

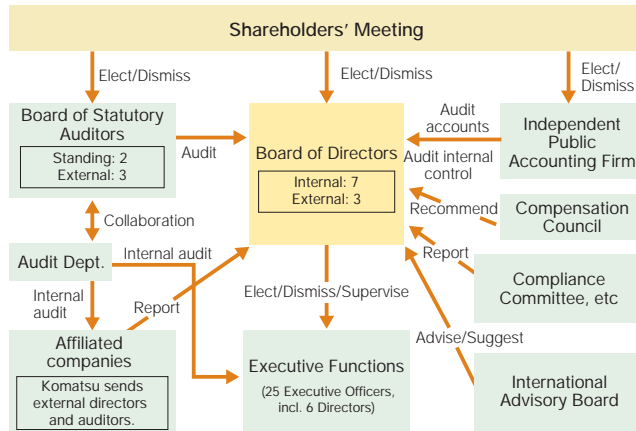
# Corporate Governance, Compliance, and Risk Management

In order to promote management that emphasizes corporate governance, the Komatsu Group is working to develop and strengthen its Board of Directors, executive officer system, and internal control. Moreover, as a result of its policy of putting compliance at the forefront, Komatsu has been promoting the observance of best business practices, dissemination of information, and the development of relevant systems.

## Corporate Governance

### System for Corporate Governance

To become a company which enjoys even more trust from all its stakeholders, Komatsu is working to strengthen corporate governance while maintaining its well-established corporate ethics, managerial transparency, and sound business practices on a group-wide basis.



As of June 23, 2006

### Organizational Profile

In 1999 Komatsu Ltd. introduced the executive officer system and has been working to separate management decision-making and supervisory functions from executive functions within the confines of the law. At the same time, the company has maintained the Board of Directors with a small number of members and appointed external directors and auditors. To improve the effectiveness of discussions in Board meetings, the company has promoted reforms in the operational aspect of Board meetings to ensure thorough discussions of important management agendas and quick decision-making.

#### Board of Directors and Directors

The Board of Directors meets every month and more often as needed. (The Board met 16 times in FY2005 [the fiscal year ended March 31, 2006].) In Board meetings, directors make decisions on management policies of the Komatsu Group, review and resolve important management matters, and strictly control and supervise the execution of management duties by all executive management personnel including the representative directors.

At present, of the ten directors on the Board, there are three external directors. When performing their duties, external directors offer opinions and suggestions from an independent position, based on their insight and rich experience. Their attendance rate at Board meetings is high, making contributions to ensure transparent and sound management through their active participation in discussions.

#### Board of Statutory Auditors and Auditors

While Komatsu Ltd. has consistently ensured that the number of external auditors represents half of the Board of Statutory Auditors, the company added one more auditor with the approval of shareholders at the annual shareholders' meeting held in June 2006, increasing the number of external auditors to three as shown in the figure above. Thus, Komatsu has strengthened the Board of Statutory Auditors with three external and two standing auditors. Auditors attend Board of Directors meetings and other important meetings, hear the conditions of execution of management duties from the directors and appropriately audit directors' performance. (The Board of Auditors met 16 times in FY2005.)

Komatsu's external auditors have extensive insights as top management officers or lawyers. Based on their expertise, they are responsible for auditing management decision-making processes as well as the legality and validity of the matters under discussion from their fair and neutral position.

#### International Advisory Board

In 1995 Komatsu established the International Advisory Board (IAB) to receive objective advice and suggestions from foreign experts. It meets twice a year to hold discussions and engage in information exchange. The term for advisors is set for three years, and the current members are in the fourth session. IAB has met a total of 22 times to date since the first session.

### Improvement of Internal Control

To ensure the efficiency of director's execution of duties, Komatsu is implementing the following.

- As described earlier, Komatsu works to maintain transparent and sound management by strengthening the management and supervisory capabilities of the Board of Directors. Komatsu has also set up operational rules for the Board of Directors.
- Komatsu has defined the separation of duties for directors, executive officers and other senior officers, and set up internal rules to ensure appropriate and effective execution of duties by directors.
- To promote efficient management of the Board of Directors, Komatsu has established a Strategy Review Committee consisting of senior executive officers and senior managers. Based on the reviews of the Committee, each executive officer and each senior manager executes his or her duties within the authority delegated by the Board of Directors.

#### Operational Framework to Ensure Effective Audits by Statutory Auditors

Statutory auditors of Komatsu attend various committee meetings related to internal control and other important meetings as observers. They also look through Japanese-style consensus-based, approved documents, which contain important decisions of the company, and important arbitrary documents. The Board of Statutory Auditors is regularly reported to by directors and executive officers concerning their execution of duties.

Furthermore, Komatsu has allocated employees who work as exclusive or concurrent assistants to statutory auditors. Concerning the recruitment, appointment, and personnel change of those employees, the approval of standing auditors is prerequisite. Standing auditors conduct performance evaluations of these employees to ensure their independence.

#### Collaboration between Statutory Auditors and the Internal Audit Department

The Internal Audit Department, in cooperation with other related departments, regularly audits business bases and affiliated companies both in Japan and overseas, evaluates the effectiveness of their internal control, reinforces their risk management and works to prevent frauds and errors. Statutory auditors observe audits by the Internal Audit Department, form their own audit opinions, and give advice and recommendations to the Internal Audit Department.

In addition to reporting the audit results above to the Board of Statutory Auditors, the Internal Audit Department maintains close and substantive collaborations with statutory auditors, for example, by providing information on a routine basis.



Munenori Nakao  
Senior Executive Officer  
Supervising Compliance and CSR

As we work to maintain and improve Komatsu's corporate value, we recognize the steadfast promotion of corporate governance, compliance, and risk management as the most important issue of all. To realize this, the management of Komatsu demonstrates robust leadership, and the continuous efforts of all Komatsu Group employees to promote these same values are considered essential.

In particular, with Japan's Corporate Law having entered into effect in May 2006, I as the executive officer supervising compliance and risk management have been striving to conduct my duties with the urgency of constructing an internal control system for the corporate Group firmly in mind.

## Following Best Business Practices (Compliance)

### Compliance

Komatsu has established the Compliance Committee as the group to oversee compliance, and the Committee regularly reports its reviews and activities to the Board of Directors. Komatsu also established a framework to ensure thorough compliance to business rules through a variety of measures, including the provision of *Komatsu's Code of Worldwide Business Conduct* (established in 1998 and revised five times to date), appointment of the executive officer in charge of compliance, and establishment of the Compliance Office. Moreover, Komatsu has established an internal reporting system through which persons reporting questionable actions and other compliance-related matters will not be penalized.

### State of Affairs in FY2005

In FY2005, as a result of inappropriately obtaining safety inspection clearance for a railroad service vehicle in the Japanese market, Komatsu and its subsidiary (at the time), as well as employees of both companies, were recipients of disciplinary action. With regard to this incident, Komatsu took steps to assess the situation quickly, issue public notification and apologies, eliminate the problem through the administrative guidance of governmental authorities, and implement policies to prevent recurrence. In addition, the Komatsu Group is making use of this incident as an opportunity to strengthen efforts to reinforce compliance at each Group company.

## Risk Management

While Komatsu continues to make efforts to improve corporate value, it recognizes the problems related to compliance, in particular, environment, product quality, accidents, information security and other matters, as major risks for continuous growth and is thus implementing the following countermeasures.

- Komatsu has established Risk Management Rules to correctly recognize and manage risks, for which the company has appointed personnel in charge of individual risks, further promoting the build-up of a solid foundation for risk management.
- Komatsu has established a Risk Management Committee to devise risk management policies of the Komatsu Group, evaluate risk measures in place, and take control of risks when they surface. The Risk Management Committee regularly reports its reviews and activities to the Board of Directors.
- Komatsu will establish an emergency headquarters when serious risks surface, and work to minimize damage(s) and implement appropriate measures.

### Activities in FY2005 and Future Plans

#### Formulation of a Business Continuity Plan\* for Komatsu Head Office

In preparation for a possible strong local earthquake under the Greater Tokyo Metropolitan area, the Komatsu Head Office has formulated both a disaster response system and a Business Continuity Plan for the main divisions at the Head Office and established a plan so that even if an earthquake should strike, major operations will be able to be carried out without suspension, or restored after only a short suspension.

Furthermore, as a means by which communications can be maintained with certainty and efficiency in the immediate aftermath of a disaster, an Urgent Communications/Safety Assessment System has been introduced. In addition, pocket-sized manuals explaining what to

do in emergency situations have been distributed to establish firmly the system for initial actions to be taken.

### Future Plans

The Komatsu Group intends to undertake actions in the following areas in the months and years to come.

- Improving the functions of the Risk Management Committee as a form of internal control
- Thoroughly reinforcing the Business Continuity Plan through education and other means

\*Plan that systematizes major operations across the entire company such that they can continue without suspension or can be brought back after only a brief suspension.

### Information Management

Komatsu safeguards and manages important information related to directors' execution of their duties, including the record of Board meetings and other consensus-based, approved documents, as stipulated by law and internal regulations.

It has established the Information Disclosure Committee to disclose information about important facts regarding decisions, facts regarding occurrences, and settlement of accounts concerning Komatsu Ltd. and other Komatsu Group companies in an appropriate manner based on laws and appropriate disclosure rules. The Committee takes control of, and works to improve the level of information disclosure.