

2 Management

We will always act with integrity and good faith to merit society's trust.

To ensure that the KHI Group remains a company able to meet the expectations of society, management is committed to operating with a high degree of transparency toward stakeholders and to promoting activities that integrate business operations in the spirit of our Mission Statement with CSR activity.

Categories

Corporate governance

Compliance

Risk management,
Crisis management

Information security

Information disclosure,
IR activities

Business partners

Overview of Activities during the Medium-term Business Plan 2010 (FY2011-2013)

During the period of the Medium-term Business Plan 2010, appointment of independent corporate officers (from fiscal 2011), holding of dialogues with experts (from fiscal 2012) and appointment of outside directors (fiscal 2013) were among the steps we implemented to gain the opinions of people outside our organization and thereby achieve higher levels of fairness, transparency and efficiency. In addition, in April 2011 we formulated and published our

Basic Policies for Material Procurement, followed by our CSR Procurement Guidelines in April 2012, both of which helped lay the foundations for CSR activities in the supply chain.

Going forward, we intend to intensify activities in the parent company and expand the scope of activities through rollout to subsidiaries and business partners in Japan and overseas.

Self-Assessment of Activities

Category	Action	Annual self-assessment (average)		
		FY2011	FY2012	FY2013
Corporate governance	System according to which the company president listens directly to employee comments	★★★★★	★★★★★	★★★★★
	Appointment of outside directors	★★★★★	★★★★★	★★★★★
	Familiarity throughout the organization with the corporate Mission Statement	★★★★★	★★★★★	★★★★★
	Operation of a system for regular and comprehensive internal audits and reporting of results	★★★★★	★★★★★	★★★★★
Compliance	Familiarity throughout the organization with codes of conduct and a code of corporate ethics	★★★★★	★★★★★	★★★★★
	Access to reporting and consultation contact point	★★★★★	★★★★★	★★★★★
	Provisions to protect whistleblowers	★★★★★	★★★★★	★★★★★
	Evaluation of effectiveness of compliance and ethics training	★★★★★	★★★★★	★★★★★
	Full compliance with local laws and regulations in overseas business operations	★★★★★	★★★★★	★★★★★
Risk management, Crisis management	Establishment of a corporate risk management system and operating framework	★★★★★	★★★★★	★★★★★
	Evaluation of the effectiveness of corporate risk management	★★★★★	★★★★★	★★★★★
	Identification of major risk at subsidiaries	★★★★★	★★★★★	★★★★★
	Formulation of a business continuity plan (BCP), and regular evaluation and revision	★★★★★	★★★★★	★★★★★
Information security	Publication of a policy for protection of confidential corporate information	★★★★★	★★★★★	★★★★★
	Preparation of a backup and recovery plan, periodic revision	★★★★★	★★★★★	★★★★★
Information disclosure, IR activities	Well-developed communication with shareholders and investors	★★★★★	★★★★★	★★★★★
Business partners	Formulation and publication of the Basic Policies for Material Procurement	★★★★★	★★★★★	★★★★★
	Requirement that business partners undertake CSR management and provision of assistance	★★★★★	★★★★★	★★★★★

★ Will take action going forward ★★ Some action taken ★★★ Robust action taken ★★★★ Sufficient action taken but further improvement targeted

Measures during the Medium-term Business Plan 2013 (FY2014-2016)

Target profile	Measures
Targeting further improvement of corporate governance	<ul style="list-style-type: none"> • Introduce and increase outside directors, consider measures to strengthen governance and internal control
Familiarizing all employees with the code of corporate ethics and code of conduct	<ul style="list-style-type: none"> • Enforce individual corporate ethics guidelines at all Group companies • Strengthen measures to prevent irregularities at provincial and small-scale operating sites
Targeting further improvement of an array of information protection measures	<ul style="list-style-type: none"> • Improve the security level to protect against confidential information leakage risk • Full-scale rollout of IT audit
Targeting further improvement of shareholder and investor communication	<ul style="list-style-type: none"> • Review information disclosed and disclosure methods, enhance IR events • Hold regular factory tours for shareholders
Promoting cooperation with business partners in CSR management	<ul style="list-style-type: none"> • Promote formulation of CSR procurement guidelines at all Group companies

Topic 1 Appointment of an Outside Director

At KHI, directors with an intimate knowledge of the Company's business operations are charged with formulating business strategy and supervising the execution of operations, while four corporate auditors, including two outside corporate auditors with no conflict of interest relating to the Company, fulfill a management oversight function. This system has thus far ensured efficient execution of business operations.

However, with business expansion proceeding rapidly at the global level, we made the assessment that, to maintain sustained growth by responding flexibly to the changing environment, we needed to welcome onto the Board of Directors a member who, drawing on a rich array of experience and specialist knowledge in areas outside KHI's business domain, would be able to provide appropriate opinions and advice from a standpoint that was objective and

independent, relative to that of the Board members responsible for the execution of operations. We accordingly appointed Yoshihiko Morita as an outside director.

Based on his range of activities, including experience of business management from a global perspective at the Japan Bank for International Cooperation and his position as president of the Japan Institute for Overseas Investment, we believe that Mr. Morita is in a position to provide useful opinions and advice relevant to decision-making on important matters relating to corporate business management and also to play a full role in the supervision of business execution.



Yoshihiko Morita
Outside Director

Topic 2 Holding of First Factory Tour for Shareholders

On March 12-13, 2013, we organized the first-ever factory tour mainly for individual shareholders at Nagoya Works 1. The participants were shareholders selected by lot from among the many applicants, whose numbers exceeded the places available.

At our factory, the participants eagerly viewed operations including an autoriveter that automatically assembles the joints of Boeing 777 fuselage panels and an autoclave that fuses at high temperature the Boeing 787 forward fuselage, which is made of carbon fiber composite.

Going forward, we will actively organize additional events of this kind as a forum for communication with shareholders and an opportunity for shareholders to gain a deeper understanding of our business operations.



Watching an autoriveter at work on Boeing 777 panels

The case regarding potential infringement of Act Concerning Elimination and Prevention of Involvement in Bid Rigging etc. in receipt of orders for the new multi-purpose helicopter (UH-X)

In regard to the receipt of orders for the new multi-purpose helicopter (UH-X), questions were raised regarding potential infringement of the Act Concerning Elimination and Prevention of Involvement in Bid Rigging etc., and an investigation was undertaken by the Tokyo District Public Prosecutor's Office.

However, the case against KHI and its associates was not prosecuted as a result. Nevertheless, KHI has been recognizing the importance of compliance.

To prevent a recurrence of the situation, KHI will enhance efforts to ensure full compliance.



For more detailed coverage, please see the full report.

http://www.khi.co.jp/english/csr/report/2013/index_full.html

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, together with sound management practices and solid relationships forged with all stakeholders, including shareholders, customers, employees and the community.

Overview of the Corporate Governance System

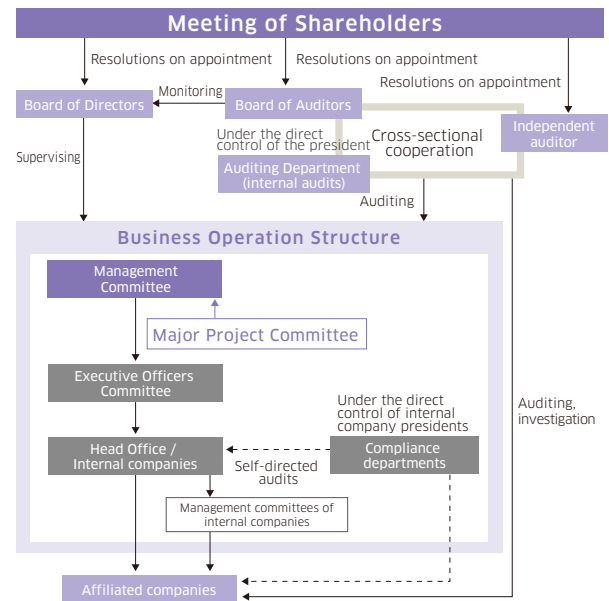
The Company has opted for the statutory auditor system with a Board of Auditors and has appointed independent auditors. With regard to corporate auditors, the Company appoints internal corporate auditors with considerable knowledge of finance and accounting as well as two outside corporate auditors with no business relationships or other potential conflicts of interests in the Company.

To protect the interests of minority shareholders, all stock exchanges require listed companies to include independent directors. Accordingly, KHI has appointed a number of outside directors.

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.

KHI has a Board of Directors, the Management Committee consisting of representative directors and other relevant officers, and the Executive Officers Committee, which additionally includes the executive officers. As explained in the previous page, in fiscal 2013, we welcomed outside directors onto the Board to promote higher levels of efficiency and transparency in our business execution. To provide a clear delineation of their management responsibilities, directors' compensation is incentive-based to reflect performance, and their term of office is limited to one year. The Management Committee generally meets three times a month to discuss management policy, management strategy and other important management issues from a Group-wide perspective.

Governance Structure of KHI



Board of Directors Meetings

The KHI Group has 10 directors, who engage in active exchanges of opinion at meetings of the Board of Directors.

In fiscal 2013, there were 13 meetings of the Board of Directors and the directors' attendance rate was 98.2%.

Number of Board of Directors Meetings, and Directors' Attendance Rate (Including Extraordinary Meetings)

	FY2011	FY2012	FY2013
Number of meetings	13	14	13
Directors' attendance rate	98.0%	98.7%	98.2%
Auditors' attendance rate	100%	100%	95.8%
Outside corporate auditors' attendance rate	100%	100%	100%

Board of Auditors Meetings

The Board of Auditors consists of two full-time corporate auditors and two outside corporate auditors.

In fiscal 2013, there were 17 Board of Auditors meetings and the attendance rate of the outside corporate auditors was 100%.

Number of Board of Auditors Meetings, and Corporate Auditors' Attendance Rate

	FY2011	FY2012	FY2013
Number of meetings	17	17	17
Auditors' attendance rate	100%	100%	100%
Outside corporate auditors' attendance rate	100%	100%	100%

Corporate Officers' Compensation

The compensation system for KHI directors and corporate auditors—which is designed to promote sustained improvement in corporate performance and corporate value and to secure outstanding human resources—ensures a level of compensation in line with the duties of the individual officer. Based on a policy of linking directors' compensation to corporate performance, the level is determined by the company president on request from the Board of Directors.

To promote their professional independence, the compensation of corporate auditors is set at a fixed level not linked to corporate performance, and is determined by the Board of Auditors. The system of compensation for directors and corporate auditors described above operates within a fixed compensation range approved by the General Meeting of Shareholders.

Amount of Corporate Officers' Compensation (in Fiscal 2013)

Category	Total amount of compensation (millions of yen)	Total amount of compensation by type (millions of yen)	Number of corporate officers eligible for compensation
Directors	739	739	15
Corporate auditors	70	70	3
Outside corporate officers	17	17	2

Note: The Company abolished retirement benefits and does not pay bonuses or offer stock options to directors, corporate auditors or outside corporate officers.

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 of the Group's business segments for audits. In this way, the department verifies and evaluates effectiveness and efficiency in the execution of operations, the reliability of financial reports, and conformity to standards of compliance (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. They 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.

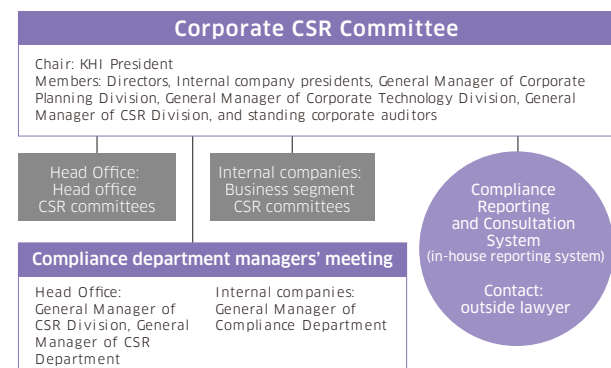
Compliance

KHI Code of Corporate Ethics

We established the KHI Code of Corporate Ethics, and the basic principles of corporate ethics are 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**
To create and maintain a comfortable workplace, we respect the individuality and human rights of all people. We do not engage in discrimination, sexual harassment and bullying.
- 3. Promotion of environmental protection**
To conserve limited resources and nature and reduce the impact on the global environment, we take voluntary and proactive efforts to save resources 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

In July 2012, a completely revised issue of the Compliance Guidebook was published and distributed to all KHI Group corporate officers, employees and temporary staff in Japan.

The Compliance Guidebook outlines the KHI Group's compliance system and compliance activities, and explains its compliance information and consultation system. Using cartoons to illustrate the points, it presents easily grasped examples of situations where care is required. Further sections deal with Matters concerning Securing the Trust of Customers and Business Partners; Matters to Be Observed as a Corporate Citizen; Matters concerning Data Protection; Matters concerning Handling Financial Transactions; Matters concerning the Workplace; and Responsibilities of Executives.

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

Starting with an explanation of the KHI Code of Corporate Ethics, which represents the basic principles underpinning the KHI Group's corporate ethics, the Compliance Guidebook states a large number of fundamental matters to be observed as a responsible corporate citizen, such as not associating with anti-social organizations and prohibiting corrupt practices.

To promote understanding of the content of the Compliance Guidebook and strengthen compliance awareness among employees, a Group-wide compliance initiative covering all employees was rolled out in fiscal 2013 under the title of Compliance Check using the Compliance Guidebook.

In concrete terms, this initiative consisted of an e-learning program for those with computer access; for those without computer access, a member of the management team read out passages from the Compliance Guidebook to junior staff in the workplace and provided explanations. The e-learning program was completed by around 18,830 staff, or more than 99% of those eligible.

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. To address this problem, we established the Compliance Reporting and Consultation System.

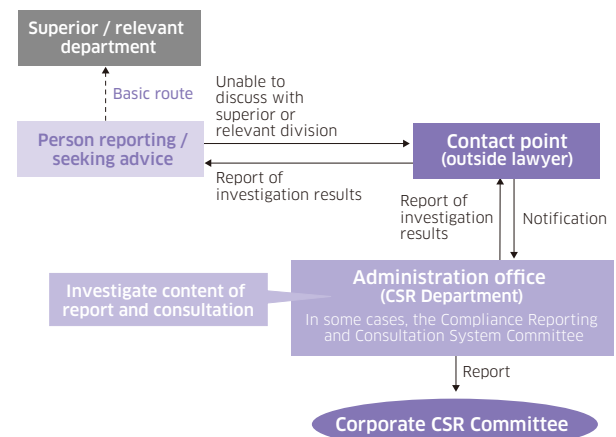
Under our compliance reporting and consultation system, reports from staff with concerns are heard by an outside lawyer who can be contacted directly for advice and consultation. The substance of the report is then investigated and an assessment is made as to whether a violation has occurred. After a decision has been made on appropriate response measures going forward, the results of the procedure are reported by the outside lawyer directly to the employee who raised the issue.

In fiscal 2013, the system was used 20 times.

Number of Report or Consultation (in fiscal 2013)

Nature of report or consultation	Number of cases
Personnel treatment	9
Power harassment	8
Others	3
Total	20

Compliance Reporting and Consultation System Flow Chart



Prohibition of Bribery and Corrupt Practices

Prevention of corruption in relations with public officials is addressed as one of the sections in the KHI Group Compliance Guidebook. As a further part of activities to promote awareness, the content of this section is also included in our program of education through e-learning. In April and May 2011, a document was distributed to sales staff in overseas sales divisions and overseas affiliated companies calling for comprehensive prevention of corrupt practices in relations with public officials in overseas operations. In fiscal 2014, a corporate regulation on prevention of corruption was laid down (Regulation on the Prevention of Corruption), in which the KHI Group set out its policy on the prevention of corruption and its approach to related initiatives.

Promoting Corporate Ethics and Compliance Overseas

The KHI Group pursues business opportunities around the world and has many companies located abroad. Up to the present, 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 the Kawasaki Global Business Ethics Guidelines, which cover 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%.

Risk Management

Risk Management Policy

In accordance with the Companies Act, the KHI Board of Directors has adopted a basic policy for internal control systems. The policy makes it clear that risk management should be addressed in accordance with the Risk Management Regulations by seeking to anticipate and avoid loss caused by risk, and to minimize risk through appropriate operation of the risk management system.

In addition, to achieve sustained improvement of profitability and corporate value, the Kawasaki Group Mission Statement identifies risk management as a guiding theme of the Kawasaki Group Management Principles.

To support these policies, the Risk Management Regulations lay down the following basic policy for the KHI Group in the field of risk management:

- (1) Aiming to realize its Group Mission—"Kawasaki, working as one for the good of the planet"—KHI and the KHI Group will facilitate global and sustained business execution by continuously implementing risk management.
- (2) In implementing risk management, KHI and the KHI Group will put in place a risk management system, for which ultimate responsibility lies with the company president, as a means of preventing risks that may hinder business execution.
- (3) In the event that a risk situation emerges, KHI and the KHI Group will work to minimize loss to customers, employees, local communities and other stakeholders, and to prevent recurrence.
- (4) Each individual corporate officer and employee will engage actively with risk management and will work to maintain the risk management system and improve risk management and response capabilities.

In accordance with these basic guidelines, the Risk Management Regulations and Corporate Risk Management Manual stipulate that, to undertake risk management organized on a Group-wide basis, the risk management activities carried out hitherto by divisions responsible for the different areas of operations should be reinforced and that Group-wide action should be taken each year to identify major risk which could have a serious impact on business operations (Group-level risk), as well as to specify risk which requires Group-wide response measures (risk requiring Group-wide action), with appropriate response

measures taken and the results subjected to monitoring.

Regarding risk associated with management strategy, in accordance with the Board of Directors Regulations, Management Committee Regulations, and Approval Regulations, the relevant divisions are required in advance to analyze the risk and consider response measures or other appropriate steps, and relevant matters should be discussed and a resolution agreed by the Board of Directors or the Management Committee in accordance with regulations. In particular, in the case of major projects with significant impact on operations, appropriate risk management should be carried out in accordance with the Major Project Risk Management Regulations, published separately.

Concurrently, action to be taken when a risk situation emerges is set out in the crisis management provisions of the Risk Management Regulations, which stipulate that emergency action guidelines should be clearly identified, a Crisis Management Officer should be appointed for each operating site, and a system should be operated as appropriate to reduce losses to the minimum.

Scope of Risk Covered

KHI defines risk as "phenomena that hinder the conduct of business operations or the achievement of organizational goals," and is committed to giving due consideration to strategic risk and other risk items, as well as to phenomena that have a beneficial effect on the organization.

In concrete terms, this means all risk listed below, classified into external risk and internal risk (strategic risk and business risk), is included in the scope.

List of Risks Covered

Risk category		Risk name	Risk category		Risk name	
External risk	Hazard	Major disaster	Internal risk	Business risk (by division)	Interest rate rise	
		Accident (caused by third party)			Foreign exchange rate fluctuation	
	Politics/Society	Government or social stability			Financial affairs	Capital procurement
		Legal or regulatory amendment				Financial management
	Technology	Technological innovation				Management of pension assets
	Market environment	Competitor companies				Company stock
		Customer needs				Credit rating
	Economic	Economic recession				Management
Stakeholders	Shareholders/activists	Evaluation of business performance				
	Harmful rumors	Consistency of goals and strategies				
Human rights issue	Child labor/forced labor	Public relations			Media response	
Internal risk	Strategic risk	Vision			Business risk (by division)	Legal affairs
		Decision making		Expansion into new business areas		Response to legal action
				Capital investment		Information processing/IT
		Corporate acquisition/merger		Network/system failure		
		Organization		Effectiveness of organizational structure		Information infrastructure
		Brand		Kawasaki Value (brand)		CSR
	Corporate governance	Supervising of management		External reporting		Evaluation of internal controls
	Sales	Sales strategy				Information disclosure
		Collection of accounts receivable		Environment		CO ₂ emissions
		Customer response				Environmental pollution
	Development	Development themes		Compliance		Irregular action by organization
		Development capabilities				Irregular action by employees
	Design	Design not coordinated with other relevant divisions			Harassment	
		Design capabilities	Compliance with corporate ethics, social norms, laws and regulations			
		Design quality	Anti-monopoly and fair trade laws			
	Procurement	Enforcement of CSR Procurement Guidelines	Export management			
		Procurement at appropriate price	Social contribution	Social contribution activity		
		Securing of stable procurement partners		Personnel/labor	Human resources/personnel deficiency	
	Management of procurement partners	Safety and health management				
	Warehouse	Inventory management (materials, work in process, products)	Labor management			
		Production	Insufficient production capacity		Personnel employment conditions	
	Production process management		Human rights issues			
	Production facilities		Business risk (cross-divisional)		Management capabilities	
	Engineering operations	Management of individual commissioned projects		Affiliated company management		
Quality assurance	Deficient product servicing	Communication				
Logistics	Management of logistics channels	Powers/restrictions				
	Export and import procedures	Operational efficiency				
Overseas	Country risk	Outsourcing				
	Business customs	Intellectual assets (knowledge/expertise)				
Domestic operating sites	Operation/maintenance	Intellectual property				
	Specific local conditions	Operational alliances				
Accounts	Accounting methods	Security				
	Financial reporting	Information sharing				
	Tax affairs	Credit management				
			Work environment			

Corporate Risk Management System

KHI has established a Corporate Risk Management System to ensure a uniform level of risk management across the Group, through which it identifies and responds to major risk with potential serious impact on operations and works to enhance risk management as outlined in the Kawasaki Group Management Principles.

To engage in continuous activities through implementation of the Corporate Risk Management System, we highlighted realization of Group-wide risk management as one of the key strategies of our Medium-term Business Plan. In addition, we revised the Risk Management Regulations in April 2010.

The KHI system places ultimate responsibility for risk management with the company president, and responsibility for coordinating risk management operations with the Chief Risk Officer (CRO). The KHI system also seeks to reinforce the risk management system by setting up a Risk Management Committee with the function of discussing important matters relating to risk management and monitoring implementation status. Meanwhile, a Risk Management Unit has been set up within the Head Office Corporate Planning Department to implement and support corporate risk management, and each business division operates a similar system, for which the general manager of the business division is responsible. These measures are designed to reinforce a system that takes a Group-wide approach to risk management.

From October 2011, similar initiatives were extended to important affiliated companies in Japan so that, by the end of fiscal 2013 a Corporate Risk Management System was in place that included domestic affiliated companies.

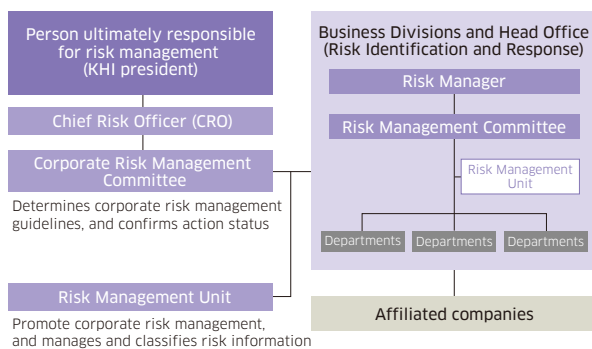
Activities in Fiscal 2013

Under the Corporate Risk Management System, major risk that could have a potentially serious impact on Group-wide operations is identified each year using uniform metrics and subjected to continuous management from a Group-wide perspective using efficient and optimal methods.

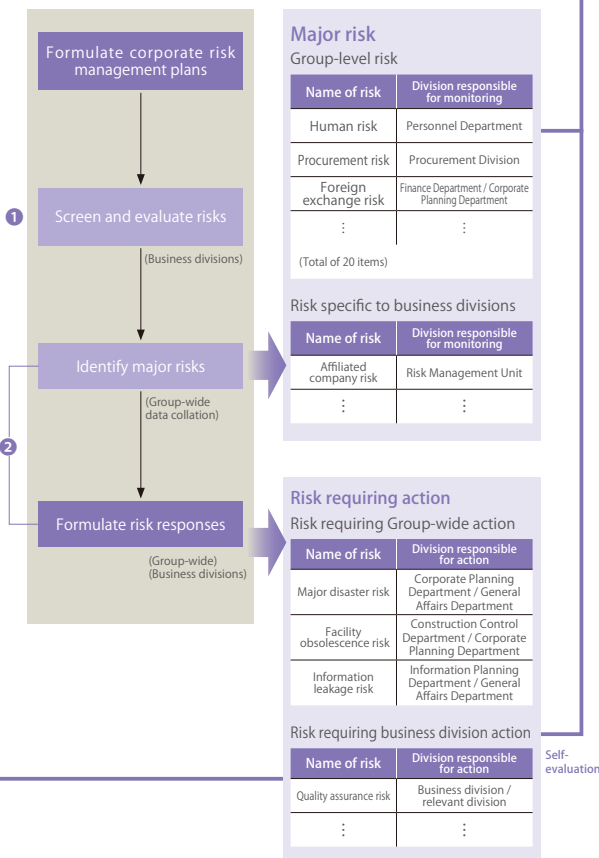
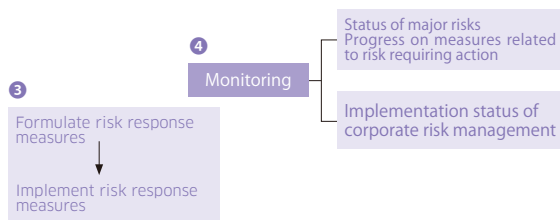
In concrete terms, this means that management of major risk at the Group-wide level is carried out by applying the following Plan-Do-Check-Act (PDCA) cycle to Group-wide risk management programs: (1) screening and evaluation of risk; (2) identification of major risk and specification of risk requiring action; (3) formulation and implementation of risk response measures; and (4) monitoring.

Regarding activities in fiscal 2013, to coincide with the formulation of the Short-term Business Plan, operations were begun in January 2013 to (1) detect and evaluate risk and (2) identify major risk and specify risk requiring action.

Corporate Risk Management System



Corporate Risk Management Programs



1 Screening and evaluation of risk

In fiscal 2013, each division undertook a risk review beginning in January 2013 and the Risk Management Committee established a list of major risk items identified for each business segment.

2 Identification of major risk and specification of risk requiring action (Identification of major risk)

Data on major risk in each business division were collated and the significance level of the risks featuring in the collated data was discussed by the Corporate Risk Management Committee, which then identified major risk that could have a potentially serious impact on operations (Group-level risk) under 20 itemized categories.

Risk items other than Group-level risk are categorized as risk specific to the business segment, to be recognized and acted on by the relevant business segment.

For Group-level risk, a Head Office division responsible for monitoring is designated which carries out regular monitoring. Monitoring for fiscal 2013 took place in April 2013.

(Specification of risk requiring action)

Within Group-level risk, we specified three items where response was insufficient and Group-wide action was urgently necessary.

At the same time, each business division specified risk items to be acted on at the business segment level (risk requiring business segment action).

3 Formulation and implementation of risk response measures

In the case of risk specified as risk requiring Group-wide action, the Head Office division designated responsible for risk action formulates risk response measures, which are then referred to the Corporate Risk Management Committee for discussion and approval prior to implementation.

Likewise with risk requiring action by the business division, risk response is formulated and implemented at the business segment level.

4 Monitoring

(Monitoring of major risk)

Regarding major risk, in March 2013 the Risk Management Unit of each business division carried out monitoring of the significance, action level, and urgency of each risk item as part of fiscal 2014 risk revision operations.

In April 2013, as a specific measure for Group-level risk, the Head Office division responsible for monitoring carried out monitoring of whether the measures and structures designed to reduce the relevant risk were functioning effectively from a Group-wide perspective with reference to the business division monitoring results.

(Monitoring of risk requiring action)

Regarding risk requiring action (risk requiring Group-wide or business division action), in September 2012 and March 2013 the implementation status of risk response measures was subject to self-evaluation by the division responsible for action, the results of which were monitored by the Risk Management Unit. (Report of monitoring results to the Risk Management Committee)

Following the monitoring at business division level of major risk and risk requiring action, the results were reported to the Risk Management Committee of the business division.

Meanwhile, the monitoring results from Group-level risk and risk requiring Group-wide action were reported to the Corporate Risk Management Committee.

Rollout to affiliated companies in Japan

From the second half of fiscal 2012, Group-wide risk management programs were introduced at major domestic subsidiaries using the same methods as at KHI.

Since October 2012, we have also provided guidance to other domestic affiliated companies to carry out risk management programs. At other affiliated companies, the content of programs implemented at KHI was the starting point for adapting methods of implementation that would allow the programs to be introduced, sometimes in abbreviated or simplified form.

Risk Identified as Group-Level Risk in Fiscal 2013

Data on major risk identified at the business division level were collated, and the Corporate Risk Management Committee then identified major risk that could have a serious impact on operations under 20 item headings.

These risks are subject to monitoring in March of every year by the Head Office division responsible for monitoring. Meanwhile, taking Group-level risk as the basis, decisions are made on which risk items to disclose as "business risk and other risk" in the Securities Report, this report, and other information sources.

The risk items are subject to yearly review.

Risk Identified as Group-Level Risk in Fiscal 2013

Name of risk	Head Office division responsible for monitoring
Human risk	Personnel Department
Procurement risk	Procurement Division
Foreign exchange risk	Finance Department/ Corporate Planning Department
Major disaster risk	Corporate Planning Department
Facility obsolescence risk	Corporate Planning Department
Individual commissioned project management risk	Corporate Planning Department
Information leakage risk	General Affairs Department/ Information Planning Department
Compliance risk	CSR Department
Quality management risk	Manufacturing Improvement Department
Economic recession risk	Corporate Planning Department
Environmental contamination risk	Environmental Affairs Department
Tax risk	Accounting Department
Development and design risk	Corporate Technology Division
Country risk	Marketing Division
Production process management risk	Manufacturing Improvement Department
Intellectual property risk	Intellectual Property Department
Debt collection risk	Finance Department
Contract risk	Legal Department
Safety and health risk	Safety & Health Management Department
Unutilized asset risk	Corporate Planning Department

Risk Specified as Risk Requiring Group-wide Action in Fiscal 2013

Within Group-level risk, we specified the three items listed below as areas where response was insufficient and Group-wide action was urgently necessary. To deal with these risks, a Head Office division responsible for action was designated to take the main role in formulating and implementing response measures.

Risk Specified as Risk Requiring Group-wide Action in Fiscal 2013

Name of risk	Head Office division responsible for monitoring
Major disaster risk	Corporate Planning Department / General Affairs Department
Facility obsolescence risk	Construction Control Department / Corporate Planning Department
Information leakage risk	General Affairs Department / Information Planning Department

Action status

(1) Major disaster risk

In reaction to the disaster scenario published in September 2012 for an event involving the Nankai Trough off Japan's Pacific Coast, KHI enforced an enhanced Business Continuity Plan (BCP) that was completed by the end of March 2013. The key points of the plan and enhancements were as follows:

- (i) Confirmation of compatibility with the basic policy
It was ordered that the enhanced plan should also be checked for compatibility with the basic policy approved at the Management Committee meeting of January 19, 2012, which designated functions that must be maintained in the event of a disaster.
- (ii) Revision in response to changes to the projected scenario
Adaptations were made in response to the revision of the projected destruction scenario resulting from an event involving the Nankai Trough off Japan's Pacific Coast.
- (iii) Revision in response to organizational change, transfers of staff in charge, and other changes in the system
BCP drills are carried out at all operating sites. After completion of each drill, a revision of the BCP should be carried out in light of the results of the drill.
Measures were taken to put in place an emergency communication system, including drills in the use of emergency contact systems and satellite mobile telephones and improvements to the teleconferencing system.

(2) Facility obsolescence risk

For facilities judged to require urgent action in the obsolescence survey carried out in fiscal 2011-2012, response measures were completed in fiscal 2013, with a few exceptions. Response measures for other obsolescent facilities are proceeding according to plan.

(3) Information leakage risk

Measures effective in dealing with cyber attacks are judged to be early detection measures, measures to prevent connection to the computers used by criminals, and ongoing education and training for employees. Accordingly, self-analysis tools, access control, and other system-based action have been introduced and employee education is being carried out.

In addition, corporate regulations have been set out for the handling of documents in the process of creation (chiefly electronic documents).

Crisis Management

The KHI Group's Risk Management Regulations contain crisis management provisions set out in readiness for the emergence of a risk situation. 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.

Systems and Structures for Routine Response

In readiness for the event of a crisis, we have put in place a Crisis Management Organization to operate as a crisis management system integrated horizontally across the Group structure. The company president is the Chief Crisis Management Officer, while the head of each operating site or organizational unit acts as its Crisis Management Officer and supervises the setting up of a Crisis Management Office. The Crisis Management Office has the role of assisting the Crisis Management Officer and undertakes the task of putting in place and maintaining a mobilization system that operates routinely in the event of an emergency. Meanwhile, the heads of the various Head Office divisions and other staff members whom they designate form a dedicated support team for the Crisis Management Office.

Reporting Route in Case of Emergency

If an accident or natural disaster occurs, information is sent where it is needed through a predetermined reporting route for use in times of emergency. This route is made known clearly to employees and executives through the Crisis Management Organization, which in normal circumstances underpins the Group's crisis management structure. In cooperation 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.

Formulating a Business Continuity Plan (BCP)

The KHI Group has formulated a BCP in preparation for a major earthquake centered on Tokyo or a similar major seismic event, or a pandemic caused, for example, by a new strain of influenza.

The plan was formulated with attention to the following basic principles:

1. Protecting the health and the life of employees and their families (including non-employees working on site and visitors)
2. Performing of duties essential to the fulfillment of our social responsibilities (commissions from customers, business partners, and government offices, and maintenance and restoration of mission-critical systems such as public infrastructure and civil defense)
3. Normalizing the business operations of the KHI Group
4. Fulfilling responsibilities and contributing to local communities

The BCP is subject to continuous review and reinforcement. For details of activities in fiscal 2013, please see the Risk Management section in the preceding pages.

Export Control

To ensure safety by maintaining international peace and security, the export of materials or technology that could be diverted for military purposes requires a license from the Minister of Economy, Trade and Industry in certain cases. This provision is contained in the Foreign Exchange and Foreign Trade Act and other export control laws and regulations.

Basic Policy on Export Control

KHI's basic policy on export control is to "refrain from transactions that might endanger the maintenance of international peace and security." Accordingly, KHI is committed to ensuring this through compliance with the Foreign Exchange and Foreign Trade Act and other export control laws and regulations. Moreover, when engaging in transactions that involve materials and technology of U.S. origin, KHI takes account of U.S. reexport regulations in its export control procedures.

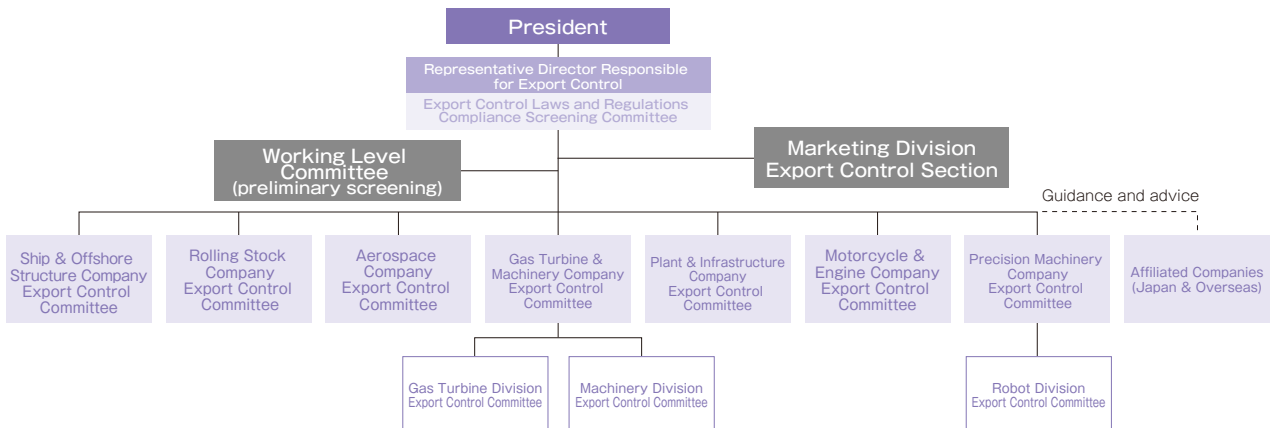
Export Control System

To ensure Group-wide compliance with export control laws and regulations, we have formulated a set of corporate export control regulations for goods and technologies relevant to security maintenance and have put in place an export control system in which a representative director acts as Chief Export Control Officer.

As a first measure, we set up the Export Control Laws and Regulations Compliance Screening Committee (hereafter the Screening Committee) at the Head Office chaired by the Chief Export Control Officer. The Screening Committee undertakes final assessment of all export transactions across the Group to confirm compliance with export control laws and regulations, and provides guidance and supervision to our internal companies to help them establish control systems that ensure legal and regulatory compliance. In addition, the Export Control Section was set up within the Head Office Marketing Division to provide secretariat services to the Screening Committee and to function as a Group-wide division to coordinate export control. Next, the Working Level Committee was instituted under the control of the Screening Committee to undertake preliminary screening ahead of the assessment by the Screening Committee, discuss matters delegated to it by the Screening Committee, report to the Screening Committee, and undertake horizontal rollout to internal companies of export control-related information.

Furthermore, each internal company and business center operates an Export Control Committee, which screens all the export transactions of the relevant company or business center and refers the screening results to the Screening Committee for discussion.

Export Control Structure



Export Control Training and Guidance

To provide Group-wide training in export control covering all Group companies, the Head Office Export Control Section organizes Group-Wide Export Control Training Meetings each year at a number of offices throughout Japan, with external lecturers invited from the Center for Information on Security Trade Control (CISTEC). Concurrently, each internal company offers export control training as a separate module in its grade-specific training.

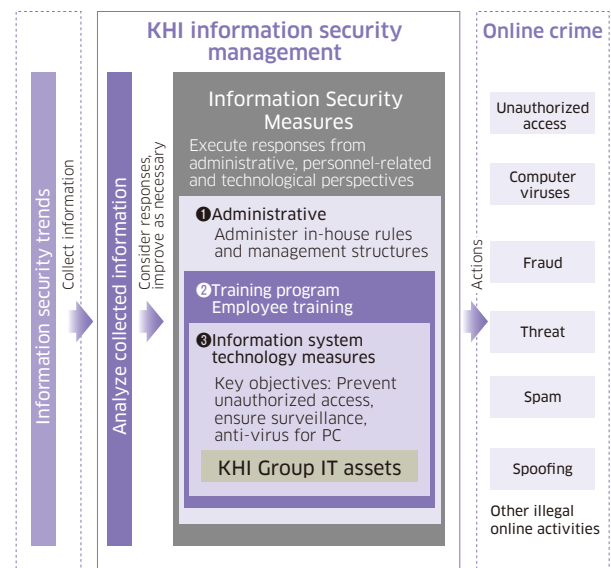
An export control audit is carried out jointly by the Head Office Auditing Department and the Head Office Export Control Section, which perform individual audits once a year of all internal companies and of major Group companies in Japan.

Moreover, overseas Group companies are subject each year to a questionnaire-based survey of their export record and related matters, with appropriate guidance and support on export control provided by the relevant internal company.

Information Security Management

The KHI Group provides products to a diverse range of customers, from general consumers and the public sector to the Self-Defense Forces, and promotes numerous information security measures suited precisely to the requirements of each customer sector.

Information Security Management System



Safeguarding Intellectual Property

KHI's basic policy on intellectual property derived from corporate R&D results is to secure patents and other rights domestically and overseas in a timely manner, to reduce risks associated with intellectual property matters worldwide and promote their full exploitation as highly valuable corporate assets. This policy also ensures technological superiority and safeguards our freedom to expand business activities.

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. This provides support in line with each segment's 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 the 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 as well as 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 has created Rules for Protecting Personal Information, a document that functions as a guide for personal information management.

As part of personal information management, a data-handling ledger is prepared to facilitate at-a-glance confirmation of 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 in place a structure that ensures a prompt response to individual requests on the use of personal information, such as disclosing it or no longer using it.

Relationship with Shareholders and Investors

General Meeting of Shareholders

At KHI, we believe that 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.



189th General Meeting of Shareholders, in June 2012

To avoid the period in which other shareholders' meetings are concentrated, we send out the convocation notice even earlier than the deadline required by law. In addition, we prepare an English-language version of our official Japanese-language convocation notice for the convenience of our shareholders overseas and post it on our website and elsewhere.

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

At the meeting venue, we seek to present information, which highlights our business progress and results over the past year, in an easy-to-understand format utilizing video. Presentation materials from past meetings are available for viewing on our website.



General Meeting of Shareholders

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

Return of Profits

Our basic policy on the return of profits to shareholders calls for a stable cash dividends appropriate to our performance, giving due attention to 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 2013, the year ended March 31, 2013.

Consolidated Net Income (Loss) and Annual Cash Dividends per Share

	FY2009	FY2010	FY2011	FY2012	FY2013
Net income (loss)	¥7.02	¥(6.51)	¥15.55	¥13.95	¥18.46
Cash dividends	¥3	¥3	¥3	¥5	¥5

IR Activities

We strive to disclose timely and fair business information, in accordance with the Disclosure Policy posted on our website, 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 results briefings and organize factory tours. We also arrange individual meetings with institutional investors in Japan and overseas, and send management executives to visit institutional investors in North America and Europe. In addition to these and other activities, from fiscal 2013 we began factory tours mainly for individual shareholders. The main content of question and answer sessions at financial results briefings is published in the IR section of our website.

We use opinions expressed in the context of these IR activities as internal feedback and work to reflect them in our management and business operations.



Disclosure Policy posted on our website

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



Please also visit the IR section of our website

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

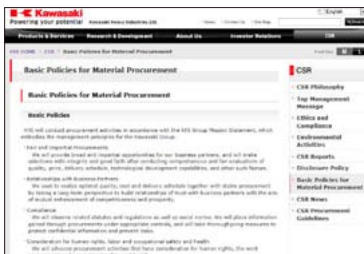
Relationship with Business Partners

Promotion of Procurement Activity Based on the Basic Policies for Material Procurement and Related Policies

KHI adopted its Basic Policies for Material Procurement and its Code of Conduct for Dealing with Business Partners in April 2011, and its CSR Procurement Guidelines in April 2012, all of which are published on the KHI website.

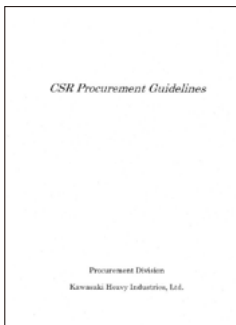
KHI's procurement activities reflect its approach to CSR in terms of compliance, human rights, labor health and safety, respect for the global environment, and other aspects. We also seek the support of our business partners in joint efforts to actively promote CSR activities throughout the supply chain.

Starting in fiscal 2014, we intend to successively roll out the guidelines to affiliated companies in Japan and overseas, to promote CSR-based procurement activity at the global Group level.



Basic Policies for Material Procurement

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



CSR Procurement Guidelines

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

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 help foster a sense of coexistence and coprosperity.

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

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

Promoting Green Procurement

In the area of green procurement, which aims to achieve product manufacture with a low environmental load, activities are coordinated with our business partners. As part of this approach, each business segment formulates guidelines to match its specific characteristics and requires its business partners to put in place environmental management systems (EMS) and to identify and monitor substances of environmental concern contained, for example, in parts and materials.

Thorough Compliance

Each year, KHI holds a group workshop intended mainly for procurement divisions within the Group to ensure compliance with procurement-related laws and regulations, particularly the Subcontractors' Act (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.

- We run sessions for design and manufacturing divisions at plants and affiliates (in fiscal 2013, 23 sessions were held, attracting 725 participants).
- We distribute a collection of examples of violation of the Subcontractors' Act, highlighting actual situations that businesses need to be aware of.
- We have prepared a checklist for self-auditing compliance status pursuant to the Subcontractors' Act for posting on our internal website on April 1, 2013, and aim to boost awareness of the checklist to divisions other than those involved in procurement, design and manufacturing.

Evaluation by External Bodies

As a company actively engaged in CSR activities aimed at sustainable development, KHI has been included since 2011 in the Morningstar Socially Responsible Investment Index (MS-SRI), calculated and operated by Morningstar Japan K.K. Among approximately 3,700 listed companies in Japan, Morning Star Japan K.K. selects 150 companies judged to demonstrate outstanding social awareness, and converts their stock prices into the index, which is Japan's first socially responsible investment index.



<http://www.morningstar.co.jp/sri/index.htm> (Japanese)
(As of August 31, 2013)