

March 29, 2019

CMK Corporation

## **Announcement on External Law Firm's Investigation Findings and the Company's Remedial Measures**

We deeply apologize to our customers, shareholders, and all other stakeholders for any inconvenience and concern caused by the matter we announced on December 14, 2018, in our press release titled "Unauthorized Change relating to Manufacturing Process." Although we agreed with some customers that their prior authorization must be obtained before changing our products' manufacturing processes, we continued changing our manufacturing processes in ways such as changing the place of manufacture of our products or outsourcing a certain part of the manufacturing processes to third parties without obtaining the necessary authorization from the relevant customers (the "**Unauthorized 4M Changes**"). We took it seriously that we were unable to rectify the Unauthorized 4M Changes that had been carried out over an extended period, and retained an external, independent law firm to conduct a thorough investigation to uncover the facts and analyze the causes of this matter.

In response to the external law firm's investigation findings in the report, we have determined the responsibility of our executives, formulated measures to prevent a recurrence of the Unauthorized 4M Changes, and hereby publish the "Investigation Report" (summarized version) (the "**Report**"). This summarized version of the Report is based on the investigation report provided by the external law firm.

We take the investigation findings extremely seriously, and will make every effort to thoroughly prevent a recurrence of the Unauthorized 4M Changes and restore the trust of our customers, shareholders, and all other stakeholders.

### **1. Summary of Facts**

Until the early 2000s, when we mainly manufactured products for electrical appliances, the Unauthorized 4M Changes were regularly made in cases where there was a need to avoid delays in delivery of our products or to change a manufacturing factory in order to utilize less busy factories. The oldest Unauthorized 4M Changes verified through objective materials is one made in 2002, but we found that the Unauthorized 4M Changes had been continuing since prior to 2002.

Since the 2000s, we have manufactured parts for automobiles, the changes in the manufacturing processes of which were to be strictly managed, and around the same period, the importance of the management of changes in the manufacturing processes came to be emphasized. However, the above-mentioned practice and attitudes of executives and employees did not change, and it became common practice for us to make the Unauthorized 4M Changes.

Around 2012, we received complaints on quality from some customers regarding the products subject to the Unauthorized 4M Changes, and in response, we devised measures to deal with them. However, such measures were not sufficiently effective, as even after that the Unauthorized 4M Changes continued to be made.

For instance, large-scale Unauthorized 4M Changes were made throughout the company in around 2016 to avoid delays in delivery, which was caused by overcapacity of factories in Thailand, Niigata and Wuxi due to a drastic increase in actual orders made by customers. For more details on the causes of the Unauthorized 4M Changes that have been revealed as a result of the investigation, please refer to "Section 3: Causes of Problems" in the Report.

According to the investigation findings, the number of customers whose products we had made the Unauthorized 4M Changes was 175. We have confirmed that there is no substantial impact on quality due to the Unauthorized 4M changes, which we have reported to each customer, and are obtaining their consent accordingly.

## 2. Responsibilities of Executives

We are taking seriously the fact we significantly inconvenienced all the parties concerned regarding the Unauthorized 4M Changes, and in order to make clear the responsibilities of our executives regarding the Unauthorized 4M Changes, we have decided to change the positions and reduce the remuneration of the relevant directors of the Company as below. We will implement fundamental corporate reforms and steadily implement the measures to prevent recurrence of the Unauthorized 4M Changes based on proposals from the external law firm that conducted the investigation.

### (1) Change of Positions

Mr. Takeo Takai, Chairman and Representative Director, became aware of the problem of the Unauthorized 4M Changes but failed to rectify the issues as President and Chief Executive Officer at the time. As announced today in the press release titled “Announcement on Retirement of the Representative Director and Change of Position of Executives,” Mr. Takai indicated his intention to retire from the position of Representative Director in order to make it clear that he holds management responsibility for the Unauthorized 4M Changes (he will remain as a member of the Board of Directors). Mr. Takai’s retirement was approved by the Company’s Board of Directors’ meeting held today. At the closure of our 59th Annual General Meeting of Shareholders, which is scheduled to take place in late June, 2019, Mr. Takai will cease to be a director of the Company as his term of office will expire at such time.

In addition, as we announced today in the press release titled “Announcement on Retirement of the Representative Director and Change of Position of Executives,” at our Board of Directors meeting held today, it was determined that the position of Mr. Shibata, who was engaged in the implementation of the Unauthorized 4M Changes as Director in charge of sales, was changed from Director and Executive Managing Officer to Director and Executive Officer.

### (2) Reduction in Remuneration

Chairman and Representative Director	Takeo Takai	50% of monthly compensation (three months from April, 2019)
President and Chief Executive Officer	Isao Osawa	50% of monthly compensation (three months from April, 2019)
Director and Executive Managing Officer (in charge of manufacturing)	Eizo Shibata	30% of monthly compensation (three months from April, 2019)
Director and Executive Officer (in charge of internal control)	Hiroshi Hanaoka	30% of monthly compensation (three months from April, 2019)
Director and Executive Managing Officer (in charge of accounting and finance)	Akira Kurosawa	15% of monthly compensation (three months from April, 2019)

## 3. Remedial Measures to Prevent Recurrence

Taking into consideration the causes of the Unauthorized 4M Changes identified by the external law firm and its recommendations regarding remedial measures to prevent recurrence, we have formulated the measures below to prevent recurrence, which we will steadily implement going forward: (For the details on recommendations made by the external law firm, please refer to “Section 5: Recommendations concerning Remedial Measures to Prevent Recurrence” in the Report)

### (1) Strengthening Functions to Control Order Quantity

As pointed out by the external law firm, we have concluded that one of the major causes of the Unauthorized 4M Changes was that the functions to control the balance of production capacity and order quantity were weak. In order to centrally manage our production capacity and order quantity, we have established the Order Receipt Control Division and introduced a system to quantitatively indicate the status of products being delivered, and such system that

would allow the Company to take appropriate action plans depending on the status of delay in delivery products and balance between orders received and our manufacturing capacity. By introducing and operating a new production management system to manage the quantity of orders, we will ensure that our customers' orders do not exceed our production capacity while meeting the delivery date.

**(2) Strengthening the Monitoring System Involving Third Parties**

Furthermore, in light of the Report pointing out the malfunction of our monitoring system as one of factors of the Unauthorized 4M Changes, the Quality Committee, the members of which include external quality consultants, will be established to discuss matters such as the quality management system, the status of the management of manufacturing process and risks related to quality assurance. In addition, the Monitoring Committee consisting of an outside director and external counsel will be established to monitor the implementation of the remedial measures to prevent recurrence.

In addition, we will strengthen our internal auditing function by increasing the number of personnel in the Internal Auditing Office and conducting internal audits at least three times a year at each factory.

Moreover, we will disseminate the existence of our internal reporting system to our employees and promote the use of the internal reporting system.

**(3) Improving Moral Standards for Compliance and Quality Assurance**

We took seriously the comments from the external law firm on the lowering of moral standards for compliance and quality assurance, and have formulated the following measures:

**A Message from Top Management**

Twice in December 2018, top management declared that the Company would focus on compliance in operations going forward. Top management will continue to send similar messages to employees on a regular basis.

**B Improving Moral Standards for Compliance**

In addition to our management undergoing quarterly compliance training by external counsel, employees will undergo continuous and regular compliance training. We will also continue to facilitate communication between management and department/section managers and conduct compliance-related internal questionnaire activities.

**C Improving Moral Standards for Quality Assurance**

Quality assurance training will be carried out by the director in charge of quality assurance for the purpose of improving the moral standards for quality and safety regarding the products for automotive use.

**(4) Communication with Customers**

In accordance with the supply-demand balance, we will ask customers to consent to the changes in our manufacturing process and/or consult them on such changes in a timely manner.

**(5) Strengthening Quality Control System**

**A Examination of Customer Requirements at the Time of Order Receipt and the Dissemination of such Requests**

We will hold quality meetings monthly, which were previously held quarterly, to closely share information among the Company on quality-related matters and convey customer requirements related to the manufacturing processes including 4M.

In addition, on receipt of orders from customers, the sales and quality control divisions will take the lead in reviewing customer requirements and discussions regarding such requirements with customers as necessary to ensure that production activities will be conducted in

accordance with customer requirements.

**B Reviewing and Disseminating Internal Rules**

We are revising the 4M change control procedure to establish a system that enables the company-wide sharing of the information regarding 4M changes made at all factories inside or outside Japan, including the status of such changes. Furthermore, in order to ensure that all employees are familiar with the internal rules, the Quality Control Division will train employees who hold the positions of section manager or higher at each factory at least twice yearly.

**C Ensuring the Reliability of Subcontractors**

In order to disseminate customers' and our requirements for the products, the Plant Quality Department will explain them to all subcontractors. In addition, we will also ensure the reliability of subcontractors by conducting reliability tests of subcontractors every three years.

**4. Impact on Our Financial Performance**

We have determined that the impact of the Unauthorized 4M Changes on the consolidated financial performance of our group companies for the fiscal year ended March 31, 2019 is minor at this point. We will make a disclosure promptly if it becomes apparent that the Unauthorized 4M Changes would have a material impact on the consolidated financial performance of our group companies.

We sincerely apologize for the inconvenience and anxiety that this matter has caused our customers, shareholders and other stakeholders.

**5. Concluding Remarks**

In recent years, technological developments such as EVs, autonomous cars, 5G, IoT and AI have led to innovation in many industrial fields, and new technological combinations are rapidly emerging to adapt to such developments. As a result, society as a whole is undergoing major changes.

In this period of drastic changes, the significance of our social existence is to provide customers with printed wiring boards that are safer and more reliable. Nevertheless, the Unauthorized 4M Changes issue undermined our customers' trust, and eventually denied the significance of our social existence itself.

We sincerely regret that we failed to take the most basic attitude and behavior in the commercial relationship: complying with the agreements with our customers.

We will further push forward with measures going forward that we have been implementing since April last year to eliminate the Unauthorized 4M Changes. At the same time, under the strong leadership of top management, we intend to steadily implement the measures we have formulated this time to prevent recurrence.

We will do our utmost to regain the trust that we have lost by honestly manufacturing our products.

[end]

Investigation Report  
(Summarized Version)

March 29, 2019

CMK Corporation

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## Chapter 1 Introduction

### Part 1 Background

In February 2018, the Company was contacted by one of its customers, who stated that his/her company had anonymously received information to the effect that the Company had made Unauthorized 4M Changes.

In May 2018, President and Chief Executive Officer B engaged the law firm that usually acts as the Company's outside counsel to conduct a preliminary internal investigation into the actual circumstances of the alleged Unauthorized 4M Changes at the Company.

In response to the findings of the said investigation, the Company, in particular President and Chief Executive Officer B, became keenly aware of the issue of the Unauthorized 4M Changes at the Company, and in order to take drastic internal measures for improvement, in November 2018, President and Chief Executive Officer B newly retained Takai & Partners and LEX Law Office, external law firms (the "Outside Investigation Team"), to investigate the actual circumstances of Unauthorized 4M Changes at the Company.

### Part 2 Purposes and Structure of this Report

This Report, for which the Company is solely responsible, summarizes (i) the investigation findings and (ii) the Outside Investigation Team's advice regarding root cause analysis and possible recurrence prevention measures taking the facts found in the investigation into consideration.<sup>1</sup>

More specifically, this Report is structured as follows: outline of facts (Chapter 2) found under the investigation by the Outside Investigation Team; root cause analysis (Chapter 3); legal liability considerations (Chapter 4); and proposals regarding recurrence prevention measures (Chapter 5).

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<sup>1</sup> The investigation findings by the Outside Investigation Team include many matters related to confidential information, including personal information, customer information, terms and conditions of transactions with customers, and trade secrets, and it is inappropriate to disclose the full report prepared by the Outside Investigation Team. In light of these circumstances, in order to fulfill the Company's responsibility to provide explanations to the extent possible, the Company is solely responsible for preparing and publishing this Report.



Part 3 Definitions

Term	Definition
CMK Group	CMK Corporation and its subsidiaries and affiliates
Products for Electrical Appliances	Products other than Products for Automotive Use
DR	Abbreviation for design review; evaluating and verifying products from the perspective of a third party to prevent quality issues during 4M Changes
Post-transfer Factory	The factory after changing the place of manufacture
Pre-transfer Factory	The factory prior to changing the place of manufacture
Products for Automotive Use	Products installed in automobiles
Quality Assurance Manual	An agreement executed or submitted by a customer to maintain and manage product quality
Unauthorized OEM	Outsourcing all manufacturing to an external business operator without customers' approval
Unauthorized Outsourcing	Outsourcing some processes to external business operators without customers' approval
Unauthorized Transfer	Changing the place of manufacture to a different factory of the CMK Group without customers' approval
Unauthorized Transfer to Internal Manufacturing	Manufacturing products whose manufacture had been outsourced to an external business operator at a CMK Group factory without customers' approval.
Unauthorized 4M Change	Making a 4M Change without customers' approval
4M	The four elements (4M) generally considered to be important in mechanical processes, namely, Man, Machine, Material, and Method
4M Change	A change occurring in any of the four elements (4M) of production, namely, Man, Machine, Material, and Method

Part 4 Investigation Method, etc.

1. Investigation Period

From November 12, 2018 to March 8, 2019 (the "Investigation Period"), the Outside Investigation Team carried out an investigation using the following methods and held discussions based on the investigation results.

During this time, the Outside Investigation Team conducted a total of 49 interviews, and

conducted deliberations in the form of a total of 12 meetings, including advance meetings.

## 2. Investigation Methods

### (1) Provided Materials

The Outside Investigation Team requested comprehensive disclosure of materials relating to the improper conduct in this case, and regularly requested from the Company disclosure of additional materials and answers to questions. The Outside Investigation Team received materials from the Company by accessing files in cloud storage and written materials from time to time during interviews.

### (2) Interviews and Hearings

During the Investigation Period, the Outside Investigation Team conducted 49 interviews of 44 officers and employees of the Company for a total of approximately 79 hours.

### (3) Digital Forensics Investigation

During the Investigation Period, the Outside Investigation Team conducted a digital forensics investigation of emails sent and received since 2011 by three employees of the Company belonging to departments having a strong connection to the improper conduct in this case.

In carrying out the digital forensics investigation, multiple keywords were used to retrieve and review emails thought to be highly relevant to the improper conduct in this case. However, because there was a considerable number of search results, some emails were scored using AI on the basis of teaching data in the form of results sorted by the Outside Investigation Team, and emails grouped with the highest scores were reviewed by the Outside Investigation Team.

### (4) Questionnaire Survey

During the Investigation Period, the Outside Investigation Team conducted a questionnaire survey of 1,564 employees of the Company regarding, among other things, their awareness of the improper conduct in this case.

In the questionnaire survey, the employees were asked to anonymously answer 25 questions, in principle in multiple-choice format, with open-ended answer sections provided depending on the question. The questionnaire survey was conducted online, and shared computers were set up at each place of business to make it easy for employees to provide answers.

Answers were received from 1,459 employees of the Company as a result of the questionnaire

survey (response rate: 93.3%).

(5) Internal Reporting Desk

When conducting the above questionnaire survey, the Outside Investigation Team notified employees of the Company of an email address for receipt by the Outside Investigation Team as the internal reporting desk for the improper conduct in this case and asked employees to provide information.

(6) Outsourcing of Investigation to PWB Consultant

In conducting an investigation into technical aspects such as whether product evaluation and verification had been properly performed when the Unauthorized 4M Changes were made, the Outside Investigation Team requested a PWB Consultant Mikio Hosaka to conduct an investigation as an expert. Mr. Hosaka submitted his investigation report on March 6, 2019.

Part 5 Investigation Assumptions, Reservations, and Matters that Could Not be Investigated

The Outside Investigation Team covered only the Company, CMKC (Dong Guan) Ltd. (the factory of which is called “Dong Guan Factory”), CMK Electronics (Wuxi) Co., Ltd. (the factory of which is called “Wuxi Factory”) and CMK Corporation (Thailand) Co., Ltd. (the factory of which is called “Thai Factory”), and could not conduct an investigation of other subsidiaries.

In addition to the Gunma Factory, the Niigata Factory, and the Kanbara Factory, the Company has the SE Center and the Chichibu Factory, but the scope of the investigation did not include the SE Center because its primary focus is the manufacture of Products for Electrical Appliances and manufacture of substrates ended around 2005 or the Chichibu Factory because its main focus is metal dies and it does not manufacture printed substrates. CMK Products Corporation mass produces printed substrates in addition to prototypes, but the Company could not disclose materials regarding CMK Products Corporation because of time constraints, and therefore, it could not be covered under the investigation.

Through the Outside Investigation Team’s investigation, it was confirmed that the Unauthorized 4M Changes were being made at the CMK Group for a considerably long period of time, but the materials that the Company disclosed to the Outside Investigation Team were mostly limited to materials from 2012 onward and older materials from before then have been scattered or lost and are difficult to gather appropriately, meaning that materials from prior to 2012 essentially were not disclosed; further, as discussed below in Chapter 2, 4.1(2), around 2012 claims arose

regarding the Unauthorized 4M Changes, and public statements were made regarding measures to prevent recurrence; accordingly, for the purposes of this investigation, the primary investigation period is the time since 2012, and a detailed investigation could not be conducted regarding the actual circumstances of the Unauthorized 4M Changes before such time.

As discussed below in Chapter 2.4, 4M Changes were made at the Company in various forms, but for the purposes of this Report, there were also time constraints, and thus, the transfers of factories and changes of place of manufacture were treated as the central matters subject to investigation.

With respect to emails as well, because of time constraints, the investigation was limited to emails of three employees of the Company in departments closely linked to the improper conduct in this case, and a digital forensics investigation could not be carried out for emails of other officers and employees.

## Chapter 2 Summary of Facts

### Part 1 Summary

The Company manufactured and sold products primarily for Products for Electrical Appliances until about the year 2000, and in the agreements with customers of such products, it was seldom provided that any 4M Change was subject to the consent of the customer. In that context, in the past in cases such as when it became necessary to prevent late deliveries or when it became necessary to move the production site to a factory whose utilization rate was poor in order to improve the profitability of the factories as a whole, the Company routinely made 4M Changes without obtaining approvals from the customers.

From around 2000 onwards, the Company began increasingly manufacturing and selling Products for Automotive Use for which 4M Change control was strict. Around that time, it had started to be recognized that the management of 4M Changes is important. However, at the Company, the actual workings of 4M Changes and the mindset of management did not substantially change in that direction and the making of 4M Changes without specific approval had become the norm.

Complaints on quality were received around 2012 from multiple customers regarding products to which 4M Changes were made without approval, and for each complaint the Company took measures to prevent a recurrence, but those recurrence preventive measures were insufficient and subsequent recurrence of the Unauthorized 4M Changes happened repeatedly.

For example, around 2016, an increase in actual orders at the Company caused production capacity to be exceeded at the Thai, Niigata and Wuxi factories, making it difficult to meet delivery dates. In order to prevent delivery delays, company-wide, the large-scale Unauthorized 4M Changes were implemented.

An overview of the Company, the 4M Change rules at the Company and a history and description of the Unauthorized 4M Changes (the Inappropriate Actions) is below.

### Part 2 Overview of the Company

The products addressed hereunder and the involved locations, among other matters, of the Group are as follows.

Relevant products	Printed wiring boards (used in automotive devices, communications)
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	equipment, AV, digital home appliances and digital cameras, etc.)
Locations involved	<p>Japan locations</p> <p>CMK Corporation G Station Factory</p> <p>CMK Corporation Niigata Factory</p> <p>CMK Corporation Kanbara Factory</p> <p>Three Overseas locations</p> <p>China CMKC (Dong Guan) Ltd.</p> <p>China CMK Electronics (Wuxi) Co., Ltd.</p> <p>Thailand CMK Corporation (Thailand) Co., Ltd.</p>

### Part 3 4M Change Rules

#### 1. Arrangements with Customers

When the Company receives an order from a customer, in addition to concluding a master transactions agreement with the customer, for the purpose of the maintenance and control of product quality it may also sign a “Customer Quality Assurance Agreement” and other agreements with the customer and be given the customer’s own Quality Assurance Manual.

It is common for master transactions agreement to also stipulate a duty to adhere to the Quality Assurance Manual.

In the master transactions agreement with the customer or in the Quality Assurance Manual, when it is provided that the advance consent of the customer is required for making a 4M Change<sup>2</sup> or when there is a separate agreement with the customer, under such agreement with the customer it is obligatory to follow the prescribed procedures stipulated in the master transactions agreement or the Quality Assurance Manual and not doing so constitutes a breach of the agreement.

#### 2. Internal Rules

In order to prevent quality issues from occurring when a 4M Change is made and ensure that 4M Changes are implemented after assurance, review and DR by the units involved, the Company Group formulated the company regulations, “4M Change Control Procedures.” The “4M Change Control Procedures” stipulate the internal application procedures for a 4M Change

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<sup>2</sup> For example, the consent of the customer may be required for a change of factory, a factory expansion or deployment of new equipment, a change of processing method, a change of processing conditions, a change of production venue, etc.

and whether there is a requirement for obtaining customer approval and procedures for doing so.

#### Part 4 History and Description of Unauthorized 4M Changes (Inappropriate Actions)

##### 1. History and Description of Unauthorized 4M Changes

###### (1) Unauthorized 4M Changes in the Past

The oldest Unauthorized 4M Change made by the Company that can be confirmed by objective materials occurred in 2002.

However, given that multiple managers stated that the Unauthorized 4M Changes occurred at the time when they joined the Company (prior to 2002) and that camouflage measures such as falsifying internal production cards were taken so that it would not be discovered by the customers, it can be surmised that the Company implemented the Unauthorized 4M Changes from prior to 2002.

Up until around the year 2000, the Company primarily manufactured and sold Products for Electrical Appliances, and the manufacturers of Electrical Appliances most often allowed the Unauthorized 4M Changes ex post facto. As was mentioned above, against this background, the Unauthorized 4M Changes were implemented in cases such as when necessary to prevent late deliveries or when necessary to move the production site to a factory with a poor utilization rate in order to improve the profitability of each factory. In addition, regardless of whether the necessity for these sorts of 4M Changes actually arose, the Company, without obtaining the consent of the customer, outsourced to companies with which it had longstanding continuous business.

###### (2) Descriptions of 4M Changes after 2012

From 2009 through 2012, the Company received quality-related complaints about products that had undergone the Unauthorized 4M Changes from a total of three companies. Each time the Company received them, it formulated a prevention plan, and reported to those companies. However, the measures to prevent recurrence formulated by the Company and their implementation were both inadequate, and the Unauthorized 4M Changes were again repeated throughout the Company from 2013 onwards<sup>3</sup>. One example is the large-scale Unauthorized 4M Changes described below that took place around 2016.

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<sup>3</sup> We confirmed that the number of the customers to whom the products subject to Unauthorized 4M Changes were delivered was 175.

### (3) Large-scale Unauthorized 4M Changes around 2016

#### A. Description of Unauthorized 4M Changes of around 2016

The Company experienced a major decline in orders as an effect of the 2008 financial crisis and continued to experience difficult business circumstances until around 2015. Due to those circumstances, the desire to strengthen marketing in order to obtain more orders grew intense throughout the Company.

Orders actually started to increase from around 2016, but the abovementioned desire to strengthen marketing did not change. First, around the start of 2016, the production capacity of the Thai Factory was exceeded, giving rise to a situation where there was pressure to meet deadlines. In order to prevent delivery delays from the Thai Factory, the Company made the Unauthorized Transfers to the Dong Guan and Wuxi Factories.

In addition, from around May 2016, production capacity was also exceeded at the Niigata Factory due to the transfer of production made to it resulting from the suspension of production at the Gunma Factory and also due to an increase in orders, resulting in it being pressured to meet deadlines. In order to prevent delivery delays from the Niigata Factory, the Company transferred production without approval to the Kanbara Factory and the Wuxi Factory, initiated the Unauthorized OEM with outside manufacturers and outsourced without approval some of the production processes in regard to multiple products.

Around December 2016, production capacity was exceeded at the Wuxi Factory, to which some production had been transferred from the Niigata Factory, and Wuxi Factory's delivery schedule came under pressure. In order to prevent delivery delays from the Wuxi Factory, the Company made the Unauthorized Transfers of some production from the Wuxi Factory to the Thai Factory and the Niigata Factory and also carried out the Unauthorized OEM and the Unauthorized Outsourcing in regard to multiple products. The result was that the Thai Factory, at which production capacity had been exceeded, also implemented the Unauthorized Transfers to the Dong Guan and the Niigata Factory and, moreover, the Dong Guan Factory itself started making the Unauthorized Transfers to outside manufacturers.

In regard to the Unauthorized 4M Changes at the Thai Factory and the Niigata Factory, the pressure to meet deadlines and a production transfer plan to alleviate the pressure were



discussed and implemented through e-mails in which Director B (at that time) was involved and at a meeting known as the Production Meeting<sup>4</sup>, which he attended. Further, the Unauthorized 4M Changes at the Wuxi Factory were discussed at the monthly explanation session attended by all the directors except the outside directors, and they were made after conversations between Executive Officer E (at that time) and President and Chief Executive Officer A (at that time).

#### B. Method of Unauthorized 4M Changes

Because the details of the 4M Changes requiring customers' prior approval in the Quality Assurance Manuals do not necessarily correspond to the "4M Change Control Procedure," ultimately it is necessary to confirm the "agreement with the customer," but the Company did not confirm each customer's agreement. Moreover, approval procedures in accordance with the "4M Change Control Procedure" were not taken.<sup>5</sup>

Furthermore, in regard to products that underwent the Unauthorized Transfers, in order to prevent customers from finding out the facts about such transfer, the Company, for example, around 2016 when it transferred products that were originally supposed to have been produced at the Wuxi Factory to the Niigata Factory without informing the customer, delivered the product to the customer after first having transported it to the Wuxi Factory from the Niigata Factory and, moreover, when delivering it to the customer, the Company put "Made in China" labels on the product or submitted to the customer a shipping inspection results sheet, among other documents, using the format of the Wuxi Factory.

In addition, the Company also adopted the measure of placing on products produced at a different factory without the approval of the customer its seal using numbers from which some letters had been removed or drafting letters using a different font from usual, so that the Company would be subsequently able to identify internally which products had been produced at which factory.

It can be surmised that this sort of camouflaging strategy for the Unauthorized 4M Changes was adopted earlier than 2002. Although it may not be possible to confirm that the Company's officers (below, "(the Company's) officers" mean, as a general rule, inside directors, inside

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<sup>4</sup> The Production Meeting held on October 20, 2016, at which the transfer of production from the Thai Factory to the Kanbara Factory was discussed, was also attended by President and Chief Executive Officer A (at that time).

<sup>5</sup>For example, the 4M change application form for the transfer of production from the Wuxi Factory to other factories in December 2016 was submitted in April 2017, and at that time, even though in essence it was a change that required customer approval, it was treated as a change for which customer approval was unnecessary.

auditors, and Executive Officers unless otherwise defined, but may have a different meaning depending on the context) knew all of the specifics and details of these camouflaging tactics, it can be concluded that, at least they were aware that, after making the Unauthorized 4M Changes on the premise that the fact they were made so would not be reported to the customer, certain steps were taken to ensure that Unauthorized Transfers were not discovered by customers.

#### (4) Discovery of Unauthorized 4M Changes and Subsequent Countermeasures

In October and December 2017, anonymous information that the Company was making the Unauthorized Transfers was relayed to one of the Company's customers. This information was that products that were supposed to have been made at the Wuxi Factory were actually made at the Thai Factory without the approval of the relevant customer. Even though this information was true, the Company reported to the customer that there was no Unauthorized Transfer of production.

In February 2018, again, anonymous information was given to one of the Company's customers that an Unauthorized Transfer of production had been made. Although the Company admitted to the customer that some Unauthorized Transfers existed, the Company did not make clear to the customer the existence of some 4M Changes. In May 2018, President and Chief Executive Officer B asked the law office to which the Company's regular outside counsel belongs to undertake an initial internal investigation of the circumstances of the 4M Changes.

Subsequently, in the Company it started to be recognized, especially by President and Chief Executive Officer B that there was an issue in regard to the Unauthorized 4M Changes, but that still did not lead to the elimination of the Unauthorized 4M Changes at the Company and again a situation arose in which new Unauthorized 4M Changes were inevitable in regard to some customers. President and Chief Executive Officer B, in November of the same year, requested the Outside Investigation Team to investigate the circumstances of 4M Changes in the Company and, in December 2018, he held a press conference. The Company, under the leadership of President and Chief Executive Officer B, formulated the Unauthorized 4M Change preventive measures, reported to the customers that it had indeed carried out the Unauthorized 4M Changes and is working to obtain approvals and achieve in-house production, etc. with respect to each customer. At the time of the preparation of this Report, the report had been made to every customer to which products subject to the Unauthorized 4M Changes are delivered by the Company.

The Company has also taken the following actions to deal with the Unauthorized 4M Changes since April 2018. The Outside Investigation Team has not, however, independently verified the accuracy or the reasonableness of the explanation.

① Summary

From April 2018, with the installment of a new management team, with B as the President and Chief Executive Officer, as mentioned in Part 1 of Chapter 1, the Company had a preliminary internal investigation carried out by an outside investigation team from the law office of its regular outside counsel. And on December 14, 2018, a public announcement concerning the Unauthorized 4M Changes was made, and explanations were provided to customers; the Company has also taken the following actions and prevention measures.

② Stringent order management

In order to improve the supply-demand balance at each factory, the Company receives feedback as necessary from each factory on its production conditions, based on which, if there are orders received that exceed production capacity after taking into account the current production situation at each factory, adjustment of the delivery schedule will be made with the customer that gave the order or other arrangements will be taken to ensure maintenance of stringent order management. If the Company after the installment of the new management team, despite having negotiated adjustments of the delivery schedule, cannot adjust the deadlines, the Company will take measures such as asking the customer to place orders elsewhere.

③ Increase of production capacity at each factory

The Company formulated a “Three-year Capital Investment Plan” aimed at increasing production capacity at each factory.

The “Three-year Capital Investment Plan” aims to increase production capacity at each factory, increase the volume of acceptable orders and realize in-house production by making large-scale capital investments in each factory over a three-year period, increasing production capacity and increasing operating efficiency by reducing obsolescence. Specifically in the plan, the overseas factories (Dong Guan, Wuxi and Thai Factories) will complete the abovementioned capital investment by the summer of 2019 and achieve in-house production for all orders. The domestic factories (Niigata and Kanbara Factory) will complete the abovementioned capital investment by 2020 and will negotiate with customers to obtain their approval with respect to orders that would require some process or processes to be outsourced after clarifying the manufacturing process in terms of what can be done by in-house processing and what is premised on

outsourcing.

## 2. Impact on Quality

### (1) Investigation by PWB Consultant

According to the report from the PWB consultant retained by the Outside Investigation Team, although no issues had been found in regard to the technical abilities, among other matters, of the outside manufacturers (providers of some processing work) and the OEMs (providers of multiple manufacturing processes), the DRs for 4M Change from FY2013 through FY2015 accurately checked product quality in accordance with the 4M Change Control Procedures, but in the production transfer from the Wuxi Factory to the Thai Factory in FY2016, some DRs in regard to product quality were inadequate because at that time some DRs were done for the purpose of resolving the delivery delays, while the checking and verification of the impact on product quality in relation to the 4M Changes were sometimes postponed. Taking into account the above facts, it can at least be concluded that quality issues were more likely to arise when the Unauthorized 4M Changes were made compared to when 4M Changes were made with the approval of the customer.

### (2) Explanation by the Company about Quality of Products That were Subject to Unauthorized 4M Change

The Company recognized as follows, in regard to the quality of the products that were subject to the Unauthorized 4M Change. The Outside Investigation Team has not, however, independently verified the accuracy or the reasonableness of the explanation.

- ① After having internally checked the production records for every customer, the products that had been subject to 4M Change and their quality, the Company prepared report materials and, from November 2018, explained to the customers to which the Company had provided products subject to the Unauthorized 4M Changes about the fact that the Company implemented the Unauthorized 4M Changes and about the resulting impact on quality, in order to obtain their understanding. The Company also, where necessary, reported to customers (places of business) that were not subject to the Unauthorized 4M Changes that there had not been any Unauthorized 4M Changes.
- ② The internal check referred to in ① above focused on whether there had been any deterioration in product quality due to the Unauthorized 4M Changes. More specifically, the check compared the production line of the factory that the customer had originally approved with the production line of the outside manufacturer or of the factory of the

Company to which production had been transferred and after verifying the differences evaluated whether there had been a deterioration of quality owing to the differences.

- ③ In the process of the check and the verification, in cases where there were differences in any of the processes, all those results of a check of the workmanship and of a reliability test were<sup>6</sup> reviewed, based upon which materials for reports to the customer were prepared. In those report materials the Company confirmed that there was no substantial impact on the quality of products due to the Unauthorized 4M Changes.
- ④ When making the Unauthorized 4M Changes, because, on the premise of coordination of the outsourcing and the production transfer, the Company checked whether any differences in workmanship were found in the products produced on each line between the Company and the outside manufacturer or between the original factory and the factory to which production was transferred and also carried out the same reliability test at the outside manufacturer and the factory to which production was transferred as usually performed at the Company itself, the abovementioned workmanship check or reliability test were infrequently redone for the purpose of internal checking; essentially, reports were made to customers on the basis of the data that the Company already had in its possession.

### 3. Involvement of Officers

#### (1) Current Officers

A became the Representative Director in April 2011, which was just prior to the receipt of quality-related complaints from customers in June 2011, and he became Vice President (in charge of manufacturing and technology) in June 2011. When the quality-related complaints from customers were received, and it was discovered that the Unauthorized 4M Changes had been made with respect to the ordered products, he, as Vice President, should have recognized the situation concerning the Unauthorized 4M Changes and accordingly he was responsible for working to ensure that they did not recur; however, despite that, he was negligent in carrying out his responsibility as he did not stringently implement the preventive measures that were explained to the customers who made quality-related complaints, the Unauthorized 4M Changes continued to be made thereafter. Furthermore, in 2016, when there was pressure to meet deadlines for delivery of products manufactured at the Wuxi Factory, and the large-scale Unauthorized 4M Change was made, it was found that he pressed for the transfer of production

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<sup>6</sup> A reliability test means a test to determine the durability of electronic components in various environments in order to prevent malfunctions when the component is used in a market environment. In reliability testing, although the exact nature of the testing varies in accordance with the assumed usage environment for the particular component, in general it involves environment testing, electrical testing, safety testing, mechanical testing and load test.

to be made to other factories and to outside manufacturers without approval from relevant customers.

B joined CMK Kanbara Electronics Co., Ltd. in September 1989, and was posted at Kuwabara Electric Works, a trading partner of the Company until joining the Company in October 2014. While he was posted at Kuwabara Electric Works, he was sometimes involved in the Company's business but at least from April 2007 until July 2013, he was distant from the Company's business. It was found that, after joining the Company in October 2014, although he was aware of the transfers of production to Niigata Factory, Kanbara Factory and CMK Products Corporation's factory, which began from September 2015 due to the closing of the Gunma Factory and the large-scale Unauthorized 4M Changes around 2016 just after he became an Executive Officer were carried out without the approvals of some customers for those 4M Changes, he nevertheless did not stop the transfers.

Furthermore, it was found that, after becoming Director in June 2016 (i.e., Director in charge of Domestic Production), and becoming aware of the pressure to meet deadlines in the Thai, Wuxi and Niigata Factories and that the Unauthorized 4M Changes were being made, he nevertheless did not stop the changes.

On the other hand, however, it was found that he realized that the implementation of the Unauthorized 4M Changes was problematic and stated that orders should be controlled in order to prevent the situation of pressure to meet deadlines, which was one of the causes for the Unauthorized 4M Changes. B became President and Chief Executive Officer of the Company in April 2018 and it was found that from May 2018, upon the advice of outside experts, he carried out an investigation. Furthermore, in December of the same year, he held a press conference at which he made public the Company's situation with the Unauthorized 4M Changes and embarked on action aimed at a complete eradication of the problem of the Unauthorized 4M Changes, which had remained unsolvable at the Company over so many years.

As far as concerns other officers (i.e., inside directors and Executive Officers in this section), although it is not the case that the Unauthorized 4M Changes were initiated pursuant to specific directives or orders by officers, it can be concluded, however, that from prior to 2002 the Unauthorized 4M Changes were being routinely made in the Company, and almost all the inside directors were aware of this, and that even after becoming inside directors, they neglected to make any active efforts to correct the situation despite being aware that 4M Changes were being made and allowed the status quo to remain. Furthermore, in regard to the large-scale 4M

Changes around 2016, it was found that C, current Director and Executive Managing Officer, as the Director in charge of sales, pushed for the transfer of production, without approval, to other factories and outside manufacturers. It was also found that D, current Director and Executive Officer, as the Director in charge of quality, was in a position where he should have checked for the appropriate compliance with the 4M Change Control Procedure, did not do so.

(2) Involvement of Previous Officers

Although quality complaints were received from 2009 through 2012 and it was perceived among officers (which mean inside directors, inside auditors, and Executive Officers in this section) that the Unauthorized 4M Changes constituted a serious compliance issue for the Company, previous officers did not take adequate steps to prevent their recurrence and, as discussed in 1 (2) of Part 4 above, from 2013 onwards, the Unauthorized 4M Changes occurred repeatedly.

During the period from 2013 through January 2017, at the Sales Meetings attended by certain members including inside directors, information was shared about the pressure to meet deadlines of delivery of products at each factory and at those meetings production transfers were discussed, so it can be concluded that directors knew, or at least could have known, that 4M Changes were being made without approval from relevant customers, but they nevertheless did not stop them from being made. Additionally, from February 2017 onwards, the situation of pressure to meet deadlines of delivery of products at each factory and information about the Unauthorized Transfers resulting therefrom was shared at the meetings called Supply-Demand Explanations attended by all inside directors, but the inside directors at the time, despite their awareness of the situation, nevertheless did not stop the improper acts.

## Chapter 3 Causes of Problems that Occurred

### Part 1 External Factors

#### 1. Order Obtaining Structure in the Substrate Industry

Even though substrate specifications are often determined during the final stages of design of the end product, substrates are positioned in the upstream segment of the manufacturing process and are characterized by the need to be manufactured and delivered the earliest.

In addition, substrates are custom products with different circuits for each product, which makes it difficult to mass produce them in advance, and the manufacturing process cannot start until after the design of the end product is finalized.

As a result of this order obtaining structure in the substrate industry, the industry is characterized by susceptibility to changes in the supply-demand balance and difficulty of making production forecasts.

In the case of Products for Automotive Use in particular, extended periods are required until products are completed, and demand may change during those periods depending on the economic environment and other factors. Even in cases where orders increase substantially more than initially anticipated and exceed the factory production capacity, because they are custom products, it is difficult to reject such increased orders from Tier 1 customers, and it is undeniable that the industry structure is susceptible to the Unauthorized 4M Changes.

#### 2. Business Practices for Products for Electrical Appliances

In the case of Products for Electrical Appliances, 4M Changes have not required customer authorization, or when authorization is required, authorization is obtained quickly compared to Products for Automotive Use, or subsequent authorization can often be obtained. In addition, social awareness concerning the importance of 4M Changes was not as high during and before the 1990s as now, and even in cases where order volumes for Products for Electrical Appliances exceeded expectations, fulfilling those orders through outsourcing, or other means, was not considered problematic.

The Company was fundamentally a manufacturer of substrates for Products for Electrical Appliances, and the business practices concerning Products for Electrical Appliances mentioned above became well-established among the officers and employees. As a result, awareness



concerning the importance of 4M Changes was low, and in manufacturing of Products for Automotive Use for which rigorous control have been established concerning 4M Changes (primarily since the 2000s when awareness concerning the importance of 4M Changes began to appear), it is possible that the existing business practices and awareness concerning Products for Electrical Appliances could not be entirely swept away.

### 3. Protraction of 4M Change Authorization Procedures

Flexible responses such as obtaining of authorization within two to three months from the delivery of a product for evaluation were possible in relation to Products for Electrical Appliances, but in contrast, in the case of Products for Automotive Use (particularly key safety related parts), in some cases, obtaining authorization took about six months to one year from delivery of a product for evaluation.

Further, in cases where requests for 4M Changes were made, in some instances the customer required payment of expenses necessary for evaluation of the changes. It is believed that at such times, the Company chose not to apply for 4M Changes to the customers out of time and cost considerations.

### 4. Rapid Increase in Orders for Products for Automotive Use

The production capacity of the Wuxi Factory, which was the cause of the large number of the Unauthorized 4M Changes made around 2016, was the result of sales activities conducted by the Sales Department of the Company from around 2014 to 2015. At that time in the automobile industry, the proliferation of electronics spread to even low-price vehicles all at once, resulting in demand for substrates for automotive use greatly exceeding expectations.

The increase in order volumes exceeding the expectations led to conditions that compelled the 4M Changes in 2016.

### 5. Pressure from Customers

The Company was informed by some customers that, if their production lines were stopped, they would demand a certain amount in compensation for damages per day or per minute. Also, when the production capacity was exceeded at the Wuxi Factory in 2016, some customers rushed into overseas production factories and continued to stay until late at night.

It is believed that such pressure from customers was also one of the causes of the Unauthorized 4M Changes..

## Part 2 Internal Factors

### 1. Inadequate Reform of Officer Awareness

It is believed that, as a result of the matters mentioned in Part 1 above, the resistance of the officers to making the Unauthorized 4M Changes declined, and they became desensitized. As a result of the complaints made by certain customers around 2012 mentioned in Chapter 2, Part 4, 1, (2) above, officers became fully aware of the risks of the Unauthorized 4M Changes and subsequently had the opportunity to make improvements, but they failed to thoroughly implement remedial measures to prevent recurrence and were later unable to prevent the occurrence of the Unauthorized 4M Changes with the purpose of improving profitability giving rise to circumstances that allowed the Wuxi problem to recur in 2016.

As long as the officers do not have an awareness of proactive compliance, it is not possible to reform the attitudes of employees. It is believed that the officers of the Company, however, were facing severe management conditions, that increasing sales was the path to the survival of the Company and that they made a decision to place greater priority on sales than on rigorous compliance.

It is believed that as the foundation of these problems some officers were overly optimistic in their awareness based on the belief that other substrate manufacturers were also conducting the similar Unauthorized 4M Changes.

### 2. Decline and Paralysis of Companywide Morale and Awareness

It is believed that the inadequate change in awareness of the officers resulted in a decline in employee morale and the employees prioritizing sales over compliance.

It is also believed that the officers and employees who joined the Company mid-career likely felt some discomfort regarding this type of culture of the Company, but eventually, they were overtaken by the Company's morale and awareness.

### 3. Ineffective Remedial Measures to Prevent Recurrence

As mentioned in Chapter 2, Part 4, 1, (1) above, it can be surmised that there were effects from business practice regarding 4M Changes for Products for Electrical Appliances, and there was little sense of resistance among the officers and employees of the Company to conducting the Unauthorized 4M Changes. However, at least, when quality-related complaints from certain customers were made from 2009 to 2012, and the customers demanded proposals of remedial

measures to prevent recurrence, these should have been opportunities to understand that 4M Changes regarding Products for Automotive Use were more stringent and to establish companywide systems for the prevention of the Unauthorized 4M Changes.

It was found that the Company, however, positioned these problems as individual incidents, trivialized these problems and did not take any effective action to conduct companywide changes relating to 4M Changes or remedy other 4M Changes discovered at that time, and the Unauthorized 4M Changes continued even after these problems occurred.

#### 4. Lack of Understanding among Officers and Employees regarding Whether Customer Approval is Required

As mentioned in Chapter 2, Part 4, 1, (3), B above, the cases that require prior customer authorization are specified in master transaction agreements with customers and Quality Assurance Manuals submitted to customers, and therefore, the determination of whether customer authorization is required in accordance with the 4M Change control procedure was not necessarily consistent with matters agreed upon with customers. For this reason, in determining whether customer authorization is required, it is ultimately necessary to check the matters agreed upon with customers and to respond appropriately.

However, these matters were not adequately understood, and it is believed that there were not a few officers and employees who believed that it was sufficient as long as they complied with the 4M Change control procedure, which is an internal rule or as long as quality was maintained.

#### 5. Problems in Sales Division and Manufacturing Division

The Company recorded consolidated operating losses for the three consecutive fiscal years from the fiscal year ended March 2009 to the fiscal year ended March 2011, and there was a sense of crisis among the officers at the time that if the losses continued, the existence of the Company would be at risk. It is believed that these circumstances were one of the factors that led to orders being received exceeding the production capacity. In addition, the factory production capacity varies depending on the type of substrates produced (e.g., whether a substrate has a multilayer structure), but the Sales Division, which obtains orders, did not understand the prerequisites of the production capacity at each factory, and there was a gap in awareness between the Manufacturing Division and the Sales Division. It is believed that this led to the formulation of plans pursuant to production plans not based on the actual production capacity, causing tight delivery schedules and large-scale outsourcing. It is also possible that the lack of effort to accurately inform customers of the production capacity of each factory and to negotiate flexibly

with customers the authorization of 4M Changes and adjustment of delivery deadlines.

#### 6. Problems in Supervisory Divisions

It is believed that supervisory divisions such as the Quality Assurance Division, the Legal Affairs Department, the Internal Audit Office, and the Internal Control Management Committee did not have any functions to monitor the Unauthorized 4M Changes or, even if they had, failed to perform the functions.

## Chapter 4 Review of Legal Liability

### Part 1 Possibilities of Contractual Liability to Customers

As mentioned in Chapter 2, Part 3, 1 above, in cases where the master transaction agreements between the Company and customers and the Quality Assurance Manual specify that the customer's prior authorization must be obtained when making 4M Changes or when separate agreements have been made between the Company and customers, it is contractually required that the procedures specified in such master transaction agreements and the like be performed, and if this is breached, this constitutes breach of contract.

With regard to conduct in breach of contract, there is a possibility that the Company could be subject to liability to pay compensation for damages to customers on the grounds of non-performance of the obligations as well as a possibility that customers could demand replacement or repair, depending on the particulars of the contract with each customer.

### Part 2 Possibilities of Criminal and Administrative Liabilities

Among the Company's conduct, the act of manufacturing products at Niigata Factory that should have been manufactured at the Wuxi Factory in around 2016 may constitute a violation of the Unfair Competition Prevention Act. Specifically, (i) the act of applying labels stating "Made in China" to the relevant products and (ii) the act of delivering to customers the result sheet of outgoing inspection and the like using the format of the Wuxi Factory may constitute mislabeling (Unfair Competition Prevention Act, Article 2, Paragraph 1, Item (14)) on the grounds that it is labeling of products or trade documents likely to mislead as to the place of origin, quality or contents and (iii) the act of selling products manufactured in such a manner may constitute mislabeling at the time of transfer or delivery. In addition, the conduct described in (i) and (ii) above could be "false labeling" of products or trade documents likely to mislead as to the place of origin, quality or contents and may constitute a violation of the Unfair Competition Prevention Act respectively<sup>7</sup>.

### Part 3 Liabilities of Officers

Under the Company's internal rules, decisions regarding 4M Changes do not require approval

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<sup>7</sup> Mislabeling is subject to penalties under the Unfair Competition Prevention Act when conducted with an "unfair purpose". The term "unfair purpose" as used herein refers to "any unfair purpose that aims to obtain illicit gains, inflicts damages on others" (Section 19, (1), (ii) of the Unfair Competition Prevention Act) and is deemed to be sufficient if there is any unfair purpose. In this case, it is undeniable that "unfair purpose" was found because the Company's action was done in order to prevent the Unauthorized 4M Changes from being discovered by the customers.

from an officer (“officer” in this part refers to internal director, internal auditor or internal Executive Officer), and decisions regarding the Unauthorized 4M Changes do not necessarily start with a specific instruction or order from an officer.

However, it was found that the Company has been making the Unauthorized 4M Changes on a continuous basis since 2002 and even before, and considering that almost all inside directors were aware of this incidents, even after appointment, they failed to make efforts to correct this situation while they were aware of the Unauthorized 4M Changes and left the situation unchanged. From about the middle of 2017, certain officers attempted to point out the problems of the Unauthorized 4M Changes at various meetings and the like. However, even after this, the Company’s fundamental attitude remained unchanged, and the Unauthorized 4M Changes continued to be made.

Thus, it was found that the officers have been broadly involved in the Unauthorized 4M Changes through omission.

Furthermore, in cases where the Company bears the contractual liabilities to customers and is subject to liabilities to pay compensation for damages to customers, if the Company’s officers and others who were aware of the Unauthorized 4M Changes on a continuous basis are determined to have breached the duty of due care, such officers may be subject to pay compensation for damages incurred by the Company.

## Chapter 5 Recommendations concerning Remedial Measures to Prevent Recurrence

Around 2012, the Company received quality-related complaints regarding the products that had been subject to the Unauthorized 4M Changes from three companies in total. On each occasion, remedial measures to prevent recurrence of the Unauthorized 4M Changes were taken. However, such measures were only temporary, and it was difficult to evaluate that such remedial measures were complied with on a continuous basis. In light of this background, implementing the remedial measures to prevent recurrence described below on a continuous basis is the highest priority issue for the Company. Therefore, reform of management structures to carry out companywide changes in awareness and monitoring conducted by external third-party of the status of implementation and improvement of those remedial measures is particularly important.

### Part 1 Reforming the Awareness of Officers and Employees throughout the Company

#### 1. Compliance Declaration

In order to create an environment where the officers and employees are aware of compliance and consider that the practice of compliance contributes to the Company's performance and that compliance leads to the benefit of the Company as well as its officers and employees, top management (Representative Director) should make a declaration regarding the importance of and strict adherence to compliance.

#### 2. Reform of Management Structures

Reform of management structures is required to eliminate the longstanding and deep-rooted trivialization of compliance relating to 4M Changes at the Company, and it is desirable that new external officers who are capable of responding appropriately to this problem be appointed and that the reform of management structures be made at an early stage.<sup>8</sup> Furthermore, it is believed that the same person serving in the important positions of the chairman of the Internal Control Management Committee and the officer in charge of quality assurance was a factor behind the Unauthorized 4M Changes not being considered a problem within the Company. Accordingly, an appropriate person should be appointed as the chairman of the Internal Control Management Committee to ensure that check-and-balance functions can operate properly.

#### 3. Sharing Information with and Increasing Use of External Officers

When appointing external directors and external auditors, the Company should proactively

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<sup>8</sup> It was pointed out by the Outside Investigation Team that the Report was submitted in mid-March 2019, and considering the time necessary to select appropriate persons, it may be difficult to appoint appropriate persons as new directors at the ordinary general shareholders meeting for the fiscal year ending March 2019.

share information on compliance issues with the external officers and make use of their knowledge.

#### 4. Periodic Compliance Training and Education

The Company conducted compliance training on 4M Changes, but the content of that training lacked substance. In light of the recent incidents and the similar incidents at other companies, external instructors should be invited to the Company to provide compliance training for different ranks of the officers and employees based on specific examples and with an emphasis on 4M Changes at least twice a year.

#### 5. Review of Personnel Systems, etc.

A personnel evaluation system that imposes strict discipline on employees who do not observe compliance relating to 4M Changes should be established. Also, it would be of value in considering provisional measures until the corporate culture of the Company of adhering to compliance relating to 4M Changes becomes established within the Company such as temporary introduction of an evaluation program that grants certain positive personnel evaluations to employees who contribute to compliance relating to 4M by obtaining the customer authorization for 4M Changes, for instance.

### Part 2 Reform of Sales Division and Manufacturing Division

#### 1. Organizational Efforts to Obtain Customer Authorization

In addition to efforts to obtain prior customer authorization regarding 4M Changes, measures that can respond to unforeseeable increases in order volumes such as obtaining the authorization during the prototype order stage from all customers in advance regarding mass production at multiple factories or the use of outsourcing should also be taken.

Furthermore, in cases where it is difficult to obtain the authorization regarding 4M Changes, ongoing organizational efforts to obtain the authorization such as the officers in charge negotiating with customers must be made rather than assigning responsibility for obtaining the authorization to a single salesperson.

#### 2. Reinforce Collaboration between Sales Division and Manufacturing Division

Structures to reinforce collaboration between the Sales Division and the Manufacturing Division should be established such as establishing and holding periodic meetings for sharing information or raising mutual understanding among the divisions through personnel exchanges.



### 3. Reinforce Coordination between Obtaining Orders and Manufacturing

A possible means of enabling checks and balances between the Sales Division and the Manufacturing Division or facilitating appropriate coordination to maintain a proper balance between supply and demand by controlling the Sales Division seeking to obtain orders without limit while encouraging the Manufacturing Division to increase the productivity would be to organize and establish a specialized department independent from both divisions to perform coordination, for instance.

### 4. Increase Production Capacity

In addition to the measures mentioned above, considering that a lack of the production capacity in comparison to the volume of orders received was one of the factors behind the Unauthorized 4M Changes, increasing the production capacity is also a possible remedial measure.

Considering that increasing the production capacity would require capital investment, however, if an expansion of demand is expected over the long term, it would be of value to consider increasing the production capacity of the Company through capital investment.

## Part 3 Organize and Review Contractual Terms relating to 4M Changes

It is necessary that the Quality Assurance Department reconfirms and reorganizes the designated procedures and the scope of 4M Changes that require the customer authorization for each customer (model) and share that information within the Company.

Also, if there are problems such as the case where contractual conditions relating to 4M conditions cannot practicably be complied with, flexible responses are necessary such as renegotiating such contractual conditions to adopt reasonable contractual conditions. Such review and renegotiation of contractual conditions should be conducted strategically with a focus on the Company's permissible scope of action, and since knowledge of and skills for negotiation and preparation of contract will be required, the Legal Affairs Division should actively be utilized.

## Part 4 Reform of 4M Change Management

### 1. Dissemination of 4M Change Control Procedure

The officers and employees should be retrained on the 4M Change control procedure when compliance training, among other trainings, is done to ensure that all officers and employees are thoroughly aware of the rule.

At those times, the officers and employees must fully understand that when they determine whether customer authorization is required, they ultimately must confirm the matters agreed upon with customers and take appropriate measures.

## 2. Review of Systems to Restrict Process Changes

If the Quality Assurance Division, which has authority to approve process changes under the internal rules, keeps records of the process changes regarding the specification changes of each product registered in the system, the management and control of process changes are systematically ensured by the Quality Assurance Division.

Companywide introduction of such systematic controls likely involves issues that are not easily resolved such as the integration of production control systems at each factory, personnel allocation and network stability, but there is a large degree of commonality in process control, and it would be beneficial to review this as a responsive measure going forward.

## Part 5 Reform of Monitoring Systems

### 1. Internal Monitoring Systems

The Company's existing internal audit structure was inadequate, with only one person assigned to the Internal Auditing Office and 4M Changes, which were given low priority, excluded from the scope of the audits. However, improvements were made starting in 2017, including adding whether 4M Changes were authorized to the scope of the audits and starting in November 2018 increasing the number of personnel in the Internal Auditing Office to three. This reinforcement of the internal audit structure is useful to prevent recurrence of the Unauthorized 4M Changes, and continued improvement of the internal audit structure as well as verification and maintenance of the effectiveness of audits would be desirable.

### 2. Notification of Internal Reporting System

The Company should make efforts to establish an environment where employees can make internal reports with a sense of reassurance by disseminating the internal reporting system throughout the Company, informing the employees of the significance and importance of the system and that making appropriate reports is proper work conduct and the employees are never treated disadvantageously because of making such reports and educating the employees about maintaining confidentiality regarding the reports on the occasion of the compliance training.

## Chapter 6 Monitoring

Each remedial measure to prevent recurrence should be taken within the Company, and a system should be established to confirm the progress and verify the effects. It is desirable that external directors and external third parties participate in such monitoring to ensure objective verification from an outside perspective.

[End]