance (110) / (intermediate products cost 200 + intermediate products 20) x intermediate products 20

*2. Amount allocated for intermediate products cost (100) = cost variance (110) - amount allocated for intermediate products (10)

(B) Accounting treatment in question

While the S&S Company determines TOV for each product in its Semiconductor Business, Toshiba's Accounting Manual stipulate, in relation to TOV revisions, that "In principle, TOV revisions shall be conducted once a year prior to budgeting, and revisions shall not be conducted during the same budget period, excluding special cases" (Article 66(iii)1). However, in actuality, revisions are conducted twice per year, at the beginning of the first quarter (April) and the beginning of the third quarter (October).

Under these circumstances, because it was expected that the plant utilization rate at the Yokkaichi Operations (Memory Division) would decline dramatically more than the levels budgeted for at the beginning of the period, the front-end TOV was irregularly revised (upward: 154%) during the period. The TOV for the back-end should also have been revised together with any revision to the TOV for the front-end revised in a normal situation to maintain continuity in the standard cost between the front-end and the back-end, but TOV for the back-end was not revised (the revision was not reflected in the TOV for the back-end). As a result, continuity in the standard cost for the front-end and the back-end was lost. Furthermore, because the TOV for the back-end was not revised in this case, a large amount of cost variance was incurred. (Subsequently, in the period from the fourth quarter of FY 2011 to the fourth quarter of FY 2014, each division irregularly conducted TOV revisions during the period only to

the front-end, and similar situations arose in each division. The history of TOV revisions made during the periods is as shown in the table below. The details, etc., of the procedures for TOV revisions carried out during the periods are as stated in (2) “Facts identified by the Independent Investigation Committee” below.

History of TOV revisions made during the periods

	Operations	Revision rate
FY2011	Yokkaichi	154%
	Oita	162% to 258%
FY2012	Yokkaichi	140% to 184%
	Oita	105% to 735%
	Himeji	254%
FY2013	Oita	203% to 785%
	Himeji	159% to 162%
FY2014	Oita	129% to 348%
	Himeji	138% to 156%

As was this case, if back-end TOV is not revised despite the fact that front-end TOV has been revised and a large amount of cost variance is incurred as a result of not making that revision to back-end TOV, then under the Combined Allocation Method employed by the S&S Company the cost variance is allocated to inventory and cost of sales at an allocation rate that is poorly compatible with the situations in which costs are actually incurred. As a result, the book values for front-end term-end inventory (term-end intermediate products), back-end term-end inventory (term-end completed products), and cost of sales (cost of completed products) were amounts that cannot be said to be appropriate. Specifically, as a large amount of cost variance is incurred in the back-end due to TOV revisions made only to the front-end, this led to more amount of cost variance incorporating that back-end cost variance and exceeding what it should have been being allocated to the front-end term-end inventory and, on the other hand, a less amount of cost variance than what it should have been being allocated to the back-end term-end inventory and the cost of sales.

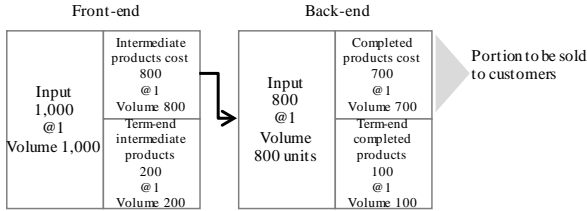
As described above, when revising TOV for the front-end, in order to conduct an appropriate accounting treatment, TOV for the back-end must also be revised together with it. On the other hand, even if front-end TOV is revised and back-end TOV is not revised, if cost variance is allocated based on the Process-Specific Allocation Method, it will result in appropriate cost variance allocation (which is nearly the same as revising back-end TOV in accordance with a revision of front-end TOV and allocating cost variance based on the Combined Allocation Method). In other words, if front-end TOV is revised and, back-end TOV is not revised together with it, then in order to conduct an appropriate accounting treatment, it can be said to be necessary to conduct calculations using the Process-Specific Allocation Method.

Accordingly, when revising front-end TOV, in order to conduct an appropriate accounting treatment, (i) back-end TOV must also be revised or (ii) if back-end TOV is not to be revised, the cost variance must be allocated using the Process-Specific Allocation Method. However, the S&S Company took neither of these procedures, and this was the cause of the inappropriate accounting treatment.

Therefore, the calculation results assuming the application of the Process-Specific Allocation Method and Toshiba's current calculations are compared in the table below.

Example: Plan at the beginning of the term

- Cost is only the depreciation cost at the front-end process plant of 1,000
- Plan to sell 700 completed products to customers and for 100 completed products and 200 intermediate products to be left at term-end
- Under this plan, the input of the front-end is equivalent to 1,000 units so the cost per unit is 1 (1,000 depreciation cost ÷ 1,000 units)



The sales volume was estimated to be lower than as contemplated in the plan (sales volume of 200 units vs 700 units), and a reduction in operation capacity was expected in connection with that, so a front-end TOV revision was carried out during the term (to avoid cost variance (CV) arising at the front-end, front-end TOV was changed from @1 to @2)

1. Toshiba's treatment in question

- Front-end TOV is revised, but back-end TOV is not revised
- Uniform allocation of CV without differentiating between front-end and back-end

TOV is in italics

*1. Amount allocated for intermediate products 171 = CV 300 ÷ (intermediate products 400 + completed products 100 + completed products cost 200) x intermediate products 400
 *2. Amount allocated for completed products 43 = CV 300 ÷ (intermediate products 400 + completed products 100 + completed products cost 200) x completed products 100
 *3. Amount allocated for completed products cost 86 = CV 300 - amount allocated for intermediate products 171 - amount allocated for completed products 43
 *4. Because the CV arises due to TOV being less than actual cost, it is an upwards adjustment in the allocation calculation (adjustment from TOV to actual cost).

2. Treatment that ordinarily should be carried out

- Revise front-end TOV and revise back-end TOV as well
- Correction (change of CV allocation method)
- Allocate CV by differentiating back-end from front-end (more precise method)

*1. Amount allocated for completed products 100 = CV 300 ÷ (completed products 100 + completed products cost 200) x completed products 100
 *2. Amount allocated for completed products cost 200 = CV 300 - amount allocated for completed products 100
 *3. Because the CV arises due to TOV being less than actual cost, it is an upwards adjustment in the allocation calculation (adjustment from TOV to actual cost).

By correcting the CV allocation method, the result matches that in the "treatment that ordinarily should be carried out shown on the left.

(C) The amount of impact resulting from inappropriate accounting treatment

The amount of impact assuming that back-end TOV is also revised together with the front-end TOV revision is as follows. Note that in the calculation of this amount of impact, an equivalent amount has been calculated by applying the Process-Specific Allocation Method without actually adjusting (revising) the back-end TOV.

Note that because front-end TOV revisions during the period have been conducted from the second half of FY 2011, the amount of impact has been calculated from the second half of FY 2011.

Unit: JPY 100 million

Profit and loss adjustment amount	Second half of FY 2011	FY 2012	FY 2013	FY2014 Q3
Total profit and loss adjustment amount	(103)	(359)	119	(5)

(2) Facts identified by the Independent Investigation Committee

(A) Regular revisions every half-year

In the regular TOV revisions that were conducted every half-year, it is stipulated that the applicable parts and revision amounts should be determined through discussions between the General Managers of the Company Finance & Accounting Divisions and the accounting division managers of operations manufacturing the applicable products (Article 66(ii)). However, in reality, the figures are determined through discussions between personnel of the Company Finance & Accounting Division, the accounting personnel of operations, and the planning department personnel, etc., in consideration of the budget decided on by the divisions (in contrast to cases where TOV revisions are made during the period as described in (B) below, there is no process of approval by the Group Manager of the Company Finance & Accounting Division).

These regular TOV revisions are conducted for both the front-end and the back-end processes.

The figures decided on through the process described above would then be registered in the system by the accounting personnel of operations (this system was set to conduct calculations based on the Combined Allocation Method).

(B) TOV revisions made during the periods

As described in (A) above, while TOV revisions were regularly conducted, as stated in (1)(B) above, from the third quarter of FY 2011 to the fourth quarter of FY 2014, TOV revisions were conducted on an irregular basis during the periods in addition to the regular revisions described in (A) above, and these revisions were only conducted on the front-end TOV.

For TOV revisions made during the period, new figures would be prepared through discussions between personnel of the Company Finance & Accounting Division personnel, the accounting personnel of operations, and planning department personnel, etc., and in the end these figures would be approved by the General Manager of the Company Finance & Accounting Division (in reality, the approval was made by the Group Manager of the Company Finance & Accounting Division, who had been delegated the authority to do so by the General Manager of the Company Finance & Accounting Division). The revisions were then reported, at the very least, to the General Manager of the Company Finance & Accounting Division and to the Vice President (among these personnel, there were some persons who have stated to the effect that they received reports on only the fact that a revision had been conducted, and did not receive reports on the figures after any such revision).

The figures decided on were then entered into the system by accounting personnel of operations in the same manner as regular revisions.

(C) Involvement of Corporate

It is uncertain whether all of the TOV revisions conducted during the period described in (B) above were reported to Corporate.

However, at the very least, the fact that statements such as “TOV-UP” and “TOV revision” can be found in distribution materials, etc., for the CEO Monthly Meetings from around April 2012 suggests that TOV revisions conducted during the period were reported to P and SEV, etc., at these meetings (however, the content of those reports did not become clear through the Committee’s investigations). On the other hand, no evidence was found that indicates that any instructions, etc., from the Corporate to the Company in response to TOV revisions.

(3) Causes of inappropriate accounting treatments

(A) Circumstances leading up to the inappropriate accounting treatment

(a) TOV revisions only to front-end process

As described in (1)(A) above, the S&S Company employs cost calculations using TOV, and because TOV is a provisional figure set in advance by the S&S Company,

when accounts are closed every quarter, the difference between TOV and the actual cost (cost variance) is calculated, and this is allocated to the term-end inventory (front-end term-end inventory and back-end term-end inventory) and cost of sales (cost of completed products) according to the amount calculated based on their respective standard costs (specifically, the accounting personnel of the Company receive the actual figures (figures related to cost calculations) from the accounting personnel of operations, and the allocation is conducted by entering the actual figures in a system in which the calculation method has been set in advance). The S&S Company traditionally has been allocating cost variance through the Combined Allocation Method, not the Process-Specific Allocation Method.

As described in (1)(B) above, when revising TOV for the front-end process during the period, in order to conduct an appropriate accounting treatment, it was necessary either (i) to also revise TOV for the back-end or (ii) if the back-end TOV revision would not be made, to allocate the cost variance through the Process-Specific Allocation Method (in the case of (ii), to conduct the calculations using a calculation method that was different to the calculation method set in the system, which is the Combined Allocation Method).

However, at the S&S Company, neither of these methods were employed, and the treatment adopted was one in which cost variances were allocated through the Combined Allocation Method (which is the same allocation method as used for regular TOV revisions) while TOV revisions were made only to the front-end process, and as a result, a lesser amount of cost variance than what it should have been was allocated to back-end term-end inventory and cost of sales. It was circumstances such as these that gave rise to inappropriate accounting treatment, namely, the “overstating of current-term profit in the quarter of the revision (giving rise to a loss in subsequent periods in the amount of the overstated portion).”

(b) Whether or not the inappropriate accounting treatment was conducted intentionally

Was the achievement of this “overstating of current-term profit in the quarter of a revision”—which was a result of the inappropriate accounting treatment whereby the revisions were made only to front-end TOV during the period in the manner described above and cost variance allocations were made in accordance with the Combined Allocation Method—something that was done intentionally?

a. Company

In relation to the fact that revisions were made only to front-end TOV during the periods, CP, Vice President, and the General Manager of the Finance & Accounting Divisions of the Company have stated that they were not made for the purpose of overstating profits, and have described the two main reasons for TOV revisions as follows.

- i. Because there is a tendency for amounts to be set low in the TOV revisions

conducted twice on a regular basis, it is easy for divergence from the actual manufacturing cost to occur, and this divergence is more likely to occur in the front-end than the back-end.

From the perspective of trying to understand the state of profits or losses during the period as accurately as possible at each point in time, it is preferable to conduct revisions during the accounting period, even if only for the front-end TOV.

ii. In the event there is a sharp fall in the utilization rate, etc., at operations responsible for the front-end process, and the actual cost at that time considerably exceeds the TOV that has already been set, profit and loss for a single operation will deteriorate (expected sales would decrease), and the valuation of the operation (by its employees) will decline. Despite the fact that drops in plant utilization rate, etc., may not necessarily be due to the operations responsible for the front-end,¹⁰³ the fact that such an event will arise will lead to a decline in motivation among employees for that operation, so TOV revision during the period is preferable.

It can be surmised that the reasons set out in i and ii cannot necessarily be said to be unreasonable as reasons for front-end TOV revisions conducted during the period. However, on the other hand:

(i) There are few reasonable grounds to only revise the front-end TOV at such a high revision rate. (In the event of divergence from the actual cost due to factors such as a decline in the utilization rate in the front-end, the likelihood of divergence also occurring in the back-end is high. Furthermore, if it is necessary to make a revision in the front-end TOV using a high revision rate such as 700% or 800%, it can be considered that some form of revision is also required in the back-end.)

(ii) Even if TOV is not revised during the accounting period, it is possible to appropriately record profit and loss for the period through the allocation of cost variance at the end of the quarter (and accordingly, a quarterly evaluation could be appropriate).

(iii) TOV revisions during the period were not conducted even once in or before the second quarter of FY 2011.

In consideration of these points, the doubt remains as to whether it can be recognized that revisions made only to the front-end TOV during the accounting period were conducted due only to the reasons in i and ii. In addition, when the circumstances below are considered together with the circumstances in (i) through (iii) above, then regardless of whether or not the reasons in i and ii above existed, the possibility cannot be denied that CP and others from the Company might also have had, together with those reasons, an intention to overstate the current-term profits of the quarterly period in question.

(iv) In consideration of the fact that TOV revisions conducted during the period were approved by the Group Manager of the Company Finance & Accounting Division,

¹⁰³ There are also external causes, such as decreases in order volumes from clients.

who had been delegated the authority to do so by the General Manager of the Company Finance & Accounting Division, and the fact that the Group Manager of the Company Finance & Accounting Division and others had considerable knowledge concerning cost variance allocation methods, it can be recognized that the General Manager of the Finance & Accounting Divisions of the Company and others were aware of the fact that revising front-end TOV during the accounting period would result in the overstatement of profits.

(v) At the Inventory Reduction Company-Wide PJ Monthly Interview held on March 23, 2012, in response to an explanation from the Company, Hisao Tanaka (SEV at that time) stated that “the structure of the measures to improve profit and loss is one in which manufacturing profits are increased by increasing TOV (advance acquisition of profit), but the M rate subsequently falls. As a result, you can’t really see how this has been linked to profit and loss, so I would like to make that visible going forward.”

(vi) At the CEO Monthly Meeting held on April 25, 2012, Norio Sasaki P made a statement to the effect that the latest improvement plan implemented in March had led to an increase in inventory and to a (high TOV) carry over to this period.

(vii) In several materials used in the CEO Monthly Meetings from July 2012, “TOV” and its monetary amount are stated as items such as “PL measures” and “improvement,” and it can be understood that they were being used in the sense that the quarterly profits were revised according to TOV revisions made during the accounting period were overstated, and the loss in the subsequent quarter after the revision would increase by the amount of that overstatement.

b. Corporate

In light of the circumstances in (v) to (vii) above, it can be recognized that Norio Sasaki P, Hisao Tanaka SEV, and furthermore personnel of the Corporate Finance & Accounting Division and others that participated in the CEO Monthly Meetings were aware of the fact that apparent profits of the quarterly periods were overstated as a result of TOV revisions made during the accounting period, but no evidence was found that any corrective measures, etc., were taken in response to these sorts of overstatement of profits on the part of the Company. Accordingly, putting aside the question of whether or not they were aware that it was inappropriate accounting, the doubt remains that, from March or April 2012, at the very least members of top management including Norio Sasaki P and Hisao Tanaka SEV had the intent to overstate apparent current-term profits of the quarterly period.

In response to this, Hisao Tanaka SEV has made statements to the effect of the following in interviews with the Committee:

- He was not aware that TOV revisions were made during the accounting period.
- He has recognized that even if current-term profits were overstated as a result of TOV revisions conducted during the accounting period, this was not a problem if the revisions were based on reasonable grounds.
- In relation to (v) above, as the overstatement of profits as a result of TOV revisions not based on reasonable grounds would be a problem, he gave instructions to the effect that he would like the reasons for TOV revisions to be clarified so that that sort of thing

did not occur.

However, these statements by Hisao Tanaka SEV diverge significantly from the statements in (v) above and the statements contained in the materials in (vii), and the doubts described above cannot be fully eliminated.

In addition, Norio Sasaki P has made the statements in interviews with the Committee to the effect that:

- He was not aware that TOV revisions were made during the accounting period.
- He was not aware that revising TOV during the accounting period caused profits to be overstated.
- When discussing measures to improve profit and loss, he stated to the effect that he wanted them to be carried out in compliance with law.
- In relation to (vi) above, he did not make the statement “(high TOV)” (that part was not his comment).

However, these statements by Norio Sasaki P diverge significantly from the statements contained in the materials in (vii), and even if he did state that measures to improve profit and loss must be conducted in compliance with law, it cannot be considered that it is possible to immediately deny the intention to attempt to overstate profits.

(B) Causes of inappropriate accounting treatments

The causes why this form of accounting treatment was carried out in a continual manner, in light of the circumstances leading up to the inappropriate accounting treatments, can be considered as follows.

(a) The over-riding current-term profit policy and strong pressure to achieve the targets

With the over-riding current-term profit policy exhibited by successive Presidents, CP and others at the S&S Company faced strong demands from successive Presidents at the CEO Monthly Meetings, etc., to achieve “Challenges” in the form of targets for profit improvements and felt pressure.

In addition, the Challenge was often set in the CEO Monthly Meetings, etc. held when there was only a short time left until the end of that quarter.

Since it was difficult for the Company issued with the Challenge to achieve such large amounts of profit improvement during the short time remaining until the end of the quarter through normal sales efforts, it can be surmised that they were often forced to use the inappropriate method of overstating profits.

In addition, the pressure to achieve the Challenge was put by considering an over-riding current-term profit policy as it was set with the goal of maximizing profit for that current period (quarter), without giving consideration to securing long-term profits. Feeling this pressure could have been an incentive for making revisions only to the front-end TOV during the period, which would lead to the overstatement of

apparent current-term profits, even if it could increase losses in the subsequent periods.¹⁰⁴

(b) The accounting treatment was effected in such a way that made it difficult to be detected from others

As described above, the possibility cannot be denied that revisions only to the front-end TOV during the period were conducted by CP, etc., for the purpose of intentional overstatements, and the actual method of making the overstatements was an accounting treatment that used the Combined Allocation Method (which is an inappropriate accounting treatment if only the front-end TOV is revised but is permissible if both the front-end and back-end TOVs are revised), namely, the method was the one whose exact mechanisms and issues can only be sufficiently understood by people with sufficient accounting knowledge. Accordingly, the accounting treatment was conducted based on a method that could not be rectified by other employees unless personnel of the Finance & Accounting Division personnel themselves specifically communicated to them that there was a problem with the accounting treatment. Accordingly, it was hard for employees other than personnel of the Finance & Accounting Division personnel involved to make rectifications.

(c) Lack of an awareness about the appropriate accounting treatment among top management

As previously mentioned, no evidence was found that members of top management such as P, SEV, and CP, had made any indications, etc., to rectify the overstatement of profits due to TOV revisions conducted during the accounting period.

As it can be recognized that these members of top management were at least aware that profits were being overstated in excess of the Company's real attainability, anyone could have understood that there was a possibility that such forms of accounting treatment were not appropriate, even without any specialized knowledge of accounting. Accordingly, if these persons were not capable of judging that there was the possibility of such accounting treatment not being appropriate, it can be recognized that that was due to the fact they had a limited awareness about the appropriate accounting treatment.

Note that several employees of the S&S Company have stated that they obtained confirmations from the accounting auditor around March 2012 with respect to the appropriateness of TOV revisions conducted during the accounting period in FY 2011. However, according to reviews by the Committee, there is a high possibility that matters such as the fact that revisions were conducted on the front-end TOV only and the

¹⁰⁴ As described above, if only front-end TOV is revised and the Combined Allocation Method is used for calculation, an amount of cost variance that is more than what it should be will be allocated to front-end term-end inventory. For this reason, it is possible that front-end term-end inventory with a high price could be used subsequently as back-end raw materials, and as a result, this could impact on back-end income and expenditure in the future, which could in turn lead to increased losses for the S&S Company.

specific revision rate were not communicated to the accounting auditor. Furthermore, no evidence was found that the accounting auditor had been told about TOV revisions conducted during the accounting period from FY 2012 onward.

(d) Inadequacy of internal control function by the internal control departments

a. Inadequacy of a checks and balances function in the Company

There were no departments other than the Finance & Accounting Division with the function of checking the appropriateness of accounting treatments within the Company. For this reason, the checks and balances function did not function with respect to inappropriate accounting treatments conducted by personnel of the Finance & Accounting Division and others.

b. Inadequacy of checks and balances function in the Corporate

As the CFOs and personnel of the Corporate Finance & Accounting Division and others participated in the CEO Monthly Meetings, it can be surmised that they were aware of the fact that the accounting treatment of TOV revisions conducted during the period would lead to the overstatement of profits. However, there was no evidence that any corrective measures, etc., have been taken in response to this, and accordingly it can be evaluated that the checks and balances function by the Corporate Finance & Accounting Division did not function.

c. Other

No facts were found indicating that the Corporate Audit Division, the Audit Committee, or the accounting auditor pointed out any issue.

Chapter 7. Summary of the analysis of causes

The analyses of the causes of the inappropriate accounting for each project investigated are as set out in the above sections of this Report describing the investigations of each project. As the facts relating to each project differ, so too do the results of the analyses of the causes vary. However, it can be seen that there are several causes that are common to each project. Accordingly, set out below are analyses of the direct causes common to multiple projects as well as analyses of the indirect causes that could be the context of those causes.

I. Direct causes

1. Institutional behavior involving top management

(1) Corporate-level involvement

Regarding some projects subject to the Investigation, it can be recognized that certain members of top management, namely, P, GCEO, and CFO, were aware of the intentional overstating of apparent current-term profits and the postponement of recording expenses and losses, or the continuation thereof, but did not give instructions to stop or correct them. Moreover, with regard to some projects in which the percentage-of-completion method was used, it has been recognized that, although the Company requested approval to record provisions for contract losses, certain top management either rejected it or instructed the recording to be postponed. In addition, with regard to the PC Business, it can also be recognized that, while certain top management was aware that this would inevitably lead to a situation where it was forced to overstate apparent profit through Channel Stuffing of ODM Parts, still they imposed strict “Challenges” onto the Company and drove it into such situation, or showed reluctance when the Company expressed its intent to eliminate the overstating of apparent profits by way of the Channel Stuffing of ODM Parts.

Also, the inappropriate accounting treatment that was carried out or continued in a number of Companies simultaneously and in an institutional manner with the involvement of certain Corporate-level top management, etc., as stated above should be considered a management decision, and correcting such situation was practically impossible. Furthermore, Toshiba did not have a risk management structure or the like that anticipated, or prevented, such inappropriate accounting treatment from being carried out and continued in an institutional way involving top management, and, as described below, the supervisory functions of various divisions and departments did not function sufficiently.

(2) Company-level involvement

For some projects, it can be recognized that certain Company-level top management

like the CP and the Vice President were involved in carrying out or the continuation of inappropriate accounting treatments. Furthermore, it can be recognized that, regarding some of these projects, the CP, as Company-level top management, actively instructed that inappropriate accounting treatments be carried out.

Also, it was practically impossible for the Companies to correct by themselves the inappropriate accounting treatments carried out or continued in an institutional manner involving Company-level top management as stated above.

2. Objective of certain members of top management of intentionally overstating current-term profit (in excess of actual attainability)

For some projects subject to this Investigation, it can be recognized that certain Corporate or Company-level top management had an objective to carry out the “overstating of apparent current-term profits.” It can also be recognized that the people in charge of these projects, such as key managers, carried out or continued inappropriate accounting treatments under such objective of certain top management.

3. Over-riding current-term profit policy, and strong pressure to achieve the budget target

As described above, each in-house Company prepared monthly budgets at the beginning of each first quarter and third quarter, and business was engaged in with the aim of achieving those budgets. Also, each month, after the state of the achievement and forecast of those budgets was reported and examined within the in-house Company, reports were made to Corporate P in discussions referred to as CEO Monthly Meeting Reports.

At these CEO Monthly Meetings, P indicated targets for profit improvement set as “Challenges” to each CP, with the strong suggestion that those targets needed to be achieved, and there were some occasions where P implied that under-performing Companies would have to withdraw from their business if they did not improve their profit. In particular, from FY 2011 to FY 2012 when inappropriate accounting treatments were carried out broadly, Toshiba’s businesses were subject to an extremely severe management environment as a result of, for example, the Great East Japan Earthquake and the ensuing accident at the Fukushima Daiichi Nuclear Power Plant, the flooding of the Toshiba plant during the floods in Thailand, and the extreme strengthening of the Japanese yen. Because stringent budgets were set at the beginning of the period even in these circumstances, some of the Companies were unable to achieve their budget, and those Companies were required by P to meet strict Challenges (excessive targets) in order to achieve budget. Therefore, the CP of each Company was faced with strong pressure to achieve these targets.

Most of the Challenges indicated by P were based not on long-term profit targets, but on target values to be achieved, set with a view to maximizing current year or current quarter profits (over-riding current-term profit policy). Also, toward the end of each quarter, when it was difficult to achieve a large amount of profit improvement even with

a concerted sales effort, a “Challenge” was given to achieve an overstated budget that exceeded the capabilities of the Company. Given this management policy, in order to achieve the Challenge, each Company was driven into a situation where it was forced to engage in inappropriate accounting treatment to bring apparent current-term profits closer to the budget and Challenge values substantially by way of pre-emption of profits for subsequent accounting periods or postponement of recording of current losses and expenses to subsequent accounting periods, instead of carrying out accounting treatment reflective of performance at the end of the applicable period. Even though pre-empting profits or postponing the recording of expenses and losses in order to overstate apparent profits in one period would make the recording of profits in subsequent periods difficult, an excessive Challenge was set for that subsequent period as well, and this resulted in Companies being forced to carry out inappropriate accounting treatment in an even larger amount in order to achieve it, the repetition of which caused the inappropriate accounting treatments to continue and expand in scale. While efforts to improve this sort of inappropriate accounting treatment could be seen during this time, because there was no alternative but to record a large amount of losses in order to make these improvements, the measures taken were not drastic ones involving a single, all-encompassing improvement such as would cause a deterioration of business results, and although the inappropriate accounting treatment at Toshiba improved in parts in FY 2013, it subsequently continued until the discovery in this case was made.

4. Corporate cultures where employees cannot act contrary to the intent of superiors

A corporate culture existed at Toshiba whereby employees could not act contrary to the intent of their superiors. For this reason, when certain top management established a “Challenge,” the CPs, who were subject to the will of such top management, the Vice Presidents under the CPs, and in turn the employees under the Vice Presidents continuously engaged in inappropriate accounting treatments to achieve the targets in line with the will of their superiors. Moreover, under this corporate culture, a de facto rule existed for Toshiba accounting practices, whereby approval from a progressively senior personnel was required before making an accounting treatment in accordance with an express rule provided for in the Company’s accounting rules, etc., with respect to any matter that entailed a significant amount of impact, such that if at any point a superior’s approval was not obtained, then the appropriate accounting treatment itself, based on an express rule, would not be carried out.

As a typical example of that, with respect to the projects in which the percentage-of-completion method was used described above, despite the fact that the accounting rules of each in-house Company provide that provisions for contract losses, where they are required to be recorded, are to be recorded at the discretion of the personnel at the sales department, the planning department or the accounting department, etc., of each in-house Company, there existed de facto rules such as those described above. As a result, where superiors did not have sufficient knowledge relating to accounting treatment, or where superiors did have sufficient knowledge but prioritized

the achievement of profit targets and had limited awareness as to the appropriate accounting treatment, then when personnel carrying out the accounting treatment sought approval from those superiors to record a provision for a contract loss, they were unable to obtain it or they received a response indicating a negative view, so the procedures for recording the provision for the contract loss were not taken. In particular, among the CPs and GCEOs, who were the top management of the Companies, some of them, when approval was sought by the sales department for recording provisions for contract losses, refused to have the appropriate accounting treatment carried out in a timely manner based on the self-justified thinking that approval should not be given because provisions for contract losses should be recorded after it has become clear that the loss will definitely arise, and recording a provision for a contract loss before that will cause a loss of incentive toward making efforts to improve profits in the sales department and would only promote the deterioration of profits. Under the management of such persons, not only were the necessary provisions for contract losses not recorded in such projects, but also the sales departments who knew that such CPs thought this way came to adopt the thinking that, even if they sought approval for timely and appropriate accounting treatment from the CP or GCEO, they definitely would not be able to obtain it, so they gave up recording such provisions even in other projects which required the recording of provisions for contract losses.

5. Lack of awareness and knowledge among top management about appropriate accounting treatment

In some projects that were investigated, one of the causes of inappropriate accounting treatment was that excessive attention to profit figures led the persons in charge of accounting, their superiors such as Vice Presidents and CPs, and even Corporate P, GCEO, and CFO to have a weak awareness or a lack of an awareness about the appropriate accounting treatment. For example, with respect to the recording of provisions for contract losses, it could be found that (i) some persons did not attempt to record them in a timely manner because of an awareness that not recording them would probably not create a big problem as long as that treatment was carried out during that business year, even if it was carried out in a different quarter, and, furthermore, (ii) some persons seemed to postpone recording them based on the thinking that (a) it was not as though the losses incurred were never going to be recorded, as in the end the losses would be recorded when the contract was completed, and (b) estimates were not very precise, especially in the case of orders for new projects, so while a loss was expected to be incurred from the outset of the project, as long as there was an expectation that profits would improve in the future, delaying the recording of provisions for contract losses would probably not create a big problem.

Also, in some projects among those subject to the Investigation, it was recognized that the persons who actually carried out the accounting treatment, their superiors such as Vice Presidents, or CPs who were the top of the Companies did not have sufficient knowledge of accounting standards that are generally accepted as fair and appropriate. Therefore, while they were aware of the occurrence of the fact requiring an accounting treatment, such as the recording of provisions, they would still fail to undertake the

appropriate accounting treatments, with no reasonable grounds for not doing so.

Toshiba has established the Toshiba Group Standards of Conduct, and those Standards provide as the Toshiba Group Corporate Policy, in 13. Accounting, that “Toshiba Group Companies shall comply with all applicable laws and regulations regarding accounting and conduct proper accounts management and financial reporting in accordance with generally accepted accounting principles.”

The Standards further provide, as the standard of conduct for Toshiba Group directors and employees, that “Directors and Employees shall:

1. maintain proper and timely accounts in accordance with generally accepted accounting principles;
2. disclose accurate accounting information promptly in compliance with law; and
3. endeavor to maintain and improve the accounting management system, and establish and implement internal control procedures for financial reporting.”

Despite the existence of these Toshiba Group Standards of Conduct, the lack of awareness of appropriate accounting treatment or the lack of requisite knowledge among Toshiba executives and employees is one of the reasons why appropriate accounting treatment was not carried out in these projects.

6. Issues with Toshiba’s accounting policy and its application

In some projects, a cause of inappropriate accounting treatments was that Toshiba’s accounting policy was inappropriate. In some other projects, a cause of inappropriate accounting treatments being carried out was that the accounting policies defined by Toshiba were not appropriately applied.

7. Inappropriate accounting treatment undertaken in a subtle manner that is difficult to detect externally

Looking at the instances of inappropriate accounting treatment subject to this investigation, many of them were continuously carried out. For example, with respect to such inappropriate accounting treatments as the understating of provisions in projects in which the percentage-of-completion method was used, from around 2008 this practice continued despite the fact that the circumstances of each project were different. Also, in many of the instances of inappropriate accounting treatment relating to the recording of operating expenses in the Visual Products Business, inappropriate accounting treatment relating to Parts Transactions, etc., in the PC Business, and inappropriate accounting treatment relating to the evaluation of inventory in the Semiconductor Business, while their commencement periods were different, once the treatment had commenced, it was subsequently continuously carried out.

One reason they continued to be carried out is that adequate and genuine explanations on inappropriate accounting treatments were not provided to the persons involved, and subtle methods were used which were difficult for external parties to identify. For example, with respect to the appropriateness of estimates of total cost of contract work

(which are the basis for deciding whether or not it is necessary to record provisions for contract losses) in projects in which the percentage-of-completion method was used, because the estimates were carried out taking into account judgments on the feasibility of sales increases and cost reductions, even if the understating of provisions was being carried out, it can be recognized that it was difficult for the external accounting auditor to detect that if the person in charge gave an explanation of some sort. Also, with respect to the overstating of apparent profit through TOV revisions during the period in the Semiconductor Business as well, the overstating was only made possible by employing the Combined Allocation Method with respect to the allocation of cost variance without making any back-end TOV revisions, and it can be recognized that even someone with accounting knowledge would not have been able to detect that easily.

It thus can be surmised that carrying out inappropriate accounting treatment in a subtle manner that is difficult to detect externally was one of the causes that enabled inappropriate accounting treatment to continue to be carried out.

II. Indirect causes

The internal control systems for checking whether or not appropriate accounting treatment is being carried out in Toshiba are, for example, the internal controls in each Company, the internal controls in each department of Corporate, the internal controls (supervisory function) provided by the Board of Directors, and the internal controls (audit function) provided by the Audit Committee, but as noted below it can be recognized that none of these systems was functioning sufficiently.

1. Internal control at the Company-level was not functioning

(1) Internal control by the Finance & Accounting/Accounting Divisions

In order to carry out appropriate accounting treatment, the Finance & Accounting/Accounting Division in each Company is stipulated as being in charge of matters relating to the monthly settlement and management of consolidated and non-consolidated accounts and such operations as management and guidance in relation to the recording of profits, the recording of expenses, and the calculating of product and sales costs, and the Finance & Accounting/Accounting Division of each Company primarily functions as the internal control department for checking whether or not appropriate accounting treatment is being carried out. However, in the cases subject to this investigation, accounting personnel knew of a fact that made an accounting treatment necessary, such as recording a provision, but did not take any action, or although they easily could have known of a fact that made a certain accounting treatment necessary, they did not take any action, and further, there were many projects where no action was taken because of the instruction of a superior such as a Vice President or CP, etc., and these facts prove that internal control by the Finance & Accounting/Accounting Divisions was not functioning.

(2) Internal control by internal audit departments

There was no internal audit department at any Company, other than the Finance & Accounting/Accounting Division, such as could check for inappropriate accounting treatment. As described below, in light of the fact that the Corporate Audit Division, which controlled all of the audits of each Company, was not functioning sufficiently, it can be pointed out that the fact that no internal audit department had been established for the Companies in a way that would make it independent from the Company's chain of command, such as the CP, was one of the causes of the internal control's not functioning.

2. Internal control at the Corporate-level was not functioning

(1) Internal control over risk of inappropriate conduct by management

As described above, while it can be recognized that the P, GCEO, and CFO, who are all members of top management, and, furthermore, such key managers as the CPs and Vice Presidents of in-house Companies had some involvement, etc., in instances of inappropriate accounting treatment with respect to some of the projects subject to the Investigation, it is important to ensure the functioning at Corporate, not at in-house Companies, of sufficient internal control with respect to such involvement of top management and key managers.

However, at Toshiba, the involvement of certain top management and key managers led to the deviation from and ineffectiveness of the internal control function for financial reporting, with inappropriate accounting treatments then being carried out by instructions, etc. from outside of the internal control framework. It also must be noted that an internal control (risk management) structure that anticipates inappropriate accounting treatment being carried out by such people's involvement had not been established.

(2) Internal control in each Corporate division

As set out below, internal control over instances of inappropriate accounting treatment was not functioning sufficiently in any of the divisions at Corporate either.

(A) Corporate Finance & Accounting Division

In terms of involvement in processing the closing of accounts, the Corporate Finance & Accounting Division's function was primarily limited to accumulating financial information prepared by each of the Companies and taking action for the purpose of the consolidated accounts, and it did not play a role in checking whether or not accounting

treatment at each of the Companies was appropriate.

On the other hand, the Corporate Finance & Accounting Division was in charge of creating the first draft of the “Challenges” for the CEO Monthly Meetings, and so was involved in the process of pressuring the Companies to achieve targets in line with the over-riding current-period profit policy; and at the least, no facts were found showing that the Corporate Finance & Accounting Division had acted to correct instances of inappropriate accounting treatment that had been carried out as a result of such pressures in each project.

Also, in some projects, it could be found that persons in charge at the Corporate Finance & Accounting Division themselves knew that inappropriate accounting treatment was being carried out but did not take any sort of action such as to point that out or correct the situation.

Furthermore, where the CFO, who is the executive officer in charge of the Corporate Finance & Accounting Division, was involved in an inappropriate accounting treatment, internal control by the Corporate Finance & Accounting Division was not functioning at all.

(B) Corporate Audit Division

According to the division of duties rules of Toshiba, the Corporate Audit Division is in charge of auditing the Corporate Divisions, the Companies, branch companies, and affiliated companies. However, in reality the Corporate Audit Division mainly provided consultation services for the “management” being carried out at each of the Companies, etc. (as part of the business operations audit), and it rarely conducted any services from the perspective of an accounting audit into whether or not an accounting treatment was appropriate. There were also some Ps who did not expect the Corporate Audit Division to perform a “supervisory” role in any general sense of that word. Also, the situation with respect to the personnel in the Corporate Audit Division was such that it was difficult to say that there were enough personnel to enable the necessary audits to actually be carried out in light of the scale of the entire Toshiba Group. Furthermore, there was a system of rotation such that people were posted to the Corporate Audit Division from each Company as a step in their career path to become a Vice President in the future. As a result, there were not many personnel posted in that Division who were thoroughly experienced in accounting or the operations of each Company, and the situation was not one in which an appropriate audit could be expected to be carried out.

As such, despite the fact that, as a result of its audits, the Corporate Audit Division was actually aware that, in several projects subject to its audits, there was a possibility that inappropriate accounting treatments were being carried out, or at least that there were facts requiring certain accounting treatments to be made, no evidence was found that the Corporate Audit Division had made any indications, etc., in relation to such accounting treatment.

There were some projects where the Corporate Audit Division requested the improvement of some situations that were the causes of inappropriate accounting treatments (although that Division did not instruct the correction of any inappropriate accounting treatment itself), and although executives prepared improvement plans

accordingly, they were not carried out. The Corporate Audit Division did not follow up on such situation.

Moreover, given that P as top management was in charge of the Corporate Audit Division, there is doubt as to whether the Division was able to make the necessary indications, etc., in respect of any matters that the persons in the Division considered to be contrary to P's will.

Based on these circumstances, the evaluation cannot be avoided that the audit by the Corporate Audit Division had inadequacies, and its control was not functioning sufficiently.

(C) Risk Management Division

According to the division of duties rules of Toshiba, the Risk Management Division was in charge of establishing fundamental policy for the assessment of the effectiveness of the internal controls relating to financial reporting (“**J-SOX Compliance**”), planning and creating proposals for measures relating to J-SOX Compliance, and implementing, supporting, and following up J-SOX Compliance at the Company-level, etc. However, in reality, the Risk Management Division does not check whether the internal control relating to financial reporting at each Company, etc. is functioning appropriately.

(D) Annual Securities Report, Etc., Disclosure Committee

The Annual Securities Report, Etc., Disclosure Committee's role is to carry out final confirmation of the results of the evaluation of the effectiveness of the internal control system relating to financial reporting, to advise the President on the contents of internal control reports, and so forth. However, it could only seem that the Annual Securities Report, Etc., Disclosure Committee was actually only carrying out some Q&As, such as asking for explanations from personnel of Legal Division and the Corporate Finance & Accounting Division based on materials prepared by them, and no evidence was found that it was making any independent confirmation or examination with respect to the effectiveness of the internal control system relating to financial reporting.

3. Internal control (supervisory function) of the Board of Directors was not functioning

According to the Board of Directors Rules, the results of the Corporate Management Meeting and the matters for the decision of the President by Corporate Management Decision Note must be reported at the Board of Directors' meetings, but as the receipt of construction orders for projects in which the percentage-of-completion method would be used and the occurrence of contract losses in such constructions are not included in the matters requiring deliberation by the Corporate Management Committee or in the matters requiring Corporate management decisions by the President and Chief Executive Officer, they are not matters that must be reported.

Moreover, the Standard Operating Procedure for Board of Directors' Meetings provides that CPs and GCEOs are to report on "business results and the state of operations" at the Board of Directors' meetings for closing every quarter's accounts, and it is stipulated that in giving these reports, they are to focus on, for example, "the occurrence of any matter that has caused, or might cause, major damage, such as a violation of law or regulation, material accident, disaster, or legal dispute and the responses to those incidents and the progress of those responses" and "the occurrence of any matter that has had, or possibly could have, a major effect on business results, such as a change in the market environment, the state of major orders, major debt guarantees, etc., or the state of major commercialization efforts and the responses to those incidents and the progress of those responses."

However, in some of the projects relating to the percentage-of-completion method, despite the fact that there was a project where a contract loss of more than JPY 1.0 billion was expected from the outset and a project where it was found that a contract loss of tens of billions of yen was anticipated to occur after the order receipt, no evidence was found that any report was made to the Board of Directors of the occurrence of contract losses in these important projects. It can be surmised that the fact that nothing in the Board of Directors Rules, etc., expressly provided for these occurrences of loss as matters to be reported to the Board of Directors was also one of the causes.

Furthermore, although it can be found, in some projects subject to the Investigation, that reports had been made to P, etc., at the CEO Monthly Meetings based on materials with which inappropriate accounting treatments could be recognized as being carried out, no evidence was found of any such report being made at the Board of Directors' meeting.

As a result, it can be considered that the internal control function of the Board of Directors was not functioning sufficiently with respect to the appropriateness of accounting treatment in these cases.

4. Internal control (audit function) of the Audit Committee was not functioning

No facts were found indicating that the Audit Committee made any report to the Board of Directors, or that the Audit Committee pointed out any issue, etc., with respect to any instances of inappropriate accounting treatment. As noted above, although several members of the Audit Committee were aware that inappropriate accounting treatments were being carried out with respect to some projects, and that there were things for which accounting treatments must be made, such as the recording of provisions, no action was taken to discuss the issues on the Audit Committee or to point out these issues at the Audit Committee to the executive persons.

With respect to the issue of Channel Stuffing of ODM Parts in the PC Business, although one member of the Audit Committee expressed concerns to other Audit Committee members and to the executive persons, there was no action taken to discuss the issues on the Audit Committee or to point out the issue at the Audit Committee to the executing persons.

To begin with, in the period over which inappropriate accounting treatment was

carried out, the Audit Committee was on the whole made up of two persons from within Toshiba and other outside directors. Of the two Audit Committee members who were from within Toshiba, one of them was primarily in charge of audits relating to finance and accounting, and the other was primarily in charge of audits relating to legal affairs, and thus there was practically only one full time member who was in charge of finance and accounting audits in the Audit Committee, and, in addition, none of the three external Audit Committee members had an adequate knowledge of finance and accounting. Also, there were not many supporting staff members assigned to the Audit Committee with detailed knowledge of finance and accounting. Given this situation, it was difficult for the members of the Audit Committee, except the one full-time member in charge of auditing the finance and accounting functions, to be aware of inappropriate accounting treatments being carried out and continued at Toshiba. Moreover, the full time member of the Audit Committee who was mainly in charge of finance and accounting audit was a former CFO during the timeframe that inappropriate accounting treatments occurred, so it can be considered that that may also be a reason that it was not possible to discover the inappropriate accounting treatments.

The Audit Committee's roles are to audit directors' and executive officers' execution of their duties and, where necessary, to demand that directors and executive officers correct how they are carrying out their duties. The three perspectives of the Committee's audit policy are stated as being (1) ensuring the effectiveness and efficiency of operations, (2) managing compliance and risks, and (3) ensuring the reliability of financial information and disclosed information, etc. Perspective (2) is achieved through audits on, for example, the state of the permeation throughout each Toshiba Group company of the Toshiba Group Standards of Conduct, and perspective (3) is stipulated as being achieved by: "regularly requesting reports from departments in charge of affairs with respect to the state of the establishment, operation, and evaluation of systems for ensuring the appropriateness of financial reports as well as receiving explanations on Toshiba's quarterly reports, securities reports, and internal control reports from the departments preparing them, before they are submitted; and by regularly requesting reports on the state of audits relating to the above-mentioned reports from the accounting auditor as well as, furthermore, requesting that reports be made to the Audit Committee without delay on matters that might have a major effect on the effectiveness of any such system." However, the actual audits by the Audit Committee mainly focus on (1) ensuring the effectiveness and efficiency of operations, and very few audits from the perspectives of (2) or (3) were conducted, so it can be surmised that this point, too, was a cause of the Audit Committee's not pointing out anything whatsoever with respect to instances of inappropriate accounting treatment.

Considering these facts above, it must be noted that internal control by the Audit Committee was not functioning.

5. Audits by the accounting auditor

Most of the accounting treatment issues that were the scope of this Investigation were not noted in the course of the audit (including the quarterly review) undertaken by the accounting auditor. As a result, the control via external audit was not functioning sufficiently. One of the reasons for that is that most of the instances of accounting

treatment in question were the intentional operation of internal accounting treatment, and were instances of inappropriate accounting treatment carried out in an institutional manner, and skillfully utilizing circumstances where confirming the facts based on external evidence was difficult, such as by using methods that were difficult for the accounting auditor to detect and, in response to questions and requests for materials from the accounting auditor, hiding facts or providing explanations by presenting materials creating stories different from the facts.

In particular, in the case of projects where the basis of the accounting treatment is an estimate based on internal data prepared by someone with detailed knowledge of the individual details of the construction, such as accounting treatment based on the percentage-of-completion method, it is very difficult for an outside accounting auditor to independently evaluate the reasonableness of those estimates, and basically such evaluations are premised on the effective functioning of the internal processes and internal controls for assuring appropriate estimates. Internal controls cannot function effectively without the will of the company's top management that would cause it to work effectively and support from relevant organizations. Under circumstances where the inappropriate involvement of certain top management or of the organization precludes the effective functioning of the internal control, an opportunity arises for the whole organization to try to protect itself by hiding facts or by undertaking inappropriate operations. It is very difficult for an accounting auditor in many cases, which is an independent third party, to obtain strong evidence to overturn the concealment of facts or the creation of explanations different from the facts by a company's organization.

The purpose of this Investigation is to find out the facts, such as the details, causes, and background, etc., relating to the inappropriate accounting treatments undertaken by Toshiba, and this investigation has not been conducted for the purpose of evaluating the reasonableness of the audit by the accounting auditor, which represents its audit opinion with respect to the overall financial statements of the company, in other words, for the purpose of investigating whether or not there was an issue in the procedures for that audit or any decisions in that audit. Attempting to evaluate the entirety of the audit of the auditor based only on the focused results of an investigation limited to individual aspects of problematic projects could lead to an incorrect evaluation of that audit and, in turn, could distort stakeholders' decisions. In order to evaluate whether or not the audit was appropriate as an external independent accounting auditor, it would be necessary to carry out a detailed investigation in an institutional manner from the perspective of the overall structure and processes of the audit business, and this Committee does not carry out any such evaluation; it only carries out an investigation in line with its delegated matters.

6. Performance evaluation system

Toshiba employs a performance evaluation system in relation to the compensation and wages of Officers and Employees. For example, the compensation of executive officers comprises a base compensation based on title and a role compensation based on work content. 40% to 45% of the role compensation is based on performance as of term-end of the overall company or division or department of which the officer is in

charge, and can range from 0x (no compensation) to 2x, and with the high degree by which it is linked to performance, there is a high possibility that it led to incentive or pressure to achieve budgets or “Challenges” based on the “over-riding current-term profit policy.”

7. Personnel rotation

At Toshiba, it was normal for employees assigned to a finance & accounting department/division to continuously work in the same department/division from hiring until retirement. Also, some employees, after serving as a General Manager of the Corporate Finance & Accounting Division, would assume the post of CFO and then go on to assume the position of an Audit Committee member. As a result, employees of finance & accounting department/divisions would engage in work relating to finance and accounting with basically the same colleagues they had been working with for a long period of time, from the time they are hired and until they retire.

As a result of such personnel rotations, it can be surmised that even if such an employee notices that an inappropriate accounting treatment has been carried out with the involvement of another employee of a finance & accounting department/division in the past, it could be difficult for the employee to actually correct the situation, due to a sense of camaraderie.

It can also be surmised that for persons who assumed positions as Audit Committee members after working for a long period in a finance & accounting department/division, even if they knew that inappropriate accounting treatment they had in the past been involved in was still continuing, it was difficult for them to correct the inappropriate accounting treatment due to a sense of camaraderie.

8. Insufficient use of the whistleblower system

A whistleblower system was put in place at Toshiba, and there had been dozens of reports made annually. However, no report was made regarding this case. Considering the size of Toshiba, the number of cases where the whistleblower system has been used is not significant, and it can be surmised that the whistleblower system has not been sufficiently used for some reason.

Also, the incident that led to the discovery of the inappropriate accounting treatment issues relating to these projects in which the percentage-of-completion method was used was an inspection by the Securities and Exchange Surveillance Commission of information disclosed by Toshiba, so it can be considered that the fact that Toshiba’s employees do not trust Toshiba’s stance on compliance can be also a cause of the fact that the self-correcting mechanism of Toshiba’s whistleblower system did not work.

Chapter 8. Measures for Preventing Recurrence (Recommendations)

I. Basic thinking

As a result of this investigation, certain facts were recognized by which the appropriateness of accounting treatment could be seen to be lacking, so the Committee sets out below its recommendations with respect to measures for preventing recurrence based on the findings of facts relating to the cases that were investigated as described above and the analyses of the causes conducted based on those findings.

The basic thinking (perspective) in making recommendations for measures to prevent recurrence was, with respect to the direct causes of the cases investigated as described above, to recommend measures the purpose of which is to eliminate those very causes themselves and, with respect to the indirect causes of the cases investigated, to recommend measures the purpose of which is to correct those causes through both tangible measures and intangible measures.

II. Measures for preventing recurrence

1. Elimination of direct causes

(1) Self-awareness of the responsibility of executives involved in inappropriate accounting treatment

As already described, it can be found that certain senior management including the P, GCEO, CFO and CP at the Companies has been involved in inappropriate accounting treatment in some cases.

Also, even if there was no direct involvement, it can be found that there were directors and executive officers who were aware of or tolerating of intentional initiatives to “overstate current-term profits” through inappropriate accounting treatment.

It will be necessary for each of these directors and executive officers to recognize his or her own level of responsibility depending on the extent of his or her involvement and the role he or she played, and that appropriate personnel measures be carried out regarding such personnel.

(2) Clarification of the responsibility of persons involved

Aside from directors and executive officers, there are also Officers and Employees who were involved in inappropriate accounting treatments or those who were aware of and accepting of intentional initiatives to “overstate current-term profits” through inappropriate accounting treatments.

Of these Officers and Employees, it would be desirable to carry out personnel

measures (potentially including disciplinary proceedings) against at least some key managers (for example, those in or above the role of general manager) upon adequate verification of the extent of their involvement.

(3) Change in mindset of top management

First and foremost, top management needs to maintain a strict compliance attitude and have self-awareness of the importance of undertaking appropriate financial reporting as a listed company, as well as to sufficiently understand that incidents such as the current inappropriate accounting treatments lead to a loss of credibility from the markets and stakeholders, which will significantly damage the corporate value, and to formulate and structure strict corporate ethics (a corporate philosophy).

In addition, top management should communicate in its message to all Officers and Employees the emphasis that it puts on compliance and the importance of appropriate accounting treatments, and the strict adherence thereto, as well as develop a fair and transparent corporate culture. Not only executives such as directors and executive officers, but also employees, should make efforts in personnel development, by carrying out training, instructions and supervision on a continual basis, in order to enhance awareness of compliance, and to cultivate and improve the understanding of the importance of appropriate financial reporting as a listed company and of appropriate accounting treatments.

(4) Budget formulation commensurate with company capability and abolition of the “Challenge” policy

The existence of the “Challenge” based on an overstated budget in excess of the corporate capability can be found as a cause of this series of inappropriate accounting treatments. While budgets and long-term business plans should be formulated based on local data that has been accumulated, adjustments through increases or decreases to such accumulated amounts should be planned from the viewpoint of the company overall and long-term management. However, a feasible and reasonable budget and long-term business plan must be formulated in line with company capabilities.

While the corporate behavior of establishing targets to achieve budget in itself should not be denied, Toshiba’s “Challenge” practice as described created inappropriate pressure (directions and orders) that falls outside of the scope of the internal control system, and as already described, was treated as compulsory targets that were strongly enforced. Particularly regarding “Challenge” initiatives in which the intent was to make a certain item achieve budget even if, as the quarter-end approached, it was difficult to improve profit with a concerted sales effort, “Challenge” initiatives of such a nature and timing should be abolished.

At the same time, there needs to be a change in the mindset permeating from top management to all Officers and Employees, from the position of forsaking a singular focus on current term profits to adopting a long-term perspective and recording and appropriately disclosing the profits actually achieved.

(5) Reforming corporate culture

The corporate culture in which employees cannot go against the intent of their superiors should be reformed.

Also, with regard to rules pertaining to the various types of accounting treatments prescribed to construct the internal controls at Toshiba mainly regarding financial reporting, all executives and employees should be informed that such rules must be complied with, regardless of the intent of any superior. When carrying out accounting treatments in accordance with these rules, all de facto rules should be abolished which cannot be executed when the immediate superior's prior approval is sought but cannot be obtained. Accounting treatments should be carried out based on the original rules.

(6) Reform of all accounting policies and rigorous application

Considering that accounting policies established at Toshiba were not appropriate and that the cause of inappropriate accounting treatments was in that accounting was not carried out compliant with accounting policies, there should be reforms in all accounting policies, including the percentage-of-completion method, as well as enforcement of the rigorous application thereof.

2. Elimination of indirect causes

(1) Tangible measures to prevent recurrence

(A) Establishment of new and enhanced internal control department

Many cases were found where the internal control systems of the Companies and Corporate and, in particular, the internal control systems relating to financial reporting did not work effectively due to direct instructions, etc. from members of the top management. Further, the Corporate Audit Division did not function effectively either in relation to such field.

As a result, one proposal for measures to improve the internal control department at the Companies is that the Finance & Accounting/Accounting Divisions of the Companies shall increase the number of personnel in the human resources structures in the Finance & Accounting/Accounting Divisions that can perform sufficient checks and balances, and establish an internal audit department that is independent from CP's instructions and orders system within the Companies.

Simply improving the internal control department within the Companies may not be adequate in countering inappropriate instructions from corporate top management, such as P and CP. For this reason, it is considered effective to abolish the Corporate Audit Division and to newly establish a powerful internal audit department that targets internal

audits of Toshiba and all group companies. The new internal control department should be independent from each division, Company, etc., acting as a large-scale unit made up of people who are proficient in the content of the business of each Company and group company, people who have knowledge of the law and compliance, and people who are sufficiently aware of finance and accounting matters, and carry out an integrated internal audit of all companies through persons who have highly expert knowledge of Toshiba and all group companies. This department should not report to top management such as P or CFO, but should ensure its independence from top management by reporting to the likes of outside directors, such that its auditing authority can be appropriately exercised even in the event of any wrongful act by top management. Furthermore, in order to enable the department to undertake an adequate and effective audit, it should be granted influential authority, such as the authority to request as much information as required from Officers and Employees. In addition, it will be effective to gain support from external auditors and legal experts as required. As such, budget measures should be established therefor.

(B) Enhancing the internal control (supervisory function) of the Board of Directors

In order to enhance the supervisory function of the Board of Directors by increasing the volume of information provided to the Board, the matters to be reported at the Board of Directors meeting should be clarified and expanded. For example, projects where a loss of a certain amount or more will or might be generated (including projects, etc., where it is found that a loss will be incurred at or after the time of execution of contracts for acceptance of construction orders) should be made matters for reporting to the Board of Directors.

Also, at least for an interim period, the recurrence of a situation where important matters are not reported to the Board of Directors can be prevented by using materials prepared for the CEO Monthly Meetings as material for reports to the Board of Directors.

(C) Enhancing the internal control (audit function) of the Audit Committee

Given the size of the Toshiba Group, it would be desirable to enhance the Group's structure, such as by increasing the number of Audit Committee members familiar with finance and accounting, and, taking into account the possibility that Audit Committee members who are internally appointed directors might need to engage in self-audits, to at least make an Audit Committee member who is an outside director the chair of the Audit Committee. Also, the human resource structures should be increased and enhanced as the support staff in the Audit Committee with knowledge of finance and accounting, and there should be enhanced cooperation with the Audit Committee members who are outside directors. As for the method of auditing, heavy emphasis should be placed on carrying out interviews with divisions and departments that are noted as having a high need for auditing.

(D) Utilization of a whistleblower system

A whistleblower system can also be referred to as the last line of defense in the internal control system. The system should be revised and sufficiently utilized so that whistleblowers can trust it and state their opinions safely.

Therefore, the entire Toshiba Group should be thoroughly informed about the existence and function of a whistleblower system, various measures taken to revise such whistleblower system into one that whistleblowers can trust and state their opinions safely, and the use of the whistleblower system promoted.

(2) Intangible measures to prevent recurrence

(A) Increase the number of outside directors and revise member structure

It is considered necessary to make efforts to enhance the corporate governance system and further ensure the independence of outside directors by increasing the number of outside directors, and to revise the member structure in light of the variety of expertise required of outside directors. In particular, it is considered necessary to appoint personnel that have legal knowledge and personnel that have knowledge of finance and accounting as outside directors that form the Audit Committee.

(B) Appropriate personnel rotations

It is necessary to strive to reform the current system regarding the responsible people in the internal audit department and the Audit Committee members in order to implement appropriate personnel rotations, by taking measures such as listening to the opinions of external experts.

In addition, appropriate personnel that are familiar with accounting and auditing business should be appointed as the personnel of the internal audit department and other departments that govern audits.

Chapter 9. Concluding Remarks

As a result of the Investigation conducted by the Committee, it has come to light that inappropriate accounting treatments were continuously undertaken at Toshiba.

Toshiba, with a 140 year history, is recognized as one of Japan's leading companies. Toshiba also became a "company with committees, etc." (*iinkai-to secchi kaisha*) early on, and has been recognized as a front runner in establishing a corporate governance structure and having an advanced corporate governance structure, and therefore should serve as a role model for many other companies.

Nevertheless, the discovery of continual inappropriate accounting treatments for significant amounts comes as a genuine surprise, and the betrayal of trust for so many stakeholders is truly a disappointment.

In the course of the Investigation by this Committee, many Toshiba executives and employees were interviewed, who by and large came across as devoted and sincere in undertaking their jobs. In the course of our interviews, in addition to the regret expressed by many of the Officers and Employees, there was remorse regarding the inappropriate accounting treatments, as well as a heart-felt desire to see Toshiba's regeneration. Similar messages were also received through the whistleblower system established by the Committee. It is the Committee's belief that the continued hopes and expectations bestowed upon Toshiba by the personnel from Toshiba and the various stakeholders will empower Toshiba's regeneration.

The Committee sincerely hopes that Toshiba will accomplish true regeneration with the help of this Report.

End of report

Exhibit 1 Overview of Digital Forensics

1. Overview of work related to computer forensics

Computer forensics is the collection and maintenance of electronic data without losing admissibility as evidence, and the viewing of the content of the electronic data that has been gathered. Specifically, computer forensics is classified under the following two categories:

(1) Securing and recovering data

Collection and preparation of reproductions of subject data and recovery of deleted data from PCs, file servers, and mail servers using specialized tools

(2) Viewing data

Storage of secured and recovered data in the viewing system, narrowing down of data subject to viewing using keywords, and viewing of content

2. Securing data

Electronic data (emails and various files) that was related to cases subject to the Investigation and stored on the PCs of 17 company personnel who did not take measures to secure the data during the digital forensics carried out by the Special Investigation Committee was collected and secured.

FTK Imager Lite and Encase Forensic were used for the collection and securing of electronic data.

3. Electronic data viewing

The secured electronic data is stored within Nuix, classified into the various categories of each application. That electronic data is uploaded to Relativity and converted into electronic data that can be viewed by the viewers. This time, the viewing implementation target for the data based on the approval of the Independent Investigation Committee was 31 people, including the data taken over from the Special Investigation Committee.

(Unit: JPY 100 million)

Cases under Investigation			Year 2008					Year 2009					Year 2010					Year 2011					Year 2012					Year 2013					Year 2014				Fiscal Year 2008 - Fiscal Year 2014 Q3
			Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q1-Q3 Total	
Percentage-of-completion method	Amount of adjustment	Sales	0	(5)	(20)	(15)	(40)	(4)	8	3	(7)	(0)	(1)	54	0	(0)	53	(0)	0	(0)	(2)	(2)	(1)	(6)	(12)	(11)	(30)	11	(228)	142	2	(73)	(31)	(14)	8	(37)	(128)
		Net profit before taxes and other adjustments	3	0	(39)	(0)	(36)	0	15	5	(19)	1	0	69	2	(0)	71	(0)	(1)	(1)	(77)	(79)	(13)	(12)	(8)	(146)	(180)	(18)	(467)	130	109	(245)	(9)	(3)	3	(9)	(477)
Parts Transactions	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
		Net profit before taxes and other adjustments	(34)	(142)	(51)	33	(193)	(91)	(122)	(73)	(6)	(291)	(136)	129	89	30	112	(154)	(76)	88	(19)	(161)	(79)	(34)	(37)	(160)	(310)	42	29	10	(84)	(3)	65	95	94	255	(592)
Expense processing	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(43)	10	0	30	(3)	(31)	1	4	27	2	(0)	(24)	(3)	23	(5)	(28)	14	(1)	(15)	(21)
		Net profit before taxes and other adjustments	-	-	-	(53)	(53)	(40)	(40)	80	(78)	(78)	(65)	(84)	97	(30)	(82)	(70)	(81)	78	104	32	(67)	(10)	24	52	(1)	4	(65)	(48)	139	30	12	9	43	64	(88)
Semiconductor	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
		Net profit before taxes and other adjustments	-	-	-	-	-	-	(20)	-	(12)	(32)	-	(20)	-	4	(16)	-	(0)	(54)	(50)	(104)	(81)	(60)	(110)	(116)	(368)	106	32	104	(78)	165	0	(18)	13	(5)	(360)
Total	Amount of adjustment	Sales	0	(5)	(20)	(15)	(40)	(4)	8	3	(7)	(0)	(1)	54	0	(0)	53	(43)	10	0	28	(5)	(32)	(5)	(8)	16	(28)	11	(252)	139	24	(78)	(59)	0	7	(52)	(149)
		Net profit before taxes and other adjustments	(31)	(142)	(90)	(20)	(282)	(131)	(167)	13	(115)	(400)	(201)	94	187	4	84	(224)	(157)	112	(42)	(312)	(240)	(116)	(131)	(371)	(858)	134	(471)	196	87	(54)	69	83	152	304	(1,518)

Exhibit 2-2

	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(36)	(36)	(17)	(7)	(7)	(32)	(68)									
	Gross profit on sales		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(255)	(0)	(255)	1	4	3	8	(247)									
Project I	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50	50	50	50	50	26	26									
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	77	77	88	88	88	90	90										
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	106	106	102	100	112	121	121	127	27	27	25	25	25	26	26													
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	163	163	158	154	172	187	187	197	99	99	99	99	99	99	98	98												
Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0	0										
	Gross profit on sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(57)	(57)	2	1	(6)	(5)	(8)	(4)	25	-	10	31	-	26	0	26	(9)											
Project J	Before adjustment	SP	114	115	113	112	112	112	111	112	110	110	109	108	108	107	107	107	144	144	149	149	146	143	142	142	142	143	143	144	144	144	144	144	144	144	144	144										
		NET	105	106	107	107	107	107	108	109	102	102	104	104	104	104	104	104	131	131	138	138	138	135	135	135	135	133	116	116	117	117	117	121	112	112												
	After adjustment	SP	114	115	113	112	112	112	111	112	110	110	109	108	108	107	107	107	144	144	149	149	146	143	142	142	142	143	143	143	144	144	144	144	144	144	144	145										
		NET	105	106	107	107	107	107	108	109	102	102	104	104	104	104	104	104	131	131	138	138	138	135	135	135	135	133	133	133	133	134	134	134	134	134	134	134										
Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(17)	(1)	(1)	(19)	4	7	9	19	1							
	Gross profit on sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(17)	(1)	(1)	(19)	4	(8)	2	(2)	(20)							
SIS Company	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(17)	(1)	(37)	(55)	(13)	(1)	1	(12)	(67)							
	Gross profit on sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(57)	(57)	2	1	(6)	(5)	(8)	(4)	(247)	(1)	9	(243)	5	23	5	32

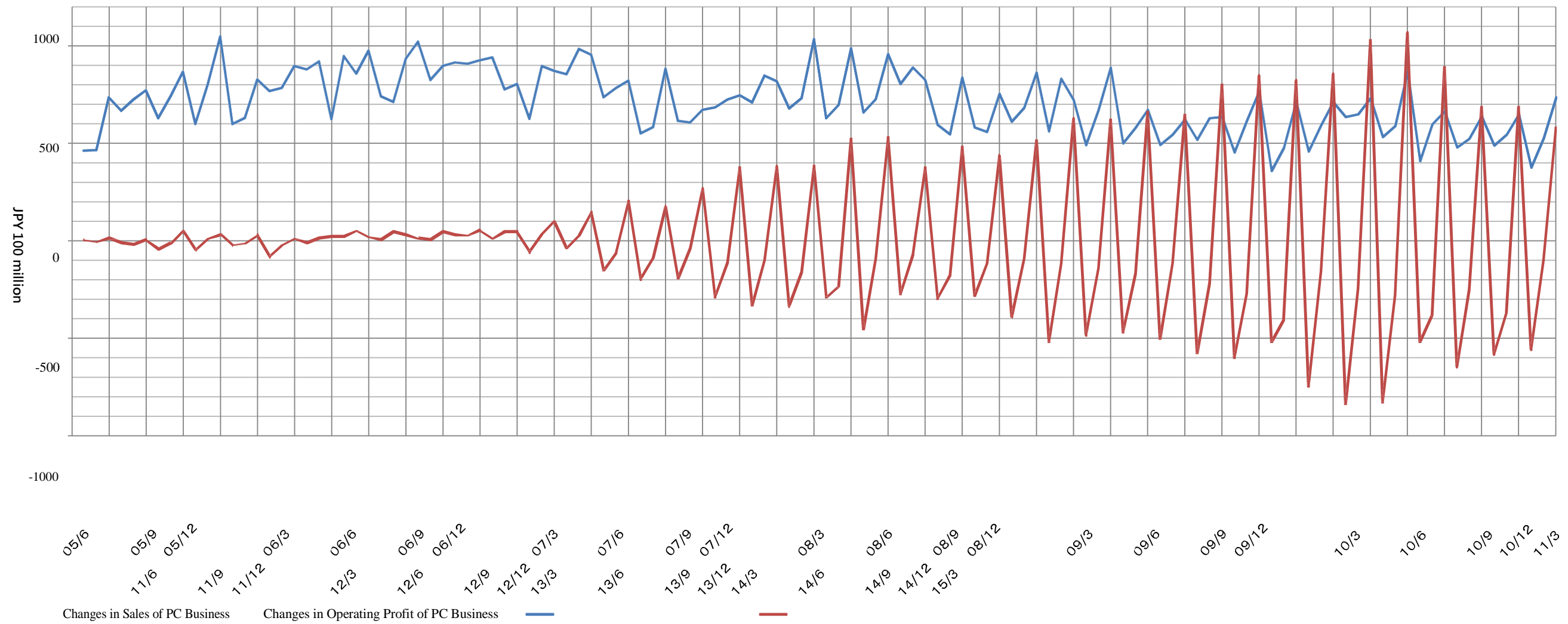
Exhibit 2-2 (continued)

(Unit: JPY 100 million)

Cases under Investigation			Year 2008					Year 2009					Year 2010					Year 2011					Year 2012					Year 2013					Year 2014			Q1-Q3 Total	Fiscal Year 2008 - Fiscal Year 2014 Q3
			Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3	Q4	Yearly	Q1	Q2	Q3		
Project K	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	97	97	97	97	97	104	104	104	104	104	121	121	121	121	121			
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	88	88	89	89	89	104	104	104	104	104	156	156	156	156			156
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	97	97	97	104	104	104	104	104	121	121	121	121	121			
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	112	112	112	260	260	260	260	247	300	300	300	319				
	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2)	(2)	(1)	(6)	(12)	(11)	(30)	11	(4)	(9)	(5)	(7)	(3)	(6)			(10)
Gross profit on sales		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(0)	(0)	(15)	(1)	(1)	(140)	(156)	-	-	12	(0)	12	-	-	(19)			
CS Company	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2)	(2)	(1)	(6)	(12)	(11)	(30)	11	(4)	(9)	(5)	(7)	(3)	(6)	(10)			
		Gross profit on sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(0)	(0)	(15)	(1)	(1)	(140)	(156)	-	-	12	(0)	12	-	-	(19)		
Project L	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	5	5	5	5	5	5	5	5	5	5	5	5	5	5	-	-		
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	5	6	6	6	6	6	6	6	6	6	15	15	-	-	-		
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	5	5	5	5	5	5	5	5	5	5	5	5	5	-	-		
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	5	6	6	16	16	16	16	16	16	16	15	15	-	-	-		
	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
Gross profit on sales		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
Project M	Before adjustment	SP	-	-	-	-	-	-	-	33	33	33	40	40	-	40	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			
		NET	-	-	-	-	-	-	-	33	33	33	55	57	-	57	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			-
	After adjustment	SP	-	-	-	-	-	-	-	33	33	33	40	40	-	40	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			-
		NET	-	-	-	-	-	-	-	43	43	43	57	57	-	57	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			-
	Amount of adjustment	Sales	-	-	-	-	-	-	-	(2)	(2)	(1)	2	0	-	2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			-
Gross profit on sales		-	-	-	-	-	-	-	(11)	(11)	0	9	2	-	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-			
Project N	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	21	20	21	21	21	21	21	21			
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	16	16	16	16	16	16	17			20
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	21	20	21	21	21	21	21			21
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	16	16	16	16	16	17	25			26
	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2)	3	0			0
Gross profit on sales		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(4)	4	(0)	(0)			
Project O	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	108	112	121	121	131	133	136	137	137	155	156	156				
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	105	103	103	103	103	103	105	111	111	124	124			133	
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	108	112	121	121	131	133	136	137	137	155	156	157				
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	105	103	103	103	103	103	105	111	111	138	143	145				
	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(13)	(8)	9			(12)	(12)
Gross profit on sales		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(13)	(8)	9	(12)	(12)		
Project P	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	59			
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	56			
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	59	59			
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	69	65				
	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(0)	(0)	(0)			
Gross profit on sales		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(10)	4	(7)	(7)			
Project Q	Before adjustment	SP	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25			
		NET	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22			
	After adjustment	SP	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	25	30	30				
		NET	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	22	36	36				
	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1)	(0)	(1)	(1)			
Gross profit on sales		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(7)	(0)	(7)	(7)				
Project R	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	144	144	144				
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	137	137	137				
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	144	144	144				
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	142	154	154					

	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(0)	(0)	(0)	(0)													
		Gross profit on sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(10)	(0)	(10)	(10)												
Project S	Before adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-													
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-													
	After adjustment	SP	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-													
		NET	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-													
	Amount of adjustment	Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-														
		Gross profit on sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(4)	(4)	4											
Other projects	Amount of adjustment	Sales	-	-	-	-	-	-	-	(2)	(2)	(1)	2	0	-	2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(13)	(11)	11	(13)	(13)									
		Gross profit on sales	-	-	-	-	-	-	-	-	(11)	(11)	0	9	2	-	11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(10)	(10)	-	-	-	10	10	(13)	(40)	13
Total	Amount of adjustment	Sales	0	(5)	(20)	(15)	(40)	(4)	8	3	(7)	(0)	(1)	54	0	(0)	53	(0)	0	(0)	(2)	(2)	(1)	(6)	(12)	(11)	(30)	11	(228)	142	2	(73)	(31)	(14)	8	(37)	(128)														
		Gross profit on sales	3	0	(39)	(0)	(36)	0	15	5	(19)	1	0	69	2	(0)	71	(0)	(1)	(1)	(77)	(79)	(13)	(12)	(8)	(146)	(180)	(18)	(467)	130	109	(245)	(9)	(3)	3	(9)	(477)														

Changes in Monthly Sales/Operating Profit of PC Business (April 2005 - March 2015)



(Unit: JPY 100 million)

	April	May	June	July	August	September	October	November	December	January	February	March	Yearly
Fiscal Year 2005	465	468	737	669	726	773	631	742	867	601	803	1,046	8,527
Fiscal Year 2006	601	632	828	769	786	896	880	920	626	947	858	975	9,718
Fiscal Year 2007	742	714	933	1,021	826	897	915	908	926	940	778	805	10,404
Fiscal Year 2008	628	896	872	855	983	954	738	785	822	553	586	883	9,553
Fiscal Year 2009	617	609	674	686	726	747	711	847	819	681	733	1,032	8,881
Fiscal Year 2010	631	698	986	660	727	957	805	888	826	597	548	837	9,160
Fiscal Year 2011	584	561	754	613	683	862	564	832	724	494	671	887	8,229
Fiscal Year 2012	502	582	673	495	547	624	520	631	637	456	616	767	7,051
Fiscal Year 2013	362	479	714	461	595	712	637	650	733	535	591	869	7,339
Fiscal Year 2014	412	599	665	482	526	639	492	547	649	380	529	737	6,658

(Unit: JPY 100 million)

	April	May	June	July	August	September	October	November	December	January	February	March	Yearly
Fiscal Year 2005	8	(2)	17	(5)	(12)	9	(37)	(8)	55	(43)	15	37	34
Fiscal Year 2006	(19)	(10)	33	(76)	(17)	15	(6)	17	28	25	56	22	69
Fiscal Year 2007	12	51	33	16	11	50	35	31	58	15	50	50	412
Fiscal Year 2008	(53)	41	102	(33)	31	149	(148)	(55)	207	(192)	(84)	179	145
Fiscal Year 2009	(188)	(34)	270	(284)	(107)	379	(326)	(96)	384	(330)	(157)	389	(99)

Fiscal Year 2010	(286)	(232)	527	(451)	(86)	534	(268)	(66)	381	(292)	(172)	484	73
Fiscal Year 2011	(277)	(112)	440	(386)	(86)	521	(514)	(114)	630	(479)	(136)	626	114
Fiscal Year 2012	(463)	(165)	663	(500)	(110)	651	(573)	(215)	806	(597)	(266)	850	82
Fiscal Year 2013	(515)	(401)	827	(742)	(153)	859	(835)	(243)	1,031	(824)	(276)	1,072	(199)
Fiscal Year 2014	(515)	(377)	895	(642)	(247)	690	(577)	(365)	689	(553)	(97)	585	(515)