

June 22, 2022

To Daito Trust Construction Co., Ltd.

Investigation Report

The Investigation Team for the Inquiry into Improper Accounting Treatment at
Consolidated Subsidiaries of Daito Trust Construction Co., Ltd.

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1 Preamble

In response to the discovery of improper accounting treatment performed by an employee of Daito Trust Construction Co., Ltd. (hereinafter “the Company”) at a consolidated subsidiary, we conducted an investigation.

The results of this investigation are reported below.

2 Events leading up to the discovery and the formation of the Investigation Team

(1) Events leading up to the discovery of improper accounting treatment

On April 13, 2022, “A,” the Representative Director and President of the Company’s consolidated subsidiary, Daito Kentaku Leasing Co., Ltd. (hereinafter “Daito Kentaku Leasing”) reported that they suspected “X,” the Assistant Manager of the Accounting Department of the Company, of making improper use of expenses. This triggered the launch of an internal investigation by the Internal Auditing Division. The team conducting the investigation was composed of three members, including the General Manager of the Internal Auditing Department.

In addition, on April 26, 2022, X voluntarily reported to “B,” Executive Officer and General Manager of the Accounting Department of the Company, that the amount of accounts payable and accrued expenses at Daito Kentaku Leasing in relation to which there were doubts regarding improper recording came to approximately ¥500 million. As a result, the Accounting Department of the Company decided to begin an internal investigation in parallel with the Internal Auditing Department. The team conducting this investigation was composed of 10 members, including B, and was led by “C,” the Director responsible for the Accounting Department.

(2) The beginning of the investigation and the investigation team

On May 10, 2022, “D,” an Outside Director of the Company, received a report from C. After consultations between D, C, and B, it was determined that the investigations being conducted by the Internal Auditing Department and the Accounting Department would continue. In addition, it was decided to add four lawyers, 18 certified public accountants, and two digital forensics specialists to those involved in the investigative operations, with the objectives of ensuring, in their role as external experts, the impartiality and neutrality of the internal investigation, and of confirming and guaranteeing the appropriateness and objectivity of the internal investigation.

3 Investigative methods and others

(1) Purpose of the investigation

The purpose of the investigation (hereinafter “the Investigation”) conducted by the investigation team that included the external experts (hereinafter “the Investigation Team”) was to clarify the cases of improper accounting treatment performed by X (hereinafter “the Cases”) and revealed by the internal investigation, as well as tasks such as investigating whether other parties were involved, investigating whether similar cases had taken place, and analyzing their causes.

(2) The investigation into the Cases and potential similar cases

The Investigation Team conducted investigations into the Cases and into potential similar cases (hereinafter “Peripheral Investigation,” with the investigation into the Cases and potential similar cases hereinafter collectively referred to as “the Cases, etc.”). In terms of the investigation into the Cases, the Investigation Team confirmed the details and cases covered in internal investigations conducted by the Internal Auditing Department and the Accounting Department and then verified whether the above-mentioned investigations were conducted appropriately. Furthermore, a separate investigation was conducted by the Investigation Team through further interviews with those involved, scrutiny of materials, digital forensic examinations, and other measures. The Investigation Team also conducted a Peripheral Investigation in order to check whether transactions similar to but different from the Cases had taken place.

(3) Period over which the investigation was conducted

The period over which the investigation, including the preliminary investigation, was conducted was April 13, 2022, to June 21, 2022.

(4) Scope of the investigation

a) Companies and businesses covered by the investigation

The companies covered by the investigation were Daito Trust Construction Co., Ltd., Daito Kentaku Leasing, and Daito Kentaku Partners Co., Ltd. (hereinafter “Daito Kentaku Partners”).¹

b) Period covered by the investigation

Based on the time at which X became responsible for accounting, it was decided that the investigation would cover the period from the fiscal year ended March 31, 2019,² to the fiscal year ended March 31, 2022, in the case of Daito Kentaku Leasing, and the period from the fiscal year ended March 31, 2018, to the fiscal year ended March 31, 2022, in the case of Daito Kentaku Partners.

Furthermore, with regard to the “Beta Department” of the Company, which was suspected of having been involved in the improper recording of accrued expenses by X, the period covered by the investigation was from December 31, 2019, when this department first began using accounting ledgers, to the fiscal year ended March 31, 2022.

(5) Investigative methods implemented

a) Interviews

Between May 13, 2022, and June 15, 2022, a total of 50 interviews were conducted with 28 individuals, such as multiple related parties with significant involvement, including X, related parties at Daito Kentaku Leasing, and external related parties (such as president of Company A).

b) Scrutiny of materials related to the transactions and analysis of transaction data

The Investigation Team received submissions of accounting documents and

¹In addition, as part of the Peripheral Investigation, a questionnaire was implemented that also covered those involved in accounting at subsidiaries and affiliates.

²In the fiscal year ended March 31, 2018, approval of journal entries was conducted by section managers and not by X; therefore, there was no impact by X on accounting treatment. However, given that it was in the fiscal year ended March 31, 2018, that X was appointed Assistant Manager at Daito Kentaku Leasing, this period was included in procedures to verify journal entries that were within X’s sphere of influence.

evidence related to the Cases from the Company, Daito Kentaku Partners, Daito Kentaku Leasing, and certain business partners, which were then scrutinized and analyzed.

For the Peripheral Investigation, the Investigation Team received submissions of accounting documents and evidence related to journal entries, extracted on the basis of the degree of risk entailed, from the Company, Daito Kentaku Partners, and Daito Kentaku Leasing, which were then checked and analyzed.

c) Digital forensics examination

In addition to the corporate PC and smartphone of X and of one employee of Daito Kentaku Leasing being retained, a digital forensic examination was conducted of mail server data for these two individuals, a former employee³ of Daito Kentaku Partners, and A.

d) Questionnaire

Between June 1, 2022, and June 14, 2022, the Investigation Team conducted a questionnaire survey, on a non-anonymous basis, of 64 people involved in accounting at the Company, and 70 people involved in accounting at subsidiaries and affiliates. Responses were received from all 134 people to whom the questionnaire was directed. The questionnaire was implemented in such a way that only the Investigation Team was able to view the results. The content of the responses was checked and, to the extent necessary, followed up.

e) External confirmation

In the case of external business partners where there was a possibility of involvement with the improper accounting treatment, interviews, email, and other methods were used to check the facts of the matter, and related evidence and other information was obtained and verified.

(6) Assumptions and limitations of the investigation

This report is a summary of the investigation and analysis conducted to the extent considered appropriate by the Investigation Team. Nevertheless, given that those

³This individual was selected because, at the time that the improper accounting treatment was performed by X, they were assigned to the Construction Control Department of Daito Kentaku Partners. This individual is currently seconded from Daito Kentaku Partners and is working at a subsidiary within the Company's group.

conducting it had no coercive investigative authority, it is undeniable that the Investigation had certain limitations. Furthermore, because the purpose of the Investigation was to examine the Cases, etc., and because it was performed on behalf of the Company, the Investigation Team is responsible only to the Company and not to any third parties.

4 Details and results of the investigated cases

(1) Results of the investigation into the Cases and the Peripheral Investigation

a) Results of the investigation into the Cases

As a result of the investigations of the Investigation Team, all of the cases in (2) below, with the exception of “q) Other,” were identified as instances of improper accounting treatment. However, among those instances, “m) Overstatement of expenses related to outsourcing of contract reading in accounts payable” and “p) Gratuitous transfer of business assets” were identified as errors, while all others were recognized to be fraudulent.

b) Results of the Peripheral Investigation

During the conduct of the Peripheral Investigation described above, the Investigation Team did not identify any instances of improper accounting treatment.

(2) Overview of each case

In relation to the Cases, the Investigation Team identified the following as instances of improper accounting treatment that were instigated by X, either at their instruction or by their approval.

a) Overstatement of campaign travel expenses in accrued expenses at a consolidated subsidiary (FY2018, ¥265 million)

b) Recording of recruitment expenses in accrued expenses without sufficient grounds for treatment (FY2018, ¥100 million)

c) Double-counting of campaign travel expenses in accounts payable at a consolidated subsidiary (FY2019, ¥308 million)

d) Recording of advertising and other expenses in accrued expenses based on invoices not grounded in actual transactions (FY2020, ¥230 million; FY2021, ¥8

million)

- e) Improper payment of advertising and other expenses based on invoices not grounded in actual transactions and other issues (FY2021, ¥162 million)
- f) Improper payment of advertising expenses based on invoices not grounded in actual transactions (FY2021, ¥29 million)
- g) Overstatement of expenses related to evacuation area signage in accounts payable and others (FY2018, ¥488 million)
- h) Double-counting of provision for bonuses at a consolidated subsidiary (FY2018, ¥261 million)
- i) Overstatement of expenses for safety harnesses in accounts payable (FY2018, ¥42 million)
- j) Overstatement of expenses for cleaning programs and others in accounts payable (FY2019, ¥203 million)
- k) Non-recording of post-closing expenses related to CK system (FY2020, ¥106 million)
- l) Understatement of provision for restoration of facilities to original state at a consolidated subsidiary (FY2020, ¥360 million)
- m) Overstatement of expenses related to outsourcing of contract reading in accounts payable (FY2019, ¥41 million)
- n) Other improper accounting treatment
 - (i) Recording of sales not grounded in actual transactions, related to free usage arising from system problems (FY2021, ¥1.2 million)
 - (ii) Recording of sales not grounded in actual transactions, achieved by impersonation and the use of business operator ID (FY2021, ¥3.1 million)
 - (iii) Recording of transactions related to system development expenses via external business operator (FY2021, ¥6.8 million)

- (iv) Reallocation of costs by using a construction company (FY2021, ¥19 million)
- (v) Recording of accounts payable following approval beyond authority (FY2019, ¥30 million)

- o) Improper use of expenses
 - (i) Purchase of commuting pass for Shinkansen use, and charges to electronic money (¥452,000)
 - (ii) Other use of expenses not approved by company (¥96,000)

- p) Gratuitous transfer of business assets (loss on transfer of ¥347,000)

q) Other

In the “Alpha Business,” X took improper actions such as unauthorized use of external meeting rooms, unauthorized agreements with an external consultancy company, possessing and using the seal of a business partner, and failing to report income for the Alpha Business. In addition, although 12 tablets used in the Alpha Business were listed as sold in the control ledger, one was provided free of charge to a business partner, and it is unclear how the rest were disposed of.

5 Accounting impact and analysis

The financial impact on previous fiscal years of the improper accounting treatment in the Cases is as follows. Because quantifying the impact and effects on income taxes and others in the event of a restatement would require the Company to form a view with regard to accounting treatments that would arise, this impact is not included in the amounts set out below.

(Millions of yen)

Parenteses indicate a decline	FY2017	FY2018	FY2019	FY2020	FY2021
Net Sales	–	–	–	–	(4)
Cost of sales	–	(530)	(134)	1,070	(466)
Gross profit	–	530	134	(1,070)	461
Selling, general and	–	(627)	(37)	(109)	48

administrative expenses					
Operating income	–	1,157	171	(961)	413
Ordinary income	–	1,157	171	(961)	413
Extraordinary loss	–	–	–	–	0
Income before income taxes	–	1,157	171	(961)	412

6 Involvement of corporate officers

Taking into account that X had been responsible for accounting at Daito Kentaku Leasing and Daito Kentaku Partners as well as being in charge of the Alpha Business, the following individuals were selected for investigation: E, who served as General Manager of Real Estate Business Headquarters for Daito Kentaku Leasing and Daito Kentaku Partners between April 2017 and March 2020; F, who, in addition to serving as president of Daito Kentaku Partners since April 2017, has served as General Manager of Real Estate Business Headquarters for Daito Kentaku Leasing and Daito Kentaku Partners since April 2020; and A, who has served as president of Daito Kentaku Leasing since April 2017.

The result of the investigation was that none of the corporate officers were recognized as having ordered X to perform improper accounting treatment and also that there was no evidence that any of them had a clear awareness of the improper accounting treatment.

7 Motivation for performing the improper accounting treatment in these cases

(1) Improper accounting treatment at Daito Kentaku Leasing

It is thought that X had a strong awareness of the desirability of minimizing the divergence between actual results and budgets⁴ and believed that in order to achieve increases in revenue and profit for the whole Company, the Accounting Department was expected to contribute to achieving targets by maintaining the externally announced figures for the whole Company. Accordingly, X utilized their position as

⁴In some cases this may mean recent forecasts or expectations, but below they are referred to uniformly as “budgets.”

a person responsible for accounting to use various accounting treatments. It is possible that by utilizing accounting treatments to respond to what X perceived as the expectation to maintain the externally announced figures for each fiscal year, X fulfilled their own need for approval, resulting in a greater presence within the company, and leading in turn to a greater sense of self-satisfaction. Moreover, it may be inferred that when performing the improper accounting treatments, X themselves took a relatively light-hearted approach to these actions.⁵

(2) Improper accounting treatment at Daito Kentaku Partners

In the same way as for Daito Kentaku Leasing, it is possible that X fulfilled their own need for approval through keeping actual results in line with budgets by utilizing accounting treatments, resulting in a greater presence within the company, and leading in turn to a greater sense of self-satisfaction. In addition, when the Construction Control Department was given warnings in internal meetings, this was perceived by X as a reprimand, and their attempts to address this in some way may also have led to their use of improper accounting treatment.

(3) Improper accounting treatment related to the Alpha Business

It is thought that X believed that their overriding mission was to secure sales for the Alpha Business, the business for which they themselves were responsible, and that they used improper accounting treatments to achieve sales targets.

(4) Personal use of expenses

X found the administrative procedures for processing expenses burdensome and, in some cases, made errors in these procedures, leading to them using expenses without approval from the company.

8 Factors behind the occurrence of the Cases

(1) Purpose and policy on analysis of causes (overview)

In this report, it was decided to focus exclusively on the analysis of causes in relation to the internal control system for financial reporting.

⁵It is thought that X took a light-hearted approach to beginning the improper accounting treatments because their attitude was that even if problematic provisions were recorded, they could be corrected by reversing them at a later date (that is, they believed that the improper accounting treatments could be rectified at some point in the future). Another reason is that X was a former certified public accountant with considerable financial knowledge and was aware of the possibility of being somehow able to cancel them out through accounting treatments.

(2) Analysis of causes

a) Background information

Among certain employees of the Company there was an awareness that the management team would do everything possible to achieve the figures in the publicly announced earnings forecasts and others. It is possible that this led to a strong sense that divergences between budgets and actual results should be minimized⁶ and that this provided the background to the occurrence of the Cases, etc. For X in particular, because they were the person creating the budget and the person responsible for accounting at Daito Kentaku Partners and Daito Kentaku Leasing, they were even more tightly focused on divergence between the budget and actual results. Another factor was that it was possible for X, as a person with authority to approve journal entries, to adjust actual results at their own discretion, enabling them to circumvent verification of the accuracy of the closing of accounts.

In addition, in the Accounting Department of the Company, nearly all the employees in the group responsible for the accounting operations of Daito Kentaku Partners and Daito Kentaku Leasing were transferred from these two companies. Because of this, the culture was in many respects different than that of other groups within the Accounting Department, and there was a lack of active communication between groups, which may have led to divisions and the like within the department that, for example, made it difficult for people to consult with one another.

b) Control activities

- (i) X served as the person responsible for accounting at Daito Kentaku Partners and Daito Kentaku Leasing, and due in part to their former status as a certified public accountant their accounting treatments were trusted completely by both A and F, who did not consider replacing X with a different individual in the role of person responsible for accounting. Accounting personnel were unable to raise objections to X, which effectively meant that X's position did not change. Furthermore, the accounting processes for each company were not unified and it was not possible to transfer personnel between different groups, leading to a

⁶The management team of the Company had a strong and long-standing perception that the figures "promised" to shareholders must be achieved without fail. Executives in the administrative divisions tended to make allowances for this attitude among the management team. It is undeniable that the facts raised in this document may also have led to this awareness permeating the Accounting Department.

situation in which there was no option but to continue to allow X to serve as person responsible for accounting at Daito Kentaku Partners and Daito Kentaku Leasing. In this way, it could be said that one of the causes of these occurrences of improper accounting treatment was that X was able to maintain their approval authority as the person responsible for accounting at both companies.

- (ii) Another cause may have been that, while serving as person responsible for accounting at Daito Kentaku Leasing, X had payment authority for the Alpha Business for which they themselves were also responsible. As a result, X was simultaneously both the person with authority for approving requests to pay invoices and the person responsible for accounting who approved journal entries. It is undeniable that this resulted in a situation where internal checks did not function adequately.

c) Control environment

Since X and accounting personnel were in a superior-subordinate relationship, it was difficult to oppose X's orders, and particularly so due to the existence of rumors that X had in the past caused people to be transferred and the workplace environment. There were also careless preconceptions such as assuming that statements by X, a former certified public accountant, must have some basis in fact. The result was a lack of compliance awareness among accounting personnel, such that X's instructions were not treated with any particular suspicion, and were obeyed without objection even if they were thought slightly odd, which was likely another cause of the improper accounting treatment.

Moreover, the compliance training that was conducted by the Company at regular intervals was aimed exclusively at branches, and no training was provided for the head office and, in particular, no training covering fraudulent accounting was conducted. It seems likely that, partly for this reason, accounting personnel had a lack of awareness and recognition of fraudulent accounting, despite working in the Accounting Department.

d) Information and communication

Some of the accounting personnel were aware of the improper accounting treatment by X. Still, because the internal reporting system was not used, they were unable to prevent the expansion of these treatments. It is thought that the internal reporting system was not used because of misunderstandings such as the idea that the internal reporting system had no duty of confidentiality and that the existence

of the report and the content of the report would become known within the company.⁷

e) Monitoring (surveillance activities)

The Internal Auditing Department has 22 employees working for it, of whom five belong to the J-SOX Promotion, with the remaining 17 working on internal audit. However, because the percentage of visits to branches by the Internal Auditing Department is extremely high while the frequency of audit visits to the head office is low, amongst other reasons, it is likely that auditing of the Accounting Department by the Internal Auditing Department has not been adequate, and this may have been another reason for the occurrence of the Cases, etc.⁸

End

⁷Looking at the Company on a non-consolidated basis, more than 300 internal reports are received annually, which is by no means a low number. However, the operation of the internal reporting system was focused on discovering compliance issues at the branch level, and because of the specialized nature of the operations in the Accounting Department, those involved felt uneasy about making a report because they feared that they would be found out if they did so. For that reason, no reports at all were made. Going forward, it will be necessary to implement measures to increase the number of reports from administrative divisions by devising investigative methods to keep the existence of reports a secret, such as conducting surprise inspections, and by ensuring that it is widely understood within the company that the person in charge of receiving reports has a duty of confidentiality and that those making reports will be protected.

⁸As for the reason for internal audit not functioning effectively in relation to the Accounting Department, it is likely that, in the same way as the internal reporting system, audits of the Company put the emphasis on discovering compliance issues at branches, and little attention was paid to auditing head office and administrative divisions. Accordingly, one issue going forward is likely to be increasing the number of auditing personnel who have the skills to exert the assurance and leadership functions that are necessary for internal audit of the Accounting Department.