

The Financial Irregularities at an Overseas Consolidated Subsidiary

Regarding the Circumstances and Response to the Financial Irregularities at an Overseas Consolidated Subsidiary and the Subsequent Decision to Terminate Financial Support

The impact on financial results for the fiscal year ended March 31, 2018

In the financial results for the fiscal year ended March 31, 2018, the Ricoh Group posted a loss of ¥11.7 billion in relation to our overseas consolidated subsidiary Ricoh India Limited (“Ricoh India”).

Since signs of the financial irregularities were recognized in 2015, Ricoh India has been trying to effectuate management reforms, cost reductions and other measures for the purpose of rehabilitating its business; however, its business performance has not improved. In these circumstances, in the fiscal year ended March 31, 2018, after reviewing the situation in Ricoh India again, we decided to terminate financial support, and announced this on October 27, 2017. At that point, we posted expenses of ¥6.5 billion in the second quarter ended September 30, 2017 as an allowance for assets not expected to be collected, including debts. Following this, we further examined assets and determined that we cannot expect to make collections in the future for assets such as inventory and accounts receivable, and so recorded an allowance of ¥5.2 billion in the fourth quarter ended March 31, 2018.

Background

Following the filing of its first quarter financial results ended June 30, 2015 to the Bombay Stock Exchange, Ricoh India, in line with good governance, changed its auditors. In order to meet its required reporting obligations with the Bombay Stock Exchange, the auditors undertook a limited review of the results for the second quarter ended September 30, 2015 as part of their new auditor processes. During this review the auditors raised concerns with Ricoh India’s management and Ricoh India’s audit committee regarding financial irregularities. While the Ricoh India’s audit committee appointed external experts to conduct an in-house investigation, new senior management were appointed on April 13, 2016 to make the necessary changes to the operating structure of the business. The delayed results for the second quarter ended September 30, 2015 were filed on May 18, 2016 to the Bombay Stock Exchange.

Following this, Ricoh India continued to investigate the financial irregularities. On July 19, 2016, Ricoh India disclosed the expected loss for the period and revised their results. Ricoh filed a petition with the National Company Law Tribunal (“NCLT”) in India regarding a capital increase with the aim of restructuring Ricoh India’s business (the capital increase was executed on October 15 of the same year).

In addition, by dispatching a new executive officer from Ricoh as Chairman of Ricoh India, Ricoh endeavored to normalize accounting and finance functions, execute appropriate reporting of accounts and implement recurrence prevention measures under the new management.

Under these circumstances, the business relationship with Ricoh India’s major IT vendor, Fourth Dimension Solutions (Headquarters: New Delhi, National Stock Exchange of India, “FDS”) has deteriorated. Ricoh India continued negotiations to review its business relationship in order to improve the profitability of several joint projects with FDS, however due to the frequent default of contracts by FDS, part of the contract with FDS was cancelled in March 2017, and negotiations for the return of advanced payments continued.

However, in September 2017, FDS filed a petition with the NCLT to initiate insolvency proceedings for Ricoh India’s insolvency, under the Insolvency and Bankruptcy Code of India. Although the petition was rejected, the dispute with FDS had surfaced. FDS filed the same petition again on October 26, 2017, but the petition was rejected, the same as the first time.

Given these circumstances, in April 2017, under Ricoh’s newly-appointed President and CEO, Yoshinori Yamashita, and based on the “RICOH Resurgent” policy, which aims to implement global structural reform across each and every business unit, without exception, we reevaluated our support to Ricoh India. As a result, we have decided not to provide any additional financial support going forward, to minimize the consolidated losses of the Ricoh Group, and disclosed this fact on October 27, 2017.

On January 29, 2018, Ricoh India made a resolution and filed an application to initiate corporate insolvency proceeding with the NCLT pursuant to Section 10 of the Insolvency and Bankruptcy Code of India*.

Ricoh India has been trying to effectuate management reforms, cost reductions and other measures for the purpose of rehabilitating its business; however, Ricoh India’s relationship with its major vendor has deteriorated, and it resulted in default of contracts by the vendor and failure to collect receivables from business partners. Ricoh India announced that, since Ricoh India has reached a position where it is unable to meet its liabilities, it decided to file the application in the best interests of its customers, employees, minority shareholders, creditors and all other stakeholders.

As the largest supplier, creditor and shareholder of Ricoh India, Ricoh will closely monitor the decision of the NCLT of India. We recognize the importance of providing services to our customers, and we will make every effort to continue to provide services to our customers in India and maintain the quality of that service going forward. Any information that needs to be reported regarding future situations will be promptly reported.

* Reconstruction process based on the Insolvency and Bankruptcy Code of India:

After the NCLT admits the application filed under Section 10 of the Code, NCLT will appoint a resolution professional to be vested with the management of corporate debtor and there will be a prescribed time period during which a resolution plan is to be prepared and submitted to the committee of creditors and to NCLT for their approvals. In the event where any resolution plan is not submitted to NCLT within the time period or where other events stipulated in the Code occur, the NCLT will pass an order requiring the corporate debtor to be liquidated.

Factors behind the issues in Ricoh India

Unlike other emerging countries, India has a market expanding around IT services, and our sales grew without an adequate understanding of the regional characteristics and business models. This led us to believe that the business was successful, and we did not recognize the rapid expansion of business to be unnatural growth, resulting in the delay of the discovery.

Also, regional headquarters, which had authority delegated to them by the headquarters (4 HQs: Japan, the Americas, Europe, Asia-Pacific) were in charge of managing overseas sales subsidiaries in their regions.

Among our overseas subsidiaries, Ricoh India is the only one that is listed on the local stock market, and in accordance with listing rules in India, a management governance system has been put in place. As such, unlike other overseas subsidiaries, it is our understanding that checks by regional headquarters became lenient.

In addition, as Ricoh India did not have its mission critical system unified, it was difficult to discover this fraud. Furthermore, our whistleblowing system did not have a mechanism for making direct reports from overseas subsidiaries to the headquarters in Japan.

Efforts to prevent recurrence

As we disclosed in October 2017, we acknowledge the gravity of the situation of having to change the financial support policy for Ricoh India, and, with the aim of strengthening group governance, we have undertaken the following measures to prevent recurrence through strengthening cooperation between Japan headquarters and regional headquarters/overseas subsidiaries.

In January 2018, in light of the fact that Ricoh India filed a petition for initiating corporate insolvency resolution process with the NCLT pursuant to Section 10 of the Insolvency and Bankruptcy Code of India, we are working on the following measures to prevent recurrence, from the viewpoint of business management and organizational enhancement.

1) Strengthen business management

- (A) Establishing a mechanism to review risk evaluation items with awareness of regional and business characteristics when planning and approving mid-term management plans and business plans.
- (B) Managing subsidiaries in a way that corresponds to the emerging country business risks and risks of new and growing businesses that they are exposed to.
- (C) Strengthening business management of overseas subsidiaries and globally standardizing purchasing processes.
- (D) Building frameworks to expose shortcoming and implement best practices in new business domains.

2) Business administration enhancement

- (A) Strengthening the management of overseas subsidiaries under the unified effort of regional headquarters, the supervisory department for subsidiaries and affiliates, and the accounting department of Japan headquarters.

- (B) Establishing a mechanism that enables the headquarters function to check the status of business in each country.

3) Strengthen the organizational structure

- (A) Establishing an organization to control sales subsidiaries in the headquarters, and redefining the scope of responsibilities and roles between the new organization, the regional headquarters and sales subsidiaries.
- (B) Integrating the headquarters accounting and finance functions to clarify the report line and management responsibility.

4) Compliance enhancement

- (A) Educating those seconded to our overseas subsidiaries as senior officers with particular emphasis on compliance and internal control, and clarification of their roles and responsibilities.
- (B) Strengthening the evaluation and supervision of senior management through the establishment of a nomination and compensation committee in the Asia Pacific region.
- (C) Enhancing the development of a whistleblowing system in group companies and thoroughly notifying all employees accordingly, as well as establishing a shared internal reporting desk enabling all group employees to report directly to the headquarters.

5) Audit enhancement

- (A) Conducting internal audits by the global audit team to improve the effectiveness of internal audits, such as checking transaction details.
- (B) Unifying the independent auditor of overseas subsidiaries into those affiliated with the auditing firm adopted by Japan headquarters and strengthening cooperation with the independent auditor of overseas subsidiaries.

6) IT governance enhancement

- (A) Implementing assessments of the core system in the Asia-Pacific region and reconstructing the system with effective IT governance.

Personnel measures

Ricoh deeply regrets this result concerning Ricoh India. On October 27, 2017, we announced that the Representative Director, President and CEO as well as four directors and one executive officer will voluntarily reduce their base monthly compensation by 15% for three months. The former President and CEO (executive adviser as of October 2017) also voluntarily reduced compensation by 30% for three months and resigned as of March 31, 2018. Shiro Kondo retired due to expiry of his tenure of office, as all outstanding issues which arose under his leadership had been, or were in the process of being satisfactorily resolved.