

No. 2024076

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**Notice Regarding the Findings of the Special Investigative Committee for Submarine Repairs
(Interim Report) and Measures to Be Implemented in Response (Progress on Disclosed Matters)**

As announced in the press release published by Kawasaki Heavy Industries, Ltd., on July 3, 2024 (“Kawasaki reports findings related to the tax investigation on the 201st Securities Report”), multiple compliance violations involving Kawasaki Heavy Industries, Ltd., have recently been identified. The Company takes these incidents very seriously and offers its assurances to all stakeholders that it will take resolute steps to ensure that such misconduct does not happen again.

At the meeting of its Board of Directors held on June 14, 2024, the Company established the Special Investigative Committee for Submarine Repairs, a committee of external legal experts, to conduct an independent investigation of misconduct related to submarine repairs. The following is synopsis of the interim report of the committee’s findings, which was submitted to the Board at a meeting held today, and of measures that will be implemented to prevent recurrence. Please refer to the attached summary version of the report for details.

The Company is currently examining whether this matter will impact its financial results and will immediately issue notification should such an impact be confirmed.

1. Interim report of findings

The investigation conducted by the Special Investigative Committee for Submarine Repairs confirmed that the details —summarized in “2. Misconduct confirmed”—are factually correct.

2. Misconduct confirmed

- (a) Fictitious transactions between the Ship Repair Department of the Company’s Kobe Shipyard and business partners.
- (b) The use of funds generated through such fictitious transactions for the purchase of goods and cash

vouchers, as well as for food and drink expenses.

- (c) The involvement of Company employees and submarine crew members in the use of these funds as indicated in (b).

At the root of this misconduct is the fact that employees of the Kobe Shipyard's Ship Repair Department, who enjoyed cozy relations with submarine crew members that exceeded what is customary for businesses associates, received requests from said crew members to procure items necessary for maintenance work, which were then purchased and provided to those crew members. Funds used for this purpose were generated through fictitious transactions with business partners and then pooled. These funds were also applied to the purchase of items needed for repair work performed by employees.

Additionally, slush funds created through the fictitious orders purportedly placed by business partners were used to pay for food and drink at social gatherings, and to purchase cash vouchers such as beer coupons, as well as for personal items for certain submarine crew members and Repair Department employees.

The committee found that the purchase of goods related to maintenance conducted by submarine crew members had continued for at least 40 years, while other acts had been taking place for at least 20 years.

As of the date of the interim report, no evidence had been discovered in a separate inquiry into the existence of any other similar systematic misconduct involving cash or monetary products at Kawasaki Heavy Industries or its Group companies in Japan.

3. Analysis of the reasons behind the misconduct

The interim report cites several causes of this misconduct, namely, (a) a motive, that is, a desire to improve relations with submarine crew members and ensure smooth operations; (b) an awareness of the importance of not pushing profits too far upwards; (c) opportunities for misconduct from the contract stage through to delivery; (d) the fact that such misconduct had become routine practice; and, (e) an organizational culture that emphasizes adhering to long-standing precedents, disregarding compliance and adopting a laissez-faire attitude.

4. Responses by the Ship & Offshore Structure Business Division

Given the seriousness of this incident, the Ship & Offshore Structure Business Division will formulate and implement appropriate measures in line with the recommendations of the Special Investigative Committee for Submarine Repairs to ensure such misconduct does not happen again, as detailed below.

(1) Review of repair contracts

In quotes for repair contracts submitted to the Japan Maritime Self-Defense Force (JMSDF), labor costs are estimated based on standard work hours per work item, since the repair work may vary depending on the actual condition of the particular submarine, and it is crucial to shorten lead times for contract execution and the performance of repairs. However, standard work hours have not been reviewed for a long period of time. In addition, in some cases there are discrepancies between cost categories used in quotes submitted to the JMSDF and those actually used in the Company's internal cost calculations.

As a consequence of these factors, the correspondence between them had become difficult to comprehend, which is viewed as one cause of this misconduct. For this reason, the division has resolved to change the basis for these quotes from standard work hours to actual costs. The division will begin discussions on how to implement this move with Ministry of Defense (MOD)-related parties.

This change will entail the collection and analysis of cost data, which will require a considerable amount of time. Accordingly, as a transitional measure, the division will continue to prepare quotes using the standard work-hour calculation, but will endeavor to improve transparency at the contract conclusion stage by attaching documentation reclassifying the figures based on the cost categories in the quote estimate, as well as the cost categories used in the Company's internal cost calculations, thereby clarifying the relationship between the two sets of calculations.

In response to this recent incident of misconduct, a special clause has been attached to all submarine repair contracts pledging to refund any excess profits confirmed after the fact as a result of a cost audit.

(2) Modification of the check system for orders and deliveries

The check system for submarine repair orders and deliveries was found to be flawed because the persons responsible for submitting orders and the persons responsible for verifying the delivery of ordered items both worked in the Ship Repair Department. This impeded the effectiveness of internal controls.

In April 2024, subsequent to the discovery of this incident of misconduct, the Production Resource Management Section of the Shipbuilding Department, which is in charge of inspecting and receiving incoming goods, took over responsibility for checking the delivery of items ordered from the Repair Works Management Section of the Ship Repair Department. A scheme was also created enabling the section to take photographs during inspections of actual incoming goods in order to conduct post-inspection verification.

Additionally, steps will be taken to strengthen related internal checks. In principle, departments making purchase requests have been prohibited from specifying specific suppliers when making such a request. If there is a specific reason for suppliers being specified, the requesting department must submit documentation explaining its reasons to the procurement department in advance to obtain approval.

(3) Review of organizational structure

The Ship & Offshore Structure Business Division has reviewed its organizational structure with the aim of further reinforcing measures to prevent the recurrence of the issues described in (1) and (2) above. Owing to the historical background of its marine vessel repair business, and the specialized knowledge and expertise required to conclude repair contracts and perform actual repair work, the Ship Repair Department is not only responsible for its own principal functions, namely, process and execution management, but also for its integrated related functions, including preparing key information serving as the basis of quotes, coordinating with customers to determine specifications, formulating budgets for the

performance of repair work, requesting the procurement of materials and reporting on the costs incurred. As a consequence, effective internal checks were difficult to ensure.

Going forward, the division will also seek to strengthen internal checks across departments by establishing a department that will exclusively handle process and execution management, and by separating out and transferring other functions to departments specifically responsible for estimates, sales and warehouses.

The division will further strive to ensure stringent compliance. In line with the recommendations of the Special Investigative Committee for Submarine Repairs, efforts will focus on working to instill a correct understanding of contracts and special agreements with the MOD, as well as on providing education regarding the National Public Service Ethics Code.

5. Groupwide responses

Cognizant of the gravity of this and other recently identified compliance violations, on April 16, 2024, the Company has established the Special Compliance Promotion Committee, which is chaired by Representative Director, President and CEO Yasuhiko Hashimoto. This committee is working diligently not only to clarify and eradicate the governance problems that led to these specific incidents, as well as any other cases of misconduct discovered within the Group, but also to prevent recurrence by scrupulously reforming the Company's compliance and governance frameworks through the building of systems that prevent misconduct, strengthening of detection capabilities and reform of its corporate culture.

(1) Creation of a system that discourages be misconduct

Because this misconduct pertained to procurement operations, the Company began its exploration in this area. Regarding procurement by the Company and/or its domestic Group companies for which there is a risk of similar misconduct—accounting for approximately 5% of the value of total Group procurement—a survey was conducted under the supervision of the Special Investigative Committee for Submarine Repairs that sought to prevent misconduct in procurement processes Groupwide by ascertaining whether systems are in place to prevent the completion of all related processes within a single department, and ensuring that approval cannot be given by the individual in charge on his or her own, and whether data is being managed appropriately, with the aim of identifying related risks and implementing corrective measures to eliminate such risks.

A total of 713 responses were received, of which 100—representing around 0.7% of the value of total Group procurement—indicated high risk levels. Corrective measures for all 100, including the tightening of rules governing physical confirmation and the introduction of additional approval procedures to ensure effective internal controls, are expected to be completed by March 31, 2025.

Consolidated subsidiaries overseas will also be surveyed. Plans are to conduct a stringent inquiry and to put appropriate corrective measures in place in fiscal 2025.

(2) Strengthening of systems for preventing recurrence

(a) Reinforcement of governance in the defense business

With the expansion of its defense business, the Company will oversee the defense business–related operations of each division, centralizing defense business management at the head office to boost governance and compliance, as well as the security framework.

To integrate the management of defense business–related information and create a unified contact point for external parties, particularly public relations officers, on November 1, 2024, the Company established the Corporate Defense Business Management Division.

(b) Strengthening of the audit and compliance functions

The Company will explore a review of Group audit and compliance systems, targeting the second and third lines of defense, with the goal of bolstering its ability to detect and prevent misconduct. The Company plans to realign its audit and compliance departments, as well as to augment related systems, by around April 2025.

(c) Promotion of efforts to prevent accounting-related misconduct

With the view that appropriate accounting procedures are essential to compliance, the Company is advancing various efforts to prevent misconduct in the area of accounting. In addition to tightening internal regulations and rules governing the calculation of expenses incurred by employees in the performance of their duties, the Company will reinforce checks on the expense calculation system, introduce data audits to consistently monitor Group employees' expense calculations, and take steps to detect and prevent accounting-related misconduct as swiftly as possible.

(d) Fortification of the whistleblowing system

The Group has deployed a compliance consultation and reporting system worldwide that allows employees to seek advice promptly regarding compliance issues, including employee misconduct or harassment, without going through their superiors or other germane parties. To promote the use of this system, the Company will continue to disseminate information through internal media, including the Group newsletter and intranet, as well as posters and leaflets. Steps will also be taken to encourage confidence in whistleblowing as a key to the resolution of such issues by introducing case studies illustrating its value in bringing about vital improvements.

(3) Efforts to modify the Company's corporate culture and transform attitudes

(a) Establishment of basic legal and compliance policies

To compensate for a lack of legal and compliance awareness, the Company is fostering a compliance-first mindset, believing that compliance must take precedence in every situation and that any gains from corporate activities that violate laws, regulations or social norms are meaningless. The Company has established basic legal and compliance policies, as well as new and revised internal regulations, and is encouraging efforts to improve awareness.

(b) Strengthening of compliance education

In addition to continuing existing compliance education initiatives targeting Group employees, including code of conduct read-through sessions and e-learning, the Company is taking steps to

promote a compliance-first mindset, including by sharing information on and encouraging discussion of compliance issues at Board of Directors' and management meetings, and by releasing regular messages from the president conveying the importance of compliance.

The Company is also accelerating compliance education. Recognizing that managers, department heads and others particularly familiar with the workplace are key to preventing compliance violations, the Company encourages these individuals to create work environments that encourage employees to recognize misconduct promptly and empowers them to speak out and take the initiative. The Company is further strengthening compliance education by disclosing detailed information on past incidents, including those that led to disciplinary action, and implementing training programs that encourage employees to see compliance as a personal responsibility and foster a strong ethical sense.

(c) Creation of positive work environments

An important factor behind this incident of misconduct is a work environment that deters employees from raising their voice when something is amiss and speaking the truth without fear. The Company is striving to create work environments conducive to freedom of expression to discourage compliance-related issues and to facilitate swift responses in the event such issues arise. Specific measures will include accelerating efforts to create regular opportunities for one-on-one communication between supervisors and subordinates with the aim of encouraging supervisors to actively listen to the views of the people they oversee, as well as conducting regular engagement surveys and using 360-degree feedback on managerial staff, to gain an objective understanding of current workplace conditions.

Furthermore, officers responsible for specific businesses visit workplaces to interact directly with employees in a bid to better grasp the actual situation on the ground. In the Ship & Offshore Structure Business Division, for example, opportunities have been created for direct dialogue with employees, including by holding roundtable meetings of division heads and managers, and of division/department general managers, manufacturing site general managers and other personnel.

In addition to reinforcing and adding depth to these measures, the Company will expand its efforts to improve work environments by, among others, listening carefully to observations and questions about its corporate culture from new employees and mid-career hires, promoting diversity through regular human resource exchanges, and taking steps to preclude inflexibility.

The Group will continue to take seriously the causes of this misconduct identified by the Special Investigative Committee for Submarine Repairs, which comprises neutral third-party experts, as well as to implement measures to prevent recurrence in line with the committee's recommendations, in order to strengthen the its compliance and governance framework.

— End of document —

December 27, 2024

Submitted to:
Kawasaki Heavy Industries, Ltd.

Interim Investigation Report

[Summary Version]

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I. Outline of the Entire Investigation

1. Establishment of the Special Investigation Committee

On June 14, 2024, KHI established the Special Investigation Committee (“**Committee**”), and commissioned the Committee to conduct an investigation (the investigation by the Committee is hereinafter referred to as the “**Entire Investigation**”).

2. Matters to Be Investigated and Analyzed by the Committee

The matters to be investigated and analyzed by the Committee are as follows:

- (i) Investigation into the facts and circumstances of the present case of impropriety in question (“**Case**”) (“**Investigation**”);
- (ii) Investigation into whether there were any other cases of systematic impropriety similar to the Case at KHI and its group companies in Japan, and the facts and circumstances in connection therewith (“**Investigation of Similar Matters**”); and
- (iii) Analysis of the causes of the impropriety referred to in (i) and (ii) above, and the proposal of measures to prevent recurrence of such impropriety.

3. Composition of the Committee

The composition of the Committee is as follows:

Committee Chairman	Toru Watanabe	Attorney-at-Law	Kitahama Partners
Committee Member	Masafumi Kodama	Attorney-at-Law	Kitahama Partners
Committee Member	Akinori Tani	Attorney-at-Law	Kitahama Partners

4. Period of Investigation and Status of this Interim Investigation Report

The Committee conducted the Entire Investigation from June 14, 2024, to December 26, 2024. This Interim Investigation Report presents the findings of the Entire Investigation in connection with the Case during that period. Subsequently, the Committee will continue the Entire Investigation after December 27, 2024, and will report the final findings of the Entire Investigation in the form of a final investigation report.

II. Findings

1. Findings of the Investigation

As a result of the Investigation, the following impropriety (“**Misconduct**”) was found in the Ship Repair Department, Kobe Shipyard:

(1) Mechanism of the Misconduct

A. Outline of the Submarine Repair Work and Contracts Handled by the Ship Repair

Department, Kobe Shipyard

There are two types of submarine repair work (“**Repair Work**”): regular inspection work performed every three years (“**Regular Inspections**”); and annual inspection work performed every year between Regular Inspections (“**Annual Inspections**” and together with Regular Inspections, collectively referred to as “**Regular/Annual Inspection Work**”). The required period of time for Regular/Annual Inspection Work is approximately eight and a half (8.5) months for Regular Inspections and approximately two and a half (2.5) months for Annual Inspections.

In the process of carrying out the Repair Work, the submarine crew members (“**Crew Members**”) use their onshore office facility (Dock House) and accommodation building (Kaiyukan) arranged by KHI in accordance with the contract.

The submarine repair contracts (“**Repair Contracts**”) between KHI and the Japan Maritime Self-Defense Force Kure District Headquarters and the Yokosuka District Headquarters (collectively referred to as the “**Headquarters**”) were concluded after having repeated coordination between KHI and the Superintendent of the Repair Supply Facility, the details of the specifications being finalized by the Repair Supply Facility, and the Headquarters formally requesting KHI to provide estimates based on the specifications, followed by business discussions between KHI and the Headquarters.

When KHI undertook the Repair Work, the Responsible Manager of Submarine Repair Work was appointed under the Senior Manager of Ship Repair Department to supervise the entire submarine repair work, the Repair Work Manager (managerial level) was appointed under the Responsible Manager of Submarine Repair Work to supervise the Repair Work on a per Repair Work basis, and the person or persons in charge of the Repair Work (“**PIC**”) were also appointed under the Repair Work Manager to supervise the Repair Work which was divided into several parts, such as the hull, engine, electricity, weapon mechanisms, and weapon electronics.

In the process of concluding a Repair Contract, for KHI to prepare the cost estimate, the PIC prepared the necessary information for a quotation for the parts for which he or she was responsible, and when carrying out the Repair Work, the PIC was also in charge of the preparation and progress management of the process plan for the parts for which he or she was responsible. As part of his or her role, the PIC had been given the authority to prepare a purchase request forms of materials necessary for the Repair Work

B. Type (1)

The Misconduct began with the following conduct (such conduct is hereinafter referred to as “**Type (1)**”):

(a) Method of Ordering and Delivering the Items Requested by Crew Members

When carrying out the Repair Work, the Crew Members would request PICs to procure certain items (“**Items Requested by Crew Members**”) by issuing a list of the Items Requested by Crew Members (“**List of Requested Items**”) to PICs in order to obtain items that were not listed in the specifications of the Repair Contract and could not be obtained as authorized items, but were considered necessary by the Crew Members for the maintenance work performed concurrently with the Repair Work or for work performed when the Crew Members were aboard the submarine.

Upon receiving the List of Requested Items, PICs passed the List of Requested Items to X1, X2 or X3 (X1, X2 and X3 are hereinafter collectively referred to as the “**Suppliers**”) and ordered the Items Requested by Crew Members.

Upon receiving the orders from PICs, the Suppliers procured the Items Requested by Crew Members on the List of Requested Items and delivered those items to the Ship Repair Department 4WK Items Management Office (“**4WK**”), and informed the PIC of the delivery.

(b) Fictitious Order Placements and Cross-checking Process to Create Funds relating to the Orders of the Items Requested by Crew Members

The PIC, in placing the orders for the Items Requested by Crew Members with the Suppliers, placed fictitious orders with the Suppliers who were colluding with the PIC, in the same manner as placing legitimate orders for items by creating fictitious purchase request forms quoting curing materials, etc. as expense items, or by affixing a seal on fictitious purchase request form created after submission of fictitious request form for purchase of the items by the 4WK, despite the fact that the items stated in the purchase request forms would not be actually delivered.

Although the Suppliers receiving the placement of fictitious orders did not actually deliver the items stated in those fictitious order forms, the 4WK affixed a seal on the statement of delivery and receipt in the circumstance where no items stated in the order form were delivered.

C. Type (2)

The following conduct was taking place in the Ship Repair Department, Kobe Shipyard which derived from Type (1) (“**Type (2)**”).

The Repair Work at the Kobe Shipyard is carried out by on-site workers (“**Site Workers**”) who belong to the Shipbuilding Department.

In response to the requests from the Site Workers, the PIC procured items used in carrying out on-site work which should have normally been purchased by the Shipbuilding Department (“**Items Requested by Site Workers**”).

There were cases where requests had not been met when using the usual procurement method, and even in the case where requests were met, it would take time to procure the Items Requested by Site Workers. Therefore, the Site Workers began to request the PIC to procure items deemed necessary for carrying out the Repair Work. Since the PIC was aware of the above situation, the PIC procured those Items Requested by Site Workers by using the scheme of Type (1) believing that the failure to procure the items necessary for seamlessly carrying out the Repair Work would interfere with the progress of the Repair Work that he or she was in charge of.

D. Type (3)

Personal items were also procured by the PIC (the type of conduct relating to the procurement of personal items is hereinafter referred to as “**Type (3)**”).

There were two types of personal items: personal items provided to the Crew Members and personal items acquired by the PIC.

Some PICs refused to procure personal items of the Crew Members if the List of Requested Items included items considered to be for their personal use, but there were a certain number of PICs who were unhesitant in accepting the request. In addition, there were a certain number of PICs who did not want to be involved in procuring personal items, but did not confirm the contents of the List of Requested Items (without checking whether personal items were included or not) and passed the list to the Suppliers to respond to the request of the Crew Members.

E. Type (4)

(a) Receipt of Benefits

In addition to personal items, there were some PICs who were receiving money for food and drink expenses, cash vouchers (mainly beer vouchers), and other benefits using the scheme of Type (1) (this type of conduct relating to the receipt of benefits other than personal items is hereinafter referred to as “**Type (4)**”).

(b) Receipt of Money for Food and Drink Expenses

A certain number of PICs had to spend considerable sums of money at their own expense every time a social gathering with the Crew Members was held. Some PICs took Site Workers out drinking and paid for most of the expenses associated therewith.

In order to mitigate such financial burden, some PICs, for example, tried to reimburse themselves for the associated expenses by giving X1 receipts for such social gatherings and receiving amounts nearly equal to the amounts stated in the receipts.

(c) Receipt of Cash Vouchers

As a method of using money for food and drink expenses, the PICs received cash vouchers, such as beer vouchers, and used those vouchers to pay for food and drinks at restaurants where such vouchers were accepted.

(d) Receipt of Other Benefits

Some PICs placed fictitious orders with X2, etc., and received in cash part of the amount appearing in the fictitious orders.

(2) Flow of Money in the Misconduct (X1)

A. Period Covered by the Investigation

The Committee investigated the total amount of money paid by KHI to X1 under fictitious orders and the amount of such money per use for six fiscal years from FY2018 to FY2023.

B. Total Amount of Money Paid under Fictitious Orders

The money obtained by X1 under fictitious orders was deposited into the deposit account of X1 and pooled in X1 to be used as a source of various payments (the money paid to X1 by fictitious orders and pooled in X1 is hereinafter referred to as “**Pooled Funds (X1)**”).

The total amount of money paid by KHI for all of its transactions with X1 was approximately 1.832 billion JPY (rounded down to the nearest million JPY; the same shall apply hereinafter) for the six fiscal years from FY2018 to FY2023. Of this amount, the total amount of money paid by KHI for fictitious orders with X1 was approximately 1.458 billion JPY (the amount for legitimate orders was approximately 3.73 million JPY).

C. Delivery of Replacements A

In the List of Requested Items, there were items which did not apparently seem out of the ordinary business for X1 to procure and deliver in its trading channels as a trading company related to the shipbuilding industry, and there were items which did seem out of the ordinary business. The former was delivered to KHI with the Pooled Funds (X1) as the source of funds (the products delivered by the use of the Pooled Funds (X1) as the source of funds are hereinafter referred to as “**Replacements A**”).

The amount recorded by X1 as the sales of Replacements A was approximately 424

million yen for the six fiscal years from FY2018 to FY2023.

D. Generating Money Off-the-books by Fictitious Re-orders to the Secondary Suppliers and Refunneling of Purchase Proceeds

As for the products that seemed out of the ordinary business to be procured and delivered by X1 as a trading company related to the shipbuilding industry, X1 used the following methods (i) to (iii) to generate money that did not appear on the books of X1 from the Pooled Funds (X1), purchase the products from the general market using such money, and deliver those products to KHI (the products delivered from the money generated from the Pooled Funds (X1) (the money is “Off-the-books Money (X1)”, which will be defined later) are hereinafter referred to as “Replacements B”).

- (i) X1 used the Pooled Funds (X1) to place fictitious orders to any of the four suppliers Y1, Y2, Y3, and Y4 (these four suppliers are hereinafter collectively referred to as the “**Secondary Suppliers (X1)**”) on the premise that the ordered items will not be delivered (“**Fictitious Re-orders**”).
- (ii) X1 received vouchers from the Secondary Suppliers (X1) as if the ordered items were actually delivered, and at the same time, paid the prices for the Fictitious Re-orders to the Secondary Suppliers by bank remittance.
- (iii) The Secondary Suppliers (X1) obtained 20% of the prices paid in (ii) above as a margin, withdrew the remaining 80% over the counter at a bank, etc., converted it into cash, and delivered it to X1.

Consequently, in cooperation with the Secondary Suppliers (X1), X1 refunneled part of the Pooled Funds (X1) as cash to produce money that did not appear on the books (the cash funneled back into X1 after deducting the margin of the Secondary Suppliers (X1) out of the amount paid to the Secondary Suppliers (X1) by Fictitious Re-orders is referred to as the “**Off-the-books Money (X1)**”).

Such Off-the-books Money (X1) was used for Type (4) as well as for the purchase of Replacements B.

For the six fiscal years from FY2018 to FY2023, X1 recorded an amount of approximately 1.028 billion JPY as the sales of fictitious orders corresponding to Fictitious Re-orders, of which the amount paid to the Secondary Suppliers (X1) through Fictitious Re-orders (purchase amounts) was approximately 732 million JPY. Of this amount, the margin obtained by the Secondary Suppliers (X1) was approximately 146 million JPY, and the amount of the Off-the-books Money (X1) funneled back into X1 from the Secondary

Suppliers (X1) was approximately 586 million JPY.

The following table summarizes the respective amounts with respect to the flow of money in the Misconduct of X1.

(Unit: JPY)

FY	Amount of all of the transactions (Total)	Amount of legitimate orders	Amount of fictitious orders (A)	Sales of Replacements A (B)	Gross Profits of X1 (C)	Margins for Secondary Suppliers (X1) (D)	Off-the-books Money (A-B-C-D)
2018	316 million	61 million	255 million	50 million	32 million	32 million	130 million
2019	348 million	50 million	297 million	78 million	55 million	34 million	139 million
2020	321 million	58 million	262 million	70 million	49 million	29 million	118 million
2021	291 million	57 million	234 million	69 million	58 million	20 million	81 million
2022	320 million	68 million	252 million	94 million	71 million	20 million	82 million
2023	234 million	78 million	156 million	59 million	28 million	8 million	34 million
Total amount	1.832 billion	373 million	1.458 billion	424 million	295 million	146 million	586 million

(3) Flow of Money in the Misconduct (X2)

A. Period Covered by the Investigation

The Investigation covered the six fiscal years from FY2018 to FY2023, consistent with X1.

B. Outline of the Misconduct relating to X2

In response to requests from the PICs, X2 (i) procured the Items Requested by Crew Members, Items Requested by Site Workers, or personal items of the Crew Members or the PICs (such items delivered at the request of the Crew Members or Site Workers are hereinafter referred to as the “**Replacements**”), and (ii) provided cash to the PICs, and, in order to generate funds for the foregoing, received fictitious orders from the PICs.

The money obtained by X2 from such fictitious orders was deposited into the deposit account of X2 and pooled in X2 as slush funds to be used as a source of various payments (the money paid to X2 by the fictitious orders and pooled in X2 is hereinafter referred to as the “**Pooled Funds (X2)**”).

The total amount of money paid by KHI for all of its transactions with X2 was approximately 385 million JPY (rounded down to the nearest million JPY; the same shall apply hereinafter) for the six fiscal years from FY2018 to FY2023.

Of this amount, the total amount of money paid by KHI for fictitious orders with X2 was approximately 180 million JPY (the amount of legitimate orders was approximately 204 million JPY).

C. Delivery of the Replacements

X2 procured all of the Replacements using the Pooled Funds (X2) in the same manner as the procurement of Replacements A in the case of X1.

The amount X2 recorded as sales of the Replacements was approximately 160 million

JPY for the six fiscal years from FY2018 to FY2023.

D. Provision of Cash

Cash was provided by generating Off-the-books Money as follows:

- (i) The PICs, etc. placed fictitious orders with X2, along with requests for the provision of cash;
- (ii) X2 received payments for the fictitious orders in (i) above from KHI without actually delivering the ordered products;
- (iii) Using the proceeds from (ii) above as a source of funds, X2 placed Fictitious Re-orders with Y6 or Mr. B (both parties are hereinafter collectively referred to as the “**Secondary Suppliers (X2)**”). (Upon placing such Fictitious Re-orders, X2 obtained the difference between the fictitious order amounts and the Fictitious Re-order amounts as gross profit);
- (iv) The Secondary Suppliers (X2) received payments for the Fictitious Re-orders in (iii) above from X2 without actually delivering the ordered products;
- (v) The Secondary Suppliers (X2) obtained a part of the payments made in (iv) above as a margin, and returned the remaining part to X2; and
- (vi) X2 obtained a part of the money that had been returned in (v) above as its margin (hereinafter, together with the gross profit that X2 obtained in (iii) above, referred to as the “**Gross Profits / Margins**”), and provided the remaining part to the PICs, etc. mentioned in (i) above.

In this way, X2, with the cooperation of the Secondary Suppliers (X2), had part of the money obtained by the fictitious orders funneled back into X2 as cash, generating cash that did not appear on the books (Off-the-books Money) (of the amount paid to the Secondary Suppliers (X2) under the Fictitious Re-orders, the remaining amount after deducting the margin of the Secondary Suppliers (X2) from the cash funneled back into X2 after deducting the Margin of X2 is hereinafter referred to as the “**Off-the-books Money (X2)**”).

The Off-the-books Money (X2) was used to provide cash to some specific PICs, etc.

For the six fiscal years from FY2018 to FY2023, X2 recorded at least approximately 19 million JPY as sales of fictitious orders corresponding to Fictitious Re-orders, of which the amount funneled back into X2 from the Secondary Suppliers (X2) and provided to the PICs, etc. was approximately 9 million JPY.

The following table summarizes the respective amounts with respect to the flow of money in the Misconduct of X2.

(Unit: JPY)

FY	Amount of all of the transactions (Total)	Amount of legitimate orders	Amount of fictitious orders (A)	Sales of the Replacements (B)	Gross Profits / Margins of X2 (C)	Margins for Secondary Suppliers (X2) (D)	Off-the-books Money (A-B-C-D)
2018	92 million	65 million	27 million	27 million	0	0	0
2019	57 million	43 million	14 million	14 million	0	0	0
2020	54 million	29 million	25 million	25 million	0	0	0
2021	33 million	14 million	18 million	16 million	0	0	0
2022	48 million	15 million	32 million	27 million	1 million	0	2 million
2023	98 million	36 million	62 million	49 million	4 million	1 million	6 million
Total amount	385 million	204 million	180 million	160 million	7 million	1 million	9 million

(4) Flow of Money in the Misconduct (X3)

A. Period Covered by the Investigation

The Investigation covered the six fiscal years from FY2018 to FY2023, consistent with X1.

B. Outline of the Misconduct relating to X3

In response to the requests from the PICs, X3 delivered the Replacements, and, in order to generate funds therefor, received fictitious orders from the PICs.

The money obtained by X3 from such fictitious orders was deposited into the deposit account of X3 and pooled in X3 to be used as a source of various payments (the money paid to X3 by the fictitious orders and pooled in X3 is hereinafter referred to as the “**Pooled Funds (X3)**”).

Unlike the cases of X1 and X2, X3 did not generate cash that did not appear on the books (Off-the-books Money) by having a part of the Pooled Funds (X3) refunneled as cash with the cooperation of other business operators.

The total amount of money paid by KHI for all of its transactions with X3 was approximately 274 million JPY for the six fiscal years from FY2018 to FY2023. Of this amount, the total transaction amount obtained by X3 through fictitious orders was approximately 60 million JPY.

C. Delivery of the Replacements

X3 procured all of the Replacements using the Pooled Funds (X3) in the same manner as the procurement of Replacements A in the case of X1.

The amount X3 recorded as sales of the Replacements was approximately 60 million JPY for the six fiscal years from FY2018 to FY2023.

(5) Background as to How the Misconduct Was Perpetrated over a Long Period of Time

Of the Misconduct, Type (1) began at least 40 years ago (around 1985), and Type (2) through Type (4) began at least 20 years ago (around 2005).

A. Background as to How Type (1) Was Perpetrated over a Long Period of Time

(a) Special Relationship between the PICs and the Crew Members

Due to the nature of their work, the PICs had many opportunities to come into contact with the Crew Members and were in a position where they needed to establish good relationships with the Crew Members to seamlessly perform their own work.

In addition, during the course of carrying out the Repair Work, which is a lengthy period, the above-mentioned nature of the PICs' work was integral in fostering close relationships with the Crew members, going beyond a mere business relationship for all intents and purposes.

Furthermore, due to the living environment of the Crew Members, the relationship between the Crew Members and the PICs became closer through drinking parties, golfing, and other private exchanges between them.

(b) Necessity of the PICs to Seamlessly Perform Their Work

With respect to the items that the Crew Members considered were necessary for the maintenance work to be performed concurrently with the Repair Work, if the PICs refused the requests by the Crew Members, the considered necessary items for the Crew Members to facilitate their work would not be supplied, which may hinder the progress of the maintenance work by the Crew Members and ultimately the progress of the entire Repair Work. In addition, the items that the Crew Members considered were necessary for their work aboard submarines were also considered necessary for the performance of their duties. The Committee understands that, against this background, the PICs came to comply with the requests made in relation to Type (1) without any strong hesitation.

On the other hand, some PICs felt that, unless responding to the requests in relation to Type (1), they would receive negative evaluations from the Crew Members, which would make it difficult for that PIC to communicate with the Crew Members and would interfere with their work. As such, they came to the understanding that it behooved them to not avoid responding in furtherance of seamlessly performing their own work.

(c) Becoming Common Practice

Within the Ship Repair Department, even though the scheme of Type (1) was not a legitimate procurement procedure, it became a common practice as a matter of course, and an atmosphere that it was normal to comply with the Type (1) request when assigned as the main PIC was fostered. In addition, because many PICs complied with the Type (1) request, those who refused to procure the Items Requested by Crew Members or deferred such procurement to other PICs and did not procure the items by themselves, were

regarded by the Crew Members as not being an excellent PIC, and could not build a good relationship with them.

B. Background as to How Type (2) Was Perpetrated over a Long Period of Time

If any items considered necessary for the Repair Work were not procured, the Site Workers would not be able to seamlessly perform their work, which might have hindered the progress of part of the Repair Work for which a PIC was responsible. Under such circumstances, the procurement of the items considered necessary was perceived to be integral for the PICs to be able to perform their work, and the PICs came to carry out Type (2) in accordance with the scheme of Type (1) without any strong hesitation. As such, the Committee understands that this procedure became common practice, and that Type (2) continued for a long period of time.

C. Background as to How Type (3) Was Perpetrated over a Long Period of Time

The same circumstances as in Type (1) presented as factors that caused Type (3) to continue over a long period of time, and in addition, the following circumstances are also considered factors specific to Type (3).

(a) Indifference to Misconduct Due to Prolonged Acts of Type (1)

Some PICs came to carry out Type (3) to maintain good relationships with the Crew Members, witnessing the adverse reactions of the Crew Members against the PICs who refused to engage in Type (3). The Committee understands that, against this background, a PIC who carried out Type (3) gradually became indifferent to misconduct once they carried out Type (3), and eventually carried out Type (3) knowingly or having an awareness that the List of Requested Items contained the Crew Members' personal items. As such, it is understood that some PICs who gradually become indifferent to misconduct were the ones who came to carry out Type (3).

(b) Enjoyment of Benefits by the PICs

Among these cases of Type (3), there were cases where the PICs enjoyed certain benefits by requesting personal items of their own.

It was recognized that a PIC who responded positively to the requests of the Crew Members with respect to Type (3), he or she became even more indifferent to misconduct, and of the PICs who were also encouraged by business partners (Suppliers) to procure personal items of their own, they came to carry out Type (3) in order to obtain personal items to benefit themselves.

D. Background as to How Type (4) Was Perpetrated over a Long Period of Time

The Committee finds that, as many PICs had responded to the requests in Type (1) and placed fictitious orders, they were aware that a certain amount of Pooled Funds or Off-the-books Money was generated through fictitious orders, and vaguely aware or at least had some level of awareness that the reimbursements for food and drink expenses were paid using the Pooled Funds or Off-the-books Money generated through fictitious orders.

However, there were almost no PICs who proactively thought about or questioned the scheme, on any deep level, that facilitated the payment of money as reimbursements for food and drink expenses, and the PICs themselves were satisfied with the circumstances in which they also enjoyed certain benefits, and such scheme was passed from one PIC to another, and continued for a long period of time.

Regarding the issue of the provision of cash with respect to Type (4), the Investigation only confirmed the involvement of some specific PICs, and did not confirm the fact that it had become a common practice among overall PICs and was passed over for a long period of time.

(6) Mechanism That Facilitated Fictitious Orders

A. Repair Contracts

In recent years, a Repair Contract took the form of a general fixed-price contract, meaning that the contract amount is fixed at the time of conclusion of the contract. In the past (prior to 2013), however, some Repair Contracts took the form of a contract with a cost audit (a contract fixed post-performance or a contract with a clause stipulating the return of excess profit) in which a cost audit was conducted by the Ministry of Defense to determine the contract amount and associated profit therewith, and the contract amount did not allow profit exceeding a certified limit

B. Preparing an Execution Budget in KHI

After the contract amount was fixed following the conclusion of a Repair Contract, KHI would prepare an internal budget for the execution of the Regular/Annual Inspection Work (“**Execution Budget**”).

The reason why KHI prepared the Execution Budget separately from the budget for the Repair Contract is that the estimated amount for each category of expense items based on the specifications provided by the Headquarters was not consistent with the actual accounting category of the Repair Work at KHI, and it was necessary to manage the progress of the Repair Work based on the budget that reflected the actual accounting procedures at

KHI. For example, the quantity of consumable materials such as curing materials provided in the specification was insufficient, and it was necessary to reclassify the costs from processing costs to material costs in order to purchase necessary consumable materials.

In addition, the processing costs in a cost estimate submitted to the Headquarters was calculated based on the standard man-hours set for each inspection item and work item, which the Superintendent was aware of and had not been re-examined between the Ministry of Defense and KHI for a long period of time.

Such standard man-hours were basically not changed once established, unless there was a particular change in the work specifications. Therefore, there was a base for adding up profit by continuous corporate efforts such as changes and improvements in work methods.

The amount transferred from processing costs to material costs (mainly to the “curing materials”) basically followed the precedent of past Repair Work performance, which had been passed on continuously, resulting in the amount that included fictitious order amount.

C. Placement of Orders

In essence, fictitious orders were placed with the Suppliers in the following manner: (i) the PICs would submit a purchase request form himself or herself, or (ii) the PICs would request 4WK to submit a fictitious request form for the purchase of the items, and in turn, 4WK would submit a request form for the purchase of the items, and the order would be placed by submitting a purchase request form.

At the time when the present case of impropriety was discovered, Mr. F, who belonged to 4WK and submitted the request forms for the purchase of the items, was the only person who had submitted the request forms for the purchase of the items, and he did so in accordance with the instructions from the PICs, even though he was fully aware that fictitious orders had also been included.

D. Delivery

Mr. F was in charge of the deliveries from the Suppliers, namely X1 and X2. When receiving these deliveries, he had been instructed by his predecessor to affix the official seal of the person in charge of confirming delivery of the items on the statement of delivery without inspecting and confirming the items, and he did so himself.

The items requested by the Crew Members, etc., except for personal items, had been delivered to 4WK, and although Mr. F unequivocally knew that the items which had been delivered were clearly different from the normally expected and authorized items, he had deliberately ignored such irregularities.

2. Findings of the Investigation regarding Similar Matters

At the time of the preparation of this Interim Investigation Report, there were no findings of fact with respect to the Investigation of Similar Matters.

III. Analysis of the Causes of the Misconduct

1. Motive and Mental State

(1) Type (1)

In order to foster good relationships with the Crew Members and to facilitate the seamless performance of their work, the PICs believed that they had no choice but to respond positively to Type (1). Furthermore, since they did not feel any sense of collusion or hesitation, the PICs came to accept Type (1) as common practice.

(2) Type (2)

If any items considered necessary for the Repair Work were not procured, the Site Workers would not be able to seamlessly perform their work, which might have hindered the progress of part of the Repair Work for which a PIC was responsible. Under such circumstances, the procurement of the items considered necessary was perceived to be integral for the PICs to be able to perform their work, and the PICs began to engage Type (2) similarly with the scheme of Type (1) without any strong hesitation.

(3) Type (3)

Regarding the personal items of the Crew Members with respect to Type (3), the procurements were handled by a certain number of PICs who became indifferent to misconduct and who had formed the view that they could not reject the requests in order to maintain good relationships with the Crew Members. In addition, regarding the personal items of the PICs with respect to Type (3), the procurements were handled by a certain number of PICs who intended to benefit themselves and who had become even more indifferent to misconduct.

(4) Type (4)

With respect to Type (4), it was found that many of the PICs were vaguely aware that a certain amount of Pooled Funds or Off-the-books Money was generated through fictitious orders. The Committee also understands that they were vaguely aware or at least had some level of awareness that the reimbursements for food and drink expenses were paid using the Pooled Funds or Off-the-books Money generated through fictitious orders.

However, there were almost no PICs who proactively thought about or questioned the scheme, on deep level, that facilitated the payment of money as reimbursements for food and drink

expenses, and the PICs themselves were satisfied with the circumstances in which they also enjoyed certain benefits, showing that the PICs had the intention of continuing to enjoy the benefits.

(5) Understanding that Profits Should Not be Made Higher (Another Motive)

A. Understanding within the Kobe Ship Business Department

Within the Kobe Ship Business Department, in cases where there was a significant difference between the costs described in the cost estimate and the actual costs incurred carrying out the work, it was understood that the accuracy of the cost estimate might be brought into question, and there was an awareness of the possibility that the man-hours and volume of work would be reduced in the subsequent Repair Work by the Ministry of Defense.

B. Knowledge within the Ship Repair Department

Within the Ship Repair Department, most of the PICs who had been in their positions since the period when the cost audit was a material part of a Repair Contract (prior to 2013) in particular, were not aware that Repair Contracts post 2013 no longer included a cost audit stipulation. Even at the time of the Entire Investigation, such PICs were strongly of the view that they would not be able to obtain any profits if the profit margins exceeded the profit margins at the time of concluding a Repair Contract. Such PICs assumed supervisory roles such as JS Repair General Managers or Repair Work Managers and evaluated the PICs as excellent who could maintain profit margins close to the target values of the Execution Budget. Therefore, PICs who were newly appointed as the main PICs after 2013 thought that if the profit margins increased too much this would negatively affect the Repair Contract in some way, and they assumed that the profit margins should be closer to the target values.

When a profit margin was likely to exceed the target values, there were some incidents where a JS Repair General Manager or a Repair Work Manager instructed the PIC to lower the profit margin by giving instructions such as placing particular kinds of orders, in a way that allowed fictitious orders to some extent, although it is not understood that they suggested the PICs to place fictitious orders.

2. Opportunity to Perpetrate the Misconducts

(1) Causes at Each Stage from Concluding a Repair Contract to Delivery

A. At the Stage of Concluding a Repair Contract

One of the causes that facilitated the placement of fictitious orders was that a Repair Contract had been concluded which was not in line with the actual conditions of the Repair Work.

B. At the Stage of Preparing the Execution Budget

After the contract amount had been fixed at the time of conclusion of a Repair Contract, KHI prepared an Execution Budget. In essence, the amount of money, etc. reclassified from the processing costs to material costs followed the precedents of past Repair Work and was carried over, and as a result, the monetary value of fictitious orders was included. The preparing of an Execution Budget, including the reclassification of those expense items, was one of the causes that facilitated the placement of fictitious orders.

C. At the Stage of the Placement of Orders

An inadequate check system in the flow of the placement of orders in KHI is one of the causes that facilitated the placement of fictitious orders.

D. At the Stage of Delivery

One of the causes of the facilitation of this Misconduct was that only one person in charge at 4WK or the PIC had been inspecting and confirming the items delivered by the Suppliers, and a system for verifying deliveries was not in place.

(2) Ineffectiveness and Maladjustment of the Whistleblowing System

With respect to this Misconduct, it has not been confirmed that any incidents of whistleblowing by KHI's employees, including the PICs, occurred prior to the discovery of this Misconduct. KHI's whistleblowing system was ineffective and maladjusted with respect to this Misconduct.

3. Becoming Common Practice

(1) Type (1)

Within the Ship Repair Department, even though the scheme of Type (1) was not a legitimate procurement procedure, it became a common practice as a matter of course, and an atmosphere was fostered in which it was normal to comply with the Type (1) procedure when assigned as the main PIC.

Generally, in most organizations, an employee learns about the job and business practices from his or her supervisor, etc. If he or she commits a wrongful act as a result of following the instruction of their supervisor, etc., the culpability of the employee who committed such wrongful act is reduced.

In addition, due to the ingrained nature of the common practices, carrying out the procurement of the Items Requested by Crew Members by the PICs had become normalized in

the process of a PIC carrying out his or her work, and was routine. It is not an exaggeration to say that carrying out the procurement of the Items Requested by Crew Members had been practically institutionalized as part of the work of a PIC.

As such, once a wrongful act has become practically institutionalized in an organization, members of the organization continue to commit such wrongful act without any deep contemplation as to the nature of the wrongful act. Such a situation was observed in KHI.

(2) Type (2)

The scheme of Type (2) also became common practice to a considerable extent, for even though it was not the same as Type (1), many of the PICs had complied with the requests, and therefore, the circumstance was similar to Type (1).

(3) Type (3)

With respect to the scheme of Type (3), the requested items were personal items that had no relation to the Repair Work, etc., but this was also due to the fact that the scheme of Type (1) had become common practice.

This is because when an act of misconduct becomes common practice, the facilitation to deviate from the original misconduct becomes easier. During the course of this Misconduct becoming common practice, it is largely understood that the PICs deviated and expanded their acts of misconduct to procuring personal items.

(4) Type (4)

With respect to the scheme of Type (4), as Type (1) become institutionalized, it is largely understood that new forms of misconduct, such as the payment of money as reimbursements for food and drink expenses and the issuance of beer vouchers, occurred and further escalated under the premise that the source of funds generated by fictitious orders became the norm.

4. Organizational Culture

It is largely understood that this Misconduct had not only been perpetrated by specific PICs over a long period of time, but was also perpetrated over a long period of time by many of the PICs in turn, so to speak, as an organizational culture of misconduct, and that this Misconduct had been perpetrated continuously due to such organizational culture following the precedents that it was considered normal to perpetrate this Misconduct.

In addition, the Committee cannot help but conclude that there was an organizational culture based on a disregard for and a lackluster approach to compliance and the “laissez-fair attitude” in the Ship Repair Department.

IV. Measures to Prevent Recurrence

1. Further Promotion of Compliance Awareness

It must be noted that the Committee has concluded that adequate compliance awareness has not yet become institutionalized in KHI's entire organization, and proposes that KHI further promote compliance awareness post haste.

2. Review of the Conclusion Practice of Repair Contracts

The fact that Repair Contracts were concluded not in line with the actual situation of the Repair Work was one of the main causes that facilitated the placement of fictitious orders. Therefore, it was necessary to make the cost estimate conform to the actual situation of the work. However, since the cost estimate was prepared with respect to the inspection terms and work terms described in the specifications issued by the Ministry of Defense to KHI, it was possible that the specifications issued by the Ministry of Defense did not align with the actual situation of the work, and therefore, it is necessary for a reassessment of the calculus of costs and the system to facilitate such.

For this reason, it behooves KHI to directly consult with the Ministry of Defense and discuss how a Repair Contract should be formulated and concluded, including the specifications and cost estimate, so that it is in line with the actual situation of the Repair Work.

3. Establishment and Implementation of a Verification System in the Process of the Placement of Orders, Delivery, and Acceptance Inspection

The deficiencies in the process of the placement of orders, delivery, and acceptance inspection in KHI are several of the main reasons that facilitated the placement of fictitious orders. Therefore, the Committee is of the opinion that the process of the placement of orders, delivery, and acceptance inspection must be changed to prevent any future incident of the placement of fictitious orders, and a verification system must be established and appropriately implemented to inspect and confirm all future orders.

4. Further Enhancement of the Functioning of the Whistleblowing System

It is unequivocally understood that the whistleblowing system of KHI was not fully functioning with respect to this Misconduct. Based on this fact, the functional aspects of the whistleblowing system must be further enhanced.

5. Reform of the Organizational Culture

It is no small feat to reform an organizational culture that follows bad precedents, disregards compliance, and is based on a laissez-faire attitude; however, the Committee is strongly of the opinion that there is no other way but to promote various concrete measures based on KHI's top management taking the lead in reforming the organizational culture, and strongly and continuously sending out the message and policies of its top management.

End