Investigation Report

Summary

December 6, 2011

Olympus Corporation

The Third Party Committee
December 6, 2011

To Olympus Corporation

Olympus Corporation  The Third Party Committee

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I Outline of the Investigation

1. Background of the formation of the Third Party Committee

(1) At the Board of Directors' Meeting held on October 14, 2011, Olympus Corporation (hereinafter referred to as “Olympus”) removed Michael Christopher Woodford (hereinafter referred to as “Woodford”. In this paper, title of address and job title are omitted.) who had suspected murky transactions conducted by Olympus, from the office of the representative director and president executive officer. However, the shareholders and others doubted that (i) the payment by Olympus to the financial advisor (hereinafter referred to as “FA”) for the acquisition of Cyrus Group PLC (hereinafter referred to as “Cyrus’) and (ii) the acquisitions by Olympus of Altis Co., Ltd. (hereinafter referred to as “Altis”), Humalabo Co., Ltd. (hereinafter referred to as “Humalabo”) and NEWS CHEF Inc. (hereinafter referred to as “NEWS CHEF”, together with Altis and Humalabo referred to as “Three Domestic Companies”) and the subsequent recognition of impairment loss, were appropriate. They demanded to investigate the situation, amid the sharp fall of the Olympus share price.

(2) To discharge the duty to inform the investors, shareholders, business alliances and the other stakeholders, Olympus requested an independent investigation committee to conduct a strict and thorough investigation and find out whether or not there was an fraudulent or inappropriate conduct or unreasonable business judgment, and to provide a proposal for improvement and enhancement of the corporate governance regime as well as an indication of the other areas to improve in the structure and management of Olympus with a proposal of improvement measures. Olympus requested five lawyers and one certified public accountant who had no conflict of interest at all in Olympus to form the Third Party Committee (hereinafter referred to as “Committee”) on November 1, 2011.

2. Olympus Press Release and Amendment of the commissioned work

(1) Olympus Press Release
On November 8, 2011 after the investigation by the Committee commenced
and in the press release entitled 'Notice concerning past activities regarding deferral in posting past loss', Olympus announced that in the course of the cooperation to the investigation by the Committee it appeared that the loss incurred by securities investment etc. since 1990s had been deferred to be recorded; and that the fee to the FA for the acquisition of Gyrus, the payment for the preference shares buy-back and the acquisition of the Three Domestic Companies, had been used for, among other things, settling the unrealized loss incurred by securities investment etc., by circulating the money around among several funds.

(2) Amendment to the Commissioned Work
On November 8, 2011 after making the announcement on the unrealized loss, Olympus expressly commissioned the Committee to investigate the situation of the unrealized loss as well. Besides facts finding, deciding and assessing in relation to the transactions during the time from the planning to the execution of the acquisitions of Gyrus and the Three Domestic Companies in light of whether or not there was any fraudulent or inappropriate conducts or unreasonable business judgment on the part of Olympus, Olympus commissioned to investigate such transactions as were suspected to be connected with the transactions during the time from the planning to the execution of the acquisitions and as were suspected to be fraudulent or inappropriate.

3. Committee Members

The Committee members are:

Chairman Commissioner  Tatsuo Kainaka (Attorney at Law, former judge of the Supreme Court, former Superintendent Public Prosecutor of the Tokyo High Public Prosecutors' Office)
Commissioner  Hideki Nakagome (Attorney at Law, former Chief Judge of Nagoya High Court)
Commissioner  Tomoyoshi Arita (Attorney at Law, former Superintendent Public Prosecutor of the Fukuoka High Public Prosecutors' Office)
Commissioner  Osamu Sudoh (Attorney at Law)
Commissioner  Eiji Katayama (Attorney at Law)
Commissioner    Katsuaki Takiguchi (Certified Public Accountant)

The Committee appointed assistant commissioners as follows:

Takusyou Sogo Law Office
(Attorneys at Law Kazuyuki Fujikawa and Hitoshi Fukase)
Fuji Partnership Law Office
(Attorney at Law Masaki Iwabuchi)
City-Yuwa Partners
(Attorneys at Law Michio Masaki, Masahiro Terada, Hiroyasu Horimoto, Hitoshi Sakai and Mika Yanagisawa)
Sudoh & Takai
(Attorneys at Law Kenji Akiha and Futoshi Nakamizo)
Abe, Ikubo & Katayama
(Attorney at Law Masahiro Otsuki, Foreign Law Lawyer Chizuko Nakandakari, Attorneys at Law Toshiyasu Suzaki, Gaku Iida, Naomi Okamoto and Emiko Maki)
Deloitte Tohmatsu FAS Co., Ltd.
(Certified Public Accountant Hitoshi Matsufuji and 17 others)
Deloitte Touche Tohmatsu LLC
(Certified Public Accountant Kentaro Fukada and 16 others)

4. Purpose of the Investigation

The purpose of the investigation by the Committee is to find out whether or not there was any fraudulent or inappropriate conduct or unreasonable business judgment on the part of Olympus in the transactions during the time from the planning to the execution of the acquisitions of Gyrus and the Three Domestic Companies and other related transactions; to provide a proposal to improve and enhance the corporate governance regime; to point out any area to improve in the structure and management etc. of Olympus in the light of the responsibility of Olympus as a listed company to the investors, shareholders, business alliances and other stakeholders; and to propose improvement measures based on the outcome of the investigation. The Committee purports only to perform the commissioned work to satisfy the
preceding purpose of the investigation from the independent and fair standpoint, but not to determine the legal liabilities or responsibilities of corporate managers that are owed by the individual persons who have been involved in the loss deferral and the unrealized loss settlement, or to prosecute them.

II Method and Scope of the Investigation

1. Investigation Method

The Committee looked into and analyzed the securities investment in 1990s, the Olympus internal documents during the time from the planning to the execution of the acquisitions of Cyrus and the Three Domestic Companies (including those retrieved by computer forensic), rules for the internal decision making etc., the communication letters prepared and provided by the accounting auditors, the agreements with FA for the acquisition of Cyrus, documents and information provided by the financial institutions who had businesses with Olympus and its related parties. The Committee also conducted interviews 189 times, on the Olympus officers (including retired ones) and, where necessary, the accounting auditors who conducted the audit of the accountings in the past, the persons of the companies who were involved in the acquisitions of Cyrus and the Three Domestic Companies etc. and the certified public accountants etc. who provided the business valuation in relation to the acquisitions of the Three Domestic Companies.

2. Investigation Scope

(1) Main Area
a. Investigation of the situation of the unrealized loss and its settlement
As is explained in the preceding, the subject matter to investigate is the unrealized loss incurred by the securities investment etc. since 1990s and the use of the acquisitions of Cyrus and the Three Domestic Companies as a mean to settle the unrealized loss.

The Committee set as the first priority the investigation of the situation of the unrealized loss and its settlement by Olympus. As to the unrealized loss, the Committee investigated how the unrealized loss incurred, how the
separation of unrealized loss started and what the whole picture of the loss separation scheme of the delayed loss booking was (as is explained later in this paper, the loss was separated from Olympus by using several funds). As to the loss settlement, the Committee investigated how the acquisitions of the Three Domestic Companies and Cyrus were proceeded, and determined the whole picture of the loss settlement scheme (as is explained later in this paper, the unrealized loss was settled by flowing the payment for the acquisition of the Three Domestic Companies and the FA fee in the form of the sales of warrant and dividend preference shares, into several funds).

The Committee, then, investigated accounting and financial effect of the found facts.

b. Olympus Corporate Governance Regime

The Committee considered it significant that the conduct of the recording of the loss was not found out for a long time and suspected that there might be some problem in the corporate governance and internal control of Olympus. The Committee subsequently decided to set as the second priority of the investigation to find out the status of the corporate governance and internal control of Olympus.

(2) Investigation of similar transactions

As to whether or not there were similar transactions, the investigation was conducted by looking up for similar schemes to the loss disposition scheme for the present acquisitions.

a. Features of the loss disposition scheme

The loss disposition scheme is featured in that Olympus sold the assets that incurred loss to the funds etc. set up by Olympus itself, and later provided the finance needed to settle the loss under the cover of the company acquisitions. More specifically, Olympus circulated money either by flowing money into the funds etc. by acquiring the entrepreneurial ventures owned by the funds at the substantially higher price than the real values, or by paying a substantially high fees to the third party who acted as the intermediate in the acquisition, resulting in recognition of large amount of goodwill, and subsequently amortized the goodwill or recognized impairment loss, which created substantial loss.
b. Point of Investigation
Because of the preceding features of the loss disposition scheme, the investigation was focused, in the transactions where large amount of goodwill or impairment loss was booked, on the points of the rational of the goodwill or impairment loss, the fairness of share purchase prices (including the FA fees), the reasonableness of the acquisition of the target businesses and the fairness of the purchase price of the target companies (including the FA fees), and whether or not there was any similar transactions with the related funds etc.
Having considered the features and points to investigate, ITX corporation, Olympus Corporation of Asia Pacific Limited (former Olympus Finance Hong Kong Ltd) and other companies were investigated.

III  Facts found by the investigation

1. Enormous amount of accumulated loss incurred by financial assets

In the situation where the operating income decreased substantially because of the sharp rise of Japanese yen after 1985, Olympus decided, during the era when Toshiro Shimoyama (hereinafter referred to as “Shimoyama”) was the President, to introduce the zaiteku (speculative investment) as the important business strategy as well as the main business, and started conducting an aggressive financial asset management. However, in 1990 the bubble economy burst and the loss incurred on Olympus by the financial assets management increased. From then on, Olympus, in the effort to recover the loss, started investing high risk high return products, risky financial products that offered interest advancement and the riskier and complex structured bonds, and the loss of financial assets increased substantially and the unrealized loss piled up to slightly less than JY100B by the latter part of 1990.
In June 1993 when the financial asset loss started increasing, Masatoshi Kishimoto (hereinafter referred to as “Kishimoto”) became the President and tried to shift to the sound business operation, but he left the problem of financial asset loss with people of the portfolio management department and did not initiate drastic solution.
2. People who managed financial assets

Around 1985 when Shimoyama changed the business operation strategy to the *zaiteku* (speculative investment), Hideo Yamada (hereinafter referred to as "Yamada"), the assistant manager of the Finance Group in the Accounting Department at that time and a former full-time company auditor, was almost solely responsible for the financial asset management. In 1987, the former vice president Hisashi Mori (hereinafter referred to as "Mori") became a subordinate to Yamada and in 1988 Makoto Nakatsuka (hereinafter referred to as "Nakatsuka"), the current head of the Corporate Center, was assigned to the *keiribu shikin group* (Finance Group in the Accounting Department).

The Finance Group in the Accounting Department changed its name to the Treasury Group in the Accounting Department and further to the Treasury Group in the Administration and Finance Department, but for a long time principally Yamada and Mori conducted the financial assets management with the assistance of Nakatsuka.

3. Drafting the Loss Settlement Measure

(1) During the time from 1997 to 1998 when the unrealized loss was ballooning, the accounting treatment of financial assets was seriously promoted to change from the historical cost basis accounting to the fair value accounting.

In that environment, Olympus led by Yamada and Mori started seeking a measure to avoid the situation where the substantial amount of unrealized loss would come up to the surface by the application of the fair value accounting.

Yamada and Mori, then, actually started seeking a measure by which financial instruments incorporating unrealized loss were passed around by using the funds that would not be the entities to be consolidated into the Olympus consolidated financial statement, with the president of Axes Japan Securities, Akio Nakagawa (hereinafter referred to as "Nakagawa") and the president of Axes America, LLC (hereinafter referred to as "Axes America"), Hajime Sagawa (hereinafter referred to as "Sagawa"), who had been consulted by them on investments before.
Yamada and Mori worked out the measure ("Loss Separation Scheme") by which the financial instruments incorporating the unrealized loss were to be sold at the book value to the funds that would not be required to be the consolidating entities into the Olympus consolidated financial statement, so as to avoid the situation where the unrealized loss would come up to the surface. In the Loss Separation Scheme, a receiver (hereinafter referred to as "Receiver Fund") who was to receive the financial instruments incorporating the unrealized loss and who was not a consolidating entity, was needed and also the money for the Receiver Fund to buy the financial instruments at the book value was needed. To flow the money into the Receiver Fund, Yamada and Mori (i) had the bank provide a finance to the Receiver Fund under the pledge of a bank deposit etc. of Olympus (a loan under the pledge of a deposit in a bank account) as well as (ii) had Olympus set up a business investment funds, from which money flowed into the Receiver Fund.

Yamada and Mori, subsequently, requested Nakagawa and Sagawa to set up the funds that were not required to be consolidated to Olympus consolidate financial statement and that were to receive the Tobashi, that is, to receive the financial instruments with unrealized loss. Nakagawa and Sagawa at the request of Olympus used their expertise and contacts that they built during their time in the securities sector and set up a fund registered in the Cayman Islands by 1998. This is the first Receiver Fund.

(2) At almost the same time, Yamada and Mori were introduced by Nobumasa Yokoo of Global Company Incorporated (hereinafter referred to as "Yokoo") to senior personnel of LGT Bank in Lichtenstein. That was for the purpose to create a system that Olympus deposited Japanese Government Bond with LGT Bank, obtained a finance from the LGT Bank under the pledge of the deposit, which was to be used to buy the financial instruments incorporating the unrealized loss from Olympus at the book value. Mori visited the LGT Bank and explained that the finance arrangement was for secret M&A of European companies, which was accepted by the LGT Bank.

By the mid fiscal year in September 1998, Olympus deposited Japanese Government Bond valued about 21 billion yen with the LGT Bank and completed the preparation for the fund as the receiver to buy the financial
instruments with unrealized loss.

(3) That was the first Loss Separation Scheme. At this stage, although Yamada and Mori did not have a specific plan to settle the unrealized loss of financial assets, which was separated from Olympus, they had a vague idea that at the time of transactions such as large investment where a large amount of money flowed out, goodwill was to be recorded by overvaluing the assets obtained by Olympus for the consideration of the flowed out money by the unrealized loss separated from Olympus, and that the goodwill was to be amortized over years as expense.

4. Report to the management on the Loss Disposition Scheme

(1) The Loss Disposition Scheme that was drafted and set up by around September 1998, was reported by Yamada and Mori to Kishimoto and approved by him. The Loss Disposition Scheme was also informed to the then General Manager of Accounting Department, Minoru Ohta (hereinafter referred to as "Ohta") since it was of course foreseen that, where the Loss Disposition Scheme was implemented, the accounting had to be influenced.

(2) In June 1999, the former President, Tsuyoshi Kikukawa (hereinafter referred to as "Kikukawa") became the executive managing director who was in charge of the department of management of the headquarter including the Finance and Accounting Department. By January 2000 at latest, Yamada reported to Kikukawa the existence and actual implementation of the Loss Disposition Scheme and Kikukawa as well obtained the knowledge.

(3) In June 2001, Kikukawa became the President and Yamada and Mori reported twice a year or so at the meeting attended by Kishimoto, Kikukawa and Ohta the status of the unrealized loss of the financial assets that was separated from OLYMPUS by the Loss Disposition Scheme and maintained by the funds. The report was also addressed to Shimoyama by Yamada and Mori in separate occasions.

(4) That brings that the persons who were aware of the existence and the
implementation status of the Loss Disposition Scheme were Shimoyama, Kishimoto, Kikukawa and Ohta as well as Yamada and Mori who actually implemented the Scheme. It appears that the Loss Disposition Scheme was a legacy of substantial negative asset of Olympus and understood as the hidden and the first priority issue to manage.

5. Implementation of the Loss Separation Scheme and Funding to transfer the unrealized loss

(i) Actual Implementation of the Loss Separation Scheme
The actual Loss Disposition Scheme that Yamada and Mori worked out may be categorized, for convenience sake, by the Receiver Fund, into (i) Europe Route, (ii) Singapore Route and (iii) Domestic Route.

a. Europe Route
From 1997 to 1998, Olympus set up, as the Receiver Fund, Central Forest Corp (hereinafter referred to as “CFC”) and Quick Progress Co. (hereinafter referred to as “QP”) and, in the same year, had the LGT Bank provide a credit line of 30 billion yen to the CFC and had 30 billion yen loaned to the CFC under the pledge of the deposit in the name of Olympus with the LGT Bank. Also, in 2000, Olympus with its subsidiary company, Olympus Asset Management Ltd. (hereinafter referred to as “OAM”) invested 35 billion yen in total into a class fund managed by the LGT Bank and subsequently flowed the money into the CFC via separately set-up funds called TEAO Limited (hereinafter referred to as “TEAO”), Neo Strategic Venture, L.P. (hereinafter referred to as “Neo”) and QP. During the time from 1998 to 2000, 65 billion yen in total was flowed into the Loss Separation Scheme.

b. Singapore Route
In 2000, Olympus had the Commerzbank in Singapore provide a loan of 45 billion to a special purpose company under the pledge of the deposit in the name of Olympus with the bank, and flowed the money into the CFC via funds such as Twenty First Century Global Fixed Income Fund Ltd. (hereinafter referred to as “21C”). Later the Singapore Route was changed in the structure, and in the end Olympus invested 60 billion yen into SG Bond Plus Fund (hereinafter referred to as “SG Bond”) and lent the bond
portfolio invested by the SG Bond to Easterside Investments Limited (hereinafter referred to as "Easterside"). That makes that 60 billion yen in total was flowed into the Loss Separation Scheme during the time from 2000 to 2005.

c. Domestic Route
On March 1, 2000, Olympus set up, besides two other funds, a business investment fund called C.C. New Vision Ventures, L.P (hereinafter referred to as "GCNVV"), to which Olympus invested 30 billion yen and the funds invested 15 billion yen. It was, however, Olympus who provided the entire amount of JY 35B. GCNVV invested some of the money into entrepreneurial ventures and also invested different amount at stages but about 30 billion yen in total to the QP.

(2) Summary of the Loss Separation Scheme
As is explained above, Olympus transferred the loss of about 64 billion yen to the Receiver Fund CFC as well as the loss of about 32 billion yen to another Receiver Fund QP, that is, separated the unrealized loss from the consolidated financial statement. (cf Exhibit 1 Loss Separation Scheme). However, because Olympus obtained the finance by the loan under the pledge of a bank deposit, the loan was to be repaid sooner or later and the money invested into the funds was also to be reimbursed. Under such circumstances, Yamada and Mori consulted the advisors and worked out the plan that Olympus flowed out money by buying entrepreneurial ventures at a high price or by paying fees etc. to the funds for large M&A transactions, and flowed back the money to settle the debit and credit balance among the funds so that the bank deposit was to be released to Olympus and the invested money was reimbursed. Also, in the plan, the excess payment Olympus made was to be booked as goodwill which was to be gradually amortized.

6. New Business Development and the Use as the Loss Disposition Scheme

(1) Share acquisition of the Three Domestic Companies
a. The Three Domestic Companies held by funds and the termination of
GCNVV

GCNVV lent approximately JY30B to QP besides the investment in entrepreneurial ventures, but the invested ventures had serious difficulty in business and fell bankrupted or dormant, which gradually enlarged loss to GCNVV.

GCNVV found out, during the period from 2003 to 2005, the three companies of Altis, Humalabo and NEWS CHEF. Yamada and Mori worked out the plan that (i) the funds were to subscribe shares at low price of 40,000 yen to 200,000 yen per share in the Three Domestic Companies so as to increase the share capital, and (ii) Olympus was to buy the shares from the funds at the substantially high price of between 5 million and more than 20 million per share based on the business plan that assumed the high growth of business. The Olympus' funds, Neo and Class Fund IT Ventures (hereinafter referred to as "ITV") obtained, during the period from 2003 to 2005, shares in the Three Domestic Companies by investment etc. for about 700 million, at 50,000 yen per share for Altis and Humalabo and 200,000 yen per share for NEWS CHEF. Later, according to the preceding plan, GCNVV bought, in March 2006, some shares in the Three Domestic Companies from Neo and ITV for about 10.8 billion yen at 5.79 million yen per share for Altis, 14.375 million yen per share for Humalabo and 4.45 million yen per share for NEWS CHEF. At the same time, Dynamic Dragon II SPC (hereinafter referred to as "DD") and Global Targets SPC (hereinafter referred to as "GT") that were both set up at the request of Olympus, bought from Neo some shares in the Three Domestic Companies for about 8 billion yen at 5.57 million yen per share for Altis, 14.1 million yen per share for Humalabo and 4.45 million yen per share for NEWS CHEF.

Yamada and Mori preceded with, in the preceding manner of using the funds, the acquisition of shares in the Three Domestic Companies. However, because of the change of the accounting standard in 2007, GCNVV and other main investment entities were required to be directly consolidated into the consolidated financial statement, Yamada and Mori considered the possibility as real that the unrealized loss booking by using QP might be revealed, and terminated GCNVV in September 2007 before the end of the term in 2010.

The shares held by GCNVV in the invested entities were decided to be
transferred to Olympus and the former general partner (manager member) of GCNVV, GCI Cayman. Among the transferred shares, those of the Three Domestic Companies were bought by Olympus at the book value of GCNVV.

b. Share Purchase of the Three Domestic Companies

In March 2008, Olympus bought the shares of the Three Domestic Companies from Neo for 31.9 billion yen and from ITV for 15.2 billion yen (at 11 million yen per share for Altis, 2.5 million yen per share for Humalabo and 9.5 million yen per share for NEWS CHEF). Olympus also bought in April 2008 the shares of the Three Domestic Companies via a subsidiary finance company called Olympus Finance Hong Kong Limited (hereinafter referred to as “OFH”), for about 9.6 billion yen from DD, about 4.1 billion yen from GT (at the price of 10.5 million yen per share for Altis, 19.5 million yen per share for Humalabo and 9 million yen per share for NEWS CHEF).

In that way, Olympus obtained including by direct investment etc. the shares of the Three Domestic Companies for about 73.2 billion yen.

(2) Repayment of loans and Reimbursement of invested money

The sale of 31.9 billion yen for the Three Domestic Companies that was paid by Olympus, was used to repay via QP the loan provided by the LGT Bank to CFC, and Olympus withdrew the deposit of 35.1 billion yen that was released by the LGT Bank.

On the other hand, the sale of 15.2 billion yen that IVT received from Olympus was flowed to PS Global Investable Markets (hereinafter referred to as “GIM”) via Neo and TEAO. The total sale of 13.7 billion yen received by DD and GT from OFH was flowed to GIM via Easterside, Creative Dragon SPC (hereinafter referred to as “CD”), GPA Investments Limited (hereinafter referred to as “GPAI”), CFC and TEAO. As the result, by October 2008, Olympus was received the reimbursement of about 37 billion yen. That made the Europe route settled.

(3) Use of Goodwill

As is explained above, a part of the loss separated and passed onto the funds by Olympus was in the end recorded as goodwill of the Three Domestic Companies by the purchase by Olympus of them at the extremely high price from Neo etc.
However, at the instruction of the accounting audit firm who pointed out that the goodwill was, having considered the actual status of the Three Domestic Companies, vastly overvalued, Olympus, in the fiscal term ended in March 2009, entered impaired loss on a large part of the goodwill of the Three Domestic Companies by 55.7 billion yen, which was followed by another loss impairment by 1.3 billion yen in the fiscal term ended in March 2010. That made Olympus finally disposed a part of the loss.

7. Large Acquisition in medical business sector to be used for loss settlement

(1) Business expansion strategy by M&A and plan to cover the investment loss

Around early 2000, Olympus was facing at the slow development in the business in hand and considered to enter into new field of business by M&A. Yamada and Mori took advantage of the movement and considered to flow money into the funds through the business acquisitions so as to cover the loss.

Yamada and Mori had been introduced since around 2004 by Nakagawa and Sagawa to target companies, and in June 2006 entered into a financial advisor agreement (hereinafter referred to as “FA Agreement”) with Axes America in the expectation of a large M&A transaction at that time. The FA Agreement provided that share option over the acquisition vehicle that was to succeed the assets of a target company, was to be granted to Axes America. Such provision was agreed based on the idea that Olympus was to flow money that was created by, among other means, buying back shares later at a high price, into the funds via Axes America so as to use the money to cover the loss.

However, the size of M&A was expected to be small because the target was changed to Gyrus, Yamada and Mori thought that the money that was available under the FA Agreement and flowed into the funds, would be insufficient. In June 2007, they amended the FA Agreement mainly to change the completion fee under the FA Agreement (hereinafter referred to as “Amended FA Agreement”). The Amended FA Agreement provided that upon the completion of the acquisition, 12 million dollars in cash, share option and warrant in respect of Gyrus shares were to be paid and given as
the completion fee. That was agreed to create money needed to cover the most of the loss as at that time. In June 2008, Axes sold the share option and the warrant to a Cayman entity, Axam Investments Ltd. (hereinafter referred to as "Axam") for 24 million dollars. Besides the completion fee, a basic fee of 5 million dollars and expenses of 7 million dollars were paid to Axes. By the end of 2008, Axes paid 12.2 million dollars in total out of the fee and expenses received, to an overseas FA and overseas legal advisors who assisted in Gyrus acquisition.

(2) Capital reorganization of Gyrus, Grant of preference share and warrant buy-back
The medical business section of Olympus had been considering the capital reorganization of Gyrus since right after the acquisition, which requested the share option and the warrant granted to Axes to be bought back. The accounting section of Olympus assessed the market price of the share option and computed the value as about 177 million dollars at the exchange rate at that time. The accounting section made a mistake in the computation in that they considered a price with a large amount of premium as the market price, which made the share option overvalued. However, Yamada and Mori, with the intention to flow money more than 177 million dollars into the funds, decided to pay for the share option by preference shares in Gyrus but not in cash, and to buy back them in the future when the Gyrus acquisition showed the benefit of synergy and the share price went up.
In September 2008, Olympus did issue to Axam preference share in Gyrus (par value 176,981,106 dollars) for the share option, and bought back the warrant for 50 million dollars. The preference share gave the right to receive dividend equivalent to 85 per cent of the balance between the interest accrued by cash deposit and internal loan of Gyrus and expenses and taxes. Also, in October 2008, Olympus, Gyrus and Axam made the amended share subscription agreement under which Gyrus was requested to obtain an approval of Axam in making decisions on material business and disposal of assets. The terms of the dividend preference shares caused later the price of them.

(3) Purchase of dividend preference shares at 820 million dollars
In November 2008, according to the secret agreement with Mori, Axam
requested Olympus to either consent to the assignment of the share subscription agreement to a third party or purchase back the dividend preference shares at a price between 530 million and 590 million dollars. Mori explained within Olympus the background of such demand to purchase back the dividend preference shares within less than 2 months after its issuance that Axam seemed to have been in need of cash due to the impact of Lehman shock. In November 2008, the board meeting of Olympus consented to the purchase back of all dividend preference shares within the above amount based by reasoning that the assignment of dividend preference shares to third parties should be avoided.

However, the purchase back of dividend preference shares was not actually executed until the auditing firm was replaced because there were outstanding accounting issues, and KPMG AZSA LLC pointed out that the FA fee was too expensive. Yamada and Mori discussed the accounting issues with the new accounting auditor Ernst & Young ShinNihon LLC, and in March 2010, approval to record the difference between the purchase price and the book value (approximately 177 million dollars) of the dividend preference shares as goodwill was obtained from Ernst & Young ShinNihon LLC, based on the reason that the accounting issues were cleared.

Subsequently, in order to adjust the final purchase price of the dividend preference shares at 620 million dollars, Mori had, first of all, the amount requested by Axam to be raised up to 724 million dollars, which was the amount necessary to cancel SG Bond. Next, after disguising a price negotiation, he eventually had the dividend preference shares purchased back at 620 million dollars in March 2010. The sale and purchase agreement for the divided preference shares was executed on March 22, and the wire transfer was completed on March 25.

(4) Fund transfer

It is considered that, the 50 million dollar purchase price of the warrant paid to Axam by Olympus in September 2008 was transferred from GPAI to Axam, and 4.1 billion yen among such was wired to SG Bond via 21C and Easterside.

Also, the 620 million dollar purchase price of the dividend preference shares paid to Axam by Olympus in March 2010 was wired to SG Bond via GPAI, CD and Easterside.
As a result, 63.2 billion yen was redeemed from SG Bond by March 2011, and the Singapore Route was settled.

(5) Use of goodwill
Part of the compensation (19 billion yen) paid to Axes America and Axam, the book value of stock option granted, and the purchase price of warrant was recorded as goodwill, and 41.2 billion yen among the purchase price of dividend preference shares was also recorded as goodwill.

8. Summary for the settlement of losses
As described above, Olympus settled the losses separated using the loss separation scheme as described above, and the outline of such is illustrated in Exhibit 2 (Loss Separation Scheme).

Having been briefed by Yamada and Mori since the early stages of its implementation, Kishimoto and Kikukawa had acknowledged the loss separation scheme, and afterwards, they were briefed in details from time to time and have approved the loss settlement scheme as well.

10. Relationship with antisocial forces
We did not find any involvement of the antisocial forces in the course of execution of the loss disposition plan, the target of our Investigation.

IV Analysis and evaluation of the financial effect based on the facts identified in our investigation.
Summary of the monetary impact on Olympus' accounting treatment by the facts discovered through our Investigation is as follows.
The amount of loss separated during 1999 to 2000, the period during which it is considered that the loss separation scheme was fixed and separation of most of the unrealized loss held at Olympus was executed, was approximately 96 billion yen, and approximately 117.7 billion yen in 2003.
Afterwards, losses expanded due to: the expansion of losses due to the failure of new investments at funds to which the losses were separated; losses due to sales of ITX shares; payment of compensation to collaborator of scheme operation; continuing outflow of fund operating expenses; among others. As a result, the following amount from the purchase price of Three Domestic Companies' shares were appropriated to the scheme management expense etc.: a total of approximately 134.8 billion yen which consists of approximately 71.6 billion yen that outflowed to funds to which the loss were separated, and approximately 63.2 billion yen purchase price of warrant and dividend preference shares paid in relation to the acquisition of Gyrus; as well as the abovementioned approximately 117.7 billion yen which outflowed by Tobashi using the loss separation scheme. On the other hand, no new off-the-book liability or asset overstated asset was found in the course of our Investigation.

V Evaluation of the reality of corporate governance and internal control system

1. Company structure

The corporate governance and internal control at Olympus are introduced with control environment; risk assessment and response; control of activities; information and communication; and monitoring; as a matter of formality. However, we inevitably have to point out that such system was flawed and insufficient. Especially in the case at issue, departments other than the Finance Department did not pay enough attention to the activities of the Finance Department which managed the financial assets, by excusing themselves that those tasks required expertise and technical knowledge that they did not have. This resulted in the arbitrary and discretionary activities of the Finance Department.

Although the board of directors of Olympus was not sufficiently informed with respect to the case in issue, we must say it did not sufficiently fulfill its duties as being the center of corporate governance.

Also, the board of auditors was urged by KPMG AZSA LLC, the then accounting auditor, to appropriately exercise its operational audit authority,
however, it blindly believed only the conclusions of the outside experts' report without sufficiently understanding its contents including the conditions precedent when the report was submitted. This being the decisive factor as to why KPMG AZSA LLC issued its unqualified clean opinion, we must say that the investigation and evaluation by the board of auditors was careless.

2. Accounting auditor

In the case at issue, KPMG AZSA LLC and Ernst & Young ShinNihon LLC were involved as the accounting auditor.

(1) KPMG AZSA LLC
First of all, with respect to KPMG AZSA LLC, the question is whether they could have discovered the overall picture of Tobashi of financial instruments with unrealized loss based on the Loss Separation Scheme implemented by Olympus from October 1998 to March 2000, if they have conducted thorough audit in their audit procedure after the discovery of Tobashi transaction by Olympus in September 1999.

One aspect is that much of the unrealized loss was accrued in the off-balance-sheet transactions such as derivatives, and it was extremely difficult to detect the accrual of such unrealized loss based on such transactions and the shifting of such loss to the funds. Another aspect is that KPMG AZSA LLC monitored the individual market value by applying the basket type cost method for the financial instruments which carried unrealized losses from the specified fund trust, however, the market price information of the financial instruments submitted from the managers of such financial instruments were manipulated. In light of these aspects we find it difficult to detect the overall picture of Tobashi.

Next, while Olympus' loss separation scheme was not detected for a long period of time, the question at issue is that they did not repeatedly ask for collateral related information among others, when their inquiry related to collateral and other restrictions on the savings accounts etc. in the course of their foreign bank accounts balance confirmation procedures were not answered.

On this point, however, we find that Olympus arranged to have only the amount of balance answered by the foreign banks when such inquiry was
received, and it was not perceived as a questionable practice in light of the foreign bank’s practice with respect to balance inquiry at the time of such inquiry. Therefore, it was inevitable that such discovery was not made.

Lastly, we can probably point out as questionable that they issued an unqualified clean opinion when there was serious conflict of opinion over the accounting treatment by Olympus at the time of audit for the fiscal year ending in March 2009. In this respect, KPMG AZSA LLC raised question as to whether it was proper business judgment, by urging the board of auditors to invoke their operational audit authority, and by implicitly suggesting to invoke action based on Section 193-3 of the Financial Instruments and Exchange Act. However, after the outside expert’s report concluded that there was no problem, they issued an unqualified clean opinion without in-depth evaluation of its contents. We cannot say this was appropriate.

(2) Ernst & Young ShinNihon LLC
Next, Ernst & Young ShinNihon LLC allowed treating and recording as goodwill, the fee that was questionable from the accounting point of view, when the dividend preference shares were purchased back. Even when we account for the fact that they have just assumed their position as the auditor, and they lacked knowledge of the past events, we cannot conclude this was appropriate.

(3) The process of succession between auditing firms
Lastly, the process implemented to take over the task when Ernst & Young ShinNihon LLC succeeded from KPMG AZSA LLC was questionable in light of the purpose of rules set forth by the Japanese Institute of Certified Public Accountants, the institute which set forth the rules for such process.
Although it was a process of succession in the course of effectively an extraordinary dismissal of KPMG AZSA LLC by Olympus, the process the two auditing firms went through when succeeding the task was nothing but a mere formality, and they did not go so far as to touch the substantive reason for such replacement of the auditing firm.

VI Analysis on the cause of the Incident

The loss in issue was caused by the failure of Zaitech, which frantically
involved number of corporations at peak of the bubble economy. Since the implementation of policy to devaluate the dollar under Plaza Accord on September 22, 1985, Olympus' operating profit decreased, and it came up with a policy to earn non operating profits for improvement.

At Olympus, in order to handle Zaitech, a series of few and proud group within the headquarter department centered around Kishimoto, Kikukawa, Ohta, Yamada and Mori (Accounting Group and Finance Group; Corporate Planning Division after Kikukawa became the president) were formed, concentrating authority to manage financial assets within their hands, and blocked all intervention from other departments. But in 1990, the bubble economy burst, and Olympus incurred large amount of loss from the management of financial assets.

The unhealthy trend at the time by manufacturers to depend on Zaitech to earn profits outside its core business itself may have to be reflected on, but the majority of fine companies which incurred large amount of loss due to its failure in Zaitech faced and accepted its failure, decided to recover losses due to such failure under the slogan of "back to core business" or "selection and concentration", actualized such losses in their accounting during the 1990s, amended their balance sheets to reflect the actual financial status of the company, and have now regained their figure as fine companies.

On the other hand, Olympus formed a management structure that merely focused on pursuing management efficiency by introducing corporate system and others; maintained system under which a single leader moved the organization with his strong leadership; not only concealed the existence of gigantic losses until the end of 1990s under such system; but used Tobashi by funds to continue concealing it and did not settle such losses, even though they had the chance to do so when the accounting standards were amended in 2000.

In other words, Olympus recorded special loss of 16.8 billion yen as difference of appraised value and book value of specified trust fund and swap during the interim period ending in September 1999, and eventually in the fiscal year ending March 2000, recorded special loss of 1.7 billion yen as loss on settlement by cancelling specified trust fund. But in reality, the unrecorded unrealized loss was 9.6 billion yen as of the end of September 1999, and on June 28, 2001 when Kikukawa succeeded Kishimoto as the president of Olympus, the abovementioned large amount of accrued loss from
financial asset management was succeeded without being disclosed. The abovementioned group came up with a loss disposition scheme (Tobashi), under which Olympus' loss from the financial asset management was separated off-balance-sheet, in order to make it consistent with the accounting standard which was to be applied from the fiscal year that started after April 2000. This was to sell financial assets with unrealized loss at book value by utilizing funds that was not included in Olympus' consolidated accounting. In this regard, Olympus transferred money to funds that served as Receivers to cover the purchase price of these financial assets, by investing money obtained in the form of bank loans secured by its own deposits to such bank, and transferring it through intermediary funds. These financial assets transferred to the Receiver Funds were, however, almost worthless, and had to be eventually settled. Therefore, they took advantage of M&A, disguised payments of purchase price of companies and FA fee which were extremely expensive than normal, generated funds for dissolution and flowed them in the form of investments into these Receiver Funds, and settled these financial assets. Then, these purchase prices were recorded as goodwill on the consolidated balance sheet based on purchase accounting treatment, and was to be written off in 10 to 20 years.

This is not only in breach of Financial Instruments and Exchange Act and Companies Act but also conducts that should not allowed by listed companies that are responsible for disclosing accurate information to the investors. If this type of conduct is allowed, only those with knowledge of the reality of Tobashi will be advanced and dominate the center of corporation, and employees with the mind of voluntary independence will not thrive. In addition, check and supervision by other departments were totally nullified. This was because such leaders totally dominated those departments mainly including HR and Finance Department; only the Finance Department (Finance Group, Accounting Department initially) executed such transactions for the management of financial asset which became the cause of loss in the case at issue; and the business operation system allowed the arbitrary discretion where even verification as well as evaluation of the result of such transactions were conducted by themselves. This is the main cause that led to this case. We will describe the cause below.
1. It was handled and concealed by the top managements

This case was led and executed secretly by the top managements such as the president, vice president, and managing directors, and selected executives that surrounded them. At Olympus, there was no risk management system that intended to counter such misconduct by top executives of the company, and the oversight function against such was ineffective. The core of management was corrupted, and the surrounding portion was also contaminated, and the situation was something that can be described as salaried workers' guts in a negative meaning.

2. There was problem in the corporate culture and mind

The top management deployed a one-man system for a long time, and an atmosphere that restrained to speak up objection was formed within the company. Past presidents lacked the sense of transparency and governance, and one had to be prepared to be kicked out of the company in order to make objection even if it was the right thing to do (this is also apparent from how Woodford was treated).

A system to replace presidents was not established among the executives, and it was possible to arbitrarily occupy such position. A corporate atmosphere where people cannot freely speak up was formed, mindset of personalizing the company prevailed, and the sense of duty of loyalty towards shareholders was sparse among the managements.

As a matter of fact, the mindset of executives were so blunt as not to even sense any issue in the face of management and transfer of enormous amount of funds, as well as enormous loss. They did not investigate the cause, determine the person responsible or pursued liability at all in the face of each event (enormous amount of loss disposition in the accounting etc.), and a system, under which not doing so was not seen as a problem, was formed. These executives can be inevitably viewed that they had mindsets to avoid trouble, and only focus on those business that they were in charge of, and survive through their job without going through real trouble, whenever they sensed some kind of trouble.
3. The method to conceal etc. was tactical

One reason the case in issue was not discovered for a long time was because: they concealed losses and conducted Tushashi without leaving document or trail of evidence; the method they used was difficult to detect even from inside; they made it difficult to generally understand by utilizing outside funds and M&A; and the information necessary was barely provided even to board of directors and board of auditors.

4. Each corporate body did not function as required under the Companies Act

In terms of governance under the Companies Act, the corporate bodies that are required to check misconducts are the board of directors, auditor, board of auditors and accounting auditor. It is normally difficult to check the misconducts that involve top management as in this case. However, in the case of Olympus, unfortunately, such function lacked way too much. The Three Domestic Companies were being acquired at an extremely high price in comparison to their status of operation, and the FA fee paid to Cyrus was enormous and beyond common sense. When a transaction so questionable from the viewpoint of a sound management mindset was submitted to the board of directors, there was no trail of sufficient discussion, although accurate information was not provided. There were a lot of yes-man among the directors, and we must find that the board of directors had become a mere formality. The outside director elected was not appropriate and defunct. The board of auditors had become far more formality, appropriate auditor including appropriate outside director was not elected, there was no trail of objection from the board of auditors against the company's business policy, and the top management endorsed it, and disliked to be pointed out anything.

5. The auditing firm did not function sufficiently

The auditing firm once did point out that a part of the Transaction was unreasonable, thus the check and balance function could have possibly worked. However, as described below, it carelessly relied on the outside
experts' report that did not serve its original function and was not eventually able to make the appropriate suggestion. The process which took place at the time of succeeding the role was insufficient, and we must find that they were not able to discharge their responsibility in a sufficient manner.

6. The committee composed of outside experts etc. did not function sufficiently

The company tried to avoid discovery of misconduct by obtaining report that was in line with the top managements' intention, by forming committee composed of outside experts and others, when the auditing firm pointed it out. However the said committee's report was incomplete and had many qualifications; and was far from something that can be trusted as an opinion of a neutral and indifferent third party. The board of auditors and also the auditing firm gave weight to only the conclusion of this report and did not conduct an in-depth examination of its content or qualification. If committees composed of outside experts were widely used in such way, no one will probably trust such investigation and report by such committee composed of outside experts in the future. Members of such outside committee composed of outside experts should also keep that in mind.

7. Disclosure of information was insufficient

Listed companies must prepare and publicly disclose the securities report at a certain time according to the Financial Instruments and Exchange Act. The purpose is to protect the public and investors. Listed companies are also required to timely disclose information that are necessary for the investors to decide according to the stock exchange rules. The individual disclosure by Olympus to the Tokyo Stock Exchange and that pursuant to the Financial Instruments and Exchange Act with respect to Three Domestic Companies was only partial and fragmented disclosure. With respect to Cyrus, only a minimum disclosure in the notes to consolidated financial statements in the "Accounting Section" pursuant to the Tokyo Stock Exchange timely disclosure and Financial Instrument and Exchange Act were made, and there was hardly any disclosure with respect to the "Overview of Corporation" and "Status of Business". As such, Olympus did not reveal the
overall picture of the case, and it cannot be said it made requisite or sufficient disclosure for the purpose of investment decisions by the investors.

8. HR rotation of the company did not function

At Olympus, they established the system that had the same person responsible for the management of important asset for a long period of time, and actually operated the HR system as such (lack of job rotation). We cannot deny that this contributed to the case in issue. Olympus should have sought human resources outside the connection and interest of the company in a timely manner, put them in charge of financial aspects of the company, and let them clean up the scums that have possibly piled up, however, they did not do so, and it realized when they happened to elect a foreigner president. Under the system maintained, human affairs which had to be indifferent was distorted, and those who shared secrets and those who were involved in the concealment were treated favorably. Maintenance of such system was a serious flaw.

9. Lacking the sense of compliance

Pushing the losses off-balance-sheet, and covering it up by dissolving them in a long period of time, is an action by someone who does not understand compliance at all. Past presidents lacked the sense of and leadership in relation to compliance, therefore, we must point out that there was a lack of corporate governance. At Olympus, due diligence for corporate acquisition, examination by the legal department or other necessary procedures could be omitted intentionally without making it a problem and such system was maintained. Corporate organization that managed the internal control or risks within the company was not independent, and the internal whistleblower system was not constructed appropriately.

10. Existence of the outside collaborator

There were outside collaborators who supported the corporate executives by providing knowledge and support, and contributed to conceal, while knowing they were illegal financial treatment. This has also been a major
contribution to the realization of loss concealing scheme for a long period of time.
As such, the misconduct in our case was not detected until it was pointed out
by the newly elected foreigner president Woodford. Woodford raised the
question with respect to the Transaction to top management and the board
meeting, however, the board meeting responded by dismissing him without
any investigation. Here again, the board of directors meeting was not able to
perform its supervising function.

VII Measures to prevent recurrence of problem

1. Replacement of the old management

Kikukawa, Yamada and Mori resigned. But other executives who were
involved in the fraudulent accounting one way or the other, and auditors who
did nothing when the auditing firm pointed out the issues during the period
between 2008 and 2009 should be fully eliminated. Directors who processed
the problematic case with a short 15 minute meeting should also be replaced
at the appropriate timing.

2. Analysis of the relationship between auditing firms and the company

The auditing firm who gave a clean opinion for the fiscal year ending March
2010 without sufficient process of succession is also a problem. Auditing firm
should renew its understanding on the importance of its duties. The
company and the auditing firm must reconstruct their relationship in a way
that it should have been.

3. Pursuit of legal responsibility of those who were involved

Those who were involved in the tortious conduct had ruined the trust they
have gained from shareholders and business partners, as well as those trusts
which had been given to the entire Japanese corporation. When we take this
into account, we must point out that the legal responsibility of those who
were involved must be pursued.
4. Establishing a committee to renew corporate governance

In addition to the measures above, the company must establish a committee to renew corporate governance composed of third parties, and thoroughly reexamine how their corporate governance should be.

5. Establishment of management supervision committee and management supervisor

As a measure unique to Olympus where the misconduct lead by top management continued for a long period of time, it may be one idea to establish such committee or supervisor with the same level of seniority as the representative director for a certain period of time.

6. Reinforcement of outside directors and outside auditors

ELECTING president's friend or people with connection from business partners as outside directors or outside auditors should be discontinued, and those who are fully suitable as outside executives should be elected.

7. Changing the mindset of new management

It is necessary that the new management is aware of the weight of its responsibility towards the society, and maintain strong ethic to reject misconduct, as well as a sense of compliance, and continue to recognize the importance of corporate governance and disclosure of information.

Directors and auditors must recognize the weight of its responsibility to the corporation and society, and freely discuss what they think questionable at the executive meeting and board of directors meeting without reservation against the top management. Directors and auditors should hold faith, and with the preparedness to risk its position, discuss with devotion, and should not easily compromise with transactions that he cannot agree. This will truly contribute to the cooperation in the long run. Directors and auditors should not focus on self protection while forgetting about the governance. Also, the management should be elected from candidates with the moral value and sense of compliance.
8. Forming compliant workplace environment and the change of mindset of the officers and employee

Compliance governance must be strictly enforced on not only officers, but also lower level employees. Fear of rocking the boat or formalities should be eliminated. Developing people who can discuss what he really thinks and creating workplace environment by establishing workplace code of conduct etc. are important.

9. Change of mindsets of auditors and board of auditors

Auditors and board of auditors must also realize the weight of their responsibility to audit directors' business execution. In this case, audit was at least implemented, but we cannot see that it was conducted seriously enough when the issue was pointed out by the auditing firm. For example, even when a problem was pointed out during the interview with the auditing firm, worthless report of an outside experts' committee was blindly trusted, and no report was made even to the board of directors. Auditors and board of auditors shall pursue what is really for the company, always think carefully, thoroughly pursue the truth of the transaction, and perform its duty from a fair perspective. In addition, in order to maintain the independency of the auditor, the board of auditors currently with only one dedicated member must be reinforced.

10. Disclosure of information

The fact that large amount of FA fee in issue was not disclosed with respect to Gyrus is a serious flaw of disclosure. Also, information useful for the investors to understand the actual status of investment into new business by Olympus were not disclosed. For example, the amount of goodwill for the Three Domestic Companies was extremely large, but it was not disclosed. This is a serious flaw in disclosure. From the listed company's perspective, because disclosure of corporate information enhances transparency of management by disclosing periodically on a regular basis, and enhances the self-control of corporate activity, we must give management the feeling of
tension to managing, by informing the reality of the corporation to shareholders and other stakeholders, and increase the reasonableness of the decision making. In order to enhance the self-control and restore trust from the stakeholders, it is very important to enhance transparency of the management. Therefore, disclosure pursuant to regulation is a matter of course. In addition, the company must promote disclosure based on whether it is important or useful for the investors.

11. Reform of each system within Olympus

Important information must be disclosed within the company. The company must establish a corporate atmosphere or system to share such information, and make sure by reforming the HR system or mutual check-and-balance system that a single person is not occupying the important position for a long period of time. In addition, in order to prevent misconduct by executives, a whistle blower system with outside window should be constructed. The above mentioned are all too much common sense. In the course of discussion with respect to the amendment of Companies Act, it is currently being discussed whether to revise the law to obligate outside directors, revise the requirements, or strengthen the audit function given to the auditors. This type of amendment of system may contribute to the prevention of this type of incident, however, it cannot completely avoid misconduct as seen in the case of United States. Consciousness and commitment to responsibilities by each of the individual director and auditor are the ultimate key to success.

VIII Conclusion

The credibility of Olympus has largely failed due to the discovery its long term fraudulent accounting lead by top management. The extraordinariness of misconduct and the path to discovery of such has had a large impact on stakeholders such as shareholders, good ordinary investors, and business partners. It is deeply regretted that it also had certain impact on the credibility of all Japanese corporations that are seriously managing the company. Olympus had originally been a sound company, with diligent employees and high technical strength. Not all part of the company was involved in this
misconduct. Olympus should remove its malignant tumor and literally renew itself.
END