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This document is an English translation
of a statement written initially in Japanese.
The Japanese original should be considered
as the primary version.

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Inappropriate transactions and accounting treatment at a consolidated subsidiary

ITOCHU Corporation (“ITOCHU”) recently discovered that a former employee of ITOCHU’s consolidated subsidiary ITOCHU Home Fashion Corporation (“IHF”) had engaged in activities at IHF such as creating fictitious inventory and using inventory in circular transactions. In response to this, ITOCHU established a special investigation committee whose members include outside experts, and carried out an investigation into the facts relating to and causes underlying the matter, as well as examination of recurrence prevention measures. ITOCHU hereby reports on this as set out below and in the attached detailed material. ITOCHU expresses its deepest apologies to all shareholders, investors, business counterparties, and other stakeholders for any concern or inconvenience caused on this occasion.

1. Impact on outlook for business results

ITOCHU has determined that this matter will not have a material impact on the consolidated accounts of ITOCHU for previous fiscal years, and will record the loss incurred due to this matter (approximately 4.3 billion yen) as a lump sum in the accounts for Fiscal Year 2015 (ended March 31, 2015). There is no change to the outlook for full year consolidated financial results announced by ITOCHU on November 5, 2014 (300 billion yen of Net Profit attributable to ITOCHU for Fiscal Year 2015 (ended March 31, 2015)).

2. Circumstances leading to the investigation and overview of the improper activities

ITOCHU became aware of the matter when conducting analysis of the monthly accounts and inventory volume of IHF. A former employee of IHF, acting on his own accord and seeking to conceal losses that had arisen in transactions he was in charge of, recorded fictitious inventory, and then, in order to account for the increased inventory, engaged in circular transactions, colluding with business counterparties and making meticulous efforts to conceal the activities. Going forward, ITOCHU will continue to make every effort to recover the losses incurred due to this matter.

3. Countermeasures aimed at preventing recurrence

IHF and ITOCHU have already implemented strict disciplinary measures against the officers and employees involved in this matter. Further, based on the recommendations of the special investigation committee, ITOCHU will continue to develop stronger compliance systems for companies in the ITOCHU Group, by formulating and rigorously implementing recurrence prevention countermeasures that are based on the facts and issues related to this matter and our conscientious examination thereof.

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Attached material

1. Circumstances leading to the investigation

In examining the monthly accounts of IHF for December 2014, ITOCHU detected an increase in the inventory volume of IHF that exceeded the corresponding outlook, and as a result of a detailed inspection of the inventory, a member of the sales personnel of IHF admitted that he had engaged in activities such as creating fictitious inventory and using inventory in circular transactions. Based on its mounting suspicion that inappropriate transactions and accounting treatment had been engaged in at IHF, ITOCHU formed a special investigation committee led by Tadayuki Seki (former Executive Advisory Officer, CFO & CAO), whose members include outside experts (an attorney-at-law and a certified public accountant) and whose objectives were to verify the facts relating to the improper activities, identify the causes and locate responsibility, determine the financial impact of the improper activities, and propose recurrence countermeasures. The committee conducted its investigation by interviewing relevant persons from IHF and ITOCHU, as well as verifying accounting books and vouchers related to the improper activities. As a result of the investigation, the facts stated in sections 2. through 4. below were revealed in relation to the improper activities.

2. Overview of the improper activities

The following is an overview of the improper activities revealed as a result of the investigation.

A member of the sales personnel of IHF, acting of his own accord and in order to conceal losses that had arisen in transactions he was in charge of, recorded fictitious inventory by means such as creating fake invoices at IHF. Then, in order to account for the resulting increase in inventory, from around the Fiscal Year 2011 he began engaging in so-called “circular transactions,” whereby he would make requests of or collude with business counterparties in order to sell them actual as well as fictitious inventory on the premise that IHF would ultimately repurchase it. Also, because the prices in such circular transactions were set so that the various business counterparties would be able to profit from the transactions, the transactions resulted in even greater losses due to the price of the inventory being higher upon its repurchase by IHF.

It was also discovered that, in order to reduce the volume of inventory that had been added as a result of the improper activities, the sales employee had been engaging in concealment accounting (such as processing such inventory as product returns, repurchasing it, and setting off purchase items and accounts payable) and in inflating the book value of inventory (by failing to appropriately reflect the actual charges for purchase when recording the sale cost, and instead recording the book value of inventory of unrelated or fictitious products).

3. Financial impact of the improper activities

The amount of financial impact of the improper activities is approximately 4.3 billion yen. The amount of fictitiously recorded sales, cost of sales, and gross profit on sales in the five fiscal years of IHF from Fiscal Year 2011(ended March 31, 2011) to the Fiscal Year 2015(ended March 31, 2015) are as stated in Table 1 and cumulatively total 1.54 billion yen; the cumulative total of funds lost by IHF over those five fiscal years is 2.18 billion yen; and the estimated amount of fictitious profit etc. in and prior to Fiscal Year 2010 (ended March 31, 2010) is 0.66 billion yen.

Table 1: Fictitiously recorded gross profit on sales by fiscal year of IHF for the past five fiscal years

(Billions of yen)

	FY 2011 (ending March 31, 2011)	FY 2012 (ending March 31,2012)	FY 2013 (ending March 31,2013)	FY 2014 (ending March 31,2014)	FY 2015 (ending March 31,2015)	Cumulative total
Fictitiously recorded sales	0.95	1.43	1.86	2.93	2.18	9.36
Fictitiously recorded cost of sales	(0.74)	(1.15)	(1.51)	(2.49)	(1.94)	(7.82)
Fictitiously recorded gross profit on sales	0.21	0.29	0.35	0.43	0.26	1.54

By verifying the existence of inventory and other methods, ITOCHU checked whether there exist any other cases similar to these improper activities, but no cases similar to these improper activities were discovered.

4. Reasons why the improper activities occurred and why they were not discovered for a long period of time

The improper activities occurred, and were not discovered for a long period of time, due mainly to the following reasons.

- (1) IHF has developed internal regulations, systems for decision making, and systems for audits by bodies such as the accounting auditor and the corporate auditors, but the discovery of this matter was made particularly difficult because the improper activities had also been utilized by some business counterparties to cover up for funds shortages, and the sales employee, colluding with such business counterparties, had made meticulous efforts to conceal the activities such as obtaining and creating fake accounting vouchers.
- (2) Rigor was lacking in management procedures regarding inventory, such as physical inventory checks.
- (3) Sales personnel at IHF were not subject to personnel rotation for long periods of time, which created an environment in which it was difficult to discover the continuation and concealment of the improper activities.
- (4) ITOCHU had engaged in business management and supervision of IHF, through the division of ITOCHU responsible for IHF and through other supervisory departments, by methods such as receiving accounting reports from IHF, but ITOCHU failed to perform its monitoring function adequately.

5. Countermeasures for preventing recurrence

In accordance with prescribed internal procedures, IHF has already implemented strict internal disciplinary measures against the officers and employees of IHF who were involved in the improper activities. ITOCHU, too, has already implemented strict internal disciplinary measures against the officers and employees of the responsible supervisory department of ITOCHU.

In addition, based on the recommendations of the special investigation committee, ITOCHU has formulated and will implement recurrence prevention measures from the following perspectives, taking into consideration the facts and issues related to the improper activities and our conscientious examination thereof.

- (1) ITOCHU will pursue stricter financial closing processes at its subsidiaries, such as by improving the effectiveness of monitoring by departments that are independent of sales departments.
- (2) ITOCHU will pursue the enhancement of its logistics and inventory management frameworks, such as through stricter inventory inspections, and the introduction and strict operation of inventory management systems.
- (3) ITOCHU will pursue the enhancement of its business management systems, such as through increasing personnel numbers and improving quality in the business management departments of each subsidiary, and through close information sharing among the divisions of ITOCHU responsible for managing subsidiaries.
- (4) ITOCHU will conduct stricter screening of the personnel of the management departments of subsidiaries, as well as enhancing training to foster human resources with superior management capabilities and expanding the support provided by ITOCHU to the management departments of subsidiaries. ITOCHU will also seek to ensure that personnel rotations are conducted with appropriate frequency.
- (5) ITOCHU will endeavor to conduct efficient and effective supervision, such as by analyzing the characteristics of each subsidiary or business division and taking strict preventive measures focused on areas where there is a typically high risk of improper accounting.

By rigorously implementing the above measures, ITOCHU will continue to further heighten awareness of compliance and foster a corporate culture in which improper activities are not tolerated.

6. Impact on outlook for business results

ITOCHU expects to record a loss of approximately 4.3 billion yen in its consolidated financial statements for Fiscal Year 2015 (ended March 31, 2015) due to the improper activities. The consolidated financial results for Fiscal Year 2015 (ended March 31, 2015) are currently being tallied and will be announced on May 1, 2015 (Friday), but at the current time there is no change to the outlook for full year consolidated financial results announced by ITOCHU on November 5, 2014 (300 billion yen in Net Profit attributable to ITOCHU for Fiscal Year 2015 (ended March 31, 2015)).

End.