

TRANSLATION FOR REFERENCE PURPOSES ONLY

*This notice has been translated from the original Japanese text of the timely disclosure statement dated September 13, 2017 and is for reference purposes only. In the event of any discrepancy between the original Japanese and this translation, the Japanese text shall prevail.*



MEMBERSHIP

September 27, 2017

To whom it may concern

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**(Replacement) Replacement of the Announcement of “Notification of the Investigation Result of the Internal Investigation Committee”**

Unicharm Corporation replaces the announcement of “Notification of the Investigation Result of the Internal Investigation Committee” dated on September 13, 2017, attaching English translation of “Investigation Report (Disclosure Version)”.

END

# Investigation Report [Disclosure Version]

September 13, 2017

Unicharm Corporation  
Internal Investigation Committee

September 13, 2017

To: Board of Directors, Unicharm Corporation

Unicharm Corporation - Internal Investigation  
Committee

Shigeru Asada, Committee Chair

Toshiro China, Committee Member

Masayoshi Tanizaki, Committee Member

Ichiro Ozawa, Committee Member

Yasuhiko Fujitsu, Outside Committee Member

Toshifumi Takaoka, Outside Committee Member

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## **I. Overview of Investigation by the Internal Investigation Committee**

### **1. The Internal Investigation Committee**

The Audit Department of Unicharm (China) Co., Ltd. (“UCCH”)<sup>1</sup> in charge of the internal audit of Unicharm Consumer Products (China) Co., Ltd. (“UCCP”), the Chinese subsidiary of Unicharm Corporation (“Unicharm”), routinely conducts audits of the departments of UCCP including the local management units (LMUs)<sup>2</sup> of UCCP and production plants (some audits are also conducted in conjunction with the Internal Audit Department of Unicharm) and one such audit revealed insufficient substantiation and other problems with respect to the accounting of sales promotion expenses (“SPEs”). In such a situation, and given the importance of the Chinese market, Unicharm has been monitoring the accounting of SPEs of UCCP and discovered insufficient provisions for SPEs of CNY134 million (JPY2,249 million) that should have been recorded in FY2016 (the “SPE Carryover”) in its audit respectively conducted by Unicharm’s Internal Audit Department and UCCH’s Audit Department from January to June 2017.

In response, Unicharm established the Internal Investigation Committee consisting of the four officers and employees of Unicharm stated in the list of members below (the “Committee”) and began an internal investigation afresh on August 5, 2017 to confirm whether or not problems with the recording of expenses<sup>3</sup> in the correct financial period (including the SPE Carryover) had occurred in earlier financial years.

Based on the results of that initial investigation, Unicharm recognized that it required further confirmation of the facts such as the form and method of the SPE Carryover and made an application to the Kanto Local Finance Bureau on August 10, 2017 (approved on August 14) to extend the filing deadline for Unicharm’s quarterly securities report for Q2 2017 in order to secure enough time for the investigation. Unicharm intended for outside experts to join the Committee in order to ensure the reliability and professionalism of the investigation by the Committee and, on August 18, Yasuhiko Fujitsu, Attorney-at-Law, and Toshifumi Takaoka, CPA, were appointed to the Committee in this capacity.

Shigeru Asada:	Committee Chair Director and Audit & Supervisory Committee Member (Unicharm)
Toshiro China:	Committee Member Executive Officer and General Manager, Business Process Transformation Division, Internal Audit Department (Unicharm)
Masayoshi Tanizaki:	Committee Member General Manager, Internal Audit Department (Unicharm)
Ichiro Ozawa:	Committee Member Department Manager, Legal Department (Unicharm)

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<sup>1</sup> UCCH is a wholly owned subsidiary of Unicharm and holds 75% of the shares in UCCP.

<sup>2</sup> LMUs handle sales & marketing, distribution channel development and customer service in the relevant region.

<sup>3</sup> If applying the International Financial Reporting Standards (IFRS) which Unicharm has adopted since FY 2017, the majority of the SPEs should be deducted from sales revenue.

Yasuhiko Fujitsu: Outside Committee Member  
Attorney-at-law (Mori Hamada & Matsumoto)  
Toshifumi Takaoka: Outside Committee Member  
Certified Public Accountant (KPMG FAS Co., Ltd.)

Regarding the composition of the Committee, Mr. Asada was appointed as the committee chair for reasons that include the following: the internal investigation conducted before the establishment of the Committee did not result in any suspicion that the management of Unicharm was systematically involved in the SPE Carryover; Mr. Asada had served as the General Manager of the Accounting Control and Finance Division of Unicharm in the past and is familiar with accounting affairs; and he serves as an Audit & Supervisory Committee Member. In addition, the following three personnel were appointed as members of the Committee: Mr. China, Executive Officer, Internal Audit Department and Mr. Tanizaki, General Manager, who conducted the audit that prefaced the discovery of the SPE Carryover; and Mr. Ozawa, Department Manager, Legal Department, who was appointed to the Committee to handle legal issues.

To assist in such investigation (the “**Investigation**”), the Committee also appointed attorneys-at-law of Mori Hamada & Matsumoto and certified public accountants and other professionals of KPMG FAS Co., Ltd. as assistants.

## **2. Purposes of the Investigation**

The purposes of the Investigation were:

- (i) to investigate the facts with respect to the SPE Carryover;
- (ii) to investigate the existence of any other matters similar to the SPE Carryover;  
and
- (iii) to analyze the causes of the SPE Carryover and make recommendations on preventing recurrence.

## **3. Scope and target period of the Investigation**

### **(1) Scope of the Investigation**

The main scope of the Investigation was UCCP which was revealed in the internal audit to have had a problem with recording expenses in the correct financial period, but other important subsidiaries where similar problems may possibly have arisen were also investigated as stated in 4.(2)D below.

### **(2) Target period of the Investigation**

The target period reviewed by the Investigation was the three financial years from FY 2014 through FY2016. The Committee based its selection of the target period on considerations that include the following: (i) in the course of investigating past financial years backwards from FY2016 in which the SPE Carryover was discovered, SPE Carryover suspected to have been intentional was discovered for FY2016 and FY2015, but no SPE Carryover suspected to have been intentional was found for FY2014; (ii) as stated in II.2.(2)A below, in FY2013 and earlier, there was instead a

tendency to record excess provisions with respect to the SPEs; (iii) as stated in II.2.(2)A below, while there was an upward trend in the SPE and the SPE to sales revenue ratio in FY2015 and FY

2016, both figures were relatively low from FY2012 through FY2014; and (iv) the officers and employees of UCCH and UCCP who were involved in the SPE Carryover assumed office in their respective positions effective from July FY2015.

#### **4. Period, methods and scope of the Investigation**

##### **(1) Period of the Investigation**

The Committee conducted the Investigation between August 5 and September 12, 2017.

##### **(2) Methods and scope of the Investigation**

The specific methods by which the Investigation was conducted were as follows.

###### **A. Interviews**

In the Investigation, the Committee conducted interviews with the eight officers and employees of Unicharm, UCCH and UCCP who may have been involved in, or been aware of, the SPE Carryover. For a list of interviewees, see **Appendix 1-4(2)A**.

###### **B. Inspection and verification of accounting data and related materials**

The Committee inspected and verified accounting data with a possibility of being linked to the SPE Carryover, related materials including substantiation and, to the degree the Committee judged necessary, meeting minutes, internal regulations and other related materials.

For the main materials subject to the Investigation, see **Appendix 1-4(2)B**.

###### **C. Digital forensics**

The Committee preserved and reviewed email data taken from the cloud-based email archives<sup>4</sup> (stored on HDE One provided by HDE Inc.) of seven officers and employees of Unicharm, UCCH and UCCP who may have been involved in, or been aware of, the SPE Carryover. For the list of persons subject to digital forensics, see **Appendix 1-4(2)A** and for an outline of the digital forensics process and the keywords used in searching and filtering the data, etc., see **Appendix 1-4(2)C**.

###### **D. A questionnaire to Unicharm subsidiaries**

In order to ascertain whether matters similar to the SPE Carryover or other inappropriate accounting practices had occurred at subsidiaries other than UCCP, the Committee sent the questionnaire<sup>5</sup> in **Appendix 1-4(2)D** to the following nine subsidiaries on August 17, 2017, and had received a response from each of the nine

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<sup>4</sup> Note that because Unicharm Group's email system only retains up to 18 months of email data, all of the data in the email archives were preserved. (With respect to Unicharm's officers and employees who do not have concurrent positions at either UCCP or UCCH, it was limited to the extent deemed reasonably necessary).

<sup>5</sup> The Japanese-language original of the questionnaire translated into English in **Appendix 1-4(2)D** was sent to subsidiaries.



companies by August 23.

Of the thirteen companies consisting of Unicharm and its important subsidiaries that represent 95% of the Unicharm Group's sales revenue and are subject to evaluation of company-wide internal controls under the Financial Instruments and Exchange Act, the questionnaire was administered to nine companies excluding the following: Unicharm itself for which interviews and digital forensics did not result in any reasonable suspicion that there was involvement in the SPE Carryover or similar events, UCCP which is the main scope of the Investigation, Unicharm Products Co., Ltd. in which SPE does not arise because it assumes the majority of product supply to Unicharm and is not engaged in sales activities and Uni.Charm Mölnlycke B.V. which is a licensee of Unicharm and delegates its management to another company.

	Company
1.	PT Uni-Charm Indonesia
2.	Unicharm Gulf Hygienic Industries Ltd.
3.	Uni-Charm (Thailand) Co., Ltd.
4.	The Hartz Mountain Corporation
5.	Diana Unicharm Joint Stock Company
6.	Unicharm Australasia Pty Ltd.
7.	United Charm Co., Ltd.
8.	LG Unicharm Co., Ltd.
9.	Unicharm India Private Ltd.

## **5. Limitations of the Investigation and disclaimer**

Because the Investigation was conducted using the methods described in 4.(2) above within the time constraints described in 4.(1) above, it was limited in some respects. In addition, the Committee judged that it had obtained a reasonable basis for achieving the purposes of the Investigation, but more time or a different approach may have brought different results. As such, the results of the Investigation cannot be guaranteed complete.

Note that the Investigation was conducted on behalf of Unicharm and the Committee is not liable to any third party other than Unicharm.

## **II. Results of the Investigation**

### **1. Overview of Unicharm and UCCP**

#### **(1) Overview of Unicharm**

The following is an overview of Unicharm as at August 31, 2017 (the number of employees is as of December 31, 2016).

Trade name	Unicharm Corporation
Listed exchange	Tokyo Stock Exchange, First Section (Securities Code 8113)
Accounting date	December 31
Major shareholders	Unitech (24.96%), etc.
Representative	President & CEO Takahisa Takahara
Address of head office	182 Shimobun, Kinsei-cho, Shikokuchuo-City, Ehime, Japan (registered address; actual head office functions are performed at Sumitomo Fudosan Mita Twin Building West, 3-5-27 Mita, Minato-ku, Tokyo, Japan)
Number of employees	1,329 (15,843 including subsidiaries) (neither figure includes temporary staff)
Business areas	Manufacture, sale, etc., of products related to baby care, feminine care, pet care and the like
Accounting auditor	PricewaterhouseCoopers Aarata LLC

#### **(2) Overview of UCCP**

Unicharm indirectly holds 75% of the voting rights of UCCP as part of its Personal Care and Pet Care<sup>6</sup> business segments. For UCCP's organizational structure, see (4) below.

From July 2015, UCCP has converted from conducting area-based operations to adopting a performance management system which includes the sales and operating profit of LMUs in Shanghai (East China), Beijing (North China) and Guangzhou (South China). In March 2016, UCCP established an EC Business Division which handles electronic commerce businesses. These four divisions form the core of UCCP's business activities. For this reason, these divisions are the source of UCCP's SPEs.

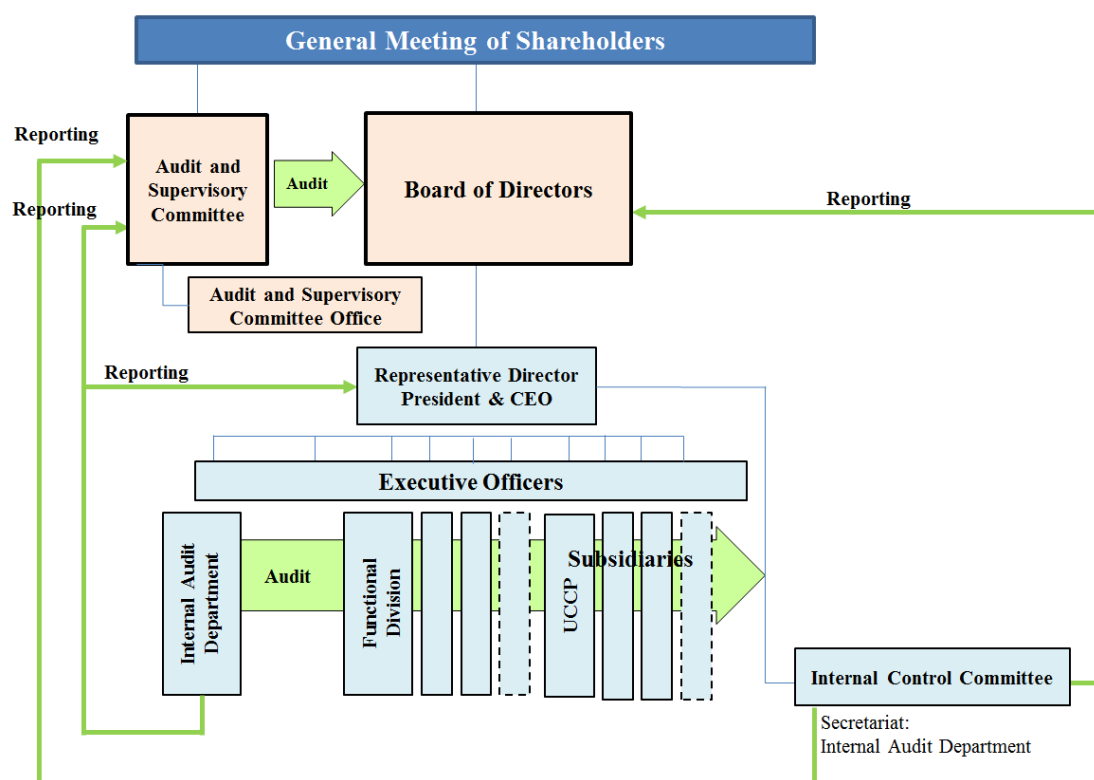
#### **(3) The Unicharm Group's corporate governance system**

The Unicharm Group's corporate governance system (as at December 31, 2016) is as described in the following diagram<sup>7</sup>. Unicharm has an Internal Audit Department (five people<sup>8</sup>) that reports directly to the Representative Director and President & CEO which also audits UCCP, apart from the internal audit conducted by the UCCH's Audit Department.

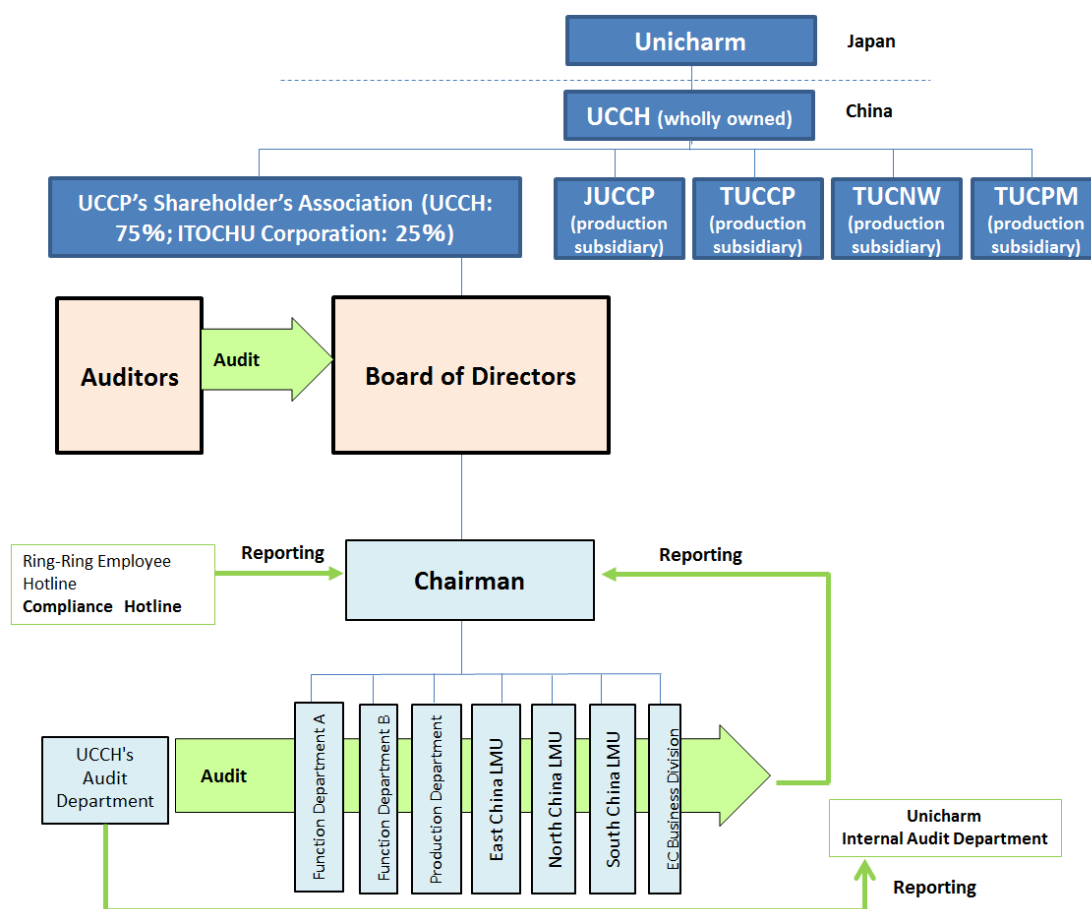
<sup>6</sup> Personal Care consists of products related to baby care, feminine care, health care and "clean & fresh" and Pet Care consists of pet care products.

<sup>7</sup> From May 2015, the Board of Corporate Auditors has been changed to an Audit & Supervisory Committee and an Audit & Supervisory Committee Office has been established. Apart from the foregoing, no material change has been made to the Unicharm Group's corporate governance system during the target period of the Investigation.

<sup>8</sup> The number of persons is as of the date hereof.



(4) UCCP's corporate governance system  
 UCCP's corporate governance system (as at December 31, 2016) is as described in the following diagram.



## 2. The SPE Carryover at UCCP

### (1) Operational flow with respect to SPEs

The operational flow with respect to SPEs (sub-categories of which include discount expenses and rebates, contract expenses, in-store activity expenses, product registration expenses, channel development expenses) at UCCP is generally as follows.

At UCCP, recording of SPEs in principle requires registration of an SPE budget in the sales and SPE management system which is the system for monitoring sales. The operational flow with respect to SPEs for a given month (the target month) is as follows.

First, the sales representative registers the budget for the SPEs of the target month in the sales and SPE management system by the 26th day of the preceding month and receives approval from the Area Manager<sup>9</sup> and the Sales Management Manager of the LMU or the Manager of EC Business Division by the 26th day of the preceding month after they review the appropriateness of the budget.

Next, the sales representative finalizes the provision for SPEs based on the budget approved in the previous step by the end of the target month in which sales promotion

<sup>9</sup> The Chinese title of Area Manager at UCCP is “大区经理” with “经理” meaning “manager” and not having the meaning that it has in Japanese (“accountant”). The same applies for Regional Managers (区域经理).

activities are carried out,<sup>10</sup> thereby finalizing the SPE budget for managerial accounting.

Once the data for the provision finalized by the above process is transferred to the ERP system, the accounting system provided by SAP SE (“**SAP**”) that is used by UCCP, on the first day of the month following the target month, recording of the provision for SPEs for the target month in the financial accounts is completed.<sup>11</sup>

After that, the sales representative prepares a payment application according to the SPEs billed by the customer and enters that payment application into the sales and SPE management system and the business process outsourcing company for SPE processing (the “**BPO**”) conducts payment procedures<sup>12</sup> after the application is approved by the Region Manager, the substantiation and application submitted by the sales representative are reviewed by the BPO and the application is approved by the Area Manager. For financial accounting purposes, the provision for SPEs recorded for the target month will be deleted.<sup>13</sup>

The system does not allow an SPE provision to exceed the budget approved by the LMU’s Sales Management Manager or allow SPE payments to exceed the recorded provision.

## (2) Background and forms of the SPE Carryover

### A. Background of the SPE Carryover

UCCP’s principal business is personal care and it mainly sells products manufactured in China. UCCP’s performance has improved in step with Chinese market growth and, as shown in the table below, in FY2014, its annual sales revenue and operating profit both exceeded the annual plan, but in FY2015 and FY2016, both sales revenue and operating profit were significantly below target. The major cause of this is the emergence of competitors in the baby-care market offering premium products<sup>14</sup> imported from Japan through online shopping.

(Unit: Thousand CNY)

	FY2014		FY2015		FY2016	
	Annual plan	Actual figure	Annual plan	Actual figure	Annual plan	Actual figure
<b>Gross sales</b>	6,961,731	7,004,127	8,589,864	7,108,425	8,561,657	6,887,359
Annual plan achievement rate	100.6%		82.8%		80.4%	
<b>Operating profit</b>	643,158	663,171	893,512	621,510	972,891	553,237

<sup>10</sup> Contract expenses which are the category of SPE are handled by master registration of the terms of the agreement in the sales and SPE management system at the start so that the budget is then automatically created based on the sales plan.

<sup>11</sup> For the purpose of SPE management, the system was improved in April 2016 so that provisions that are not used after a certain period of time has passed are automatically deleted.

<sup>12</sup> As of the date hereof, UCCP delegates to the BPO the work of ensuring correspondence between the month for which an SPE budget was registered in the sales and SPE management system and the month for which sales promotion activities were carried out as stated in the actual invoices.

<sup>13</sup> Until the system was improved in January 2016, the deletion of provisions in SAP was not transferred to the sales and SPE management system and it was manually processed, but as a result of the system improvement, such provision deletions in SAP are now designed to transfer automatically to the sales and SPE management system.

<sup>14</sup> “Premium products” refer to high-quality, high-price products.

Annual plan achievement rate	103.1%	69.6%	56.9%
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Note: The figures in the above table are on a managerial accounting basis.

In this context, UCCP's SPEs grew in FY2015 and FY2016 and the SPE to sales revenue ratio also significantly increased compared to FY2012 through FY2014 as shown in the table below.

(Unit: Thousand CNY)

	FY2012	FY2013	FY2014	FY2015	FY2016
<b>Sales revenue</b>	5,780,932	5,915,571	6,835,501	6,940,022	6,647,284
Revenue growth rate (year-on-year)	124.7%	102.3%	115.6%	101.5%	95.8%
<b>SPE</b>					
SPE to sales revenue ratio					
<b>Operating profit</b>	790,416	497,899	670,185	600,026	511,457
Operating profit to sales revenue ratio	13.6%	8.4%	9.8%	8.6%	7.7%
Profit growth rate (year-on-year)	104.2%	63.0%	127.1%	89.5%	85.2%

Note: The figures in the above table are on a financial accounting basis.

Regarding UCCP's SPEs, particularly in the case of the business flow such as delivering products to a commercial agent and then shipping to retailers, it can be difficult to accurately estimate in advance the period in which SPEs occur and their total cost since they tend to be affected by the actions of other manufacturers and status of sales negotiation between UCCP and other retailers and sales strategy must also be taken into account. On the other hand, as stated in 2.(1) above, the system did not allow an SPE provision to exceed the budget or allow SPE payments to exceed the recorded provision. Therefore, the sales representative tended to apply for the SPE budget somewhat in excess of their actual needs in order to secure the budget. In this case, provision was recorded excessively compared to the SPEs actually recorded and in fact excessive recording of SPE provision was a continuing trend up until FY2014.

#### B. Forms of SPE Carryover

In the context described in A. above, the SPE Carryover that occurred generally took the following forms:

##### (a) SPE adjustment

At UCCP, as described in (1) above, while SPEs were recorded after budget approval in the sales and SPE management system in the previous month and *wèifù* finalization<sup>15</sup> in the relevant month, SPE adjustments were made in each of the following stages: (i) at the time of approving the budget in the previous month, (ii) the *wèifù* finalization stage in the relevant month and (iii) after SPE recording in the relevant month. The

<sup>15</sup> “*Wèifù*” (or “未付”) means “accrued” in Chinese and “*wèifù* finalization” means to finalize accrued SPEs which have been registered and approved in the sales and SPE management system but have not yet been finalized.

specific manner in which SPEs were adjusted in each stage is described below. Although this section (a) mainly describes the situation in FY2016, the same applies in much the same way to FY2015, although there are differences in scale.

- (i) At the time of approving the budget in the previous month (excessive limitation of budget)

At East China LMU and North China LMU, as described in (1) above, while it was necessary to make budget applications with sales and SPE management system by the 26th of the preceding month and obtain approval in order to record SPEs in the relevant month, there were cases where SPEs were reduced at the time of approving the budget by excessively limiting sales promotional campaign approving the budget. Regarding these cases, the effect was that the SPEs actually required in excess of the budget were recorded in the following month.

For example, in the additional sales promotional campaign for feminine care and baby care conducted from October 2016 to January 2017, the person in charge of Sales Management Department of East China LMU (“**Mr. A**”<sup>16</sup>), although being aware that the sales promotional campaign itself would also be carried out during FY2016, did not approve the budget at the time of application because it had been difficult to estimate SPEs in such additional sales promotional campaign in the past and sales representatives had made excessive budget applications for SPEs. He then put off the budget approval until January 2017 when actual SPEs would be finalized and recorded such SPEs in February 2017.

- (ii) Adjustment before *wèifù* finalization in the relevant month (restrictions on *wèifù* finalization)

The Sales Management Department of the North China and East China LMUs instructed the sales representatives that they should not finalize unnecessary SPEs when finalizing the SPEs that received budget approval at the end of the previous month through the sales and SPE management system (*wèifù* finalization) and that, if the expense became necessary, an additional application in the following month would be approved. As a result, expenses related to sales promotional campaign executed in a particular month would not be recorded on the accounts for that month.

The person in charge of Sales Management Department of North China LMU (“**Mr. B**”) and Mr. A at East China LMU instructed sales representatives on such adjustments. While *wèifù* finalization was restricted each month in this manner since sales representatives tended to make excessive budget applications for SPEs, restrictions tended to become stricter as the end of the accounting period approached and expectations for annual goal achievement became clear.

- (iii) Adjustment after SPE recording in a particular month (cancellation of finalized SPE provisions)

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<sup>16</sup> Mr. A concurrently serves as the Senior Manager of EC Business Division.

It was found that, at UCCP's South China LMU, Mr. C, the person in charge of Sales Management Department ("Mr. C"), instructed the sales representatives to cancel SPE provisions finalized in the sales and SPE management system at the end of the accounting period. Considering that SPEs were re-recorded in the following accounting period in many of these cases, the Committee finds that SPEs related to sales promotional campaign that should have originally been recorded as provisions in that fiscal year were carried over into the following fiscal year.

Although these SPE adjustments were mainly carried out by Mr. A at the East China LMU, Mr. B at the North China LMU and Mr. C at the South China LMU after discussions held frequently with Senior Manager D ("Mr. D"), who is the officer in charge of the General Planning Department which is responsible for formulating budget and monitoring the results of budgets for UCCP at UCCH, the subjects, methods, and amounts, etc. of SPE adjustments were determined by each LMU at its sole discretion in order to meet profit targets for which LMU was responsible, so it was not found that Mr. D directly gave specific instructions to each LMU in relation to SPE adjustments. However, it cannot be denied that, overall, SPE adjustments were conducted under the influence and based on the intention of Mr. D, because, especially when the end of a fiscal year was approaching, the adjustments were carried out while making comparisons with profit target and amid references being made to matters such as targeted reduction of SPEs.

(b) Addition of sales promotional campaign after budget approval

At UCCP, as described in (1) above, amounts for which a sales and SPE management system budget application is not made by the 26th of the preceding month are not included in the *wèifù* finalization. The effect of this was that additional sales promotional campaign conducted after the 26th of the preceding month were not transferred to SAP or recorded in the accounts for that month because they were not registered in the sales and SPE management system.

At UCCP and at the financial year-end in particular, sales and operating profit targets including countermeasures against competitors were being met by using a sales method in which sales promotional activities were created in haste as those have not been registered in the sales and SPE management system in the previous month under a budget for SPEs and these sales promotional activities were carried out more than usual towards business partners such as commercial agents and retailers to have them purchase more products. In this case, it was technically impossible under the current sales and SPE management system to record the SPEs in that month and, as a result, this led to the SPEs being recorded in the following accounting period.

For example, at the North China LMU, due to the fact that sales of baby-care products were significantly underperforming at the end of FY2016, sales promotional campaign for December 2016 were drawn up in haste in that month. For this reason, it was not possible to obtain approval for the plans by November 26 which was the deadline for registering and approving in the sales and SPE management system and also it was not possible to record SPEs in December 2016, so the SPEs were recorded in the following



accounting period.

(c) Failure to register SPEs in the sales and SPE management system

In some cases, UCCP pays a part of rebates under a rebate agreement<sup>17</sup> even if the sales plan provided for therein was not met, taking into account UCCP's sales strategy and for the purpose of maintaining customer relationships. In such case, because the sales plan was not met, it was temporarily deleted from the SPE budget for that month as an unpaid amount and registered in the sales and SPE management system in the following month when payment is confirmed, thus being recorded in the accounts for the following month.

Because the question of whether or not payments of SPEs will be required is decided in the following month or thereafter by negotiations with customers, the Committee believes it is not necessarily the case that the above instances should be regarded as cases of SPE Carryover, but the Committee cannot rule out that there might have been some cases in which a considerable degree of probability existed that payments were required to be made in the relevant month considering matters such as the progress of negotiations with customers in the past.

(d) Changes from cash payment to offset (*piàokòng*)

At UCCP, in some cases, SPEs that were intended to be paid in cash were instead paid by *piàokòng*<sup>18</sup> in order to enjoy tax advantages, in which case, prior to the system update in July 2017, even though the SPEs were registered in the sales and SPE management system, the SPEs paid by *piàokòng* were not transferred to SAP. Thus, the cost was not recognized in the financial accounts until the results were finalized and invoices were issued after offsetting SPEs against sales.

The Committee believes that the accounting treatment described above was not conducted intentionally by employees and officers but occurred due to the fact that the employees and officers were not aware of the above problem under the system, namely that if SPEs that were intended to be paid in cash were instead paid by *piàokòng*, they were not transferred to SAP.

(3) Intention of the SPE Carryover

The Committee believes that the intention of Mr. D, Mr. A, Mr. B, and Mr. C (collectively, "**Mr. D and Others**") with respect to the forms of SPE Carryover described in II.(2)(a) through (c) above was as follows.

As stated in (1) above, UCCP's system requires an SPE budget to be registered in the sales and SPE management system no later than the preceding month and if this is not approved then payment of that month's SPEs is not permitted. For this reason, it became normal for sales representatives to register SPE budgets in excess of their monetary needs in the sales and SPE management system, however, the balance of the provisions in the sales and SPE management system at the end of the month is transferred to SAP which meant that SPEs were over-recorded in the financial accounts.

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<sup>17</sup> An agreement in which UCCP pays a customer the amount calculated by multiplying a fixed percentage depending on the sales volume of UCCP products by the customer.

<sup>18</sup> A method in which SPEs are paid after offsetting them against sales charged to the customer.

Mr. D and Others had worked to reduce less-necessary SPEs in an attempt to improve SPE budget management in the sales and SPE management system in response to the decline in the business environment beginning in FY2015 with the result of removing SPEs that should have been recorded in the financial accounts as having been incurred in that financial year. The Committee did not find evidence that it was the initial intention of Mr. D and Others to remove SPEs, despite being aware that they were necessary in order to adjust profit figures in the financial accounts.

However, the Committee cannot rule out the possibility that Mr. D and Others made some SPE adjustments for a purpose beyond removing unnecessary SPEs but to affect profit figures in terms of managerial accounting (intention to achieve profit targets or fill the gap with them), particularly with respect to the SPE Carryovers from FY2016 to FY 2017, in light of the fact that (a) the shortfall in the SPE provisions was very large (CNY 140,645 thousand), (b) some adjustments were made immediately before the end of FY 2016 with reference to the profit targets in terms of managerial accounting for FY2016, (c) a lot of the SPEs that the South China LMU cancelled in December 2016 were re-recorded in FY2017, (d) additional applications were made in FY2017 for SPEs concerning the sales promotional activities carried out by North China LMU and East China LMU in December 2016 and (e) although Mr. D and Others could anticipate that, amid difficulties in ascertaining an accurate state of affairs regarding SPEs, emphasizing removal of SPEs at the end of the period could possibly result in removal of SPEs that actually should be provisioned, they did not adopt active countermeasures to prevent such an occurrence.

Nor can the Committee rule out such possibility with respect to SPE Carryovers from FY2015 to FY2016 in light of the fact that a substantial difference was not seen between FY2015 and FY2016 other than the scale of amount.

Note that Unicharm's management is highly focused on the figures in terms of managerial accounting and Mr. D and Others, too, are exclusively focused on profit figures in terms of managerial accounting and, while the Committee did not find that Mr. D and Others directly intended to affect the financial accounts, they must have been aware that any effect on managerial accounting would also have a consequential effect on the financial accounts. Furthermore, as stated in II.2.(2)A above, insufficient and excess SPE provisions existed simultaneously and, although it is possible that Mr. D and Others were aware that, because it cannot be accurately ascertained by looking at the SPE account items overall whether there are insufficient or excess provisions, even if they adjusted certain SPEs, resulting in insufficient provisions with respect to those SPEs, these could be absorbed by excess provisions with respect to other SPEs, they were not able to accurately ascertain the actual state in the first place and there was also no basis for believing the SPE accounts overall to be appropriate.

Therefore, the Committee cannot rule out that Mr. D and Others were undeniably aware of and accepted the fact that these accounting practices could be inappropriate for the financial accounts and made adjustments and the like to the SPEs around the end of each period.

#### (4) Effect of the SPE Carryover

The effect on the financial statements for each financial year from FY2014 to FY2016 due to the SPE Carryover described in II.2.(2) above and the separate excess provisions

is as follows.<sup>19</sup>

(Unit: Thousand CNY)

	FY2014	FY2015	FY2016 <sup>20</sup>
Insufficient provisions	-14,136	-53,144	-140,645
Carryover (Note 1)	N/A	-51,072	-104,715
Mistake (Note 2)	-14,136	-2,072	-35,929
Excess Provisions (Mistake)	34,776	36,875	62,839
Total amount (Note 3)	20,639	-16,269	-77,805

Note 1: Those insufficient provisions that were, or are suspected of having been, intentionally carried over to the following fiscal period.

Note 2: Those insufficient provisions that were carried over not intentionally but due to either a system error or an error in estimation.

Note 3: Figures are before taking taxes into account.

Note 4: The mark “-” indicates an increase in expenses.

(Reference: Conversion to JPY)

(Unit: Million JPY)

	FY2014	FY2015	FY2016
Insufficient provisions	-243	-1,020	-2,302
Carryover	N/A	-981	-1,714
Mistake	-243	-39	-588
Excess Provisions (Mistake)	599	708	1,028
Total amount	355	-312	-1,273

Note: Conversion to JPY was performed using the following exchange rates: FY2014, CNY 1 = JPY 17.23; FY2015, CNY 1 = JPY 19.22; FY2016, CNY 1 = JPY 16.37

### 3. Investigation of other problems at UCCP

At UCCP, except for SPEs, no cost items were found that are likely to give rise to improper or false accounting because they are essentially estimations in their nature for the most part. For this reason, no cost items were found that are deemed qualitatively significant in the investigation of issues similar to SPE Carryover. However, materially large cost items include cost of sales, marketing expenses, transport costs and royalty payments.

The Committee determined that, among the above items, the risk of similar problems with respect to cost of sales is low because it is managed by the Production Department

<sup>19</sup> As stated in I.1 above, a large portion will be deducted from sales revenue if IFRS is applied.

<sup>20</sup> As stated in I.1 above, Unicharm has recognized insufficient provisions in FY2016 of CNY134 million (JPY 2,249 million) as a result of the audits respectively conducted by Unicharm’s Internal Audit Department and UCCH’s Audit Department and Unicharm disclosed this amount in the “Notification of Application Filing to Extend Deadline for Filing Quarterly Securities Report for the Six Months Ended June 30, 2017” dated August 10, 2017; however, the results of the Committee’s investigation revealed, as is shown in the table above, that the total amount of the insufficient provisions in FY2016 was CNY140,645 thousand. However, as it was also revealed that there were separate excess provisions, the net amount was CNY77,805 thousand.

and is analyzed using standard methods, so is controlled to a certain degree, and SPEs and cost of sales are handled by different people in different departments and at different physical locations.

With respect to marketing expenses, the Committee conducted a search of those transactions occurring prior to the end of the period from January 2015 through June 2017 setting the search parameters as transactions having occurred during that period, as recorded in the “Remarks” section on the SAP account data, and then used sampling to conduct an investigation of evidence regarding transactions for which there was a possibility of carryover. As a result, the Committee determined that no material carryovers have occurred.

The Committee determined that the risk of problems of same kind arising with respect to transport expenses is low because of the fact that, (i) as a result of its analytical investigation of changes in transport expenses, no unexplainable change was discovered and (ii) logistics operations were outsourced to the BPO who conducted recording processes based on the invoice<sup>21</sup> and it is difficult to intentionally adjust the timing of recording.

Royalty payments were made by UCCP to Unicharm and for this reason they had no impact on the consolidated financial statements because the amount of those payments was eliminated due to being set off against other amounts arising as a result of transactions among consolidated companies for the purpose of consolidated accounting.

Based on the analysis above, the Committee determined that no matters have occurred that are similar to the SPE Carryover with respect to cost of sales, marketing expenses, transport expenses and royalty payments.

#### **4. Other subsidiaries**

As stated in I.4.(2)D above, the Committee administered questionnaires to the presidents and accounting managers of nine subsidiaries of Unicharm, but no SPE Carryover or similar matter or other inappropriate accounting practices that are significant were discovered.

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<sup>21</sup> An “invoice” (發票) is documentary evidence of the receipt of payment for a sale of goods, provision of services or other commercial activity and is the financial evidence (i.e. substantiation) required by statute in China. It can also be translated as “receipt.”

### **III. Analysis of Causes**

#### **1. Intention of employees and officers (Motive)**

It cannot be denied that, as stated in II.2.(3) above, the intention of Mr. D and Others with respect to the SPE Carryover (excluding the form of SPE Carryover described in II.2.(2)(d) above) included an element of achieving profit targets or filling the gap with them that went beyond the purpose of reducing unnecessary SPEs and it also cannot be denied that they had recognized and accepted that their conduct may cause inappropriate accounting practices in financial accounting.

On the other hand, such an intention cannot be acknowledged in the form of SPE Carryover described in II.2.(2)(d) above.

#### **2. Inappropriateness of the system for SPE management (Opportunity)**

##### **(1) Inappropriateness of the sales and SPE management system**

As stated in II.2.(1) above, UCCP's system means that if registration and approval are not completed in the previous month, SPEs cannot be paid. However, SPEs include many expenses that are difficult to estimate with accuracy and requiring approval of a budget the month before as part of the accounting process means that SPEs in excess of the budget cannot be paid in the month they are incurred and, instead, must be recorded in the following month, so carryovers cannot be prevented.

Also, as stated in II.2.(2)A above, the sales representatives tended to apply for the SPE budget somewhat in excess of their actual needs in order to secure a budget and were also required to reduce their SPEs.

Therefore, the Committee considers one element in the background to the SPE Carryover to have been the inappropriateness of the configuration of the sales and SPE management system.

##### **(2) Inappropriateness of the system for SPE management with respect to personnel placement**

Because SPEs include an extremely large number of expense items and many items of SPEs are difficult to estimate with accuracy, it is necessary to have a system for properly managing SPEs, however, there was only one SPE manager in the Sales Department at the South China LMU (compared to about three at the North China and East China LMUs; the person in charge of the East China LMU held a concurrent position in the EC business division) and neither that person nor the president of the South China LMU had accounting experience. Therefore, appropriate systems for SPE management were not in place especially in the Sales Department at the South China LMU.

##### **(3) Insufficient accuracy and comprehensiveness of the estimate for provisions of SPEs**

Although UCCP as a whole has taken care not to record provisions related to SPEs that are unnecessary and to delete such provisions in a timely manner if they have been recorded, some cases have been found where provisions related to SPEs were actually over-recorded in the accounts and such SPEs were deleted in the following period because the recording of such SPEs was recognized to be unnecessary, so the

Committee believes that the accuracy and comprehensiveness of the estimate for provisions of SPEs were insufficient.

In April 2016, the sales and SPE management system was partly changed and a mechanism was introduced to automatically delete provisions that were not used despite a specified period of time passing, but a reasonable estimate of the amount of provisions related to SPEs including the confirmation of the difference between the budget and actual for the provision was not carried out.

### **3. Insufficient involvement of the Accounting Department in SPE recording and system inadequacies with respect to SPE recording (Opportunity)**

(1) Insufficient involvement of the Accounting Department in SPE recording  
As stated in II.2.(1) above, UCCP's Sales Management Department is responsible for the operational flow with respect to SPEs, including the registration of provisions in the sales and SPE management system based on sales promotional campaigns or expectations based on them to be executed and the deletion of unused provisions in the budget and, as stated in (2) below, UCCH's Finance Department which concurrently serves as UCCP's Accounting Department had lacked in its independence with respect to the inspection of timing and expectation of occurrence of the SPEs related to such sales promotional campaigns and the recording time of the actual SPEs, and the like, and ultimately the involvement of UCCH's Finance Department was insufficient in these respects.

Although some accounting tasks were delegated to the BPO and, currently, examinations including confirmation of consistency in the time of the sales promotional campaign and the time of occurrence of SPEs related to such sales promotional campaign have been strengthened, if UCCH's Finance Department had been appropriately involved in the SPE operational flow, the SPE Carryover would have been detected without an internal audit and could have been prevented or remedied. Therefore, one cause of the SPE Carryover is believed to be the insufficient involvement of UCCH's Finance Department.

(2) Insufficient independence of the Accounting Department  
Further, at UCCP and UCCH, Mr. D, who is responsible for UCCH's General Planning Department which is in charge of the business progress management (managerial accounting), is, as an officer of UCCH, responsible for UCCH's General Management Department which is an administrative division under which UCCH's Finance Department is positioned. Because of this, UCCH's Finance Department may have unconsciously prioritized business progress management based on managerial accounting instead of fully implementing the checks and balances function as an accounting division. This may have constituted a remote cause for the insufficient involvement of UCCH's Finance Department as stated above.

### **4. Lacking or insufficient awareness with respect to proper financial reporting (Opportunity and Justification)**

As stated in II.2.(1) above, data with respect to provisions for finalized SPEs in the sales and SPE management system are automatically transferred to SAP for accounting so it was inevitable that the actual figures for profits and losses for the period were not

reflected due to SPE Carryover and that these problems would have an impact on the financial reports of UCCP and the Unicharm Group. We believe that Mr. D and Others must have been aware of this while acknowledging that the depth of their awareness would depend on their individual levels of experience. It must be said that Mr. D and Others have lacked in their awareness with respect to proper financial reporting because they nevertheless adhered to the profit figures in terms of managerial accounting without considering the consequences brought by distortions in financial reporting to be a serious problem.

Also, while it is unknown whether the persons at the level of sales representative of UCCP were clearly aware of the impact on the financial reports caused by inappropriate registration of SPEs in the sales and SPE management system, at the very least, it is undeniable that they had insufficient awareness with respect to proper financial reporting.

## **5. Overemphasis on managerial accounting in the Unicharm Group (Opportunity and Justification)**

In the Unicharm Group, each accounting division makes a report on closing accounts on a quarterly basis but the formulation of an annual budget that directly connects with the management plan and the management of monthly results for monitoring its progress are based on managerial accounting, so people in the Unicharm Group are very conscious of budget and result management figures based on managerial accounting.

Although it has not been objectively determined that excessive pressure related to achieving managerial accounting goals existed, the Committee believes that, in UCCP, the overemphasis on managerial accounting has become a breeding ground for (i) the insistence on budget management and profit planning based on managerial accounting, (ii) a certain amount of pressure based on such insistence and (iii) insufficient awareness with respect to proper financial reporting as stated in 4. above.

## **6. Problems with the Unicharm Group's internal auditing (Opportunity)**

### **(1) Insufficient internal auditing system in the Unicharm Group**

Unicharm's Internal Audit Department regularly audited UCCP and UCCH's Audit Department also conducted audits.

However, despite being responsible for auditing all divisions of Unicharm, its seven domestic major subsidiaries in Japan and 18 overseas major subsidiaries, Unicharm's Internal Audit Department consists of only five people. UCCH's Audit Department was likewise only six people and the auditing system was insufficient in terms of both quality and number of people.

In this way, the audits by Unicharm's Internal Audit Department and UCCP were insufficient in terms of staffing and expertise which is recognized to be one of the reasons the SPE Carryover was not detected and remedied sooner.

### **(2) Insufficient independence of UCCH's Audit Department**

As with UCCH's Finance Department, in UCCP and UCCH, Mr. D is the director in charge of UCCH's Audit Department which therefore may have unconsciously prioritized business progress management based on managerial accounting instead of

fully implementing the checks and balances function by internal audit. This may be a remote cause why this matter was not recognized as a problem sooner.

## **7. Problems in the Unicharm Group's corporate governance (Opportunity)**

### **(1) Insufficient information sharing within the group**

The results of audits of UCCP by Unicharm's Internal Audit Department were regularly reported to Unicharm's Audit & Supervisory Committee and the results of audits conducted by UCCH's Audit Department in conjunction with Unicharm's Internal Audit Department were confirmed by the Internal Audit Department before being reported to the Audit & Supervisory Committee.

However, the results of audits conducted by UCCH's Audit Department alone were reported to the Chairman and executives of UCCP and the audited departments while only a part of such results were reported to Unicharm's Audit & Supervisory Committee because the audit was not conducted at the initiative of Unicharm's Internal Audit Department. For example, an audit conducted by UCCH's Audit Department in 2016 in fact pointed out several problems related to SPEs at UCCP although these may not necessarily be the same as the SPE Carryover and if Unicharm's Internal Audit Department had been actively involved in 2016 when these audit results came to light, the problems that led to the SPE Carryover could have been discovered sooner.

### **(2) Non-existence of departments or divisions dedicated to managing overseas subsidiaries in the Unicharm Group**

Also, the Unicharm Group did not have a department or division dedicated to managing overseas subsidiaries and their management was handled function by function, therefore, roles and responsibilities were not entirely clear. As such, it cannot be denied that there is some inadequacy in the control by Unicharm of its overseas subsidiaries. It is possible that this has led to insufficiencies in managing SPEs at UCCP and caused problems such as the SPE Carryover.

## **8. Lacking awareness among sales representatives with respect to reduction of SPEs (Opportunity and Justification)**

In UCCP, sales revenue is a major criterion in the incentive plan for sales representatives. For this reason, the sales representatives may have lacked in awareness of the need to increase profit rate by reducing unnecessary SPEs and, as a result, they may have excessively used SPEs and then SPE managers needed to reduce or adjust SPEs. This may be one cause of the SPE Carryover.



## **IV. Prevention of Recurrence**

### **1. Raise awareness**

#### **(1) Spread the message of thorough compliance**

As stated in III.1 above, the officers and employees of UCCP had insufficient awareness of proper accounting practices.

Based on the events that occurred in this instance, each of the officers and employees should enhance its cognitive powers and judgment skills in line with the corporate philosophy and action guidelines of Unicharm, devote itself to act in accordance with those philosophy and guidelines and pursue organizational management that continually adapts to changes in social values and environment; however, in order to attain that, top management should, first of all, spread the message of thorough compliance through various means in order to demonstrate their stance toward taking the lead in thoroughly pursuing compliance, including proper financial reporting.

For example, at Unicharm's morning meeting on every Monday, the division manager in charge of the meeting should have all of the staff (including all employees as well as division manager-level managerial staff, president, representative director and executive officers) in attendance repeat the action guidelines of the Unicharm Group. One idea to consider would be the calling at that meeting for a stance that places maximum priority on compliance including proper accounting practices so that all officers and employees will enhance their mind toward compliance-awareness. Accordingly, introducing a similar type of meeting as a forum at UCCP to have all of its officers and employees become more compliance-minded is an idea to consider.

#### **(2) Improve compliance training**

In addition, the compliance training that was previously only offered to executive officers and above and to new staff in marketing divisions should be offered to more people and E-learning or other methods should be used to foster increased compliance awareness.

#### **(3) Clarify who is responsible**

Furthermore, it is necessary to show that there are severe penalties for acting against compliance and, including in this case, once it is clear who is responsible, appropriate steps should be taken.

#### **(4) Improve awareness of financial accounting**

In addition to implementing these measures to improve compliance awareness in staff, Unicharm should change its inclined stance of overemphasis on managerial accounting which is literally an accounting system for business management, therefore, it goes without saying that this system is an important tool for managing a business. However, as a result, this overemphasis may possibly lead to a lack of awareness of appropriate accounting practices which Unicharm's management should have avoided and it should continue to spread awareness of the importance of appropriate accounting among all staff of the Unicharm Group through E-learning or other methods that the Accounting Control & Finance Division of Unicharm has been implementing.

## **2. Strengthen the checks and balances functions of UCCH's Accounting Department**

As stated in III.3.(1) above, insufficient involvement of UCCH's Finance Department was one of the factors that led to the SPE Carryover.

In order to strengthen the functions of UCCH's Finance Department, its organizational structure should be improved and it should be actively involved in SPE management. In addition, it should consider an organizational structure that can increase its independence from the senior manager in charge of business progress management in order to make it possible to adequately execute its checks and balances function over the department that handles business progress management (i.e. managerial accounting).

## **3. Strengthen the audit system**

As stated in I.1 above, although the issue of SPE Carryover has previously been detected in a regular audit by UCCH's Audit Department, no fundamental remedial measures were taken.

Monitoring of matters identified in the internal audit should be strengthened and thorough pursuit of improving them in a top-down style by the Chairman should be implemented to ensure early resolution of problems. Specifically, when UCCH's Audit Department makes a regular report to the Chairman of its internal audit results, it should follow up on the progress of remedial measures for previously identified matters as well as pursue having the Chairman bring the attention of the sales departments to newly identified matters.

Furthermore, in order to allow UCCH's Audit Department to adequately execute their checks and balances function over the department that handles business progress management, Unicharm should consider establishing an organizational structure that would increase the independence of UCCH's Audit Department from the senior manager who is in charge of business progress management.

In particular, in future audits of UCCP by UCCH's Audit Department, the control function in internal control work processes under the Financial Instruments and Exchange Act should be strengthened by conducting internal audits for proper recording of expenses in the correct financial period.

Furthermore, Unicharm's Internal Audit Department and UCCH's Audit Department were both insufficient in terms of staffing, so an increase in personnel should be considered in the medium- and long-term.

## **4. Strengthen governance of subsidiaries**

As stated in 3 above, the SPE Carryover was detected in an audit of UCCP by Unicharm's Internal Audit Department so there was no particular issue with Unicharm's governance of UCCP, but, as stated in III.7. (1) above, Unicharm's Internal Audit Department was not actively involved in the audit after the results of the audits conducted by UCCH's Audit Department on its own came to light.

The material parts of such audit results should be reported directly to Unicharm's Audit & Supervisory Committee and Unicharm should improve governance by having a more rapid and direct awareness of the problems at UCCP and other overseas subsidiaries.

In addition, Unicharm should consider establishing an organizational structure that

would strengthen the management of overseas subsidiaries including establishing a department dedicated to manage those overseas subsidiaries.

## **5. Improve systems concerning SPE management**

### **(1) Reduce incentives for sales representatives concerning SPE applications**

As stated in III.8 above, it is believed that one of the causes of SPE Carryovers was that there were too many instances of sales representatives applying for SPE budget plans that were relatively in excess in order to secure budget. There needs to be consideration of frameworks, including such things as reviewing incentive systems for sales representatives or segregating sales representatives and the power to determine sales promotional campaign, to ensure that sales representatives do not apply for excessive SPE budgets as a means of increasing sales.

### **(2) Develop and strengthen SPE management systems**

As stated in III.2.(2) above, it is believed that one of the causes of SPE Carryovers was inadequate personnel for the SPE management systems. In order to develop appropriate management systems for SPEs, the management capabilities of managers need to be improved by, including, conducting training to develop their knowledge of accounting and improving their language proficiency so that they are able to communicate closely with local sales representatives. Furthermore, work needs to be done to strengthen personnel and develop systems including utilizing local human resources who are well versed in local SPE management.

### **(3) Manage budget vs. actual**

It is believed that if Unicharm could be aware of the cause of gap between the budget and actual for SPEs in a timely manner, the SPE Carryover could have been detected and remedied sooner.

The sales and SPE management system should be improved so that irregular operations including the cancellation of SPEs can be viewed in a checklist and gap between budget and actual can be detected sooner and it should also be constructed to give alerts when the said gap exceeds a predefined limit, allowing continuous monitoring. It should be noted that, as at the date hereof, UCCP has already started to strengthen its checking function by, as a proof, delegating to the BPO the work of ensuring correspondence between the month for which an SPE budget was registered in the sales and SPE management system and the actual month for which sales promotional activities were carried out as stated in the actual invoices SPEs were billed.

### **(4) Make the sales and SPE management system more appropriate**

As stated in III.2.(1) above, despite some SPEs being hard to estimate, the sales and SPE management system required that an SPE budget be registered and approved by the previous month in order to record the SPEs in the accounts which the Committee considers to have been one factor that led to the SPE Carryover. On the other hand, the system of approving budget in the month before is necessary for SPE budget management.

The system should be changed so that, while budget approval in the previous month is still generally required for SPE payments, an exception is made for SPEs that can

reasonably be considered difficult to estimate thus these can be recorded in the month they occur, rather than the month before.

All problems of the sales and SPE management system and SAP, not necessarily limited to those described in the preceding paragraph, are discovered in their daily operations so the operational status should be regularly checked and efforts should be made to promptly remedy any problems that were discovered.

(5) Ensure correspondence between the sales and SPE management system and SAP

At UCCP, information that is registered in the sales and SPE management system is in principle automatically transferred to SAP and recorded in the accounts but there are no guaranteed procedures for checking the correspondence of information entered in the multi-systems. Thus, unless the systems are continuously monitored, it is not possible to promptly detect even when these systems do not correspond each other for some reasons. However, continuous monitoring by way of manual means is impractical.

Therefore, the related systems should be improved so that an alert is promptly given in the case of any anomalies for regularly checking the proper operation of each system by ensuring such correspondence.

End of report

## **Appendix 1-4(2)A**

### List of Persons Subject to Interviews and Digital Forensics Process

	<b>Persons</b>	<b>Department / Title, etc.<sup>1</sup></b>	<b>Interview</b>	<b>Digital Forensics</b>
<b>Unicharm</b>				
1.	Mr. E	Executive Officer, General Manager of Corporate Planning Division	○	○
2.	Mr. F	General Manager of Business Promotion Office, Corporate Planning Division	○	○
<b>UCCP</b>				
1.	Mr. G	Chairman & President of UCCP & UCCH <sup>2</sup>	○	○
2.	Mr. D	Director of UCCP and Director & Senior Manager of Planning Department of UCCH	○	○
3.	Mr. H	President of UCCP South China	○	-
4.	Mr. A	Manager of Sales Management Department of UCCP East China	○	○
5.	Mr. B	Manager of Sales Management Department of UCCP North China	○	○
6.	Mr. C	Manager of Sales Management Department of UCCP South China	○	○

<sup>1</sup> The departments and titles, etc. stated above are those at the time of the interview and the latest information at the time when the SPE Carryover occurred is stated above as appropriate.

<sup>2</sup> Mr. G is also Director & Senior Executive Officer of Unicharm.

## **Appendix 1-4(2)B**

### Outline of Documents Subject to Investigation

- Organization chart
- A set of materials for the internal investigation on the SPE Carryover at Unicharm
- Answer form for the questionnaire conducted by the Internal Investigation Committee
- Reports on audit results of UCCP by Unicharm's Internal Audit Department
- Reports on audit results by UCCH's Audit Department
- Meeting minutes for Management meeting at UCCP
- Email data of persons subject to digital forensics
- List of finalized SPE payments (SAP)
- Finalized data of actual SPEs (the sales and SPE management system)
- List of data for the cancellation of SPEs (the sales and SPE management system)
- Slip for SPE payments and substantiation of those payments
- Data for returned goods
- Journalizing data for marketing expenses
- Trial balance for expected amount of SPEs
- Materials on the expected marginal profit for each business in each LMU
- Breakdown of SPEs

## **Appendix 1-4(2)C**

### **Outline of Digital Forensics Investigation Process**

#### **1. Digital Forensics Conducted in the Investigation**

(1) Preservation of email data

An external hard disk drive containing a copy of the email data in the email archives (308GB) was received from the system administrator of Unicharm the data of which were then preserved in the working hard disk drive.

(2) Preparation for full-text search

The reproduced email data were read into Nuix version 6.2.7 created by Nuix Pty Ltd (“Nuix”), and a full-text indexing process was conducted in preparation for the full-text search.

(3) Filtering the emails subject to review by a conditional search

The conditional search (see paragraph 2. below for details) was conducted using Nuix on the email items in Nuix on which the full-text indexing process had been conducted in accordance with paragraph (2) above and the emails that met the search criteria were extracted as the object of the email review.

(4) Email review

The emails for review were reviewed after performing full deduplication using a hash value and importing those emails into Relativity version 8.1 created by Relativity ODA LLC (U.S.).

#### **2. List of Search Keywords Used**

(1) Keywords used

[Omitted]

(2) Details of the conditional search

A. UCCH/UCCP

The search was conducted on the 332,444 preserved emails of the persons from UCCH/UCCP subject to the email review using the 62 keywords contained in the “UCCH/UCCP” row in the table above. It is assumed that the people subject to the email review have many occasions to send emails to large groups of officers and employees simultaneously due to the nature of their job, but since it can be expected, in light of the forms of the SPE Carryover, that it is unlikely that the emails matching to the purpose of the Investigation are included in such mass emails, a search was conducted on the email data that contained the keywords above for the emails whose total number of email addresses contained in the “To” “CC” and “BCC” boxes was 5 or less and the emails that met those search criteria were determined as the object of the email review.

Regarding the keywords contained in rows KW051 through KW062 in the table above, the emails sent and received from December 2016 to February 2017 were determined as the object of the email review.

Ultimately, those emails were reviewed after performing full deduplication using a hash value and importing 10,485 emails to the reviewing environment.

## B. Unicharm

The search was conducted on the 17,606 preserved emails of the persons from Unicharm subject to the email review with the 24 keywords contained in the “Unicharm” row in the table above. For the same reason as given in the preceding paragraph, the search was conducted for the emails whose total number of email addresses contained in the “To”, “CC” and “BCC” boxes was 5 or less and the emails that met those search criteria were determined as the object of the email review.

The period subject to the search regarding persons from Unicharm subject to the email review was May and June 2016 and November and December 2016.

327 emails that met the above criteria were reviewed after performing full deduplication using a hash value and importing those emails to the reviewing environment.



**Appendix 1-4(2)D**

August 17, 2017

To all concerned:

Unicharm Corporation  
Internal Investigation Committee

**Notice of Questionnaire Investigation regarding Accounting Treatment**

Because it was recognized that it is necessary to validate the appropriateness of periodical allocations of expenses and other items at UCCP in the UC Group's previous financial results, the Committee is conducting an investigation of the appropriateness of accounting treatment at the UC Group as a whole. Please see the attached "Notice of Investigation Related to the Previous Financial Results" dated August 10, 2017. Specifically, up to the present time, it was recognized that 2,249M JPY of sales promotion expenses that should have been recognized in FY2016 were not accounted for, and were instead deferred to the next fiscal year (the "Sales Promotion Expenses Deferral").

As part of its investigation, the Committee has decided to conduct the following questionnaire investigation of certain local subsidiaries with the objective of investigating each local subsidiary to determine whether there has been the Sales Promotion Expenses Deferral described above and whether similar events have occurred, and moreover, whether there is any other inappropriate accounting treatment beyond the sales promotion expense issue.

Therefore, after conducting necessary and sufficient investigations at each local subsidiary in order to answer, please give your answers by filling in every answer field, signing your name at the end of the questionnaire, and attaching a PDF of the Questionnaire and Answer Form to an e-mail addressed to Mr. China by no later than August 21.

Notes:

- Please keep the entirety of this questionnaire investigation, not only the details of its questions and answers but also the fact that it is being conducted, strictly confidential, both internally and externally.

\* For inquiries regarding this matter:

Internal Investigation Committee Secretariat

Toshiro China, Director, Business Reform Division

(E-mail: toshiro-china@unicharm.com; or phone: 090-8854-3685)

## Questionnaire and Answer Form

**\* If there is insufficient space in the answer field, please use a separate sheet of paper or the like. In addition, please attach any materials that are relevant to the content of your answers as appropriate.**

**Q1:** Have you ever participated in, or been aware of any, Sales Promotion Expenses Deferral at the local subsidiary you are responsible for (regardless of whether it was done organizationally or individually)? Please state the specific details (e.g., when, where, who) for any relevant cases.

**A1:** After having conducted an investigation of the local subsidiary for which I am responsible that I believe to be necessary and sufficient, and in the full awareness that I may be subject to some kind of sanction if I give a false answer, I hereby answer as follows.

**Q2:** Have the local subsidiary you are responsible for carried out any inappropriate accounting treatment similar to the Sales Promotion Expenses Deferral? Have you ever participated in, or been aware of any inappropriate accounting treatment similar to the Sales Promotion Expenses Deferral at the local subsidiary you are responsible for (regardless of whether it was done organizationally or individually)? For any relevant cases, please state the specific details (e.g., when, where, who) of that accounting treatment or act.

**A2:** After having conducted an investigation of the local subsidiary for which I am responsible that I believe to be necessary and sufficient, and in the full awareness that I may be subject to some kind of sanction if I give a false answer, I hereby answer as follows.

**Q3:** Have the local subsidiary you are responsible for carried out another inappropriate accounting treatment or an act that you suspect of being an inappropriate accounting treatment? Have you ever participated in, or been aware of another inappropriate accounting treatment or an act that you suspect of being an inappropriate accounting treatment at the local subsidiary you are responsible for (regardless of whether it was done organizationally or individually)? Please state the specific details (e.g., when, where, who) of that accounting treatment or act for any relevant cases.

**A3:** After having conducted an investigation of the local subsidiary for which I am responsible that I believe to be necessary and sufficient, and in the full awareness

that I may be subject to some kind of sanction if I give a false answer, I hereby answer as follows.

I hereby pledge that the preceding is true and correct.

Date:

Department and position:

Signature: [seal]