



(TRANSLATION FOR REFERENCE ONLY)

December 20, 2024

To Our Shareholders:

Corporate Name: PROTO CORPORATION

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Securities Code: 4298

(TSE Prime, NSE Premier)

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Notification on serious defects in internal control related to financial reports that should be disclosed, and the submission of a report on revisions to an internal control report

As mentioned in “Notification on the submission of a report on revisions to securities report, etc. for previous fiscal years and the revisions to the brief reports on financial results in previous fiscal years” released today, our company submitted a report on revision to the securities reports, etc. for previous fiscal years to Tokai Local Finance Bureau, and revised the brief reports on financial results in previous fiscal years.

In parallel, our company has submitted a report on revisions to the internal control report, which describes that there are serious defects that should be disclosed in the internal control reports for previous fiscal years, which have been submitted to Tokai Local Finance Bureau, in accordance with Article 24-4-5, Paragraph 1 of the Financial Instruments and Exchange Act, today, as described below.

1. Details of serious defects that should be disclosed

It was revealed that a former employee of our company had conducted false deals (transactions in which money was sent to or received from business partners or the like without confirming the provision of services), and our company is suspected of having recorded certain amounts of false sales toward business partners and false costs of sales (hereinafter referred to as “this case”), so we established a special investigation committee on October 18, 2024, and have been proceeding with the investigation. Our company received an investigative report from the special investigation committee on December 10, 2024, and found that the former employee of our company continued transactions for posting false sales from a specific client under pressure to achieve target sales, etc. from around January 2013 to March 2024, and faked the collection of accounts receivable from said client with funds spent for payment to outsourcees for said transactions.

After recognizing the fact about this case revealed with the investigative report, the reports on analysis of the cause, and the cause of this case, our company reevaluated the internal control for financial reports while considering the impact on financial reports, risks, and the problem of delay in reporting to accounting auditors, consultation and cooperation with external experts, etc. As a result, it was clarified that there were some defects in the processes of selling, purchase, settling accounts, and reporting financial results. Our company judged that these defects are so serious that they should be disclosed, because they are likely to significantly affect financial reports.

2. Reason why we were not able to correct the defects by the last day of the fiscal year

The above serious defects that should be disclosed in internal control related to financial reports were discovered after the last day of the fiscal year, so we were not able to correct the defects by the last day of the fiscal year.

3. Policy for correcting the serious defects that should be disclosed

As mentioned in “Notification on the receipt of an investigative report of the special investigation committee” dated December 10, 2024 and “Notification on the formulation of measures for preventing recurrence in response to the results of the investigation by the special investigation committee” dated December 20, 2024, our company received an investigative report regarding this case from the

special investigation committee, and formulated measures for preventing recurrence based on the suggestions in said investigative report. By implementing the formulated measures for preventing recurrence without fail, we will develop and operate an appropriate internal control system and correct the serious defects that need to be disclosed.

4. Effects on consolidated and non-consolidated financial statements

Necessary revision items attributable to the above serious defects that should be disclosed have been reflected in consolidated and non-consolidated financial statements.

5. Auditors' opinions in reports on audits of consolidated and non-consolidated financial statements

They are unlimited appropriate opinions.

6. Internal control reports subject to the revisions

The 42 nd term	Internal control report	(From April 1, 2019, to March 31, 2020)
The 43 rd term	Internal control report	(From April 1, 2020, to March 31, 2021)
The 44 th term	Internal control report	(From April 1, 2021, to March 31, 2022)
The 45 th term	Internal control report	(From April 1, 2022, to March 31, 2023)
The 46 th term	Internal control report	(From April 1, 2023, to March 31, 2024)

7. Details of the revisions

Our company has corrected Section 3 “Matters regarding Results of Assessment” in the above-mentioned Internal Control Report as follows.

The corrected parts are underlined.

3 【Matters regarding Results of Assessment】

(Before the correction)

As a result of the assessment mentioned above, we have concluded that our corporate group's internal control over financial reports as of the end of the fiscal year under review was effective.

(After the correction)

We have concluded that our corporate group's internal control over financial reports was not effective as of the end of the fiscal year under review because the defects in our internal control over financial reports described below have a significant impact on our financial reports and fall under serious defects that should be disclosed.

Our company set up a special investigation committee on October 18, 2024 and has conducted an investigation with the committee because it was revealed that a former employee of our company had conducted false deals (transactions in which money was sent to and received from business partners or the like without confirming the provision of services) for the period from July 2016 to March 2024 and our company is suspected of having recorded certain amounts of false sales from business partners and costs of sales (hereinafter referred to as “this case”). Our company received an investigative report from the special investigation committee on December 10, 2024, and it indicated that the former employee of our company continuously conducted transactions with a specific client in which false sales were booked for a long time due mainly to the pressure of achieving target sales and committed fraudulent acts under a scheme of faking the collection of accounts receivable from the client by using the money spent as payments to the outsourcee involved with the transactions as funds.

Considering that it is crucial to remove the false sales and costs of sales retroactively in relation to this case, our company has corrected the parts subject to this case in the relevant financial results in the previous fiscal years and submitted a report on revisions to the securities reports for the period between the fiscal year ended March 2020 and the fiscal year ended March 2024 and the quarterly reports for the period between the third quarter of the fiscal year ended March 2022 and the third quarter of the fiscal year ended March

2024.

First, we have identified the following as the causes of the false sales and costs of sales that were recorded for a long period of time in this case and the defects in our internal control.

① Defects in our company's selling process (actualness)

Concerning transactions with clients, our company has established a control procedure that requires confirmation and approval by the sales manager for the details of transaction applications at the time of order receipt and confirmation by the sales manager regarding the details of sales for each client and statement at the time of recording of sales. In this case, however, the former employee was the sales manager and thus approved the transactions with the clients whom the former employee was in charge of and sales generated therefrom by oneself, which means that the control procedure failed to function properly. In addition, we did not have any internal control procedure regarding self-approved transactions in place.

Furthermore, with regard to transactions related to such printed matter as flyers in newspapers involving outsourcees, including this case, selection of outsourcees and order placement were entrusted to each division, which enabled the former employee to be the only person who was involved in all the processes, ranging from order receipt and selection of an outsourcee to confirmation of deliverables from the outsourcee, in these fraudulent transactions despite the scale of the transactions with the clients was large. Therefore, no one other than the former employee knew the details of the transactions, and consequently, the illicit transactions were not brought to light for a long period of time.

② Defects in our company's process of procurement (actualness)

Concerning sales from monthly usage fees of the MOTOR GATE system in the used car field that is our company's core business, as internal control for guaranteeing the actualness of costs of sales, we have in place a system of checking that services have been provided by collating data between our company's sales and contract systems and our service provision management system. Meanwhile, regarding transactions related to such printed matter as flyers in newspapers involving outsourcees, including this case, confirmation of deliverables from outsourcees to clients were entrusted to each division as described above. We had no unified rule for storage of evidence of service provision or confirmation by other people than sales representatives with regard to transactions related to printed matter involving outsourcees. As a result, we did not have in place any internal control framework that guarantees the actualness of costs of sales in transactions related to printed matter involving outsourcees.

Next, regarding the issue that our company did not swiftly report to the external audit corporation, or consult external experts or cooperate with them while taking into account the impact and risks on our financial reports after we discovered this case, our company has identified the following as the defects in our internal control framework:

③ Defects in our company's process of settling accounts and reporting financial results (measures against irregular account processing)

With regard to our company's process of settling accounts and reporting financial results, we did not have any proper structure that allows us to take timely and appropriate measures against extraordinary events, such as this case, with effects and risks on our financial reports taken into consideration or any proper system for information collection (measures against irregular account processing).

Our company has concluded that these defects have significant impact on our financial reports and fall under serious defects that should be disclosed.

The above-mentioned facts were found out after the end of the fiscal year, so we were unable to correct the defects by the end of the fiscal year.

Recognizing the importance of internal control over financial reports, our company will take the following improvement measures and establish and operate a proper internal control framework by taking the suggestions and advice of the special investigation committee into account in order to correct these serious defects that should be disclosed.

① Measures for improving the defects in the selling process of our company

(A) To increase the number of staff members in charge of large clients to more than one

Every six months, Accounting & Finance Division will extract clients for which transaction amount is not less than a certain amount in the past six months, define said clients as large clients, and assign the existing sales representative and another employee (assistant sales representative) to transactions with the large clients in each division, except some cases, such as the cancellation of the transactions. We will allow the assistant sales representative to grasp the details and situations of contracts for transactions with said clients, and establish an internal check system for the sales representative who directly communicates with clients.

At the time of internal audits, we will interview the sales representative and the assistant sales representative about large clients that have been extracted according to the records and situation of transactions, etc. and check whether they make transactions in a proper manner.

(B) Internal Audit Department will regularly check self-approved transactions

Accounting & Finance Division will list self-approved transactions (applied for and approved by a sales manager) in each quarter (excluding the product categories in which the actualness of service provision is separately secured, such as products managed by a service provision management system and pay-per-use sales) at the end of said quarter, and Corporate Governance Department, which is in charge of internal audits, will narrow down the transactions in said list according to risk from the viewpoints of transaction periods, continuity, profit margin, charging conditions, and payment status, and then check whether services have been actually offered for the transactions and the appropriateness of the transactions from the aspects of both sales and costs of sales.

② Measure for improving the defects in the purchase process of our company

(A) Separation of the authority to select an outsourcee and place an order in transactions for printed matter, etc. from the division

We will transfer the authority to select an outsourcee and place an order in transactions for printed matter, etc. from the division to Management Division. Management Division will conduct a series of tasks, including selecting an outsourcee, requesting a price estimation, placing an order, confirming delivery, and checking invoices, based on applications from the division, from a standpoint independent from the division. Like this, we will develop a system for internal check for the division. We will also prohibit the sales representative from delivering products to clients directly.

In addition, Management Division will collect and store vouchers for transactions, etc., which prove the provision of services, without fail, in purchase transactions, so that said vouchers will be checked at the time of internal audits.

③ Measure for improving the defects in the processes of settling accounts and reporting financial results

(A) Improvement in the structure and system for responding to extraordinary events in the processes of settling accounts and reporting financial results

We will train management-level employees to deepen their understanding of the processes of settling accounts and reporting financial results, and cement the cooperation with respective departments, to establish a structure and a system in which Accounting & Finance Division will be able to swiftly collect every piece of information that would affect financial reports. If a serious extraordinary event is found, Accounting & Finance Division or the like will consult external experts and others immediately, to establish a system for implementing necessary measures timely and appropriately.