

# Explanatory Memorandum on the Audit & Supervisory Board Members

(The companies with Audit & Supervisory Board)

Japan Audit & Supervisory Board Members Association  
(JASBA)

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# 1 Corporate Governance in Japan (two different systems)

In Japan, most of companies limited by shares must adopt either of the following two governance systems, namely the “Companies with Audit & Supervisory Board Members” or the “Companies with the Three Committees”.

※ 97.8% of the companies listed on the Tokyo Stock Exchange (2,275 companies in total) are Companies with Audit & Supervisory Board Members (as of September 2012)

## The Companies with Audit & Supervisory Board Members

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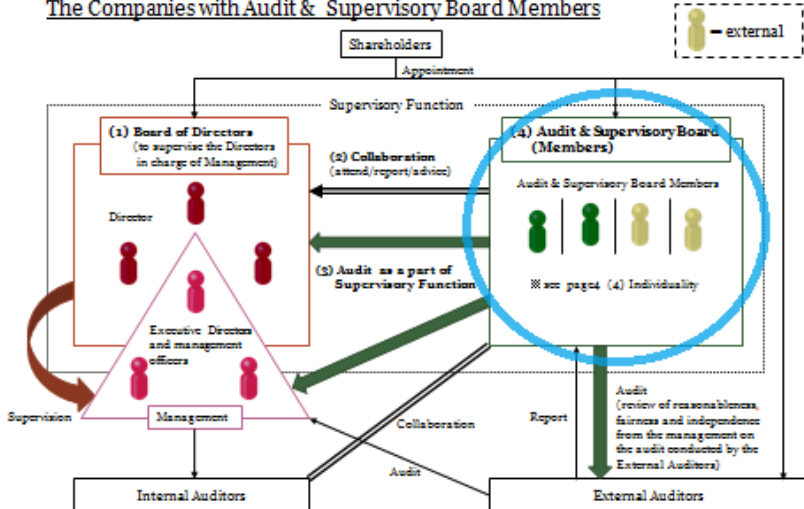
## The Companies with the Three Committees

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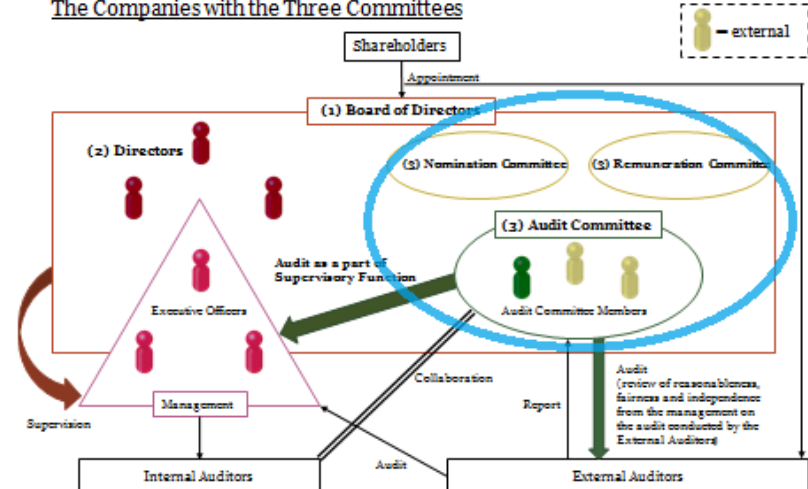
### 1 Corporate Governance in Japan (two different systems)

#### The Companies with Audit & Supervisory Board Members



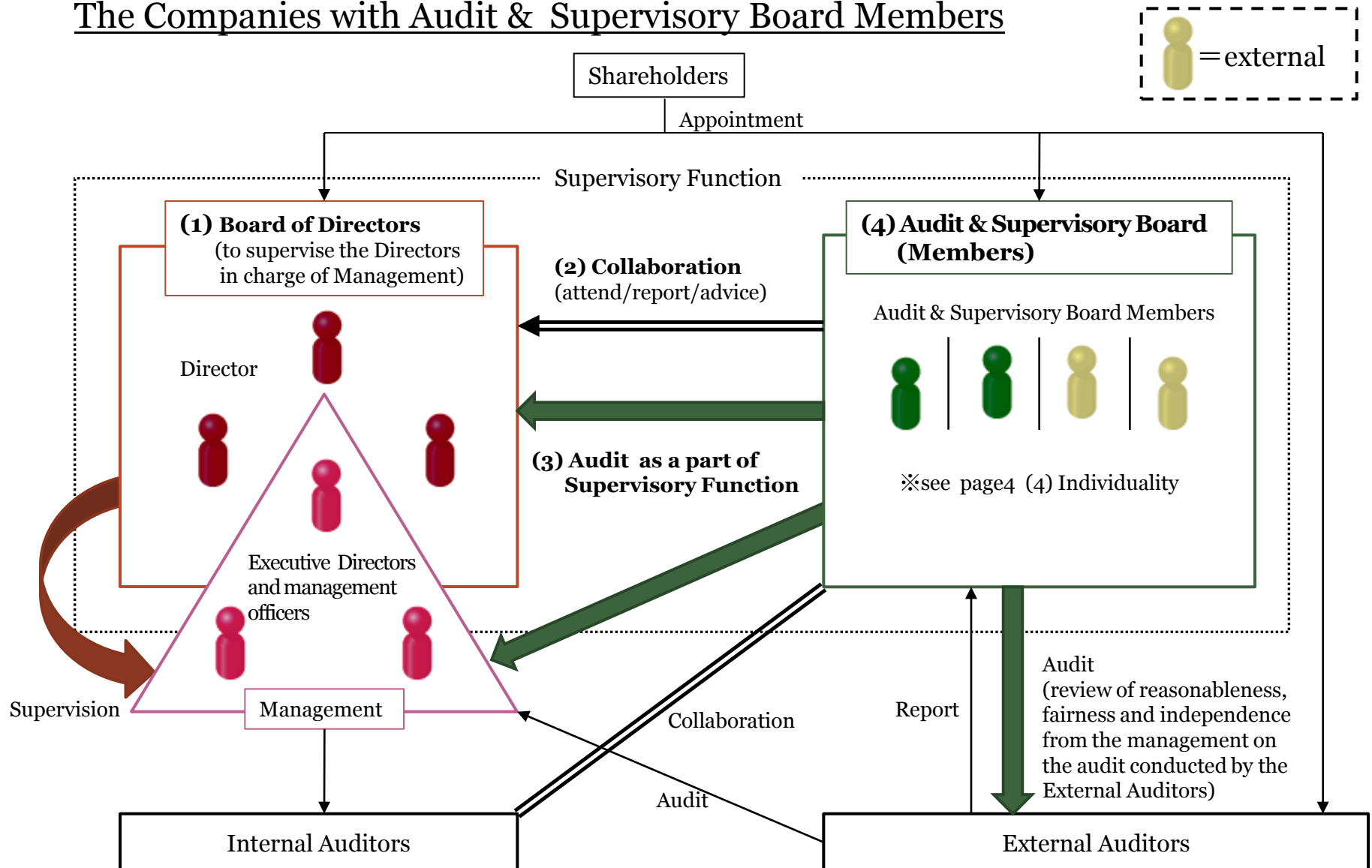
### 1 Corporate Governance in Japan (two different systems)

#### The Companies with the Three Committees



# 1 Corporate Governance in Japan (two different systems)

## The Companies with Audit & Supervisory Board Members



# 1 Corporate Governance in Japan (two different systems)

## Features of the Companies with Audit & Supervisory Board Members

### **(1) Board of Directors**

Each Director can act as a member of management as well as a member of the Board of Directors.

### **(2) Independence and Collaboration**

Each Audit & Supervisory Board Member (hereinafter referred to as the “Member”) is appointed directly by the shareholders. Each member is independent not only of management but of the Board of Directors though it is required to collaborate with the Board of Directors in performing its supervisory functions over management.

### **(3) Major Supervisory Function**

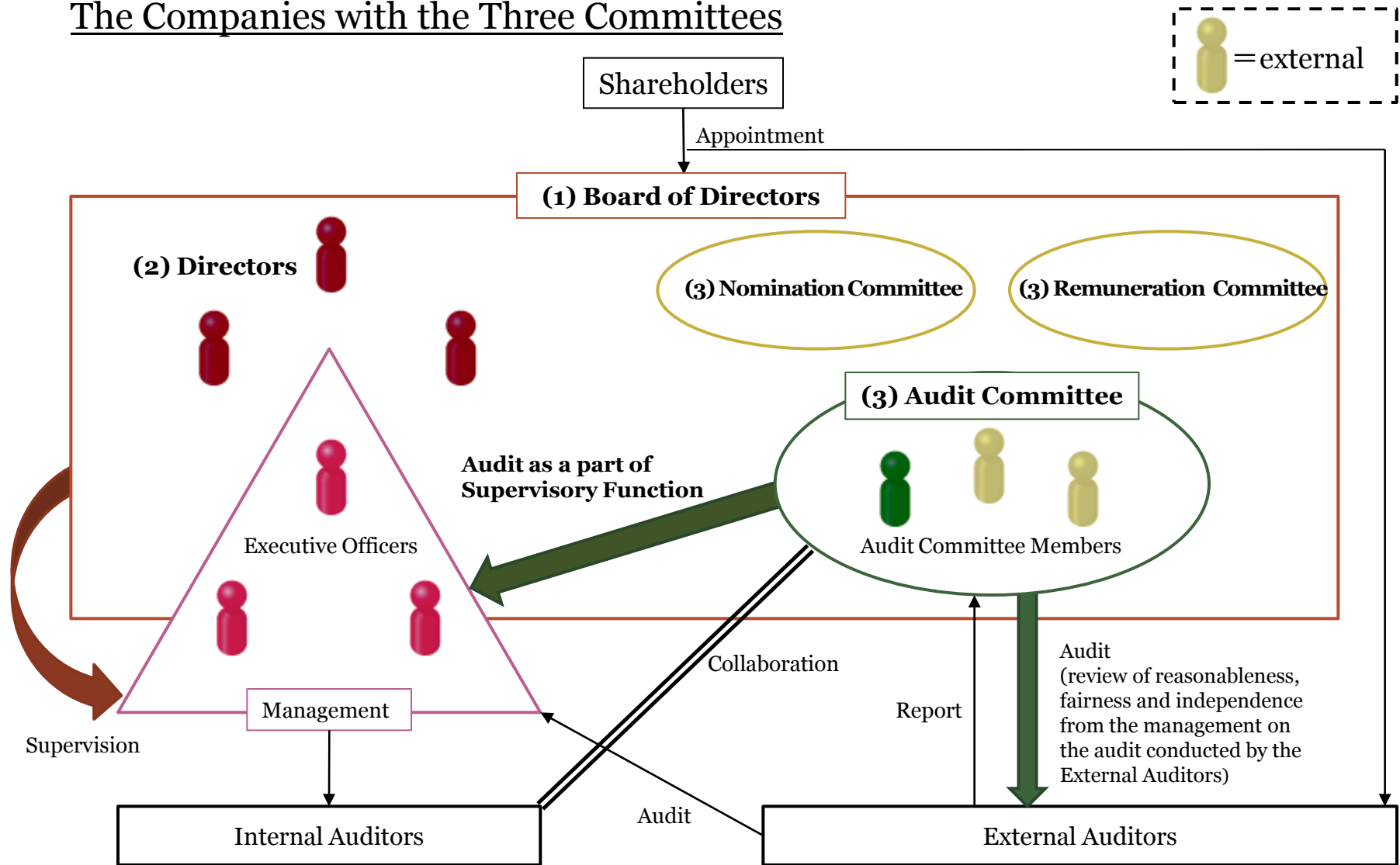
The major supervisory functions of the Members are “checking and monitoring management activities, including abuse of power by management over the external auditors” and “reporting (with opinions) to the Board of Directors”.

### **(4) Individuality**

Except for some prescribed matters, namely (1) preparation of audit reports, (2) appointment and removal of full-time Members and (3) preparation of annual audit policy and coordination of the roles among the Members such as allocation of territories and/or commodities to be audited by each Member and (4) consent to appointment and removal of the External Auditors, which need decisions by the Audit & Supervisory Board (hereinafter referred to as the “A&S Board”), each Member is expected to perform his/her roles individually (not as a body). Although it would not prevent the Members from consulting among them or acting jointly, legal effects of their activities shall be treated as several.

# 1 Corporate Governance in Japan (two different systems)

## The Companies with the Three Committees



# 1 Corporate Governance in Japan (two different systems)

## Features of the Companies with Three Committees

### **(1) Board of Directors**

The Board of Directors basically specializes in supervisory functions. It delegates the management of the company to the executive officers.

### **(2) Directors**

Each Director can act as a member of management as well as a member of the Board of Directors if elected as an Executive Officer by the Board of Directors.

### **(3) Three Committees**

The Three Committees are formed under the authorities of the Board of Directors. Members of each committee are appointed by the Board of Directors from among the Directors. Majority of its members must be external Directors. Functions of each committee are as follows;

- “Nomination Committee”  
to propose nomination and dismissal of the Directors at the shareholders meeting.
- “Remuneration Committee”  
to determine the remuneration for each Director and Executive Officer.
- “Audit Committee”  
to audit activities by management. Its major functions are “checking and monitoring management activities, including abuse of power over the external auditors” and “reporting (with opinions) to the Board of Directors”.

## 2 Comparison of the Audit & Supervisory Board and the Audit Committee

### Commonality between the two bodies

**Function** : Audit and Supervising

### Differences between the two bodies

#### (1) Source of Authority

- A&S Board

The Members are appointed by the shareholders. A&S Board is independent of the Board of Directors though they must collaborate with each other in performing supervisory functions.

- Audit Committee

Members are appointed by the Board of Directors from among the Directors. Audit Committee acts under the control of the Board of Directors.

#### (2) Exercise of Powers and Authority

- A&S Board

Each Member is expected to perform its roles individually (not as a body). Although it would not prevent the Members from consulting among them or acting jointly, their responsibility, legal effects of their activities shall be treated as several.

- Audit Committee

Each member has no individual power and authority. Power and authority are given to the Committee as a body.

#### (3) Relationship with administrative sections, such as internal audit division

- A&S Board

Although A&S Board and respective administrative sections are expected to collaborate with each other, A&S Board has no authority to direct them because they are under the control of management.

- Audit Committee

Under the authority delegated by the Board of Directors, the Committee has the authority to direct them.



### 3 Comparison of the Audit & Supervisory Board Members and the Audit Committee Members

	<b>Audit &amp; Supervisory Board Members</b>	<b>Audit Committee Members</b>
Appointment	By the shareholders directly	By the Board of Directors
Responsibilities	Audit and Supervision on management activities Preparation of Audit Report to be submitted to the shareholders	Audit and Supervision on management activities Preparation of Audit Report to be submitted to the shareholders
Exercise of Power and Authority	Each member/Individually	Not individual/As committee*
Voting at the Meetings of the Board of Directors	No (though members are required to attend and express their opinion at the meeting)	Yes
Term	4 years	1 year (as director)
Full-time Member	One or more	Not required
External Member	Half or more	Majority
Relationship with administrative sections such as internal audit division	No authority to direct (collaboration)	Authority to direct to such extent as delegated by the Board of Directors

\* except for preparation of audit report where each Member may express any individual opinion

## 4 Who are “the Audit & Supervisory Board Members”?

The Members are;

- Appointed by the shareholders.
- Not allowed to be a Director of the company where they are appointed as a Member.

### Types of the Members

- Full-time/Standing

The Members who are normally stationed at the principal place of business of the company and spend main part of their working time to perform their duties as Members. They can easily get information on the operation and affairs of the company through constant contact with all relevant company sections.

- External

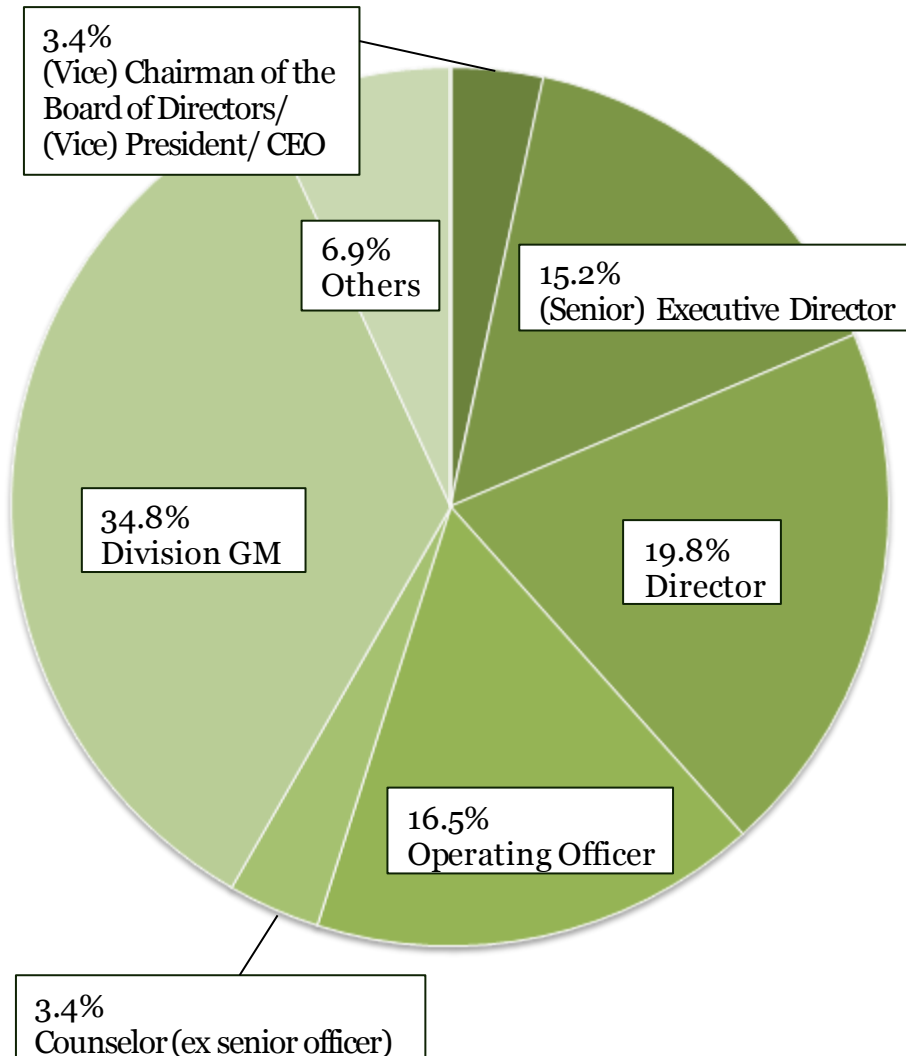
The Members who satisfy the prescribed requirements on independence from the management of the company. Neutral and fair assessment is expected without being affected by the operations and affairs of the company.

➔ Existence of various types of Members enables supervision from different angles.

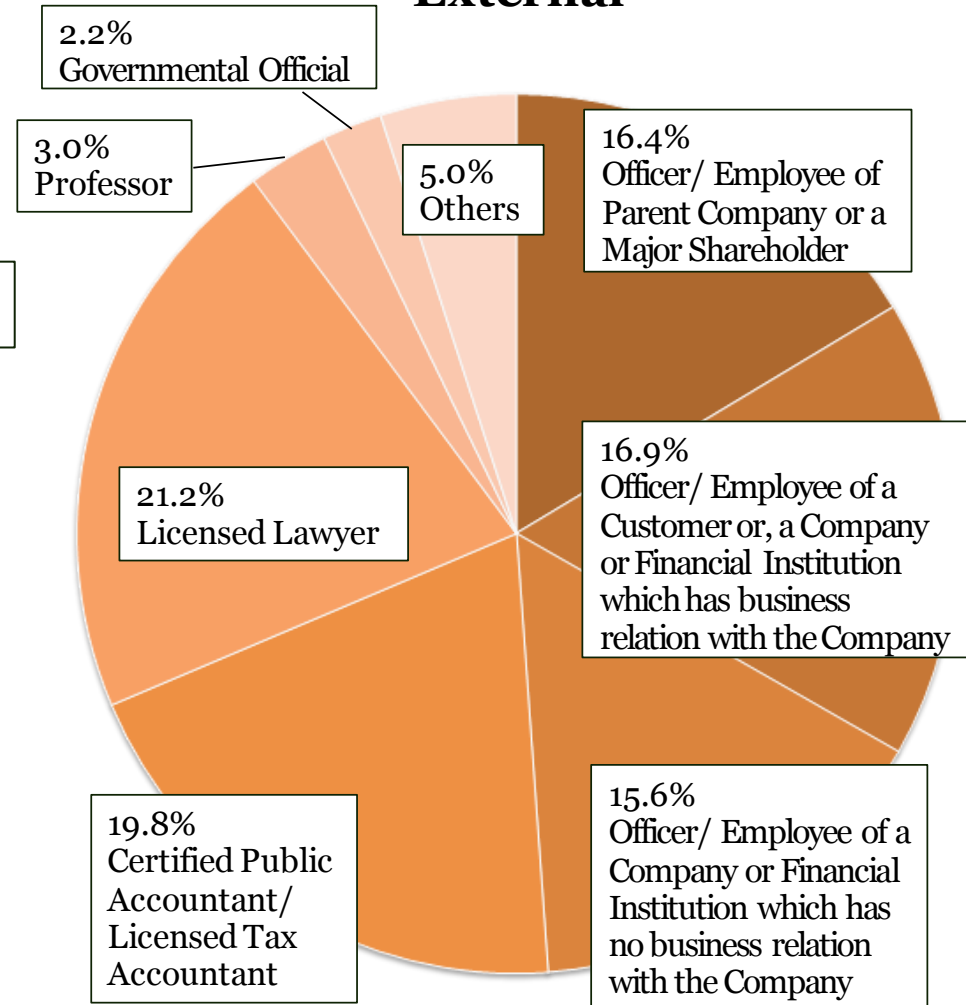
## 4 Who are “the Audit & Supervisory Board Members”?

### Career Background

#### Company Related



#### External



Extract from the 13<sup>th</sup> Internet Survey by JASBA

## 5 Activities of the Audit & Supervisory Board Members

Among their powers, rights and obligations, the Members have the following as primary:

### (1) Research & Investigation

- Power to order officers and employees to report to them operations and affairs of the company.
- Power to investigate operations, financial status and affairs of the company.
- Power to investigate operations, financial status and affairs of subsidiaries.

### (2) Actions on operation of the company

- Obligation to attend and express their opinions at the meeting of the Board of Directors.
- Power to convene a meeting of the Board of Directors.
- Right to seek an injunction against an act by the Directors if certain requirements are satisfied.

### (3) Actions on external auditors

- Power to order the external auditors to submit final/interim report on their audit.
- Right to consent to the Directors on submission to the shareholders meeting of their proposal on appointment or removal of the external auditors.
- Right to consent to the Directors on fee for the external auditors.

### (4) Reporting

- Obligation to submit their audit report and perform supplemental explanation at the annual shareholders meeting.
- Obligation to investigate and report the result to the shareholders meeting if any violation of laws and regulations or constituent documents, or any material injustice is found in a proposal or its related materials to be submitted to the shareholders meeting.

### (5) Legal action against Directors

- Obligation to examine and judge the reasonableness of a request by a shareholder to take legal action against a Director or Directors for his/her (their) breach of duty of care and/or fiduciary duty to the company and if such request is considered reasonable, to take legal action against them as a representative of the company.

## 5 Activities of the Audit & Supervisory Board Members

The Members conduct various activities to fulfill their duties and responsibilities.

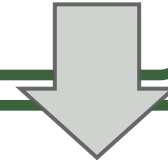


## 5 Activities of the Audit & Supervisory Board Members

Typical Annual Action Plan of the Members is as follows;

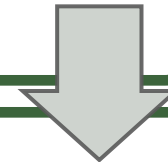
### **Immediately after Annual Shareholders Meeting** (Normally within 3 months after the end of each financial year of the company)

- Preparation of annual audit plan
- Coordination of schedule with the sections concerned (including the external auditors)



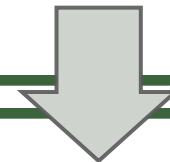
### **During each financial year of the company**

- Hearing from the management of the company
- On-site survey
- Inspection of constituent documents and other important documents



### **End of each financial year of the company**

- Preparation of Audit Report
- Examination of accounting documents and business report prepared by the management of the company



### **At the Annual Shareholders Meeting** **after the end of each financial year of the company**

- Report to the shareholders the result of the audit in writing which could be supplemented verbally
- Q&A Session

## 6 Roles of the Audit & Supervisory Board Members for prevention and settlement of misconduct and wrongdoing

The Members shall contribute to prevention of occurrence of misconduct and wrongdoing through their ordinary audit and supervisory activities and shall timely take appropriate actions in order to minimize damage to the company.

