

Inappropriate accounting at our US subsidiary Suminoe Textile of America Corporation and measures to prevent any recurrence

We deeply apologize for the inconvenience and anxiety we have caused due to the accounting problems at our subsidiary.

Based on the "Report on the Investigation by the Internal Investigation Committee and the Framework of Measures to Prevent Any Recurrence" released on November 4, 2016, we hereby report the history and the details of the inappropriate accounting that was subject to correction, as well as the actions taken and measures to prevent any recurrence, as follows.

Following the above release, the measures to prevent any recurrence were approved by the Board of Directors and then reported at the extraordinary general meeting of shareholders on December 20.

1. Overview and progress of investigation

At STA, a rapid increase in production that began around June 2015 caused confusion on its production lines, which resulted in postponement of the midterm inventory count scheduled for the end of September 2015. After that, the interim inventory count conducted at the end of December 2015 found a large inventory difference. An internal investigation began in January 2016 and identified the cause of the difference

as problems with the core system and an inadequate inventory count operation. Then an investigation into the cause of these problems started.

Against this backdrop, on March 4, 2016 a former STA employee became a whistleblower to Deloitte, and the subsequent audit by Deloitte in the same month identified a reasonably questionable transaction. Subsequent events are as follows:

- April 2016 Suminoe Textile and STA set up an investigation team to conduct an internal investigation.
- May 30, 2016 It was found that inappropriate upgrading of stock and sales returns took place possibly under the influence of the Business Division operating officers and general managers of Suminoe Textile.
- June 6, 2016 An investigation committee of experts, including external lawyers, and an internal investigation committee were set up. Investigation by an external investigation organ began in the United States.
- July 22, 2016 An interim report was submitted by the external investigation organ.
- July 29, 2016 A third-party committee was set up to ensure a higher level of fairness in the investigation.

The third-party committee was set up for the following three purposes:

- ① To clarify the presence and details of involvement of Suminoe Textile (specifically, the Automotive Textile Business Headquarters) in the inappropriate accounting at STA
- ② If Suminoe Textile's involvement were found, to analyze the causes and problems
- ③ To analyze Suminoe Textile's corporate governance and internal control systems related to this issue

On October 25, 2016, we received an investigation report submitted by the third-party committee. In parallel with the investigation by the third-party committee, our internal investigation committee analyzed the results of the investigation by the external investigation organ, conducted a follow-up investigation of the matters yet to be investigated and an on-site examination of various documents at

STA and other necessary investigations. As a result of this verification, we concluded that the financial results for past fiscal years should be corrected regarding the two matters described below, and the consolidated financial statements for the 123rd (fiscal year ended May 2012) through the 127th (fiscal year ended May 2016) periods, which had already been submitted, were thus corrected.

2. Outline of corrections to financial statements for past fiscal years

Major problems detected and corrected according to the investigation results described above are as follows.

◆ Inadequate use of codes and locations

Availability codes and location codes for the inventory control system were inadequately used to cover up defective or fictitious inventory, thereby making the balance of payments appear to improve.

deducted from expenses before obtaining the customer's agreement on payment of the cost. It was then decided through negotiations that the amount received for the express delivery cost would be paid back by means of adjustments to the selling prices for subsequent years. But the future financial burden was not appropriately recorded.

◆ Inappropriate handling of accounts receivable (express delivery costs)

Express delivery cost for delivery to a customer was

◆ Valuation of spare parts inventory

Standards for handling the spare parts inventory were not clarified. Some products in stock exceeded the reasonably estimated quantity but there was no proper write-down for it.

◆ Chargebacks (return of funds) to customers

Payment of chargebacks (return of funds) to customers (3 companies) was delayed and carried over to the next period.

◆ Other

① Upgrading of stock and other handling that were corrected but had little impact on the final financial statements; ② problems that were found by the internal investigation committee to be not inappropriate or already being corrected, or problems that were too insignificant to be subject to correction.

◆ Influence of the above corrections

In line with these corrections, numerical corrections related to tax effect accounting, such changes or write-offs were performed retrospectively.

■ Monetary impact of the inappropriate accounting on our consolidated financial statements (Unit: Millions of yen)

	FY ended May 2012	FY ended May 2013	FY ended May 2014	FY ended May 2015	FY ended May 2016
Net sales	△ 5	△ 24	△ 47	△ 61	△ 149
Operating income	△ 131	△ 135	△ 386	△ 53	△ 425
Ordinary income	△ 131	△ 135	△ 386	△ 53	△ 425
Net income	△ 403	225	△ 254	△ 34	△ 1,188
Net assets	△ 403	167	△ 276	△ 121	△ 1,076
Liabilities	26	20	145	△ 184	45
Total assets	△ 377	188	△ 130	△ 306	△ 1,031

3. Measures to prevent any recurrence of problems

Framework of measures to prevent any recurrence is as follows. We will draw out practical measures and steadily implement them.

(1) Reform of corporate culture

To promote an understanding of the importance of awareness reform, enhanced compliance, and disclosure, communicate top messages to employees. Also, conduct an employee questionnaire survey ahead of schedule, to gather frank opinions to be reflected in the improvement measures. Provide training programs for members in the Operating Officer or higher class, and for general manager-class executive employees.

which had been established independently from other divisions, and implement company-wide assessment and analysis from an objective perspective.

(2) Providing company-wide educational programs for awareness raising

Continuously provide the above training programs for executive-class employees, and offer education on accounting, compliance, internal rules, etc. for regular employees, according to their qualifications, position, and duties.

② Developing and enhancing an efficient and effective system for monitoring subsidiaries
Review the contents of weekly and monthly reports, which are prepared as tools for monitoring the performance and management issues of subsidiaries, and establish an integrated management structure for systems, including system investment, which can be linked to the accounting system and operation management system of each subsidiary.

(3) Review of the performance management system and management of subsidiaries

① Review of the performance management system
Review the performance management system unique to the Automotive Textile Business Headquarters,

③ Review of the affiliate management regulations, and on-site audits and confirmation by the subsidiary corporate auditors
Review the affiliate management regulations, and identify the subsidiaries to be monitored with particular attention to the status of their internal control. For overseas subsidiaries with high priority, the corporate auditors of each subsidiary will conduct as many on-site audits as possible to ensure confirmation from an objective perspective.

Feature① Inappropriate Accounting at STA and Future Initiatives Corporate Governance and CSR Promotion System

(4) Review of the STA management system

① Understanding the importance of awareness reform, enhanced compliance, and disclosure

At STA, hold training programs particularly to deepen understanding of the importance of compliance and disclosure, so that all employees, including executive members, can fully understand the factors that caused the inappropriate accounting, basic accounting principles, and measures to be taken for improvement.

② Examining proper personnel arrangements

Considering the excessive operations assigned, review the STA management system, and enhance and properly distribute the necessary human resources. Make continuous flexible adjustments to work burdens according to the situation.

③ Measures for expatriates from Suminoe Textile

To enable early discovery of any wrongdoing, apply rotational transfers (between STA and Suminoe Textile) on a regular basis, and hold personal interviews and meetings with the Human Resources Department.

④ Placing CFOs under the direct control of Head Office

Change the chain of command for CFOs (chief financial officers) of overseas subsidiaries so that they are put under the direct control of Head Office and are able to strictly supervise irregular accounting processes.

(5) Review of STA inventory control system

① Sharing the rules concerning inventory control within the Suminoe Textile Group

Strengthen control by Suminoe Textile and develop a control system that will not allow any intentional interference in inventory valuation by each subsidiary.

② Ensuring proper implementation of physical inventory counting and analysis of differences found

At STA, clarify the physical inventory counting processes and confirm their necessity and detailed operation on a quarterly basis, so as to make employees aware of the importance of physical inventory counting, thereby ensuring proper implementation. Also, ensure that the analysis of inventory differences is clearly prescribed in the guidelines and properly implemented, so it can be utilized to improve the operation.

4. Actions taken to clarify the management's responsibility

In view of the importance of this problem and to clarify the management's responsibility, all Directors had their remuneration reduced, demonstrating their determination not to allow such an inappropriate operation to happen again.

③ Constantly raising awareness of and educating system users

Provide internal education programs for the management class, and prepare a manual for IFS, an ERP (enterprise resource planning) package. Also, clarify the persons and departments in charge of controlling the information entered and retrieved from the IFS system.

(6) Redevelopment of internal control systems

① Checking and examining the status of operation of internal control systems

Re-examine the adequacy and appropriateness of the internal control systems (status of development and operation) resolved by the Board of Directors. If any problem is found as a result, re-establish the system. If no problem is found in the system, check whether it is properly operated and then improve the operation where necessary.

② Redeveloping the whistle-blowing (Corporate Ethics Hotline) system

For early discovery of any wrongdoing or misconduct inside the company, enhance the whistle-blowing system as a scheme to spontaneously guide our corporate culture in the right direction.

③ Importance of the duties of the corporate auditors

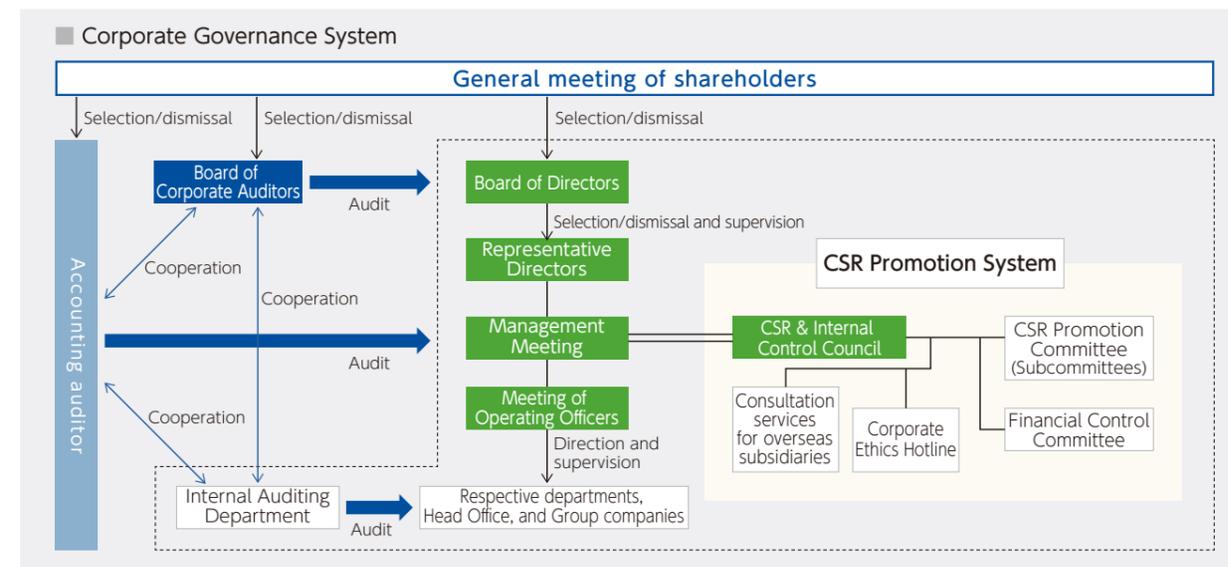
Increase the number of full-time corporate auditors or appoint corporate auditor staff to conduct focused audits on important subsidiaries, especially overseas subsidiaries, in view of the Group's governance.

④ Operate an effective internal control report system
Clarify the exact operation status at STA, determine and assess the risks, and identify the controlling activities that are effective for evaluation of internal control. At the same time, increase the number of staff members in the Internal Auditing Department, thereby establishing and improving the internal control system through evaluation.

Regarding company-wide internal control for Suminoe Textile and STA, implement the actions announced in the above measures to prevent any recurrence, so as to ensure effectiveness of the evaluation.

Corporate Governance*1

Suminoe Textile has established the corporate governance system outlined below. As announced in our measures to prevent any recurrence in response to the STA's inappropriate accounting, we will enhance our governance with particular emphasis on the role of the monitoring organs through enhancing the functions of Corporate Auditors and increasing the number of staff members in the Internal Auditing Department.



Board of Directors

The Board of Directors comprises eight directors (including two outside directors), and supervises business execution and makes decisions on important matters.

Board of Corporate Auditors

The Board of Corporate Auditors consists of three auditors (including two outside auditors). The Board decides auditing policies and plans, and deliberates on audit reports.

Management Meeting/CSR & Internal Control Council

The management meeting is held every week, in principle, to report and deliberate on important management

matters. Matters of particular importance will be reported to the Board of Directors. CSR-related important matters and evaluation of internal controls concerning financial reports are discussed at the meeting of the CSR & Internal Control Council. The meeting is attended by one full-time corporate auditor as an observer.

Meeting of Operating Officers

The Meeting of Operating Officers comprises President and operating officers of Suminoe Textile Co., Ltd., and holds its meeting once a month. At the monthly meeting, the decisions made by meetings of the Board of Directors or by the Management Meeting are announced, and reports are made on the present status of business execution by each operating officer.



Back: Outside Corporate Auditor Yasufumi Yamashita, Outside Corporate Auditor Hidenao Yoichi, Corporate Auditor Makoto Tatsumi, Director Yoshiteru Mimura, Director Kunihiko Kotaki, Director Katsuyuki Sawai Front: Outside Director Yutaka Masuyama, Representative Senior Managing Director Hitoshi Iida, Chairman and President Ichizo Yoshikawa, Representative Senior Managing Director Yoshiaki Tanihara, Outside Director Haruo Shimizu

*1 Corporate governance: The mechanisms by which company management is controlled and supervised, in order to enhance its management transparency and corporate value

Message from new Independent Outside Director

I am Haruo Shimizu, a corporate advisor with EXEDY Corporation. Appointed as the independent Outside Director of Suminoe Textile, a board member of a company with 100 years of history, I feel strongly the weight of responsibility with the position. My experience of operating many overseas businesses has taught me that CSR-based management is the key to business continuity. It is very important that the corporate philosophy is reflected in each employee's action. As the Group companies grow, people, goods, money and risks that the headquarters should control expand year by year. Various troubles are likely to occur at this

stage. Reporting, communication, and consultation immediately after occurrence is the first step in ensuring compliance. It is crucial to ensure that what is decided by the Company is done as it is decided. To this end, I personally think it would be meaningful to require all employees to review the corporate philosophy and the significance of CSR. I hope I can be of some help to you.



Haruo Shimizu,
Outside Director

Outside Director Shimizu's challenging life and EXEDY Corporation

"Just dive into it"

Without fear of failure, be passionate about achieving your goal. Achieve your wish by making clear what you are trying for.

Overview of EXEDY Corporation

EXEDY is a comprehensive manufacturer of drivetrain components, such as manual clutches and torque converters for automobiles, covering the entire process from development to production. Head Office is located in Neyagawa City, Osaka, and the 43 EXEDY Group companies are in 24 countries for production and sales.

- Founded:1923 ■ Established:1950
- Capital:8,284 million yen
- Employees:17,872 (consolidated) (as of March 31, 2016)
- Sales:268.7 billion yen (consolidated) (FY ended March 2016)



40 years devoted to setting up subsidiaries for 43 companies in 24 countries worldwide

Outside Director Shimizu's challenging life		History of EXEDY Corp.	
	1950s	1950	Established Daikin Manufacturing Co., Ltd. (now EXEDY).
1969 21 years old Challenge! While at university, toured the U.S. As one of the 73 members of seven bands, held concerts at several universities on the West Coast.	1960s	1963	Relocated the Headquarters to Neyagawa City.
1970 Joined EXEDY Corporation.	1970s	1967	Dispatched workers to Chicago, USA.
1977 29 years old Challenge! Set up the first overseas subsidiary - Daikin Clutch USA. Became the first Vice President.		1975	Opened the Ueno Factory.
1982 35 years old Challenge! Succeeded in exporting plants to East Germany. Accelerated global operation.	1980s	1977	Established Daikin Clutch USA. (now EXEDY Globalparts Corporation)
1988 40 years old Challenge! November 1987 set up a fully-owned subsidiary DCC (now EGP). Became the first president. Learned the difficulty of plant management.		1981	Opened the Kawagoe Plant.
1994 Became Director of EXEDY Corporation.	1990s	1995	Changed the corporate name from Daikin Manufacturing to EXEDY Corporation.
1999 Became Managing Director.		1997	Listed in the First Section of the Tokyo Stock Exchange.
2002 Became Senior Managing Director.	2000s		
2006 59 years old Became President & CEO. Challenge! Set consolidated sales of 200 billion yen as target for the 60th anniversary (2010).		2008	Set up on-site daycare at Head Office.
2009 62 years old Challenge! Released management strategy keywords to show the direction. Spread CSR, the EXEDY WAY, and integrated rules worldwide.		2009	Provided the MotoGP Fiat Yamaha Team with its dry-type multi-plate clutch.
2015 Became Director and Chairman.	2010s	2011	Established a special subsidiary EXEDY Sun Co., Ltd.
2016 Became Corporate Advisor.		2012	Constructed a new Head Office building.

Compliance

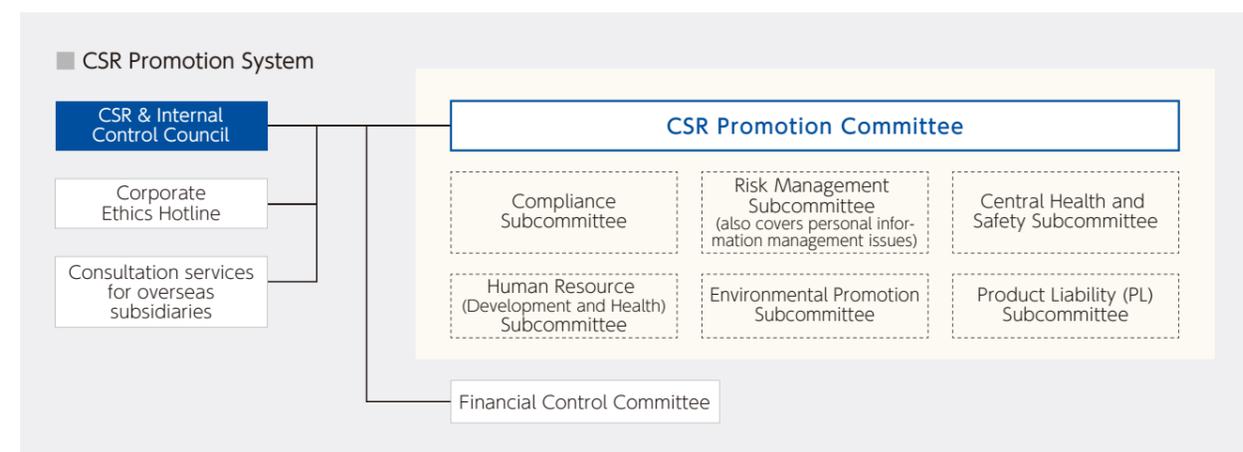
Since the publication of the Suminoe Textile Group Compliance Guidance in 2006, we have promoted compliance awareness among employees through providing compliance education as part of the training on entering the company and training by level using the Guidance as an education tool. For whistleblowing, we have set up an in-house contact point for receiving information and an attorney's office as an

outside contact point, and have encouraged our employees to use them if they find any incidence of violation of laws and regulations or corporate ethics. However, as the inappropriate accounting at STA showed these efforts to be insufficient, we will steadily implement measures to prevent any recurrence, including training for executive class employees, thereby promoting awareness reform.

CSR Promotion System

The CSR Promotion Committee, officially inaugurated in December 2014, has conducted surveys of employees' opinions on workplace comfort on a regular basis. Reflecting the results of the surveys, we have promoted various CSR activities, such as offering training programs to raise awareness of compliance and prevent harassment, and initiatives to better control labor hours and vitalize employees.

Realizing from the accounting problems that our activities are still not enough, as the main organ in promoting measures to prevent any recurrence, the Committee will listen to the opinions of the subcommittees that have been formed by category to further accelerate initiatives to promote CSR.



CSR Promotion Committee