The Items Published on the Internet Website Concerning the Notice of the 194th Ordinary General Meeting of Shareholders

Kawasaki Heavy Industries, Ltd.

6. System to ensure that Directors' execution of duties complies with laws and the Articles of Incorporation, other systems to ensure proper execution of business and overview of operation status of such systems

At the Board of Directors Meeting of May 24, 2006, the Company made a resolution regarding the basic policies on the establishment of internal control systems pursuant to the Companies Act and confirmed the status of established internal control systems. Henceforth, whenever there are organizational changes or changes to internal regulations, resolutions are made at Board of Directors Meetings with regard to the revision of the basic policies. The details of resolutions regarding the basic policies as of the end of the fiscal year under review and an overview of the operation status of internal control systems for the fiscal year under review are as follows:

I. Basic policy for developing a system for internal controls

The KHI Group develops and maintains systems for internal controls to establish systems to ensure formation of proper organizational structures, development of company rules and regulations, dissemination of information and proper execution of operations. KHI's management philosophy is indicated in the Group Mission (missions and roles which must be carried out) "Kawasaki, working as one for the good of the planet" (Enriching lifestyles and helping safeguard the environment: Global Kawasaki), "Kawasaki Value," "The Kawasaki Group Management Principles" and "The Kawasaki Group Code of Conduct." KHI strives to improve its internal controls by constantly reviewing them, and in doing so improves the efficiency and lawfulness of company systems which contribute to the Group's sound and sustained growth.

More specifically, a resolution was made at the Board of Directors Meeting with respect to the Company's efforts to establish the following internal control systems and to streamline, maintain, and improve them based on this basic policy.

1. Necessary systems to ensure proper execution of business of the Company

(1) Systems to ensure that execution of duties by the Company's Directors and employees are compliant with laws and the Articles of Incorporation

(i) We are thoroughgoing in ensuring compliance with laws and the Articles of Incorporation and other KHI regulations and policies, and bind KHI's officers (directors and corporate auditors are collectively called "Officers") and employees: "put an ethics into practice as business person," "respect individuals and individual rights and prohibit discrimination," "promote protection of the environment," "comply with laws and social rules," and "use proper accounting practices and ensure reliability of financial reports" (hereinafter, "Fundamental Principles of Corporate Ethics") as stipulated in KHI Code of Corporate Ethics.

(ii) We establish a system to promote measures, with President as the chief executive of internal controls and General Manager of each division as the manager in charge of internal controls, and manage the internal control systems in a unified way. We do so based on the roles and responsibilities given to Officers and employees, in order to ensure the appropriateness of business operations by achieving objectives such as effective and efficient business operations, reliable financial reporting, compliance with laws, and safeguarding of assets.

(iii) We deliberate and make decisions on policies and measures, under the governance of President, for the Company-wide CSR Committee and the CSR Committee for Business Divisions (consisting of Officers and other employees) to comply with the "Fundamental Principles of Corporate Ethics" and to take thoroughgoing compliance initiatives for the KHI Group (which means the corporate group consisting of the Company and its subsidiaries). We continue to improve understanding and awareness of compliance through ongoing education and training activities for various types of legal compliance and also monitor operational status.

(iv) We work to enhance compliance systems by establishing the internal whistleblower system to report information regarding compliance breaches.

(v) Executive Officers who are delegated to execute business operations within an appropriate scope are appointed at Board of Directors Meetings. And by appointing outside directors (independent officers stipulated in the Regulations of the Tokyo Stock Exchange) who are not likely to have any conflict of interest with any general shareholder, the Company enhances the supervisory and monitoring functions of the Board of Directors for overall management. In addition, by appointing outside auditors who are not likely to have any conflict of interest with any general shareholder (independent officers stipulated in the Regulations of the Tokyo Stock Exchange), the Company ensures the objectivity and neutrality of the management monitoring function, and enhances the monitoring function.

(vi) The Internal Audit Department carries out KHI's business audits and evaluation/assessment of internal controls over financial reporting to ensure the proper execution of duties and the reliability of financial reporting.

(2) Systems for storage and management of information related to execution of duties by the Company's Directors

(i) Information pertaining to execution of duties by the Company's Directors (meeting minutes, decision making records and appurtenant materials, account books, account invoices and other information) shall be appropriately stored and managed in accordance with applicable internal regulations. The information shall be made accessible at any time to Officers and employees nominated thereby.

(ii) Confidential information and personal information shall be appropriately stored and managed in accordance with internal regulations and enforcement thereof shall be ensured through such measures as business audits.

(3) Systems for management of risk of loss of the Company

(i) With President as the chief executive of risk management, General Manager of Corporate Planning Division at the head office as chief risk officer and General Manager of each division as risk manager, we grasp the assumed risk in detail, and establish a risk management system, which is designed to avoid or minimize risk or losses caused by such risk.

(ii) With respect to risks pertaining to management strategies, risk analysis and consideration of countermeasures shall be conducted in advance by the concerned divisions in accordance with applicable internal regulations. Then, deliberations and decision making regarding those risks shall be carried out at Board of Directors Meetings. In particular, we implement risk management individually for major projects that have a significant impact on business operations.

(iii) As a measure to be taken when a risk becomes evident, we set forth codes of conduct in the event of emergencies, and also appoint persons in charge of crisis management at each place of business to establish the system, which is designed to minimize losses.

(iv) When a material risk becomes evident, reports are immediately given to President, who is the chief executive of risk management, in accordance with the reporting route specified in advance.

(v) In particular, in anticipation of the occurrence of disasters, including large-scale earthquakes and pandemic diseases, we predetermine important operations to which priority should be given to ensure the continuation or recovery of the operations in order to minimize the impact on KHI's business. We also formulate a business continuity plan to shorten the length of time until recovery.

(4) Systems to ensure efficient execution of duties by the Company's Directors

(i) Based on the KHI Group's role and objectives as articulated in the Kawasaki Group Mission Statement, we share final goals for the future by setting forth a long-term vision for the whole group and each business division.

(ii) To attain the goals set forth in the long-term vision, we have formulated specific action plans, including the Medium-Term Business Plan and Short-Term Business Plan, and have determined goals for each organization, Officer and employee. Furthermore, by conducting regular reviews of these respective plans and goals, we aim to secure a system that enables more appropriate and efficient execution of business operations.

(iii) We have stipulated matters such as division of roles and approval authority in internal regulations. We have also appointed Executive Officers based on a resolution passed at Board of Directors Meetings to clarify the Systems for Execution of Business Operations. As a result of establishing these systems, we aim to efficiently execute business operations in each business and function area.

(iv) We have established the Management Committee, which acts as a deliberative organ to support the Board of Directors Meetings' resolutions and President's decision making, to ensure efficient execution of duties by Board Members through discussions at Management Committees. Furthermore, we hold meetings of Executive Officers Committee, which consists of all Executive Officers, to ensure familiarity and a common understanding of management strategies and plans.

(v) According to the in-house company system, each business division makes decisions on its own under delegated authority and responsibility, and executes flexible business operations to adapt to changes in the environment. We have also established the Company Management Committee in each Company, and it is led by the Company President who assumes the ultimate responsibility for execution of duties of company's business operations.

2. Necessary systems to ensure proper execution of business of KHI Group Companies

We ensure proper execution of business of the KHI Group through efforts to establish the following systems according to business contents, size, region and significance of each subsidiary and affiliate (hereinafter, "Group Companies").

(1) Systems to ensure that execution of duties by Directors and employees of Group Companies are compliant with laws and the Articles of Incorporation

(i) The Company governs internal controls of Group Companies from the perspective of the parent company and establishes a system to ensure the appropriateness of business operations. It does so by achieving objectives regarding matters such as the effectiveness and efficiency of business operations, reliability of financial reporting, compliance with laws and safeguarding of assets as a whole group.

(ii) The Company establishes a system to have the Company-wide CSR Committee deliberate strategies and policies and measures concerning the "Fundamental Principles of Corporate Ethics" and compliance as the entire KHI Group, and check operational status.

(iii) The Company implements controls as shareholders of Group Companies through the execution of voting rights at the General Meeting of Shareholders, and also carries out management supervision and monitoring over the operation thereof by dispatching non-full-time Directors or non-full-time Corporate Auditors, or both (collectively referred to as "Non-Full-Time Officer"), to Group Companies, on an as-needed basis. In addition, we secure appropriate Group business management systems by establishing a department which presides over subsidiaries' operation.

(iv) The Auditing Department, which presides over the Group's internal audits, ensures the appropriateness of operations and reliability of financial reports through business audits and assessment of internal controls over financial reporting at Group Companies.

(2) Systems with regard to reporting to the Company on execution of duties by Directors of Group Companies

(i) The Company receives reports regarding the status of execution of duties by Directors of Group Companies through a Non-Full-Time Officer who is dispatched thereto.

(ii) Group Companies regularly report on the status of business operation as a management report and have discussions in advance with the relevant department of the Company with regard to important matters subject to decision-making on corporate management in accordance with applicable internal regulations.

(3) Regulations for management of risk of loss of Group Companies and other systems

(i) The Company promotes group-wide risk management, striving to prevent or minimize risk or losses caused by such risk.

(ii) As a measure to be taken when a risk becomes evident at Group Companies, the Company instructs Group Companies to formulate crisis handling measures and policies to establish the crisis management system.

(iii) When a material risk becomes evident, reports are immediately given to the Company, in accordance with the reporting route specified in advance.

(4) Systems to ensure efficient execution of duties by Directors of Group Companies

(i) With respect to the management at each Group Company, while respecting the autonomy thereof, the Company establishes a system in which execution of duties is ensured in a fair and efficient manner by sharing the basic philosophy and vision indicated in the Kawasaki Group Mission Statement, long-term vision, the Medium-Term Business Plan, and so forth, and clarifying group-wide final goals.

(ii) The Company instructs Group Companies to establish Approval Regulations to ensure efficient execution of duties.

3. Necessary matters for the Company's Corporate Auditors to execute duties

(1) Policies regarding employees in cases where the Company's Corporate Auditor requests appointment of employees to assist with his/her duties

We allocate the required staff according to the Corporate Auditors' requests.

(2) Policies regarding independence of employees who assist with the duties of the Company's Corporate Auditors from the Company's Directors and matters regarding ensuring efficiency in directions given to employees who assist with the duties of the Company's Corporate Auditors

The employee who assists with the duties of the Corporate Auditor shall follow the Corporate Auditor's directions and orders. For personal transfer, personnel performance evaluation and disciplinary punishment, prior consent of the Board of Corporate Auditors is required.

(3) Systems for the Company's Directors and employees to report to the Company's Corporate Auditors and systems for Directors and employees of Group Companies and those who receive reports from the said Directors and employees of Group Companies to give reports to the Company's Corporate Auditors

(i) The Company's Corporate Auditors attend Board of Directors Meetings, the Management Committee, Executive Officers Committee and company-wide meetings, including Company-wide CSR Committees and Company-wide Risk Management Committees. At these meetings, the Company's Directors and employees shall provide the Company's Board of Corporate Auditors with reports concerning important matters about group management and business operations, including matters regarding compliance, risk management and internal controls, and the status of execution of duties.

(ii) The Company's Directors and employees shall immediately report to the Company's Board of Corporate Auditors when discovering that there is a risk of the KHI Group suffering significant damage.

(iii) Directors and employees of Group Companies shall immediately report to the relevant department of the Company when discovering that there is a risk of the KHI Group suffering significant damage. Upon receiving reports, the said department shall report the details to the Company's Board of Corporate Auditors.

(iv) The Company's employees shall, in accordance with applicable internal regulations, report to the Company's Board of Corporate Auditors regarding the execution of business operations of the KHI Group by circulation of internal memos.

(v) The Company's Auditing Department and Accounting Auditors from time to time report to, and exchange information with the Company's Board of Corporate Auditors regarding the status of audits on the KHI Group.

(4) System to ensure that those who give reports described in the preceding Item (3) will not be treated disadvantageously for reason of having made such report

The Company stipulates a provision regarding the prohibition of unfair and unfavorable treatment of those who give reports described in the preceding Item (3). The Company also instructs Group Companies to stipulate a provision of the same contents in their company regulations.

(5) Policies on prepaid expenses for the execution of the duties of the Company's Corporate Auditors, or expenses for procedures for repayment and the execution of other relevant duties, or on debt processing

When the Company's Corporate Auditors request the Company to make prepayment on execution of duties pursuant to the Companies Act, the Company shall promptly proceed with payment of appropriate expenses and debt settlement, except where the expense or debt whose payment is requested is deemed unnecessary to execute their duties.

(6) Other systems to ensure the effective conduct of audits by the Company's Corporate Auditors

(i) The Company's Directors and Corporate Auditors regularly hold meetings to ensure mutual understanding, and the Company's Corporate Auditors also attend important meetings such as Board of Directors Meeting and Management Committee meeting, and directly express their opinion regarding execution of duties by the Company's Directors.

(ii) The Company's Directors and Group Companies' Directors promote collaboration between the Company's Corporate Auditors, the Company's Auditing Department and Group Companies' Corporate Auditors, and cooperate to establish systems which enable greater effectiveness in the conduct of audits.

(iii) The Company and Group Companies obtain the consent of the Board of Corporate Auditors or approval of the Board of Corporate Auditors with regard to the election of Corporate Auditors and their remuneration, and so forth, in accordance with laws and the Articles of Incorporation.

(iv) Of Corporate Auditors appointed by the Company, one or more shall have substantial knowledge about finance and accounting.

4. System regarding expulsion of anti-social forces

Because our Group resolutely refuses to comply with any unreasonable demands from anti-social forces, and works to cut off all relations with anti-social forces, we distribute the "Compliance Guidebook" to all Officers and employees. The Guidebook explains the prohibition of "giving favors to anti-social forces" by listing specific examples of prohibited acts. We work to ensure that Officers and employees are thoroughly familiar with the matters contained in the Compliance Guidebook by conducting training, and so forth, and do not merely distribute the guidebook.

Furthermore, with respect to internal systems, we have established a department in the headquarters which is responsible for overseeing handling of expulsion of anti-social forces, established close cooperation with external specialized organizations such as the police force, and in collaboration with the concerned departments, we systematically handle unreasonable requests from anti-social forces.

II. Overview of the operation status of internal control systems

An overview of the operation status of internal control systems for the fiscal year under review is as follows. The said operating status is assessed at the end of every fiscal period and the assessment results are reported to the Board of Directors Meeting.

1. Efforts on internal control systems in general

(i) We set forth the "Fundamental Principles of Corporate Ethics" in KHI Code of Corporate Ethics, distribute guidebooks that describe the contents of the principles, and conduct various training programs to ensure that the said principles are thoroughly disseminated.

(ii) The Company's Audit Department carries out evaluation/assessment of internal controls over business audits and financial reporting for the KHI Group to ensure effectiveness and efficiency of business operations and reliability of financial reporting.

2. Efforts on compliance

(i) We establish the Company-wide CSR Committee, which is responsible for deliberating and making decisions on policies and measures to promote compliance at a group-wide level and monitoring the compliance status thereof (performed three times during the fiscal period under review). The said committee also plays the leading role in the establishment of related internal regulations, preparation and distribution of the "Compliance Guidebook" (hereinafter, the "Guidebook"), provision of various training programs, and operation of the whistle-blowing system. In addition, we establish the CSR Committee for Business Divisions and therewith implement appropriate measures for each business environment through compliance activities performed by each business division.

(ii) In an effort to eliminate anti-social forces, we distribute the Guidebook to all Officers and employees. The Guidebook lists specific examples of prohibited acts. We work to ensure that Officers and employees are thoroughly familiar with the contents thereof. We also offer training and education to ensure thorough dissemination.

3. Efforts on risk management

(i) We build a risk management system on a company-wide level based on the Risk Management Regulations. We also prepare a manual to explain the procedures of specific risk management practices and exhaustively grasp the assumed risks on a scale common to the Group to prevent and minimize risk or losses caused by such risk. In addition, we hold Risk Management Committee meetings on an as-needed basis at both the company-wide level and divisional level to report and deliberate on determination of material risks, designation of risks to be addressed, results of risk monitoring and other important matters.

(ii) For major projects that have a significant impact on business operations, a head office division conducts risk assessment and considers risk control measures before accepting orders. In addition, while strengthening progress monitoring control of projects underway and working to prevent incidents before they occur, including those of profitability deterioration, and so forth, we also evaluate the profitability after completion, conduct factor analysis on projects that have significantly deteriorated and aim for the mean level development of other projects.

(iii) In anticipation of the occurrence of large-scale disasters and pandemic diseases, we proactively formulate a business continuity plan for each business division, and conduct annual assessment and review thereof. We also establish and build a system to minimize losses in case we suffer damage in disasters.

During the fiscal period under review, we reviewed estimates of damage by disasters in major areas in Japan, performed disaster prevention drills and BCP drills, and conducted safety confirmation drills for all the employees.

4. Efforts to ensure efficient execution of duties

(i) Based on the company-wide policies and strategies determined with reference to the contents of the Kawasaki Group Mission Statement, which stipulates the KHI Group's role and objectives, we determine the ideal way to be in each business area as well as the medium-term business plan and the short-term business plan to clearly show our final goals. We also strive to share objectives by holding a brief meeting in each business division.

(ii) We articulate division of roles and approval authority to enhance efficiency of execution of duties in each business and function area. We also give various types of guidance to Group Companies to enhance efficiency of execution of duties.

(iii) We strive to form a common understanding among Directors through thorough deliberation of important management policies, management strategies and management issues at Management Committee meetings (held 34 times during the fiscal period under review) to ensure that Directors efficiently execute duties.

5. Efforts on management of Group Companies

(i) We exert group-wide efforts to work on compliance and risk management and successively develop these systems to overseas Group Companies. In order to ensure further dissemination and familiarization, we will establish and operate the systems according to business contents, size, region and significance of each Group Company.

(ii) We carry out management supervision and monitoring over the operation of Group Companies by dispatching Non-Full-Time Officers to Group Companies to attend meetings of the Board of Directors thereof. We regularly receive reports on the status of business operation from Group Companies and have discussions in advance with the relevant department of the Company with regard to important matters subject to decision-making on corporate management in accordance with applicable internal regulations.

6. Efforts on ensuring appropriateness of audits performed by Corporate Auditors

(i) We assign two employees who are dedicated to assist with the duties of the Company's Corporate Auditor. For personnel transfer, personnel performance evaluation and disciplinary punishment of these employees, we obtain prior consent of the Board of Corporate Auditors.

(ii) The Company's Corporate Auditor attends the Company's important meetings. The Company's Directors and employees provide the Company's Board of Corporate Auditors with reports concerning important matters about corporate management and business operations as well as the status of execution of duties through the said meetings, and report to the Company's Board of Corporate Auditors regarding the execution of business operations by circulation of internal memos.

(iii) We establish regulations that prohibit unfair and unfavorable treatment of those who cooperate with a Corporate Auditor to perform audits and give reports to a Corporate Auditor pursuant to the "Basic Policy for the Establishment of Internal Control System." We also instruct Group Companies to stipulate regulations similar thereto.

(iv) The Company's Auditing Department and Accounting Auditor regularly hold liaison meetings or discussions with the Company's Corporate Auditor to exchange information and opinions with him/her so as to ensure close communication.

During the fiscal period under review, we held liaison meetings/discussions ten times with the Auditing Department and five times with the Accounting Auditor to communicate with the Company's Corporate Auditor.

(v) We establish regulations regarding requests for prepaid expenses incurred for the execution of the duties of the Company's Corporate Auditor, and so forth.

Consolidated Statement of Changes in Net Assets

(From April 1, 2016 to March 31, 2017)

(Unit: Millions of yen)

	Shareholders' equity				
	Common stock	Capital surplus	Retained earnings	Treasury stock	Total shareholders' equity
Balance at the beginning of the period	104,484	54,394	279,627	(86)	438,419
Changes of items during the period					
Cash dividends			(18,376)		(18,376)
Net income attributable to owners of parent			26,204		26,204
Change of scope of consolidation			(7)		(7)
Treasury stock purchased				(10)	(10)
Treasury stock disposed		(0)		0	0
Net changes of items other than shareholders' equity					
Total changes of items during the period	–	(0)	7,820	(9)	7,810
Balance at the end of the period	104,484	54,393	287,448	(96)	446,230

	Accumulated other comprehensive income					Non-controlling interests	Total net assets
	Net unrealized gains on securities, net of tax	Deferred gains (losses) on hedges	Foreign currency translation adjustments	Accumulated adjustment for retirement benefits	Total accumulated other comprehensive income		
Balance at the beginning of the period	2,705	692	8,990	(19,439)	(7,051)	14,257	445,625
Changes of items during the period							
Cash dividends							(18,376)
Net income attributable to owners of parent							26,204
Change of scope of consolidation							(7)
Treasury stock purchased							(10)
Treasury stock disposed							0
Net changes of items other than shareholders' equity	527	(1,874)	(9,331)	8,747	(1,931)	(176)	(2,108)
Total changes of items during the period	527	(1,874)	(9,331)	8,747	(1,931)	(176)	5,702
Balance at the end of the period	3,232	(1,182)	(341)	(10,692)	(8,983)	14,080	451,327

Notes to the Consolidated Financial Statements

(Notes to the basis for preparation of consolidated financial statements)

1. Scope of consolidation

(1) Number of consolidated subsidiaries and names of principal consolidated subsidiaries — 93 in total

(Domestic) Kawasaki Trading Co., Ltd., Kawasaki Machine Systems, Ltd., NIPPI Corporation, Kawasaki Thermal Engineering Co., Ltd., Kawasaki Motors Corporation Japan, EarthTechnica Co., Ltd.

(Overseas) Kawasaki Motors Corp., U.S.A., Kawasaki Motors Manufacturing Corp., U.S.A., Kawasaki Motors Enterprise (Thailand) Co., Ltd., Kawasaki Rail Car, Inc., Kawasaki Motors Europe N.V., PT. Kawasaki Motor Indonesia, Kawasaki Motors (Phils.) Corporation, Kawasaki Robotics (U.S.A.), Inc., Flutek, Ltd.

Two newly established subsidiaries have been included in the scope of consolidation. Of the eight consolidated subsidiaries excluded from the scope of consolidation, KCMJ Corporation was excluded from the scope of consolidation following the completion of its liquidation. Green Park Chiba New Port and six other subsidiaries have been excluded from the scope of consolidation due to the decrease of significance.

(2) Names of principal non-consolidated subsidiaries, etc.

Green Park Chiba New Port and other companies

(Reason for exclusion from scope of consolidation)

The non-consolidated subsidiaries were excluded from the scope of consolidation because they are small in size, and its accounts, such as total assets, net sales, net income (for the Company's equity interest) and retained earnings (for the Company's equity interest), have no significant effects on the Company's consolidated financial statements.

2. Application of the equity method

(1) Number of affiliates which are subject to application of the equity method — 18 in total

Name of principal company: Nantong COSCO KHI Ship Engineering Co., Ltd.

Of the two affiliates excluded from the scope of application of the equity method from the current consolidated fiscal year, Tongfang Kawasaki Energy Saving Equipment Co., Ltd. was excluded from the scope of application of the equity method due to the transfer of shares, and other company was excluded from the scope of application of the equity method due to the decrease of significance.

(2) Non-consolidated subsidiaries not subject to application of the equity method (Green Park Chiba Shin-Minato and other companies) and affiliates (Commercial Airplane Co., Ltd. and other companies) are excluded from the scope of application of the equity method, because they only have minimal effects on the Company's consolidated financial statements with respect to net income (for the Company's equity interest) and retained earnings (for the Company's equity interest), and they have no significance as a whole.

3. Significant accounting policies

(1) Standards and methods for evaluation of significant assets

(i) Marketable securities

a. Bonds held to maturity

Amortized cost method (straight-line method) is principally applied.

b. Other marketable securities

Securities with market quotations

Market value method based on the market value as of the account closing date (with all valuation differences charged to net assets and the cost of sale computed mainly by the moving-average method) is applied.

Securities without market quotations

The cost method based on the moving-average method is principally applied.

(ii) Inventories

Stated at cost principally using the specific identification method, the moving-average method and the first-in first-out method (balance sheet amounts are determined based on the method of lowering the book value in accordance with the deterioration of profitability).

(iii) Derivatives

Stated at market value.

(2) Depreciation and amortization method for significant depreciable assets

(i) Net property, plant and equipment (other than leased assets)

The straight-line method is principally applied.

(ii) Intangible assets (other than leased assets)

The straight-line method is applied. The software used by the Company is subject to amortization based on the internal useful life (generally five years).

(iii) Leased assets

The leased assets involved in finance lease transactions that involve transfer of ownership

The same method as that applied to property, plant and equipment is applied.

The leased assets involved in finance lease transactions that do not involve transfer of ownership

The straight-line method, whereby the leasing period is deemed to be the duration of useful life and the residual value as zero is applied.

Of the finance lease transactions that do not involve transfer of ownership, the lease transactions which commenced on or prior to March 31, 2008 are accounted for in conformity with the accounting process applicable to operating lease transactions.

(3) Accounting standards for significant provisions

(i) Allowance for doubtful receivables

In order to provide for losses due to doubtful accounts from trade receivables and loan receivables, allowance for doubtful receivables is provided based on the historical default rate of normal receivables and with reference to the collectability of receivables from companies in financial difficulty.

(ii) Accrued bonuses

To cover bonus payments to employees, provision for bonuses is provided in the amount for the consolidated fiscal year based on the estimated amount of payment.

(iii) Provision for product warranties

A provision is recorded for expenditures for warranties concerning construction contracts based on past experience or on estimations of individual cases.

(iv) Provision for losses on construction contracts

A provision for an estimated amount of losses is recorded for the next fiscal year and thereafter concerning construction works which are anticipated to incur significant losses and which allow reasonable estimation of the loss incurred at the end of the consolidated fiscal year under review among those construction works that have not been delivered as of the end of the fiscal year.

(v) Provision for environmental measures

The Company provided an estimated amount to cover expenditures such as the disposal of polychlorinated biphenyl (PCB) waste required under the "Law Concerning Special Measures for Promotion of Appropriate Disposal of PCB Waste."

(4) Method of accounting treatment for retirement benefits

(i) Method of allocation of expected retirement benefit payments

In calculation of retirement benefit obligations, the method of attributing the projected benefits to periods until the end of the current consolidated fiscal year is based on the benefit formula basis.

(ii) Method of amortization of actuarial gains or losses and prior service cost

Prior service cost will be recognized as expenses mainly by amortizing the amount by the straight-line method over a certain period of time (mainly 10 years) which is shorter than the employees' average remaining service period.

Actuarial differences are amortized from the year following the year in which the differences are recognized using the straight-line method over the average remaining years of service of the employees (mainly 10 years).

(iii) Method of accounting treatment for unrecognized actuarial gains and losses, and unrecognized past service costs

Unrecognized actuarial gains and losses, and unrecognized past service cost, net of applicable taxes, are recorded in "Accumulated adjustment for retirement benefits" of "Accumulated other comprehensive income" in "Net assets."

(iv) Simplified accounting method used by small companies

Certain consolidated subsidiaries apply a simplified accounting method in which the calculation of liabilities for retirement benefits and retirement benefit expenses is carried out by using a method in which the retirement benefit obligations are deemed to be the amount of retirement benefits to be paid in cases where all eligible employees retired at the fiscal year-end date.

(5) Standards for the recognition of significant revenues and expenses

Recognition of net sales of completed construction contracts and cost of sales of completed construction contracts

a. Construction activities whose outcome from the completed portion as of the end of the consolidated fiscal year are deemed to be definite

Percentage-of-completion method (the cost-to-cost method is used to estimate the percentage of completion) is applied.

b. Other construction activities

Completed-contract method is applied.

(6) Standards for the translation of major assets or liabilities denominated in foreign currencies

Receivables and payables denominated in foreign currencies are translated into yen at the foreign exchange spot rate on the date of the balance sheet, and differences arising from the translation are calculated as gains or losses. The Company translates assets and liabilities of foreign consolidated subsidiaries into yen at the foreign exchange spot rate on the date of the balance sheet of each of those subsidiaries. Revenues and expenses are translated using the average foreign exchange rate of the statement of income's period. Translation adjustments are included in "Foreign currency translation adjustments" and "Non-controlling interests" in "Net assets."

(7) Method of significant hedge accounting

(i) Method of hedge accounting

Deferred hedge accounting is applied.

(ii) Hedging instruments and hedged items

Hedging instrument	Hedged items
Forward exchange contracts, currency options	Receivables and payables (including forecast transactions) denominated in foreign currency
Interest rate swaps, currency swaps	Borrowings

(iii) Hedging policy

Hedging is conducted as a measure against the risk of interest rate variation and foreign currency variation based on internal regulations of respective subsidiaries.

(iv) Method of assessing hedging effectiveness

Hedging effectiveness is evaluated based on fluctuation amounts of hedged items and hedging instruments by comparing the cumulative changes of market fluctuations between the hedged item with the hedging instrument during the period between the start of the transaction to the point at which effectiveness is assessed.

(8) Method and period for amortization of goodwill

Goodwill equivalent is equally amortized over the estimated effective period of the investment. However, goodwill is amortized in lump-sum in the fiscal year when incurred if the amount is minimal.

(9) Other significant matters for preparing the consolidated financial statements

(i) Accounting treatment for consumption taxes

The tax-exclusion method is applied for the consumption tax and the local consumption tax.

(ii) Application of the consolidated taxation system

The consolidated tax system is applied.

(Additional Information)

Application of ASBJ Guidance on Recoverability of Deferred Tax Assets

Effective from the consolidated fiscal year ended March 31, 2017, the Company has applied the "Guidance on Recoverability of Deferred Tax Assets" (ASBJ Guidance No. 26, March 28, 2016).

(Change in Presentation Methods)

Consolidated statement of income

From this consolidated fiscal year under review, a "subsidy income" (¥1,028 million in the consolidated fiscal year under review) was included and presented in "other" under non-operating income as a result of the decline in the significance of the amount. "Loss on retirement of non-current assets" (¥1,119 million in the previous consolidated fiscal year), in the meantime, is presented independently as a result of the increase in the significance of the amount.

(Notes to Consolidated Balance Sheet)

1. The amounts presented are rounded down to the nearest unit.
2. Accumulated depreciation of property, plant and equipment ¥780,439 million
3. Assets pledged as collateral

Buildings and structures, net	¥69 million
Investments in securities	¥14 million
Other	¥83 million

Liabilities relating to collateral

Short-term debt	¥9 million
Long-term debt	¥61 million
Other	¥4 million

4. Guarantee obligations for bank loans of subsidiaries and affiliates, etc. and employees ¥18,252 million
5. With respect to some work in process, a trust beneficiary right has been established with the expected trade receivables as a trust asset. Work in process related to the said trust asset amounts to ¥7,373 million.

(Notes to Consolidated Statement of Income)

1. The amounts presented are rounded down to the nearest unit.
2. Gain on sale of fixed assets as non-operating income was realized by gains of deferred revenue in conjunction with sale and leaseback related to fixed assets of a North American subsidiary.
3. Gain on sales of fixed assets as extraordinary income was generated by the sale of land and buildings of Tokyo Office of the Company.

(Notes to Consolidated Statement of Changes in Net Assets)

1. The amounts presented are rounded down to the nearest unit.

2. Total number of shares issued as of end of the consolidated fiscal year under review
Ordinary share 1,670,805,320 shares

3. Dividends

Resolution	Total dividend (million yen)	Dividend per share (yen)	Record date	Effective date
General Meeting of Shareholders on June 24, 2016	11,694	7	March 31, 2016	June 27, 2016
Board of Directors Meeting on September 30, 2016	6,682	4	September 30, 2016	December 1, 2016

Scheduled date of resolution	Total dividend (million yen)	Dividend per share (yen)	Record date	Effective date
General Meeting of Shareholders on June 28, 2017	3,341	2	March 31, 2017	June 29, 2017

(Notes to financial instruments)

1. Matters regarding financial instruments

KHI Group raises necessary funds, in light of its business plans; for long-term working capital and capital expenditure funds the Group predominantly raises funds through bank loans and issuance of corporate bonds, for short-term working capital it raises funds through bank loans and issuance of short-term bonds (electronic commercial paper), and so forth. Temporary surplus funds are invested in highly secure financial assets. We use derivatives to avoid risks described hereunder and do not engage in speculative transactions.

Operating receivables, namely, trade receivables are exposed to counterparty credit risk. The currency exchange risk of the debts and credits in foreign currencies which arise from global business operations is hedged by using foreign exchange forward contracts, and so forth in principle against the net amount of the debts and credits in the foreign currency. Investments in securities are mainly shares of corporations which we have business dealings with, and of these investments, those shares that are listed are exposed to the risk of market price fluctuations.

Most trade payables, which are operating liabilities, have maturities of less than one year. Some of those are denominated in foreign currencies due to the import of materials, and so forth, and although they are exposed to the risk of currency fluctuation, most are within the limit of the balance of accounts receivable in the same foreign currency. Debts payable that are composed of borrowings and corporate bonds are raised for the purpose of securing working capital and capital investments, and the longest maturity from the date of balance sheet is about 20 years. Some of those instruments have floating interest and are denominated in foreign currencies and are therefore exposed to the risk of interest rate and currency exchange fluctuations, however we hedge those risks as required by using derivatives transactions (interest rate swap transactions and currency swap transactions).

Derivative transactions are transactions which include exchange forward contracts and currency options and currency swap transactions for the purpose of hedging exchange fluctuation risks of the debts and credits in foreign currencies, and interest rate swap transactions and so forth for the purpose of hedging interest fluctuation risks of debts payable. Details of hedging instruments, hedged items, hedging policies, assessment of hedging effectiveness of hedge accounting are stated in "3. Significant accounting policies, (7) Method of significant hedge accounting" of "Notes to the basis for preparation of consolidated financial statements" described above.

2. Matters concerning market value, etc. of financial instruments
The prices recorded in the consolidated balance sheet, market values and the difference between those as of the end of this consolidated fiscal year are as follows.

(Unit: Millions of yen)

	Price recorded in the consolidated balance sheet (*)	Market value (*)	Difference
(1) Cash on hand and in banks	55,388	55,388	-
(2) Trade receivables	444,633	444,588	(45)
(3) Investments in securities	8,562	8,562	-
(4) Trade payables	[240,572]	[240,572]	-
(5) Electronically recorded obligations	[101,449]	[101,449]	-
(6) Short-term debt	[111,456]	[111,456]	-
(7) Current portion of bonds	[10,000]	[10,000]	-
(8) Bonds payable	[130,000]	[131,714]	(1,714)
(9) Long-term debt, less current portion	[147,492]	[147,299]	193
(10) Derivative transactions	[1,595]	[1,595]	-

(*) Figures which are posted as liabilities are shown in [ ].

(Note 1) Matters concerning the method for calculating the market value of financial instruments and marketable securities and derivatives transactions

(1) Cash on hand and in banks
These instruments can be settled within short term and the market value is roughly equal to book value, therefore the fair market value is stated at book value.

(2) Trade receivables
Trade receivables are grouped into a specified period, and are stated at market value calculated by the discount rate, which takes into account the respective period to maturity and credit risk.

(3) Investments in securities
The market value for these securities is stated at the price listed on the exchange.

(4) Trade payables, (5) Electronically recorded obligations, (6) Short-term debt, (7) Current portion of bonds
These instruments can be settled within short term and market value is roughly equal to book value, therefore the fair market value is stated at book value.

(8) Bonds payable
The fair market value of these instruments is stated at the market value.

(9) Long-term debt, less current portion
The market value of long-term debt is determined by discounting the total of principal and interest by the interest rate on similar new debt.

(10) Derivatives transactions
The market value of derivatives is stated at the forward exchange rate or the price offered by the trading financial institution.

(Note 2) Financial instruments whose market value is deemed extremely difficult to ascertain
Shares of affiliates, investments in affiliates and unlisted stocks, and investments in silent partnerships (amount recorded in the consolidated balance sheet was ¥76,726 million) are not included in the table above, as it is deemed to be extremely difficult to ascertain fair market value because those instruments have no market prices, and it is not possible to estimate their future cash flows.

(Notes to per share information)

1. Net assets per share ¥ 261.73
2. Net income per share ¥ 15.68

(Other)

(Damage caused to NIPPI Corporation by snowfall)

The heavy snowfall on February 15, 2014 caused a hangar roof in Atsugi Works of NIPPI Corporation, which is KHI's consolidated subsidiary, to collapse, causing damage to aircrafts of the Japan Maritime Self-Defense Force that was undergoing regular maintenance. The Company and NIPPI Corporation are currently having discussions with the Japan Ministry of Defense regarding the way to handle this case. Some discussion results could have a material impact on the KHI Group's financial performance.

Non-consolidated Statement of Changes in Net Assets

(From April 1, 2016 to March 31, 2017)

(Unit: Millions of yen)

	Shareholders' equity							
		Capital surplus		Retained earnings				
				Other retained earnings				
	Common stock	Legal capital surplus	Other capital surplus	Provision for special depreciation	Provision for advanced depreciation of fixed assets	Retained earnings brought forward	Treasury stock	Total shareholders' equity
Balance at beginning of the period	104,484	52,210	0	162	7,674	139,863	(86)	304,308
Changes of items during the period								
Cash dividends						(18,376)		(18,376)
Net income						17,493		17,493
Treasury stock purchased							(10)	(10)
Treasury stock disposed			(0)				0	0
Reserve for special depreciation				1,194		(1,194)		–
Reversal of provision for special depreciation				(140)		140		–
Reserve for advanced depreciation of fixed assets					1,939	(1,939)		–
Reversal of provision for advanced depreciation of fixed assets					(916)	916		–
Net changes of items other than shareholders' equity								
Total changes of items during the period	–	–	(0)	1,053	1,023	(2,958)	(9)	(892)
Balance at end of the period	104,484	52,210	0	1,215	8,697	136,904	(96)	303,416

	Valuation and translation adjustments			Total net assets
	Net unrealized gains on securities, net tax	Deferred gains (losses) on hedges	Total valuation and translation adjustments	
Balance at beginning of the period	1,957	633	2,590	306,899
Changes of items during the period				
Cash dividends				(18,376)
Net income				17,493
Treasury stock purchased				(10)
Treasury stock disposed				0
Reserve for special depreciation				–
Reversal of provision for special depreciation				–
Reserve for advanced depreciation of fixed assets				–
Reversal of provision for advanced depreciation of fixed assets				–
Net changes of items other than shareholders' equity	395	(1,677)	(1,281)	(1,281)
Total changes of items during the period	395	(1,677)	(1,281)	(2,174)
Balance at end of the period	2,353	(1,044)	1,308	304,725

Notes to the Non-consolidated Financial Statements

(Significant accounting policies)

1. Valuation standards and methods of assets
   (1) Valuation standards and methods of marketable securities
      (i) Shares of subsidiaries and affiliates
      Stated at cost using the moving-average method.
      (ii) Other marketable securities
      Securities with market quotations
      Stated at market value based on the market price on the account closing date (net unrealized gains or losses on these securities are reported as a separate item in the net assets on a net-of-tax basis. Cost of securities sold is determined by the moving average method).
      Securities without market quotations
      Stated at cost using the moving-average method.
   (2) Valuation standards and methods of inventories
      Stated at cost using the specific identification method and the moving-average method (balance sheet amounts are determined based on the method of writing down book value in accordance with decreased profitability of assets).
   (3) Valuation standards and methods of derivatives
      Stated at market value.

2. Method of depreciation of fixed assets
   (1) Net property, plant and equipment (other than leased assets)
   The straight-line method is used.
   (2) Intangible assets (other than leased assets)
   The straight-line method is used.
   Software for internal use is amortized by the straight-line method over the internally estimated useful lives (within 5 years).
   (3) Leased assets
   Finance lease transactions not involving the transfer of ownership
   The leased assets involved in finance lease transactions that do not involve transfer of ownership are subject to the straight-line method, whereby the leasing period is deemed to be the duration of useful life and the residual value as zero.
   In addition, out of the finance lease transactions that do not transfer ownership, lease transactions whose lease transaction commencement date was on or prior to March 31, 2008 are accounted for on a basis similar to ordinary rental transactions.

3. Standards of accounting for provisions
   (1) Allowance for doubtful receivables
   In order to provide for losses due to doubtful accounts from trade receivables and loan receivables, allowance for doubtful receivables is provided principally based on the historical default rate of normal receivables and with reference to the collectability of receivables from companies in financial difficulty.
   (2) Accrued bonuses
   To prepare for the bonus payments to employees, provision for bonuses is provided in the amount based on the estimated amount of bonus payment.
   (3) Provision for product warranties
   A provision is recorded for expenditures for warranties concerning construction contracts based on past experience or on estimations of individual cases.
   (4) Provision for losses on construction contracts
   A provision for an estimated amount of losses is recorded for the next fiscal year and thereafter concerning construction works which are anticipated to incur significant losses and which allow reasonable estimation of the loss incurred at the end of the fiscal year under review among those construction works that have not been delivered as of the end of the fiscal year.

(5) Provision for environmental measures
The Company provided an estimated amount to cover expenditures such as the disposal of polychlorinated biphenyl (PCB) waste required under the "Law Concerning Special Measures for Promotion of Appropriate Disposal of PCB Waste.

(6) Employees' retirement and severance benefits
Employees' retirement and severance benefits is recorded based on the estimated amount of retirement benefit obligations and plan assets as of the end of the fiscal year under review (including the retirement benefit trust) in order to cover employee retirement benefits.
(i) Allocation of expected retirement benefit payments
When calculating retirement benefit obligations, the benefit formula basis is used to allocate expected retirement benefit payments to the period as of the end of the fiscal year.
(ii) Method of recognizing actuarial differences and prior service costs
The past service costs are amortized using the straight-line method over a certain years (10 years) within the average remaining service period of the employees when the costs incurred in each year.
Actuarial differences are amortized from the year following the year in which the differences are recognized using the straight-line method over the average remaining years of service of the employees (10 years).

4. Standards for recognition of revenue and expenses
Recognition of net sales of completed construction contracts and cost of sales of completed construction contracts
(i) Construction activities whose outcome from the completed portion as of the end of the fiscal year are deemed to be definite.
Percentage-of-completion method (the cost-to-cost method is principally used to estimate the percentage of completion) is applied.
(ii) Other construction activities
Completed-contract method is applied.

5. Other important matters forming the basis for preparing the non-consolidated financial statements
(1) Accounting treatment for hedges
(i) Method of hedge accounting
Deferred hedge accounting is applied.
(ii) Hedging instruments and hedged items

Hedging instrument	Hedged items
Forward exchange contracts, currency options	Receivables and payables (including forecast transactions) denominated in foreign currency
Interest rate swaps, currency swaps	Borrowings

(iii) Hedging policy
Hedging is conducted as a measure against the risk of foreign currency variation and interest rate variation based on internal regulations.
(iv) Method of assessing hedging effectiveness
Hedging effectiveness is evaluated based on fluctuation amounts of hedged items and hedging instruments by comparing the cumulative changes of market fluctuations between the hedged item with the hedging instrument during the period between the start of the transaction to the point at which effectiveness is assessed.

(2) Standards for the translation of assets or liabilities denominated in foreign currencies
Receivables and payables denominated in foreign currencies are translated into yen at the foreign exchange spot rate on the date of the balance sheet, and differences arising from the translation are calculated as gains or losses.
(3) Accounting treatment for retirement benefits
Accounting treatment for unrecognized actuarial gains or losses and unrecognized

past service cost for retirement benefits are different from accounting treatment for them in the consolidated financial statements.

(4) Accounting treatment for consumption taxes
Consumption tax and local consumption tax are accounted for by the tax-exclusion method.

(5) Application of the consolidated taxation system
The consolidated taxation system is applied.

(Change in Presentation)
Non-consolidated statement of income

From the fiscal year under review, a "subsidy income" (¥1,028 million in the fiscal year under review) was included and presented in "other" under non-operating income as a result of the decline in the significance of the amount. "Interest on bonds" (¥1,040 million in the fiscal year under review), in the meantime, is included and presented in "other" under non-operating expenses as a result of the decline in the significance of the amount.

(Notes to Non-Consolidated Balance Sheet)

1. The amounts presented are rounded down to the nearest unit.
2. Accumulated depreciation of property, plant and equipment ¥592,644 million
3. Monetary receivables from and payables to affiliates

Short-term monetary assets	¥160,108 million
Long-term monetary assets	¥27,333 million
Short-term monetary liabilities	¥82,754 million

4. Asset pledged as collateral and liability relating to collateral

(1) Assets pledged as collateral

Investments in securities	¥14 million
Shares of affiliates	¥67 million
Buildings	¥69 million
Total	¥150 million

(2) Liability relating to collateral

Short-term debt	¥9 million
Long-term debt	¥61 million

5. Guarantee liability for bank loans of subsidiaries and affiliates, etc. and employees ¥23,028 million
6. With respect to some work in process, a trust beneficiary right has been established with the expected trade receivables as a trust asset. Work in process related to the said trust asset amounts to ¥7,373 million.

(Notes to Non-consolidated Statement of Income)

1. The amounts presented are rounded down to the nearest unit.
2. Transactions with affiliates

Transaction from operating transactions	
Net sales	¥406,153 million
Purchases	¥191,758 million
Transaction from non-operating transactions	¥23,533 million

3. Gain on sales of fixed assets as extraordinary income was generated by the sale of land and buildings of Tokyo Office of the Company.

(Notes to Non-consolidated Statement of Changes in Net Assets)

1. The amounts presented are rounded down to the nearest unit.
2. Type of treasury shares and number of shares at the end of the current fiscal year
   Common stock 259,108 shares

(Notes to Tax Effect Accounting)

Among other factors, the main contributing factor to deferred tax assets is the disallowance of various provisions such as the employees' retirement and severance benefits and the losses on construction contracts, and the main contributing factor to the deferred tax liabilities incurred is net unrealized gain on securities.

(Additional information)

Application of Implementation Guidance on Recoverability of Deferred Tax Assets

Effective from the fiscal year ended March 31, 2017, the Company has applied the "Guidance on Recoverability of Deferred Tax Assets" (ASBJ Guidance No. 26, March 28, 2016).

(Notes to Leased Fixed Assets)

Other than the fixed assets recorded on the balance sheet, certain manufacturing facilities are used under finance lease contracts not involving the transfer of the ownership of the leased property.

(Notes to transactions with interested parties)

Unit: Millions of yen

Attributes	Company name	Percentage of voting rights held	Relationship with interested party	Content of transaction	Amount of transaction	Item	Balance at fiscal year-end
Affiliate	Commercial Airplane Co., Ltd.	40% directly held	Sale of the company's products Directors concurrently serving	Sale of the company's products	130,785	Accounts receivable Advances from customers	37,320 46,476
Affiliate	Enseada Indústria Naval S.A.	31.09% directly held	Sale of the company's products Loan of funds	Sale of the company's products Loan of funds	– –	Claims provable in bankruptcy, claims provable in rehabilitation and other	–

Terms and conditions of trade and policy, etc. on deciding terms and conditions of trade

(Note 1) The Company presents its preferred price in consideration of the overall cost and then decides the terms and conditions of trade through price negotiations.

(Note 2) The Company decides the loan of funds in consideration of market interest rates.

(Note 3) The year-end balance of receivables to Enseada Industria Naval S.A. is the amount after deducting an allowance for doubtful receivables. The balance of allowance for doubtful receivables is ¥14,871 million and the provision therefor for the current fiscal year is ¥4,583 million.

(Note 4) Of the above amounts, consumption taxes are not included in the trade amount, but are included in the balance at the end of fiscal year.

(Notes to per Share Information)

1. Net assets per share ¥182.41
2. Net income per share ¥10.47

(Other)

(Damage caused to NIPPI Corporation by snowfall)

The heavy snowfall on February 15, 2014 caused a hangar roof in Atsugi Works of NIPPI Corporation, which is KHI's consolidated subsidiary, to collapse, causing damage to aircrafts of the Japan Maritime Self Defense Force that was undergoing regular maintenance. The Company and NIPPI Corporation are currently having discussions with the Japan Ministry of Defense regarding the way to handle this case. Some discussion results could have a material impact on the KHI Group's financial performance.