

[This is an English translation of the original text written in Japanese]



March 13, 2019

LIXIL Group Corporation  
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Director, Representative Executive Officer,  
Chairman and CEO (First Section of TSE/NSE, code 5938)

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About Receipt of the Interim Report from the Special Investigation Committee  
Related to Inappropriate Transactions of a Consolidated Subsidiary

As stated in the “Announcement Regarding Establishment of a Special Investigation Committee Related to Inappropriate Transactions of a Consolidated Subsidiary” announced by LIXIL Group Corporation (hereinafter “LGC”) on February 8, 2019, incorrect information may have been reported from its consolidated subsidiary, LIXIL Renewal Corporation to LGC and also, there may have been inappropriate accounting processes for recording some revenues earlier than at the actual timing. LGC has established a special investigation committee and is now investigating to understand the full scope of the issue, including details of the issue and financial impact to LGC’s consolidated financial statements as well as to consider preventive measures.

LGC hereby announces that, in the process of the investigation, LGC received the interim report from the investigation committee, including details of the issue, impact to LGC’s consolidated financial statements, and confirmation of whether or not there are any similar issues for other subsidiaries. As for the report, partial non-disclosure measures and anonymization methods are applied from the viewpoint of protecting the privacy of individuals and confidential information. The full investigation report and proposal of preventive measures from the special investigation committee is expected to be submitted around end of March, 2019.

Based on the discussion with the auditor, LGC does not plan to revise its past consolidated financial statements because the impact of this incident on its consolidated financial statements is deemed to be immaterial. Since the review by the auditor is still ongoing, the Quarterly Securities Report for the Nine Months Ended December 31, 2018, is expected to be filed on March 14, 2019.

LGC sincerely apologizes to shareholders, investors, and all other stakeholders for any inconvenience caused by this issue.

End

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# Interim Report

March 13, 2019

LIXIL Group Corporation  
Special Investigation Committee

March 13, 2019

To: LIXIL Group Corporation,

Special Investigation Committee of  
LIXIL Group Corporation

Chairman: Maki Kumagai  
Member: Shoichi Seino  
Member: Takuei Maruyama

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## **Introduction**

This interim report is prepared by the Special Investigation Committee (hereinafter "the Committee") established by the LIXIL Group Corporation (hereinafter "LGC") to perform the investigation described in #1 below (hereinafter "the Investigation") conducted until March 12, 2019.

Following the completion of this interim report, the Committee will conduct further investigations and produce a final report after clarifying the root cause of the issue and proposed preventive measures

## **Section 1. Outline of the Investigation**

### **1. Background of Establishing the Committee**

On December 3, 2018, it was reported to LIXIL Corporation, a consolidated subsidiary of LGC (hereinafter "LIXIL"), that there was an allegation of inappropriate accounting carried out by Business Division 1 of LIXIL Renewal Corporation, a consolidated subsidiary of LGC (hereinafter "LR"). As a result of an internal investigation conducted at LIXIL, it was ascertained that there was a possibility of improper accounting treatments such as inappropriate recognition of accelerated sales with violating the basis for recognizing sales in LR (hereinafter "the Allegation").

Therefore, on February 8, 2019, Executive Officers of LGC decided to establish the Committee on February 12, which consists of lawyers and certified public accountants who were not involved in the internal investigation that had already been conducted and who are independent from LGC, in order to conduct a highly transparent and effective investigation and to receive recommendations on effective measures to prevent recurrences.

### **2. Objectives of the Investigation**

The objectives of the Investigation by the Committee are as follows:

- (1) Investigate the facts of the case, including whether or not there are any similar issues that have not yet been recognized
- (2) Determine the financial impact on LGC's consolidated financial statements resulting from this issue
- (3) Clarify the root cause of the issue and propose preventive measures

### **3. Scope of the Investigation**

Following the commencement of the Investigation, the Committee identified facts that East Kanto Building Branch Office Chiba Sales Office<sup>1</sup> of LIXIL, which operates under LIXIL Building Technology (hereinafter "LBT"), a Division of LIXIL, was conducting inappropriate recognition of accelerated sales, as claimed by a notification by an external contractor to Kinya Seto (Director, Representative, Executive Officer, President and CEO of LIXIL as of October 12, 2018).

The notification stated that Building Chiba Branch (currently the Building Chiba Sales Office under the Building East Kanto Branch) is: (1) requesting to process all payments without the completion of construction work or only partial completion of total contracted work; (2) referring that Building Chiba Branch cannot process payments for supplemental construction because sales are already recognized; and (3) payments will be made from another project. Following this notification, an internal investigation was conducted until February 6, 2019 and confirmed that there was inappropriate recognition of accelerated sales since July 2015 at Building Chiba Branch.

Moreover, the Committee recognized that there was an accusation raised by an anonymous source to the law firm on November 26, 2018, which serves as the whistleblower hotline established by LGC, related to fraudulent accounting treatment in LIXIL Suzuki Shutter Corporation (hereinafter "LIXIL Suzuki Shutter").

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<sup>1</sup> Tokyo metropolitan area Sales Division, Chiba Branch, Building Chiba Branch, Chiba Building Front Office (as of July 2015)

Therefore, the Committee started the Investigation from Business Division 1 of LR, where the Allegation arose. As described in the Section 3,1, inappropriate accounting treatments at LR were from the sales recognition basis adapted as Completed-Contract by Finalizing the Main Construction. The branch managers and construction manager were demanding external contractors to input false completion dates in completion reports in order to reach revenue and business profits targets by accelerating sales recognition. Even before the actual completion date of the construction, by manipulating the date of completion, LR was also billing the client for the entire construction, inclusive of supplemental construction. It was assumed that similar cases to the Allegation could be uncovered in Building Technology Business as it outsources construction work as well. However, it was also assumed that it would be difficult for businesses in LBT which adapt the sales recognition basis other than Completed-Contract by Finalizing the Main Construction, such as those engaged in merchandizing without any construction work, could conduct such inappropriate accounting treatments, and so they were not included in the scope of the Investigation. In addition, the sales amount from those merchandizing business were not significant compared to those engaged in construction work having huge impacts on planning figures when the construction period is delayed, thus the impact on financial statements was not considered critical.

Also, Business Division 2 of LR, Water Technology Business of LIXIL, Housing Technology Business, Kitchen Technology Business, Distribution & Retail Business, and Housing & Services Business are mainly conducting the merchandizing business though some of the transaction requires minor installation work and the process to place order toward external subcontractors differ significantly to those of Business Division 1 of LR or LBT. Also the amount of each transaction were not significant thus it was considered that the possibility of conducting similar inappropriate recognition of accelerated sales which occurred at Building Division 1 at LR was considerably low.

In addition, LGC's overseas consolidated subsidiaries engaged in construction work related to buildings were excluded from the Investigation as their business practices differ significantly, and there was strict monitoring of billing without clients acceptance, the clients required assurance from financial institutions to initiate the transaction. Therefore, it was considered that the possibility of conducting similar inappropriate recognition of accelerated sales which occurred at Building Division 1 at LR was considerably low.

Based on the above, the Committee has decided to conduct the Investigation mainly on (1) Business Division 1 of LR; (2) LBT of LIXIL; (3) LIXIL Suzuki Shutter and its full subsidiary, LIXIL Okinawa Suzuki Shutter Corporation. (hereinafter "LIXIL Okinawa Suzuki Shutter"); and (4)LIXIL Sales Okinawa Co. Ltd (hereinafter "LIXIL Sales Okinawa"), a consolidated subsidiary of LGC, which was established in April 2015 by incorporating the Okinawa Branch of LBT as a separate entity ,and which conducts construction work related to buildings and apartments similar to LR & LBT.

#### **4. Members of the Committee**

The members of the Committee is as follows (the members of the Committee are independent from LGC).

Chairman:	Maki Kumagai (Attorney at Iwaida Partners)
Member:	Shoichi Seino (Attorney at Iwaida Partners)
Member:	Takuei Maruyama (Certified Public Accountant, PwC Business Assurance LLC)

It was necessary to conduct a detailed investigation by defining the appropriate scope for multiple entities. Therefore, in order for the Committee to determine the method of the Investigation and conduct the proper work promptly, it was considered effective and fundamental to proceed with (1)

exchanging the information with the administrative office of LIXIL (hereinafter “the Administrative Office”) related to selection of the device and data for the digital forensic investigation, nomination of the interviewees, accumulation of the financial data, conducting survey and requesting voluntary declaration; (2) utilizing the know-how, experience, and information accumulated at the internal audit division related to the group audit;

In addition, as the Investigation was initiated from the report related to LR, which is a subsidiary of LIXIL where the Administrative Office is established, it was necessary to ensure that proper handling of information and exchanging information between the Committee and the Administrative Office would not harm the quality of the Investigation itself. Therefore, the committee members were not selected in accordance with the Japan Federation of Bar Associations' Guidelines for Third-Party Committees Relating to Corporate Scandals. Instead, the Committee was established to conduct the Investigation.

However, LGC entrusted the Investigation policy adopted to the Committee, and the Committee decided the Investigation method accordingly at its sole discretion. Moreover, the rights to make judgments on the facts and drafting the reports belong to the Committee. Additionally, the Committee will disclose the findings and its evaluation in the report, even if those findings are unfavorable to LGC and its management. The Committee has the right to dispose of the information gathered through the Investigation.

As described above, the Committee conducted independent and neutral investigation in accordance with the Japan Federation of Bar Associations' Guidelines for Third-Party Committees Relating to Corporate Scandals.

In addition to support from the Administrative Office, the Committee selected external legal counsel as assistants who are also independent from LGC.

Department	Name, etc.
Iwaida Partners	Attorneys (Kazuki Nakabayashi, Takuya Toda)
PwC Business Assurance LLC	Certified Public Accountants (Mamoru Honda, Mihoko Nasu, Takashi Nakayama, Eiichi Shirahige) Hironori Tanaka (other 13 members)

## 5. Period of the Investigation

At the time of submitting this Interim Report to LGC, the Committee conducted the Investigation from February 12, 2019, to March 12, 2019, and convened 19 meetings during this period.

## 6. The Investigation Methods

The Committee conducted the Investigation mainly by the following methods:



i. Conducting interviews

The Committee interviewed officers and employees of LR, LBT, and Suzuki Shutter (40 in total). The positions listed below are as of February 12, 2019 (date of commencement of the Investigation).

Interviewee	Organization/Title
LR	
Susumu Hamada	President and CEO
[Redacted]	
LBT	
[Redacted]	
LIXILSuzuki Shutter	
Satoshi Yamada	President and CEO
[Redacted]	

ii. Inspection and Examination of Financial Data, Operation Data and Related Documents

The Committee inspected and examined the financial data, operation data and related documents which could be connected to the Allegation. Also, related documents which are considered necessary by the Committee, such as internal rules and regulations, were also inspected and examined.

iii. Digital Forensic Investigation

The Committee collected electronic data stored on the personal computers and other devices which were loaned by LGC to the 45 officers and employees of the LR, LBT, and LIXIL Suzuki Shutter who could be connected to the Allegation. After recovery deleted files as much as possible, the stored electronic data was analyzed and investigated (Word, Excel, PowerPoint, PDF, and other types of electronic data that was deemed necessary by the Committee).

In addition, The Committee collected, analyzed, and investigated the e-mail data of 14 executives and employees (including retired employees) of LR, LBT, and LIXIL Suzuki Shutter which had been stored on the mail server.

iv. Survey

The Committee requested the following members to respond to its survey:

	Target	Number of responses
LR	All directors and employees (339)	333 people
LBT	Branch Manager, Manager, GL, TL, Staff Related to Sales, Procurement, and Construction Management (410)	409 people
LIXIL Suzuki Shutter	First time: Employees within the Sales Division (283)	276 people
	Second time: All directors and employees (480)	453 people
LIXIL Sales Okinawa	All directors and employees (42)	41 people
LIXIL Okinawa Suzuki Shutter	All directors and employees (9)	9 people

Those who were unable to respond to the above survey were personnel who took leave for medical reasons or were on childcare leave, and the reasons why they were unable to respond to the survey were considered reasonable.

#### v. Request for Voluntary Declaration

The Committee requested LR to voluntarily declare possible inappropriate business processes or accounting processes which were carried out for all the properties with sales recorded in March, June, September, and December 2018 (excluding those for which the order amount is less than 1,000,000 yen). Also the Committee requested LR to submit objective evidence for the properties if they are claimed to be normal transactions.

In addition, the Committee requested LBT and LIXIL Sales Okinawa to voluntarily declare items that had been improperly processed or accounted for, and to submit objective evidence for items that were alleged to be normal transactions but which the Committee determined that inappropriate recognition of accelerated sales had been conducted.

The Committee confirmed and reviewed these voluntary declarations with confirming the results of the survey and the results of data analysis.

## Section 2. Underlying Fact and Assumptions for the Investigation

### 1. Overview of LGC

(As of March 31, 2018)

Name of Company	LIXIL Group Corporation
Stock Exchange	The First Section of the Tokyo Stock Exchange The First Section of the Nagoya Stock Exchange
Fiscal Year End	March
Shareholders	Japan Trustee Services Bank,Ltd. (Trust Account) (4.59%) The Master Trust Bank of Japan ,Ltd. (Trust Account) (4.53%) STATE STREET BANK CLIENT OMNIBUS OMO 4(Standing Proxy / Tokyo Branch of Hong Kong Shanghai Banking) (3.34%) The Nomura Trust and Banking Co., Ltd. (Trust Account) (3.07%) JPMC OPPENHEIMER JASDEC LENDING ACCOUNT (Standing Proxy / The Bank of Tokyo-Mitsubishi UFJ, Ltd) (2.71%) The Dai-ichi Life Insurance Company, Limited (Standing Proxy / Trust & Custody Services Bank, Ltd.) (2.26%) LIXIL Employee Stock Ownership (2.22%) Japan Trustee Services Bank,Ltd. (Trust Account 5) (1.92%) Sumitomo Mitsui Banking Corporation (1.91%) STATE STREET BANK WEST CLIENT – TREATY 505234 (Standing Proxy / Settlement Sales Department of Mizuho Bank, Ltd.)(1.65%) and others
Representative	Representative Executive Officer and President Kinya Seto
Registered Office	2-1-1 Ojima, Koto-ku, Tokyo 136-8535, Japan
Number of Employees	61,140
Major Business	Water Technology Business Housing Technology Business Building Technology Business Kitchen Technology Business Distribution & Retail Business Housing & Services Business
Accounting Auditor	Deloitte Touche Tohmatsu LLC

(NOTE) The Bank of Tokyo-Mitsubishi UFJ, Ltd has changed its trade name to MUFG Bank, Ltd. as of April 1, 2018.

### 2. Overview of LR

(As of March 31, 2018)

Fiscal Year End	March
Representative	Susumu Hamada
Registered Office	2-1-1, Ojima, Koto-ku, Tokyo
Employees	301

LR operates under LBT, one of the main businesses of LIXIL.

On April 1, 2013, Shin Nikkei Building Materials Sales Corporation and LIXIL Reform Sales Division (dedicated to the renovation of buildings) merged to launch LIXIL Building Remodeling Sales Co., Ltd. Subsequently, on April 1, 2015, the company merged with LIXIL Renewal Corporation, and acquired the business of Sunwave Living Design Co., Ltd., and changed its trade name to its present name.

LR's Business Division 1 engages in the design and construction of renovation projects for existing apartments, buildings, and large stores, while LR Business Division 2 sells housing equipment and water technology products. Most of the renovation work for buildings and large stores is outsourced to general contractors. However, many apartment renovation projects are outsourced directly by condominium management associations.

The business results and financial position (JGAAP) of the LR are as follows.

(Unit: Million yen)

By term	Sales	Operating income	Ordinary profit	Net income
FYE2016	18,038	2,185	2,204	1,386
FYE2017	17,772	2,265	2,286	1,497
FYE2018	15,960	1,241	1,257	848

### 3. Overview of LBT

In LIXIL, LBT is one of the main businesses of LGC.

LBT mainly manufactures and sells building materials, etc., and manages contracts related to the installation of these products. It also carries out renovation projects for existing buildings.

### 4. Overview of LIXIL Suzuki Shutter

(As of March 31, 2018)

Fiscal Year End	March
Representative	Satoshi Yamada
Registered Office	1-1-4, Minami-Otsuka, Toshima-ku, Tokyo
Employees	440

In October 2000, Suzuki Shutter Kogyo Co., Ltd. became a subsidiary of LIXIL through a share transfer, and changed its name to its current name in April 2011. Okinawa Suzuki Shutter Co., Ltd. is a wholly owned subsidiary of LIXIL Suzuki Shutter.

LIXIL Suzuki Shutter manufactures, sells and installs shutters with fire and smoke-proof properties, and provides maintenance services for shutters. Most of the construction work for shutters is outsourced by a general contractor. However, the maintenance work may be outsourced directly from building owners or management companies.

The business results and financial position (JGAAP) of the LIXIL Suzuki Shutter are as follows.

(Unit: Million yen)

By term	Sales	Operating income	Ordinary profit	Net income
FYE2016	12,004	831	825	549
FYE2017	11,134	834	1,196	811
FYE2018	11,956	848	1,138	799

## 5. Overview of LIXIL Sales Okinawa

(As of March 31, 2018)

Fiscal Year End	March
Representative	Tomoyuki Tsuji
Registered Office	237-5, Ojana, Ginowan-shi, Okinawa
Employees	28

LIXIL Sales Okinawa is a company centered on the building technology business, one of the main businesses of the LGC Group. It was established on April 1, 2015 with the incorporation of the Okinawa branch in LBT.

LIXIL Sales Okinawa is mainly engaged in the manufacturing and sales of building materials, etc. as well as the contracting of the installation of these products. However, some of the existing buildings are also being renovated by LIXIL Sales Okinawa.

The business results and financial position (JGAAP) of the LIXIL Sales Okinawa are as follows.

(Unit: Million Yen)

By term	Sales	Operating income	Ordinary profit	Net income
FYE2016	-	▲8	▲8	▲9
FYE2017	3,170	251	252	168
FYE2018	3,848	211	217	141

### **Section 3. Findings from the Investigation**

#### **1. Facts with Respect to LR**

##### **i. Summary of the Investigation Results**

From LR, from the past fiscal years, there were (1) manipulation of the completion of construction date and recording sales at an early stage with violating the basis for recording sales (hereinafter "Acceleration of sales through manipulation of completion date"), and (2) splitting the properties intentionally in order to recognize the sales from completing the construction of the split properties (hereinafter "Acceleration of sales by splitting of construction/property")<sup>2</sup>. The Committee has determined that these practices do not conform to generally accepted accounting principles.

There were 9 cases in FYE2018 and 20 cases in Q2 of FYE2019 from the Acceleration of sales from manipulation of completion date

In LR, there was no registration of fictitious orders (i.e. registration of orders without actual orders).

##### **ii. Underlying Fact Gathered from the Investigation**

###### **a. Sales Recognition Basis**

All entities inside the Company operating building technology businesses, including LR, adopt the same basis for recognizing sales.

For the sales transaction from unit basis (hereinafter "Unit sales transaction"), sales are recognized based on the shipment date of the equipment.

For the sales transaction from packaging (hereinafter "Package sales transaction"), sales are recognized based on the date of the delivery.

Sales of transactions for which installation work is required (hereinafter "Sales transaction with construction contract") are recorded as of the time when the main construction is completed. The standards for the recording of sales of the property are called "Completed-Contract by Finalizing the Main Construction". For works other than Main Construction (hereinafter "Supplemental Construction"), the cost required for such works shall be estimated in advance and the sales shall be provisioned.

The Main Construction and Supplemental Construction are defined as follows.

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<sup>2</sup> LR financial statements are prepared based on Japanese GAAP. Consolidated financial statements are prepared based on IFRS. Therefore, only the profit part of accelerated sales are recognized on the consolidated financial statement when inappropriate recognition of accelerated sales were conducted.

Main Construction	Supplemental Construction (Cost Required Estimated in Advance)
[Construction of Curtain Wall] Mutual and coastal cover, Mullion and Mullion Cover, Unit, Fireproof Board, BBOX, Frame, Committee, Coping, Border, Operator, Ecorator, Engine, Chamber Box, Ventilator, Seal, Decorative Cover	Cleaning, Screen Door, Window Grate, Operator Face
[Other Construction Work] Sash Construction, Door Construction, Operator Construction, Front Construction, Engine Construction, Handrail Construction, Sanitary Room Construction, Kitchen Construction, Living Room Construction, Fireproof Board Construction	Screen Door, Sash Adjustment, Cleaning, Seal, Lock, Push Rod, Door Stop, Window Grate

The time of completion of the Main Construction is confirmed by receiving the report of completion of the work from the Outsourcing Subcontractor.



b. Operations Flow

The basic flow of operations in the Building Technology Business is as follows.

Receiving Purchase Order	Sales will create the budgetary cost from the requirement given by the clients and receive purchase order after the negotiation. After receiving the purchase order or instructions to initiate the designing, the purchase order will be registered into T-PROCESS (purchase order management system)
Modification of Purchase Order Amount	After receiving the request from the sales staff, the budgetary cost will be reviewed based on the detailed requirement given by the clients. If there are any differences between the budgetary cost and actual cost after the review, the sales staff are required to re-negotiate with the clients to agree the final price. After receiving the updated purchase order or instruction to initiate the designing, the sales staff will also re-register the purchase order amount into T-PROCESS.
Arrangement of Construction Component	Select the required component from the design blue-print and place order toward LIXIL factory for LIXIL components and place order toward external vendors for other components. When placing the order, it is required to issue the purchase order and collect the acknowledgement of those purchase order.
Arrangement of Subcontractor	Prepare the proper construction planning and select and place the order to the Construction Subcontractor (hereinafter "Construction Subcontractor") for the construction. When placing the order, it is required to issue the purchase order and collect the acknowledgement of those purchase order.
Confirmation of Delivery	Based on the statement of delivery and delivery status report, confirm the delivery of ordered components with registering the purchase into T-PROCESS related to the designated property. Also, the delivery date shall be registered in the BKP, which is the process control system.
On-Site Work Management	Check the statement of delivery and site installation progress from the Construction Subcontractor. Those purchased for the designated property shall be registered into T-PROCESS.
Progress Billing	Even before the completion of the construction work ordered by the client, the client is requested to assess the progress and to be billed based on progress.
Sales	Sales are recognized based on the Completed-Contract by Finalizing the Main Construction after receiving the completion of the work report from Construction Subcontractor. Supplemental Construction shall be estimated and provisioned accordingly.
Acquisition of Confirmation Documents	When LR undertakes the renovation work, provide the key to the residents of the property in exchange with acquisition of signed and stamped confirmation documents at the time of completion.
Payment Collection	Collect the proceeds (or the balance if there were any progress billing).

c. Target Figure and Sales Preparation Meeting

For each fiscal year, LR sets sales target, profits, orders to be received, etc. Target values are set for first half (April to September) and second half (October to March), and each branch will create the monthly plan to achieve the target. The achievement rate of the plan is considered a major factor in the personnel evaluation of the executives and employees of the company's sales members, including the President, General Managers of business divisions, and Branch Managers.

Each branch office shall report the progress of the plan on a weekly basis to the head of the First Business Division 1 and the President, etc.

In addition, each branch holds a sales preparation meeting every month to check the progress of

properties for which sales are scheduled to be recorded in that month. Participants at the sales preparation meeting are the branch manager of each branch office, the construction manager who is responsible for sales recording, and the person in charge of construction and sales of each property.

The performance of LR as a whole will be shared with the person in charge of the LIXIL's Building Technology business (Prior to March 2018, shared with the person in charge of the renovation division) at the monthly performance review meeting.

iii. Facts found as a result of the Investigation

a. Identified Inappropriate Recognition of Accelerated Sales

From March 2018 to December 2018, in LR, sales were recorded in advance by operating the construction completion date in the following transactions.

Project name	Sales record date	Sales Amount (Yen)
Kanto Branch		
	2018/3/30	
Mansion East Kanto Branch		
	2018/3/31	
	2018/3/30	
	2018/3/31	
	2018/3/31	
	2018/3/31	
	2018/9/30	
	2018/9/30	
	2018/9/29	
	2018/9/30	
	2018/9/30	
	2018/9/29	
	2018/9/30	
	2018/9/30	
	2018/9/30	
	2018/9/30	
	2018/9/30	
Mansion East Kanto Branch Chiba Sales Office		
	2018/9/29	
	2018/9/29	
Mansion West Kanto Branch(Formerly Kanagawa Branch)		
	2018/3/30	
	2018/3/29	
	2018/3/30	
	2018/9/29	
	2018/9/30	
	2018/9/29	
	2018/9/28	
	2018/9/29	
Kyushu Branch		
	2018/9/30	
	2018/9/30	

Regarding the 29 properties listed above, "[REDACTED]" was deemed to record sales because the person in charge of construction misunderstood that the Main Construction has been completed.

Regarding remaining other properties, although the Construction Manager, who is responsible for the revenue recognition, realized that the Main Construction has not been completed, he intentionally recorded acceleration of sales for the purpose of achieving the monthly target figures based on the explicit or implicit instructions from the branch manager.

#### b. Analysis of Motivation, Opportunity and Rationalization

The reason why the branch manager and the construction manager recorded acceleration of sales as above mentioned, was deemed to be the existence of the psychological background that they wanted to escape from the strong pressure to meet targets by achieving the monthly target figures. In addition, some branches were afraid of workforce reduction and increase of workload of remaining employees if they could not achieve the target. It is also deemed to be a factor that the achievement of the target sales and business profits was major consideration factors in performance evaluation for managers, such as branch manager.

And, because most construction subcontractors, which undertake LR renovation work, were small business owners, there was a circumstance that subcontractor easily accepted requests that LR staffs asked to describe fictitious construction completion dates on the construction completion report. As such circumstances, the branch manager and the construction manager, personally or with instruction of their subordinates, make the request to the Construction subcontractors. The Construction subcontractor accepted the requests from the person in charge of LR because they were able to bill the full cost of the construction work quickly, including the remaining construction work with no disadvantage.

In addition, the company uses external warehouse to store products used for Main Construction in the following constructions; "[REDACTED]", "[REDACTED]", "[REDACTED]" and "[REDACTED]". As the storage space for building materials was lacking in the renovation construction site of LR condominiums, the external warehouses were used even in normal transactions. Therefore, it is considered to be easy to use external warehouse in this case as well.

It is considered that the branch managers and the construction managers rationalized the acceleration of sales because of the following reasons: (1) there are the actual conditions of the construction work, (2) there were cases the construction period was postponed and the construction was not completed on schedule due to the circumstances of the contractor, (3) there were not significant difference between the sales record date and the actual completion date of the Main Construction, and (4) there was no disadvantage to the construction subcontractor in order to settle the full amount of the construction cost at an early stage.

#### iv. The Impact on Consolidated Financial Statements

As mentioned above, inappropriate recognition of accelerated sales was conducted in LR business in each quarter.

The company adopted the International Financial Reporting Standard (hereinafter "IFRS") as the accounting standard in preparation of the consolidated financial statements. If the impact of the

inappropriate recognition of accelerated sales in the individual financial statements is reclassified to the "Cost recovery method<sup>3</sup>" set forth in IFRS 15, "Revenues from Contracts with Customers" the sales revenue and gross profit on sales were excessively recorded in the consolidated financial statements as shown in the following table.

(Unit: Million yen)

	March 2018	June 2018	September 2018	December 2018
Sales revenue	43	-	247	-
Gross profit	43	-	247	-
Number of properties	9	-	20	-

## 2. Facts with Respect to LBT

### i. Summary of the Investigation Results

In LBT business, there has been inappropriate recognition of accelerated sales by manipulation of construction completion date in several offices since the previous year. The Committee has determined that these practices do not conform to generally accepted accounting principles.

Most recently, it was estimated that there were at least 23 cases in FYE2018 and 33 cases in FYE2019.

In these cases of inappropriate recognition of accelerated sales, the case of the Building Chiba Branch was conducted under the instructions of the sales branch manager and the construction manager. The reason why sales branch manager and the construction manager recorded acceleration of sales, was deemed to be the existence of the psychological background that they wanted to escape from the strong pressure to meet targets by achieving the monthly target figures. It is also deemed to have been a reason that the achievement of the target sales and business profits was a major consideration factor in performance evaluation for managers, such as branch manager.

Because most of the construction subcontractors in the Building Chiba Branch, which undertake installation work, were small business owners, there was a circumstance that subcontractors easily accepted requests that sales branch staff asked to describe fictional construction completion dates on the construction completion report. In such circumstances, the branch manager and the construction manager, personally or with instruction of their subordinates, make the request to the Construction subcontractors. The Construction subcontractor accepted the requests from the person in charge of LR because they were able to bill the full cost of the construction work quickly, including the remaining construction work with no disadvantage to the construction subcontractors.

It is considered that the sales branch managers and the construction managers rationalized the acceleration of sales because of the following reasons: (1) there are the actual conditions of the construction work, (2) there were cases the construction period was postponed and the construction was not completed on schedule due to the reasons of the contractor, (3) there were not significant difference between the sales record date and the actual completion date of the Main Construction, and (4) there was no disadvantage to the construction subcontractor in order to settle the full amount

<sup>3</sup> According to IFRS 15, paragraph 45, "in some circumstances (e.g., in the early stages of a contract), it may not be possible for an enterprise to reasonably measure the consequences of its obligations to perform, but it may expect to recover the costs incurred in fulfilling those obligations. In such cases, the enterprise must only recognize earnings within the extents of the costs incurred until the results of the obligations can be reasonably measured."

of the construction cost at an early stage.

#### ii. Impact on Consolidated Financial Statements

If the impact to the financial statements by making inappropriate recognition of accelerated sales made in LBT business is reclassified in accordance with Cost recovery methods in IFRS, it is found that the sales revenue and gross profit were excessively recorded in each quarter as shown in the table below.

(Unit: Million yen)

	March 2018	June 2018	September 2018	December 2018
Sales revenue	47	11	103	2
Gross profit	47	11	103	2
Number of properties	23	4	25	4

In addition, the committee estimated that the maximum amount of the impact on the consolidated financial statements of sales revenue and gross profit on sales that may have been recorded in advance in each quarter, including the above, is as follows. This maximum amount was estimated based on a comparison between the delivery date of the product used for the relevant property recorded in the data of process management and the sales recording date. Further investigations may confirm that all or some of these transactions are appropriate.

(Unit: Million yen)

	March 2018	June 2018	September 2018	December 2018
Sales revenue	370	245	342	316
Gross profit	370	245	342	316

### 3. Facts with Respect to LIXIL Suzuki Shutter

#### i. Summary of the Results from the Investigation

In LIXIL Suzuki Shutter, there was a suspicion that inappropriate sales have been recorded by manipulation of construction completion date since prior years. The accounting policy regarding revenue recognition of LIXIL Suzuki Shutter adopted the Completed-Contract by Finalizing the Main Construction, and that required the completion of electrical connecting line construction for shutter installation work. However, as described in (ii a) below, the President and CEO Satoshi Yamada of LIXIL Suzuki Shutter (hereinafter "President Yamada") misunderstood that sales would be recorded even if the construction of the electrical connecting line had not been completed. In LIXIL Suzuki Shutter, there is a possibility that other officers and employees have the same misunderstanding. In such cases, sales might have been recorded based on the wrong recognition.

Accordingly, on the date of submission of this Interim Report, it is impossible to determine whether or not there was an inappropriate accounting procedure before identifying the property. However, based on a comparative analysis of the date of delivery of the products and the actual date of sales recording and a comparative analysis of the sales recording date estimated from the collection site of the sales receivables and the actual date of sales recording, the Committee estimated the maximum amount of impact of the Company on the consolidated financial statements due to the accelerated sales.

## ii. Meetings Held During the Execution of the Investigation

### a. Background of Holding the Meeting

In LIXIL Suzuki Shutter, in addition to the Investigation of the Committee, investigations inappropriate acts concerning the qualifications for receiving fire prevention equipment inspectors<sup>4</sup> were also conducted by outside legal counsels (hereinafter "Investigation of Qualifications for Participation"). On February 26, 2019, it was found that President Yamada conducted a meeting (hereinafter the "Meeting") with senior employees in relation to the Investigations of the Committee and Investigation of Qualifications for Participation. The background of holding this meeting are as follows, based on the result of the Investigation of the Committee.

The Committee sent questionnaires to 283 of the LIXIL Suzuki Shutter's employees as part of the investigation at around 12:30 on February 25, 2019. In response to this request, President Yamada decided to hold a meeting of the relevant members for the purposes of responding to questionnaires and responding to the Investigation of Qualifications for Participation at a meeting in the morning on February 26. Following this decision, Person A sent an e-mail titled "URGENT: TV conference meeting for the questionnaire " to 16 senior executives and employees, including branch managers.

From 16:00 on the same day, a meeting on questionnaires was held in the main conference room in LIXIL Suzuki Shutter. The branch manager, located in a remote location, participated in the meeting through a videoconferencing system.

At the meeting, President Yamada explained to the branch managers that the questionnaire was due to the fraud in LR, and instructed them to have the employees respond to the questionnaire. In addition, he checked with the branch office whether or not employees had any questions. In this context, the accounting policy on revenue recognition in LIXIL Suzuki Shutter became an agenda. As the accounting policy on revenue recognition in LIXIL Suzuki Shutter adopted Completed-Contract by Finalizing the Main Construction, the completion of electrical work is necessary to recognize revenue in the shutter installation. However, President Yamada interpreted that sales could be recognized with the cost allowance regarding remaining work for the electrical work even if the electrical work had not been connected. In response to this, Person B explained that electric work had to be completed. President Yamada stated that we might need to reconsider the revenue recognition in future.

During the meeting, President Yamada told participants that the meeting was 'off the record'.

[Omitted]

On March 4, 2019, LIXIL issued a business order to President Yamada to suspend the execution of LIXIL Suzuki Shutter's duties as president in response to the discovery of this meeting and its content.

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<sup>4</sup> In LIXIL Suzuki Shutter, it was found that employees who were not experienced in the required practical work were qualified and certified for the "Qualifications for Technical Fire Prevention Shutter and Door Inspection" which are the condition to qualify for "Qualifications for Fire Prevention Equipment Inspectors". Moreover, those certified personnel were also qualified and certified for "Qualifications for Fire Prevention Equipment Inspectors," which were established in accordance with the periodic report system for fire prevention equipment introduced in accordance with the revision of the Building Standards Act enforced on June 1, 2016.

b. Evaluation of the Impact of this Meeting

As mentioned above, it is not considered that President Yamada made specific instructions on the content of the responses to the questionnaires at this meeting. However, he had a misunderstanding of the accounting policy related to revenue recognition. He also mentioned they may need to review their accounting policy regarding revenue recognition in future when his misunderstanding was pointed out.

[Omitted]

Furthermore, when the Committee visited LIXIL Suzuki Shutter on March 4, 2019, after ascertaining the presence of this meeting, interviewed participants initially concealed the presence of the notes from the meeting.

Based on the above, the Committee evaluated that the response to the questionnaire issued on February 25, 2019, could not be accepted as valid response. Again, the questionnaire was sent to all officers and employees of the LIXIL Suzuki Shutter on March 5, 2019, after the issuance of the order to suspend the execution of duties to President Yamada.

Subsequently, as a result of the Investigation, the Committee did not recognize the fact President Yamada conducted management override over the internal control on financial reporting of LIXIL Suzuki Shutter.

iii. Impact on Consolidated Financial Statements

The committee estimated the maximum amount of the impact on the consolidated financial statements of sales and gross profit that could be affected by inappropriate recognition of accelerated sales in each quarter of the LIXIL Suzuki Shutter as follows. These amounts are estimated based on a comparison of the delivery date of the products used for the relevant property and the sales recording date recorded in the data of process management. Further investigations may confirm that all or some of these transactions are appropriate.

(Unit: Million yen)

	March 2018	June 2018	September 2018	December 2018
Sales revenue	440	97	331	360
Gross profit	440	97	331	360

#### 4. Facts with Respect to LIXIL Sales Okinawa

##### i. Summary of the Investigation Results

In LIXIL Sales Okinawa, it was confirmed that sales were recorded prior to the construction completion date from the previous fiscal years. The Committee has determined that these practices do not comply with generally accepted accounting principles.

Most recently, it is confirmed that at least one case was recorded in FYE2018.

##### ii. Impact on Consolidated Financial Statements

If the impact of inappropriate recognition of accelerated sales made in LIXIL Sales Okinawa is reclassified in accordance with Cost recovery methods as set forth in IFRS, it is found to be the sales revenue and gross profit were excessively recorded in each quarter as shown in the table below.

(Unit: Million yen)

	March 2018	June 2018	September 2018	December 2018
Sales revenue	▲4	-	-	-
Gross profit	▲4	-	-	-
Number of properties	1	-	-	-

In addition, the Committee estimated the maximum amount of the impact on the consolidated financial statements of sales revenue and gross profit that may have been recorded in advance in each quarter from accelerated sales, including the above, as follows. This maximum amount was estimated based on a comparison between the delivery date of the product used for the relevant property recorded in the process management system and the sales recording date. Further investigations may confirm that all or some of these transactions are appropriate.

(Unit: Million yen)

	March 2018	June 2018	September 2018	December 2018
Sales revenue	▲8	0	▲5	5
Gross profit	▲8	0	▲5	5



#### Section 4. Summary

As described above, it was found that in LR, from previous fiscal years, inappropriate recognition of accelerated sales by manipulating the construction completion date and by dividing the properties, was conducted. On the other hand, there were no transactions recognized as fictitious orders.

In LBT, it was found that, from previous fiscal years, inappropriate recognition of accelerated sales was conducted from the previous fiscal year.

Although there are no transactions recognized as accelerated sales at present in LIXIL Suzuki Shutter, the possibility of such transactions from accelerated sales cannot be denied

In LIXIL Sales Okinawa, it was recognized that from previous fiscal years, there have been transactions in which sales were recorded prior to the completion of the Main Construction due to errors.

Based on the above, the Committee estimated the maximum impact on sales revenue and gross profit from those possibility of inappropriate accounting treatment whose possibility cannot be denied for LR, LBT, LIXIL Suzuki Shutter, and LIXIL Sales Okinawa. The summary is as shown in the following table.

(Unit: Million yen)

	March 2018	June 2018	September 2018	December 2018
Sales revenue	845	343	915	682
Gross profit	845	343	915	682

The maximum impact to the net income before income taxes in the LGC's consolidated financial statements as of the end of the periods is as follows.

(Unit: Million yen)

	June 2018	September 2018	December 2018
Income before income taxes	6,555	13,910	36,209
Effect of income	502	▲70	163
%	7.7%	▲0.5%	0.5%

The retained earnings as of March 31, 2018 may be in excess of ¥845 million.

Based on the above, as described in section 1 and 3, the Committee will continue to conduct investigations into LR, LBT, LIXIL Suzuki Shutter, and LIXIL Sales Okinawa, and make a final report including analysis of the causes and measurements to prevent recurrence.

(Notes)

- This interim report are prepared based on the information collected by the Committee as of March 12, 2019. The Committee is planning to issue the final report. From the information to be received until the finalization of the final report, the contents of the report may differ from those of the interim report.
- The investigation conducted by Special Investigation Committee are discretionary based on the support from the relevant personnel. The contents of the report are limited to the findings from the investigation scope within the investigation period between February 12, 2019 to March 12, 2019.
- This interim report is created solely for the purpose stipulated in “Section 1. Outline of the Investigation (2. Objectives of the Investigation)” and has no other intention or purpose.
- Regarding the LIXIL Suzuki Shutter, it is under investigation by the external legal counsel related to inappropriate action with related to the qualification issue of fire prevention equipment inspector. In order to avoid the impact to the Investigation by the Committee, the disclosure related to the qualification issue are withheld. Moreover, from the privacy protection and confidentiality of the business point of view, some of the disclosure are also withheld.