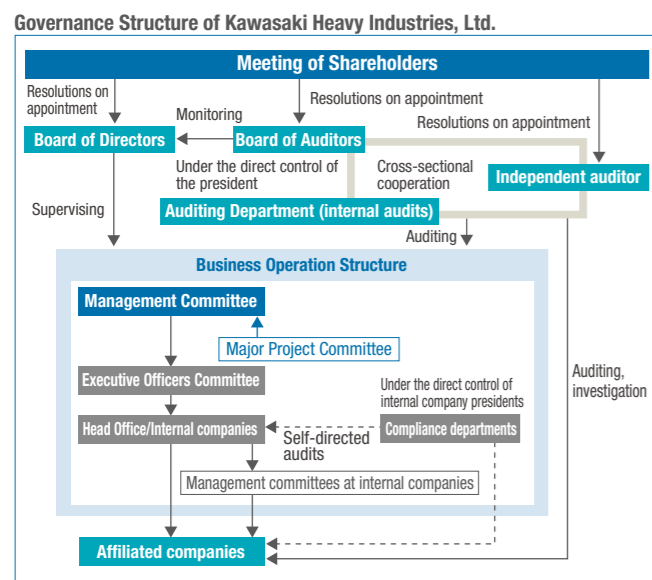


We will always act with integrity and good faith to merit society's trust.

More information on Theme 2 "Management" is available in the Full Report.

Corporate Governance System

The Company has a Board of Directors, a Management Committee consisted of representative directors and others, and an Executive Officers Committee which includes all executive officers. As for directors, the Company appoints a director who does not have roles in the execution of operation. Also, the Company applies incentive-based compensation corresponding to their business performance and limits the term of office to one year. These conditions serve to clarify the management responsibilities of directors. The Company opted for the statutory auditor system with board of auditors and has appointed independent auditors. The board of auditors includes two outside corporate auditors with no business relationships or other vested interests in the Company. One of these outside corporate auditors is an independent officer as required by the Tokyo Stock Exchange.



Auditing Structure and Status

The Auditing Department, an internal auditing unit under the direct authority of the president, audits management activities in all the Group's business segments. Corporate auditors attend various meetings, including those of the Board of Directors and the Management Committee, and also review important documents and check the status of business operations and financial assets through periodic meetings with representative directors and business audits of corporate divisions and subsidiaries. With regard to independent auditing, KHI undergoes audits of its financial statements conducted by the independent auditor, KPMG AZSA LLC.

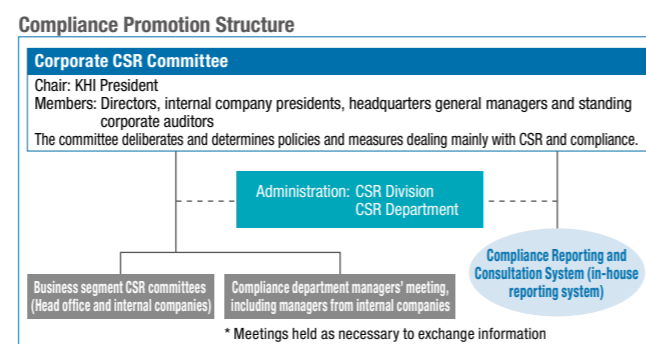
Compliance

Developing a Deeper Awareness of Compliance

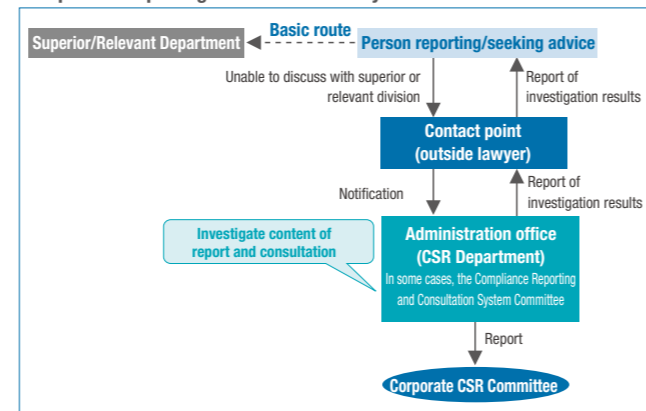
In fiscal 2012, KHI implemented a learn-by-example program to reinforce compliance in the workplace. This was a compliance activity shared throughout the Company. With the consent of newspaper companies, we prepared original instruction materials using newspaper articles describing various examples of actual corporate compliance violations, and superiors in all offices used these materials as the basis of presentations to instill the importance of compliance. In addition, to verify the effectiveness of such approaches in raising awareness of compliance issues, in February 2012 we directed a compliance awareness survey of all employees and temporary staff at Group companies in Japan.

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

In certain situations, employees who suspect a violation of compliance practices in their department may find it difficult to report the situation or seek advice from superiors or a department that would normally address alleged misconduct. We established the Compliance Reporting and Consultation System to solve this problem. In fiscal 2012, the system was used 18 times.



Compliance Reporting and Consultation System Flow Chart



TOPICS

Example of Compliance Education in the United States

At KCMA Corporation, a manufacturer of construction machinery—wheel loaders—in the United States, a code of conduct describing corporate ethics and compliance was created and all 120 employees became signatories to the document, thereby affirming their agreement to observe the code of conduct. Also, a company meeting is held every three months in which all employees participate and where the Senior Manager of the Personnel & General Affairs continues to bring up the importance of corporate ethics and compliance and reminds everyone to be alert to compliance issues. In this way, KCMA persistently strives to raise awareness of corporate ethics and compliance among its employees.



Crisis Management

To prepare for the possibility that risk might become reality, the KHI Group adheres to internally defined Crisis Management Regulations and has a structure in place to expedite the establishment of command centers to ensure a quick response in the event of a crisis. To prepare for crisis situations, we rely on the Crisis Management Organization, a horizontally integrated Group structure for crisis management.

Reporting Route in Times of Emergency

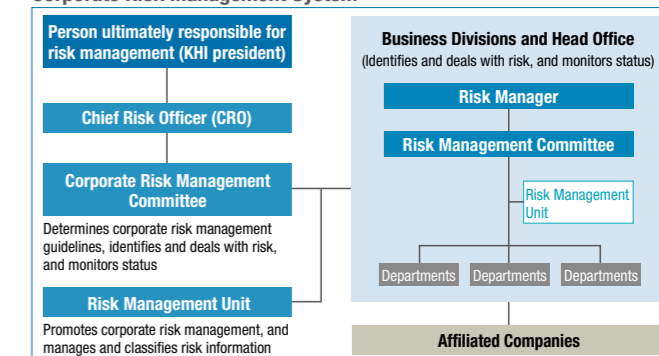
Should an accident or natural disaster occur, information gets to where it is needed through a predetermined reporting route for use in times of emergency. This route is made widely known to employees and executives through the Crisis Management Organization, which under normal circumstances underpins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

Risk Management

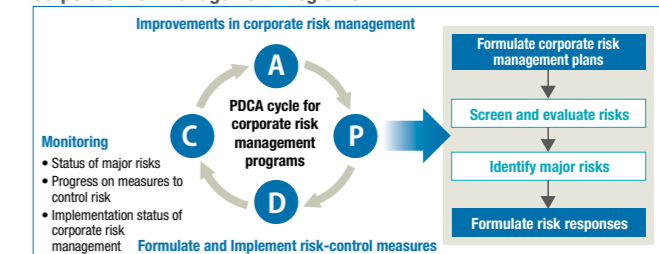
Under the Corporate Risk Management System, we have been implementing corporate risk management programs—an integrated process of screening and evaluating risk, identifying major risks and determining risk treatment, and formulating, executing, and monitoring risk-hedging policy—to pinpoint any major risks having a significant impact on business according to annual and universal risk criteria, and we are controlling

such risks with reasonable and appropriate methods from the perspective of enterprise management. Since fiscal 2012, the Corporate Risk Management System has been gradually introduced at domestic affiliated companies. We plan to establish the Corporate Risk Management System across the Group including overseas affiliated companies in fiscal 2014.

Corporate Risk Management System



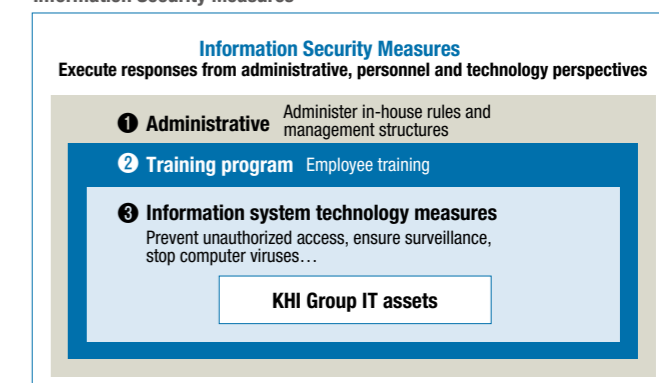
Corporate Risk Management Programs



Information Security Management

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

Information Security Measures



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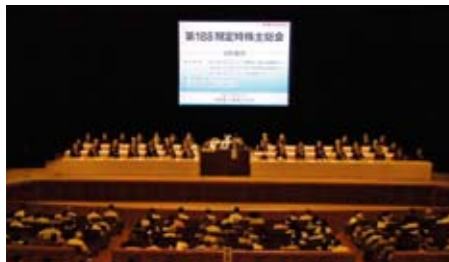
Relationship with Shareholders and Investors

General Meeting of Shareholders

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

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

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



General Meeting of Shareholders

IR Activities

We keep an open channel to shareholders and investors through various investor relations (IR) activities at home and abroad to promote communication.

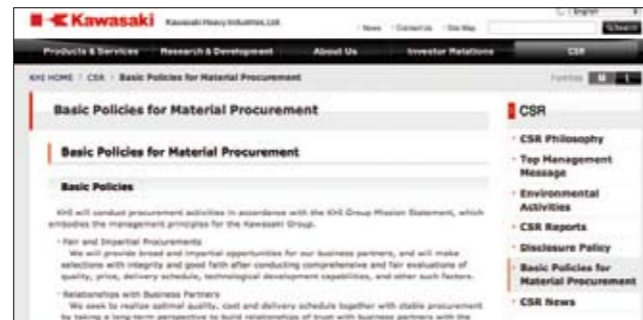
We hold financial performance briefings for institutional investors and analysts. Corporate representatives visit institutional investors outside Japan. We send shareholders our Business Report, an easy-to-understand update on management conditions. Also, we strive to enrich the content of the IR Information section on our website.

Relationship with Business Partners

Fair Transactions and Bonds of Trust

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

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



Basic Policies for Material Procurement (excerpt)

CSR-Driven Procurement

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

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



CSR Procurement Guidelines

Thorough Compliance

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

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

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