

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

## Ideal

Corporate Governance: Pursuing sound, transparent management, we will realize the independent operation of each business division and demonstrate the combined strengths of the Group.

Compliance: We will build an organization that is open and self-regulating in order to establish a corporate culture with credibility.

## Corporate Governance System

### Corporate Governance

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

### Overview of the Corporate Governance System

The Company opted for the statutory auditor system of corporate governance and has appointed independent auditors. The Chairman serves as the presiding officer of the Board of Directors, which consists of 11 directors (authorized number: 15 directors). The Company has four corporate auditors and a Board of Auditors. In addition to the Board of Directors, the Company has a Management Committee and an Executive Officers Committee, on which representative directors and managing executive officers sit. The Executive Officers Committee also includes executive officers.

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

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

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

As a rule, the Management Committee meets three times a month to discuss management policy, management strategy, important management issues, and other matters from the perspective of the Group as a whole.

### Status of Internal Control System Preparations

We are making progress on the establishment of the internal control systems described below and, with an emphasis on such factors as changes in the operating environment, will reassess matters as necessary in the future. The status of preparations in 2011 is as follows:

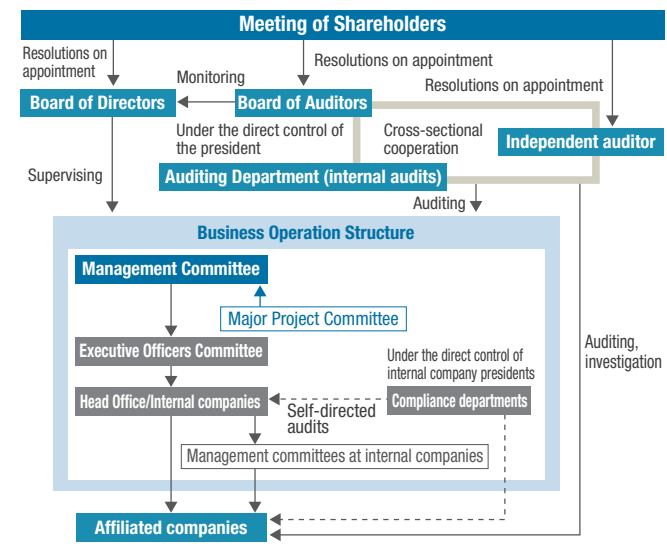
#### (1) Establishment Risk Management System

We revamped our risk management system into a corporate risk management system by appointing the president, who has ultimate responsibility for risk management, as chief risk officer (CRO) overseeing risk management practices and by forming the Risk Management Committee, which discusses important issues related to risk management and monitors the implementation status of responses to identified risks. In addition, we set up a risk management unit within the Corporate Planning Department at the head office to promote and support enterprise risk management, and we are shaping a structure for business segments that taps heads of the segments—that is, the presidents of internal companies—for the responsibility of risk management in their respective business segments.

#### (2) Framework for Promoting Compliance

Each business segment has its own compliance department, and structures are in place to promote initiatives to raise awareness of compliance issues. We encourage efforts to enrich the content of compliance education for employees to instill a deeper appreciation of compliance throughout the Group. Additionally, we introduced the Compliance Report and Consultation System, with access to an outside attorney, as a mechanism for employees to report and consult discreetly.

Governance Structure of Kawasaki Heavy Industries, Ltd.



## Auditing Structure and Status

### Internal Auditing

The Auditing Department, an internal auditing unit with a staff of 13 under the direct authority of the president, targets management activities in all the Group's business segments for audits to verify and evaluate effectiveness and efficiency in the execution of operations, the reliability of financial reports, and conformity to standards of compliance, namely corporate ethics and laws, and offers suggestions if audits indicate a need for improvement.

### Statutory Auditing

Corporate auditors attend various meetings, including those of the Board of Directors and the Management Committee, and also review important documents and check the status of business operations and financial assets through periodic meetings with representative directors and business audits of corporate divisions and subsidiaries. In addition, two outside

corporate auditors ensure the objectivity and neutrality of the management oversight function, and the full-time corporate auditors and outside corporate auditors share information and strive to enhance this function still further.

### Independent Auditing

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

## Compliance

### Measures to Promote Compliance

In fiscal 2011, a compliance-building activity undertaken throughout the Group involved the reconfirmation of compliance in every workplace using the Compliance Guidebook.

Each site utilized assembly opportunities, such as morning staff meetings, to instill a wider appreciation for compliance issues and actions. Many participants said the approach deepened their awareness of compliance, substantiating the success of this activity.

We will continue to promote compliance education in various formats, such as harassment seminars, which were first undertaken in fiscal 2009, and workplace dialogue like that recently undertaken.



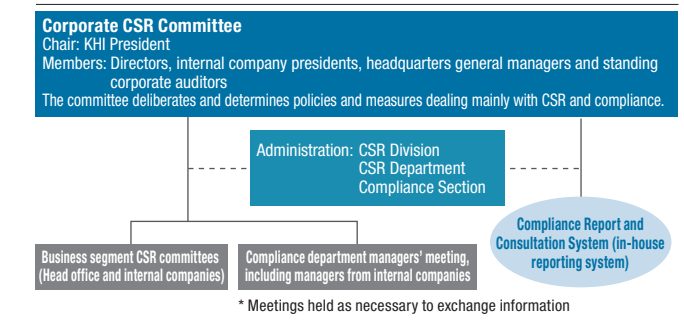
Compliance Guidebook

### Promoting Corporate Ethics and Compliance Overseas

We have decided to create the Kawasaki Global Business Ethics Guideline, featuring elements that are generally accepted in any country to facilitate application by local subsidiaries in emerging markets and developing nations, as well as small local subsidiaries in developed nations.


In addition, we took the opportunity afforded by promulgation of the new UK Bribery Act, which went into effect July 1, 2011, with a much broader scope of application, to emphasize to relevant divisions that they must be exceedingly cautious in extending corporate hospitality to foreign public officials lest such actions be misconstrued as acts of bribery.

### Compliance Promotion Structure



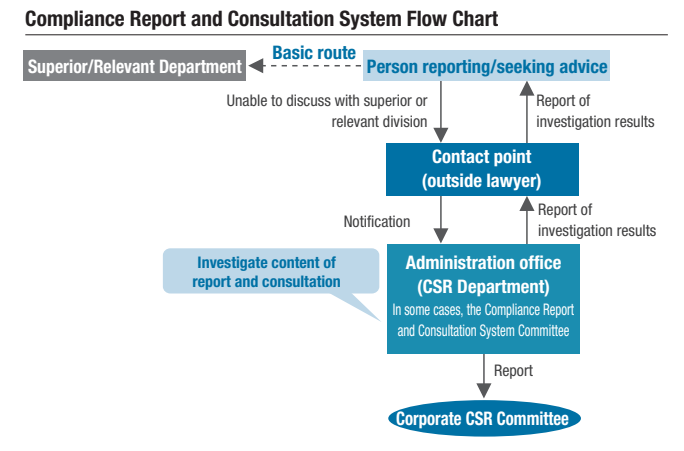
**Topics**  
**Example of Compliance Education in the U.S.**

Kawasaki Rail Car Inc. (KRC), a production point for rolling stock in the United States, issued a code of conduct, outlining corporate ethics and compliance. Every year, the company holds a code of conduct training for all employees (about 400 people). The training is presented by representatives from the personnel department who take participants through the entire document. Participants are given a short quiz comprising 20 questions and then check the answers together. At the end of the training, participants make a written pledge to respect the code of conduct. This training ensures that employees have a solid understanding of the code of conduct to which KRC subscribes.



KRC Code of Conduct training

We established the Compliance Report and Consultation System to solve this problem. To promote effective use of the system, we make employees aware of its existence, explain how to use it and post the results of its use. We do this through various channels, including the Compliance Guidebook, the intranet bulletin board and in-house newsletters. In fiscal 2011, the system was used 11 times.



**Compliance Report 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.

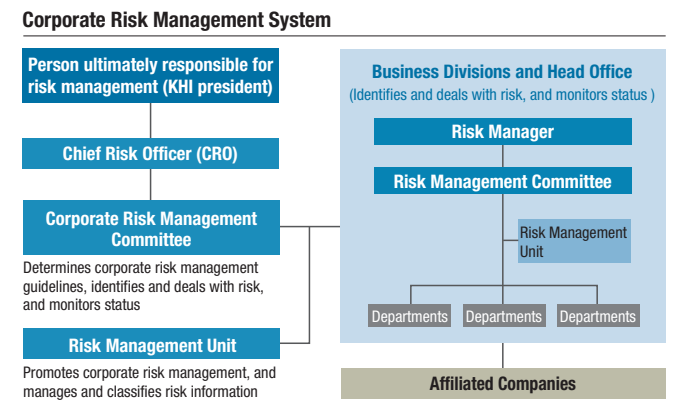
**Export Control**

To ensure that export-related laws are carefully observed throughout the Group, we drafted internal rules on export control for goods and technologies related to international safety and security, and we maintain an export control structure with a representative director taking primary responsibility for export control.

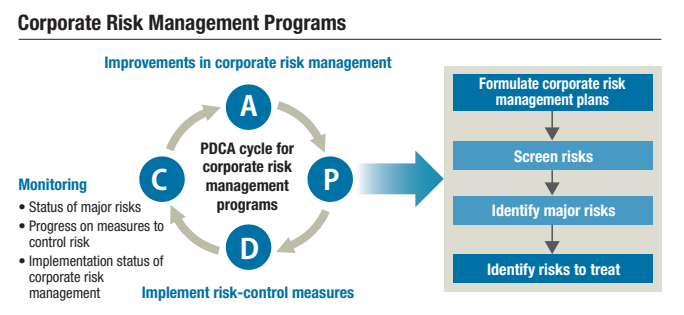
**Risk Management and Crisis Management**

**Risk Management**

Efforts to control risk run deep in our organization. The KHI president bears ultimate responsibility for risk management, while the Chief Risk Officer shoulders the duty of overseeing risk management activities. The Risk Management Committee discusses major items connected with risk management and monitors the implementation status of measures aimed at controlling risk. The Risk Management Unit promotes and supports risk management efforts throughout the Company, and similar structures exist in each business segment, with the president of each internal company acting as a risk officer, to facilitate effective risk management throughout the Company. In Fiscal 2012, the Corporate Risk Management System will be gradually introduced at affiliated companies.



Since Fiscal 2011 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 risks to treat, 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.



**Crisis Management**

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

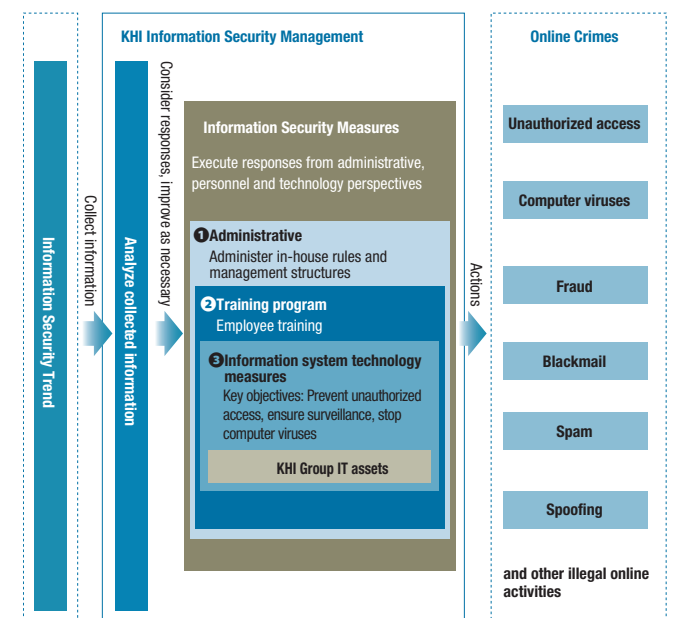
**Reporting Route in Times of Emergency**

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

**Information Security Management**

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

**Information Security Management System**



**Protecting Intellectual Property**

Our basic policy regarding intellectual property derived from R&D results emphasizes the acquisition of rights at home and abroad at appropriate times and concerted efforts to utilize these very valuable corporate assets to their fullest potential, primarily to grant us the freedom to develop business activities and to protect acquired technological excellence. To promote and manage these strategic intellectual property activities, we have a structure in place whereby the Intellectual Property Department in the Corporate Technology Division plans and implements corporate strategies, and also cooperates with intellectual property management departments in each business segment and provides support matched to respective business activities.





## Relationship with Shareholders and Investors

### General Meeting of Shareholders

At KHI, we believe the General Meeting of Shareholders—the highest corporate decision-making body of any company—is an important opportunity for communication between the Board members and our shareholders. To enable shareholders to properly consider important matters on which they will cast their vote at the General Meeting of Shareholders, we send out the convocation notice even earlier than required by law. In addition, we prepare an English version of our official Japanese-language convocation notice for the convenience of our shareholders overseas. Shareholders who are unable to attend the annual meeting in person now have the option of exercising their voting rights through the Internet or by mobile phone. At the meeting venue, we endeavor to present information, highlighting new developments and business results over the past year, in an easy-to-understand format utilizing video. Presentation videos from past meetings are available for viewing on our web site.



General Meeting of Shareholders

### Distribution of Dividends

Our basic policy on the return of profits to shareholders calls for a stable dividend appropriate to our performance, tempered by sufficient maintenance of retained earnings to strengthen and expand profitability and the business foundation in preparation for future growth. Taking an overall perspective, with particular consideration to future business performance and retained earnings, management resolved to pay a year-end dividend of ¥3 per share for fiscal 2011, the year ended March 31, 2011.

Ended March 31	2007	2008	2009	2010	2011
Net income (loss)	¥18.94	¥21.08	¥7.02	¥(6.51)	¥15.55
Dividends	¥5.00	¥5.00	¥3.00	¥3.00	¥3.00

### IR Activities

We strive to disclose timely and accurate business information, in accordance with the disclosure policy posted on our web site, and we keep an open channel to shareholders and investors through various investor relations (IR) activities at home and abroad to promote communication. For institutional investors and analysts, we hold interim and end-of-year financial performance briefings and one-on-one meetings. Corporate representatives visit institutional investors outside Japan to explain recent business performance and other critical information. In addition, we post the latest data, including performance forecasts, on our web site in the IR Information section, along with management policies, historical financial results by business segment, various accounting documents and presentation materials distributed at interim and year-end performance briefings. Also, at the end of June and in early December, we send shareholders our Business Report, an easy-to-understand update on management conditions and business content.



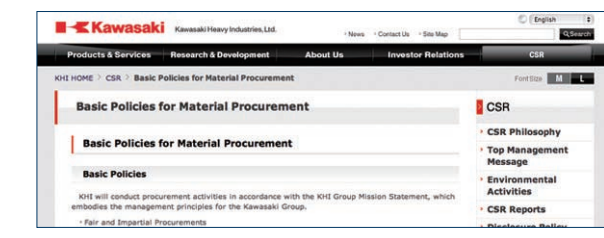
Disclosure policy posted on our website

For details, please visit our IR Information section online at <http://www.khi.co.jp/english/ir/index.html>

## Relationship with Business Partners

### Promoting Procurement with Basic Policies for Material Procurement

We established our basic position on procurement activities under Basic Policies for Material Procurement and posted this information on our web site in April 2011. Guided by these policies, we conduct procurement activities along the lines of our approach to CSR, with an emphasis on compliance, human rights, labor, safety and health as well as concern for the environment, and we encourage our business partners to join us in actively promoting CSR activities in the supply chain.



Basic Policies for Material Procurement (excerpt)

### Fair Transactions and Bonds of Trust

In accordance with Basic Policies for Material Procurement, we undertake procurement activities predicated on long-standing relationships of trust with our business partners. Coinciding with the establishment of these policies, we partially revised our Code of Conduct for Dealings with Business Partners, and everyone—including employees in design and manufacturing departments—who deals with business partners strives to carry out his or her duties in line with these guidelines. 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.



Code of Conduct for Dealings with Business Partners (excerpt)

### Reinforcing the “Partner” Sentiment in Partnership

We have organized cooperation-building associations for each business segment that have as their members business partners with whom the respective segment has developed particularly close ties. These associations promote cooperation based on mutual trust between KHI and its business partners and serve to foster a sense of coexistence and coprosperity. Specific activities, described below, reinforce the “partner” sentiment in our relationships with business partners.

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

### Promoting Green Procurement

In regard to green procurement, which encourages product manufacturing with low environmental impact, we formulated Green Procurement Guidelines fine-tuned to the specific issues that characterize each business segment. We also ask our business partners to establish environmental management systems and work with them to understand and manage the environmentally hazardous substances, which are included in parts and raw materials.