

Corporate Governance System

Corporate Governance

At KHI, the basic stance on corporate governance is to increase the corporate value of the Group as a whole through highly transparent, efficient, and sound management practices and solid relationships forged with all stakeholders, including shareholders, customers, employees and the community.

Overview of the Corporate Governance System

The Company opted for the statutory auditor system with board of auditors and has appointed independent auditors. With regard to corporate governance, the Company has a Board of Directors presided by the chairman, a Management Committee consisted of representative directors and others, and an Executive Officers Committee which includes all executive officers.

To reinforce the oversight and monitoring function of the Board of Directors, the Company appoints directors who do not have roles in the execution of operation. With regard to corporate auditors, the Company appoints internal corporate auditors with considerable knowledge of finance and accounting as well as two outside corporate auditors with no business relationships or other vested interests in the Company. One of these outside corporate auditors is an independent officer as required by the Tokyo Stock Exchange for all listed companies.

The Board of Directors appoints executive officers to execute operations. The Board of Directors decides the basic objectives and policies for the execution of operations under the prevailing management plan and promptly issues directives for implementation to all executive officers. The Executive Officers Committee ensures that the objectives and policies are implemented.

The Company applies incentive-based compensation corresponding to business performance and limits the term of office for directors to one year. These conditions serve to clarify the management responsibilities of directors.

As a rule, the Management Committee meets three times a

month to discuss management policy, management strategy, important management issues, and other matters from the perspective of the Group as a whole.

Auditing Structure and Status

Internal Auditing

The Auditing Department, an internal auditing unit under the direct authority of the president, targets management activities in all the Group's business segments for audits to verify and evaluate effectiveness and efficiency in the execution of operations, the reliability of financial reports, and conformity to standards of compliance, namely corporate ethics and laws, and offers suggestions if audits indicate a need for improvement.

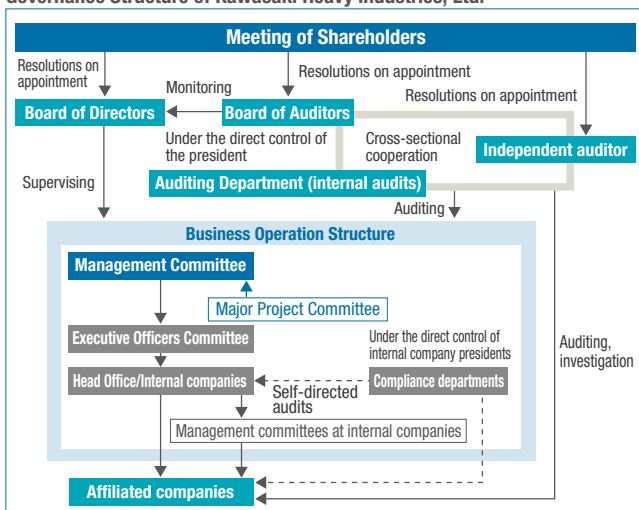
Statutory Auditing

Corporate auditors attend various meetings, including those of the Board of Directors and the Management Committee, and also review important documents and check the status of business operations and financial assets through periodic meetings with representative directors and business audits of corporate divisions and subsidiaries. In addition, two outside corporate auditors ensure the objectivity and neutrality of the management oversight function, and the full-time corporate auditors and outside corporate auditors share information and strive to enhance this function still further.

Independent Auditing

With regard to independent auditing, KHI undergoes audits of its financial statements conducted by the independent auditor KPMG AZSA LLC. The corporate auditors and the Board of Auditors receive an outline of the audit plan and a report on important audit items from the independent auditor, and the Board of Auditors explains the Company's auditing plan to the independent auditor. The corporate auditors and the Board of Auditors periodically receive reports on the results of independent auditing and strive to keep lines of communication open with the independent auditor by exchanging information and opinions.

Governance Structure of Kawasaki Heavy Industries, Ltd.



Compliance

KHI Code of Corporate Ethics

We established KHI Code of Corporate Ethics, and the basic principles of corporate ethics is stipulated in the Code as follows.

1. Practice of ethics as a business person

We do not hide the truth and do the right things when performing the duties.

2. Respect for individuality and human rights / Prohibition of discrimination

For creating and maintaining comfortable workplace, we respect for individuality and human rights of all people. We do not engage in discrimination, sexual harassment and bullying.

3. Promotion of environmental protection

For conserving limited resource and nature and reducing impact on global environment, we take voluntary and proactive efforts to save resource and energy, minimize waste, promote resource recycling and prevent environmental pollution.

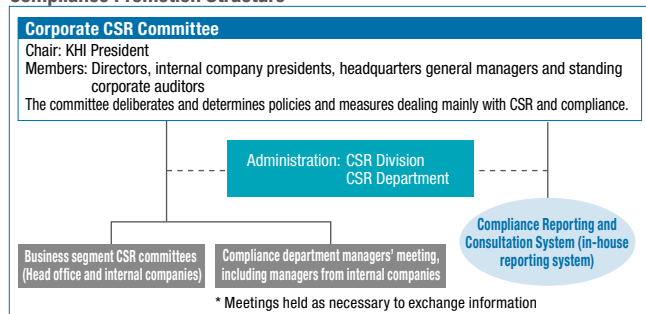
4. Compliance with laws, regulations and social rules

We recognize the importance of compliance and proactively ensure compliance.

5. Proper accounting and reliability of financial reports

We record and disclose corporate activity in accordance with proper accounting standards stipulated in laws and regulations. We ensure reliability of financial reports.

Compliance Promotion Structure



Distribution of Compliance Guidebook

We prepared a manual, the Compliance Guidebook, which provides information on each type of compliance-related violation and distributed copies to all employees and temporary staff at KHI Group companies in Japan.



Compliance Guidebook

Compliance Declaration

KHI requires that executives and employees in administrative positions (section chief and above) submit a handwritten statement declaring their intention to observe laws and regulations.

Developing a Deeper Awareness of Compliance

In fiscal 2012, KHI implemented a learn-by-example program to reinforce compliance in the workplace. This was a compliance activity shared throughout the Company.

With the consent of newspaper companies, we prepared original instruction materials using newspaper articles describing various examples of actual corporate compliance violations, and superiors in all offices used these materials as the basis of presentations to instill the importance of compliance.

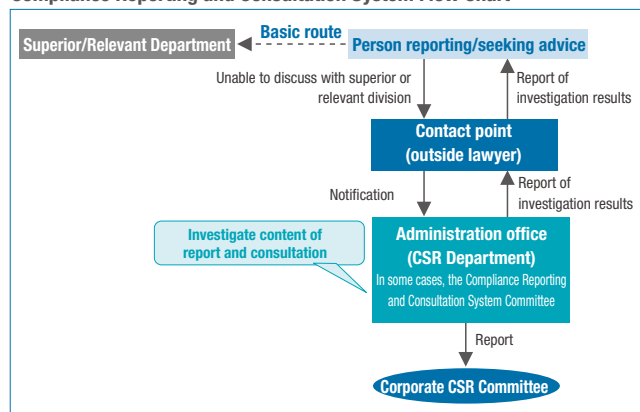
In addition, to verify the effectiveness of such approaches in raising awareness of compliance issues, in February 2012 we directed a compliance awareness survey of all employees and temporary staff at Group companies in Japan.

Compliance Reporting and Consultation System (in-house reporting system)

In certain situations, employees who suspect a violation of compliance practices in their department may find it difficult to report the situation or seek advice from superiors or a department that would normally address alleged misconduct. We established the Compliance Reporting and Consultation System to solve this problem.

In fiscal 2011, the system was used 18 times.

Compliance Reporting and Consultation System Flow Chart



Promoting Corporate Ethics and Compliance Overseas

The KHI Group pursues business opportunities around the world and has many companies abroad. To date, a number of companies operating in emerging nations and small companies did not have policies in place to address corporate ethics and compliance.

As a result, in September 2011, we drafted Kawasaki Global Business Ethics Guidelines, which covers items generally applicable in any country, and asked that companies without their own existing policies on corporate ethics and compliance adopt our Global Business Ethics Guidelines as their own.

Consequently, nearly all overseas companies* of the KHI Group now have policies on corporate ethics and compliance.

* Companies where the KHI Group's equity stake exceeds 50%.

TOPICS

Example of Compliance Education in the United States

At KCMA Corporation, a manufacturer of construction machinery—wheel loaders—in the United States, a code of conduct describing corporate ethics and compliance was created and all 120 employees became signatories to the document, thereby affirming their agreement to observe the code of conduct.

Also, a company meeting is held every three months in which all employees participate and where the Senior Manager of the Personnel & General Affairs continues to bring up the importance of corporate ethics and compliance and reminds everyone to be alert to compliance issues.

In this way, KCMA persistently strives to raise awareness of corporate ethics and compliance among its employees.

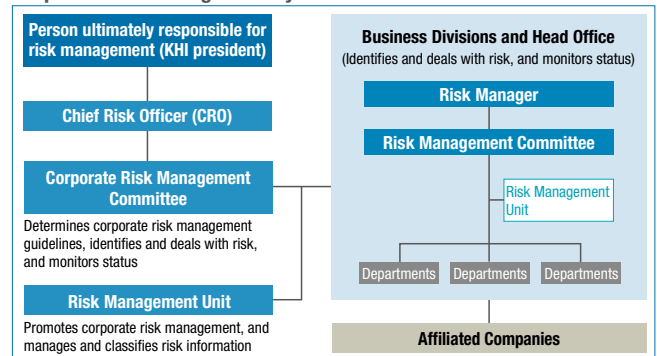


KCMA company meeting

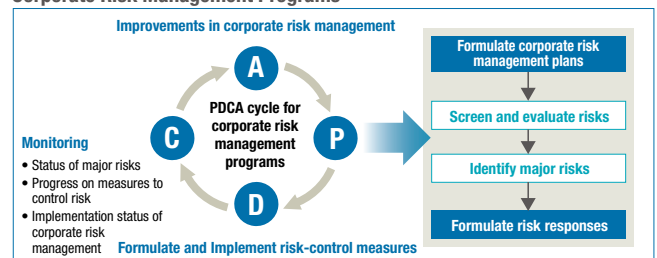
Risk Management

Under the Corporate Risk Management System, we have been implementing corporate risk management programs—an integrated process of screening and evaluating risk, identifying major risks and determining risk treatment, and formulating, executing, and monitoring risk-hedging policy—to pinpoint any major risks having a significant impact on business according to annual and universal risk criteria, and we are controlling such risks with reasonable and appropriate methods from the perspective of enterprise management. Since fiscal 2012, the Corporate Risk Management System has been gradually introduced at domestic affiliated companies. We plan to establish the Corporate Risk Management System across the Group including overseas affiliated companies in fiscal 2014.

Corporate Risk Management System



Corporate Risk Management Programs



Crisis Management

To prepare for the possibility that risk might become reality, the KHI Group adheres to internally defined Crisis Management Regulations. These regulations set forth behavioral guidelines and response systems that serve to protect lives and preserve assets, minimize damage and loss, and expedite the resumption of business activities in the event of unplanned interruption. To prepare for crisis situations, we rely on the Crisis Management Organization, a horizontally integrated Group structure for crisis management, and have a structure in place to expedite the establishment of command centers at the head office and local works or offices, as necessary, to ensure a quick response in the event of a crisis.

* For information about the review of business continuity plan for large-scale earthquakes, see pages 9-10.

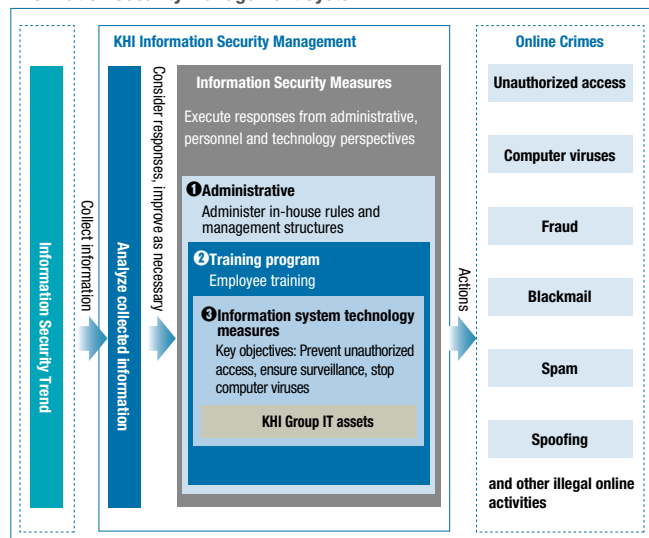
Reporting Route in Times of Emergency

Should an accident or natural disaster occur, information gets to where it is needed through a predetermined reporting route for use in times of emergency. This route is made widely known to employees and executives through the Crisis Management Organization, which under normal circumstances underpins the Group's crisis management structure. In conjunction with the emergency-activated reporting route, we have introduced contact networks in all business divisions and at all operating sites to ensure quick updates on the status of personnel and facilities throughout the Group.

Information Security Management

The KHI Group provides products to a wide range of customers, from general consumers to the public sector and further to defense forces, and meticulously promotes various information security measures matched to the requirements of respective customer sectors.

Information Security Management System



Safeguarding Intellectual Property

KHI applies a basic policy to safeguard intellectual property derived from corporate R&D results, which is to secure trademark registration/protection in Japan and overseas at appropriate times and thereby reduce risks associated with intellectual property and also to utilize such very valuable corporate assets to their fullest potential, for reasons including the freedom to expand business activities and ensure technological superiority.

To promote and manage these strategic intellectual property-oriented activities, we maintain a structure whereby the Intellectual Property Department in the Corporate Technology Division drafts corporate measures for implementation and works with other intellectual property management departments in each business segment to provide support in line with respective business activities.

Invention Reward System

In accordance with the Patent Law regulation pertaining to inventions by employees, KHI has established a provision in its internal rules regarding inventions by employees to reward these employees at specific milestones, such as the filing of a patent application (application reward), patent registration (registration reward) and practical application (performance-based reward). The Company faithfully adheres to this provision. In addition, the same reward system is applied even when the invention is not made public for strategic reasons. Of note, the performance-based reward is awarded after duly taking into consideration how the Company has benefited from the invention, using an evaluation standard that is based on comparisons with other companies in the same industry and trends in society.

Protecting Personal Information

KHI abides by its Privacy Policy (Personal Information Protection Policy), a basic policy for protecting personal information. This policy is publicly disclosed.

The Company also has a chief personal information protection officer and created Rules for Protecting Personal Information, which functions as a guide for personal information management.

As part of personal information management, a personal data-handling ledger is prepared to facilitate at-a-glance confirmation regarding the status of personal information handled by each business segment. The information is updated on a regular basis.

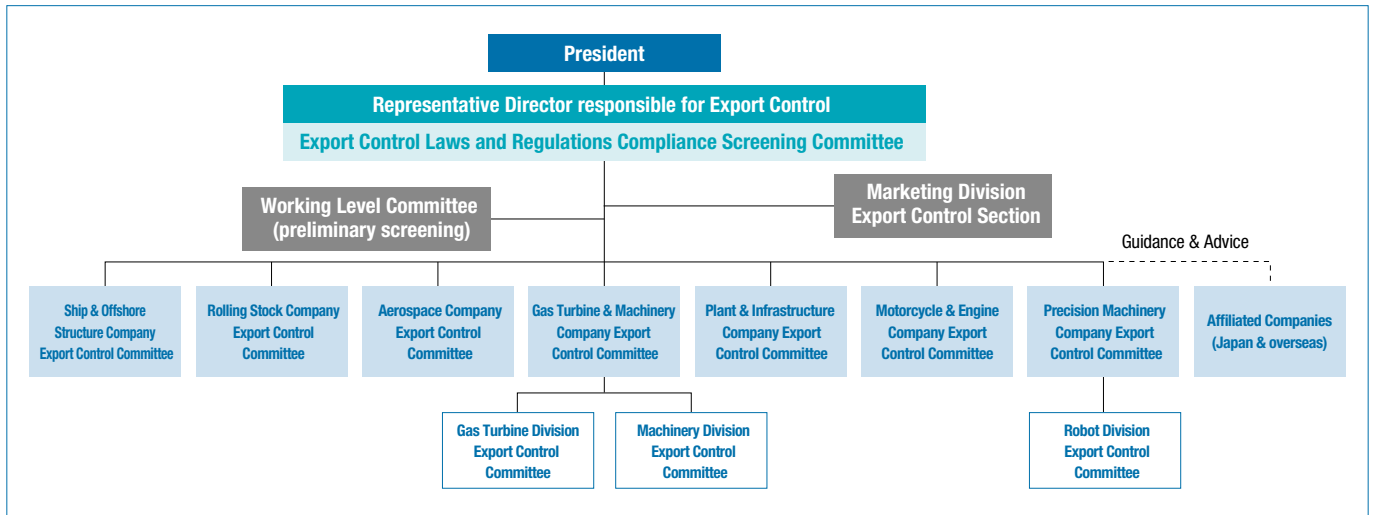
With regard to personal information in its possession, the Company has put a structure in place that ensures a prompt response to individual requests on the use of personal information, such as disclosing it or no longer using it.

Export Control

To ensure that export-related laws are carefully observed throughout the Group, we drafted internal rules on export control for goods and technologies related to international

safety and security, and we maintain an export control structure with a representative director taking primary responsibility for export control.

Export Control Structure



Relationship with Shareholders and Investors

General Meeting of Shareholders

At KHI, we believe the General Meeting of Shareholders—the highest corporate decision-making body of any company—is an important opportunity for communication between the Board members and our shareholders.

To enable shareholders to properly consider important matters on which they will cast their vote at the General Meeting of Shareholders, we send out the convocation notice even earlier than required by law. In addition, we prepare an English version of our official Japanese-language convocation notice for the convenience of our shareholders overseas and make it posted on our website.

Shareholders who are unable to attend the annual meeting in person now have the option of exercising their voting rights through the Internet or by mobile phone.

At the meeting venue, we endeavor to present information, highlighting new developments and business results over the past year, in an easy-to-understand format utilizing video. Presentation videos from past meetings are available for viewing on our web site.



General Meeting of Shareholders

Distribution of Dividends

Our basic policy on the return of profits to shareholders calls for a stable dividend appropriate to our performance, tempered by sufficient maintenance of retained earnings to strengthen and expand profitability and the business foundation in preparation for future growth. Taking an overall perspective, with particular consideration to future business performance and retained earnings, management resolved to pay a year-end dividend of ¥5 per share for fiscal 2012, the year ended March 31, 2012.

Consolidated Net Income (Loss) and Annual Dividends per Share

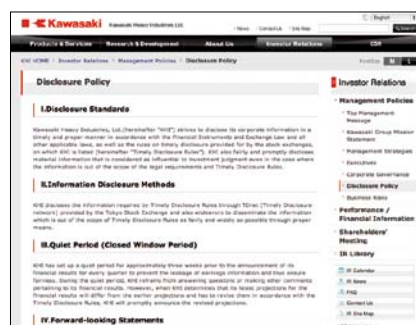
| Ended March 31 | 2008 | 2009 | 2010 | 2011 | 2012 |
|-------------------|--------|-------|---------|--------|--------|
| Net income (loss) | ¥21.08 | ¥7.02 | ¥(6.51) | ¥15.55 | ¥13.95 |
| Dividends | ¥5.00 | ¥3.00 | ¥3.00 | ¥3.00 | ¥5.00 |

IR Activities

We strive to disclose timely and fair business information, in accordance with the disclosure policy posted on our web site, and we keep an open channel to shareholders and investors through various investor relations (IR) activities at home and abroad to promote communication.

For institutional investors and analysts, we hold quarterly financial performance briefings and one-on-one meetings. (The briefings for the first and third quarters have started from fiscal 2012). Corporate representatives visit institutional investors outside Japan (North America, Europe and Asia) to explain recent business performance and other critical information. We disclose principal questions and answers at the briefings in the IR section of the KHI website since the second quarter of fiscal 2012.

Also, at the end of June and in early December, we send shareholders our Business Report, an easy-to-understand update on management conditions and business content.



Disclosure policy posted on our web site



For details, please visit our IR section online at

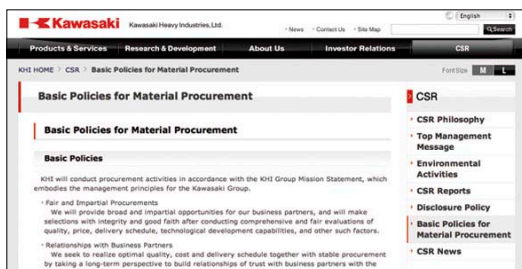
<http://www.khi.co.jp/english/ir/index.html>

Relationship with Business Partners

Fair Transactions and Bonds of Trust

In accordance with Basic Policies for Material Procurement and Code of Conduct for Dealing with Business Partners, everyone—including employees in design and manufacturing departments—who deals with business partners undertake procurement activities predicated on long-standing relationships of trust with our business partners.

We seek to ensure widespread acknowledgement of the guidelines and toward this end post them on our web site, with each division prominently displaying them as a constant reminder of the importance of fairness and mutual trust.



Basic Policies for Material Procurement (excerpt)

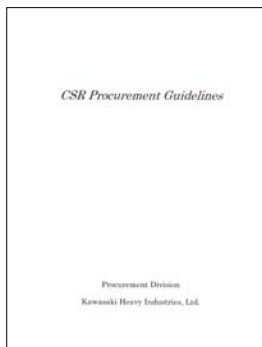


Code of Conduct for Dealing with Business Partners (excerpt)

CSR-Driven Procurement

From the perspective of CSR-driven demands and customer trust, KHI formulated CSR Procurement Guidelines in April 2012 and placed the document on its website.

Backed by the Basic Policies for Materials Procurement and these new guidelines, the Company will encourage suppliers to support its position on these issues and promote procurement activities in line with CSR principles, such as compliance, of course, and human rights, labor and employee health and safety as well as environmental consciousness.



CSR Procurement Guidelines

Reinforcing the “Partner” Sentiment in Partnership

We have organized cooperation-building associations for each business segment that have as their members business partners with whom the respective segment has developed particularly close ties.

These associations promote cooperation based on mutual trust between KHI and its business partners and serve to foster a sense of coexistence and coprosperity.

Specific activities, described below, reinforce the “partner” sentiment in our relationships with business partners.

- Hold regular meetings, to share policies on procurement, production and other operations
- Implement improvement initiatives, emphasizing joint efforts between KHI and business partners to enhance quality and production
- Hold lectures and workshops on such themes as human resource development and management practices
- Offer factory tours and discussion opportunities for member companies

Thorough Compliance

Every year, KHI holds a group workshop mainly for procurement divisions within the Group to ensure compliance with procurement-related laws and regulations, especially the Subcontractors’ Act—or more formally, the Act against Delay in Payment of Subcontract Proceeds, etc., to Subcontractors—and the Construction Industry Law.

Of note, with regard to the Subcontractors’ Act, we maintain proactive measures, as outlined below.

- Run sessions for design and manufacturing divisions at plants and affiliates (in fiscal 2012, a total of 16 sessions attracting 769 participants)
- Distribute a collection of examples on violation of the Subcontractors’ Act, which highlights actual situations that businesses need to be aware of.
- Planning to prepare a checklist for self-auditing compliance status pursuant to the Subcontractors’ Act, post it on the internal website in fiscal 2013, and widely raise awareness of the checklist to divisions other than those involved in procurement, design and manufacturing.