The revision of the Corporate Governance Code requires companies listed on the TSE Prime Market to further strengthen their governance systems. We spoke with Independent Audit & Supervisory Board Member Hideyo Uchiyama about the function of the Audit & Supervisory Board in OMRON’s governance structure and the new Key Audit Matters (KAM).

— Could you tell us about the characteristics of OMRON’s governance structure and your assessment of it?

The governance structure of Japanese companies has long supported economic growth after WWII, with Directors and executives serving concurrently, and without sufficient separation between execution and supervision. In recent years, there has been a transition to governance through monitoring, which encourages decisive decision making by management and strengthens the accompanying supervisory structure. The role of Audit & Supervisory Board Members has become more essential and clearer at the same time as the Audit & Supervisory Board system has also experienced historical changes and has been reformed to ensure adequate functioning. Although OMRON has an Audit & Supervisory Board, it has a hybrid institutional design with four voluntary committees chaired by Outside Directors, and the Chairman of the Board of Directors is a Non-executive Director. My opinion is that this distinctive system design is, in a nutshell, close to the perfect form of a company with an Audit & Supervisory Board. I believe that this is an extremely appropriate governance structure that was uniquely established under OMRON’s corporate culture, since it addresses the demands of the times with a monitoring board, while also strengthening the functions of Audit &
Supervisory Board Members.

— Mr. Uchiyama, as an Audit & Supervisory Board Member, you are also a member of the Corporate Governance Committee. What are the functions and roles of that committee?

OMRON’s Corporate Governance Committee consists of Outside Directors and Independent Audit & Supervisory Board Members, and its main role is to evaluate and report on the effectiveness of the Board of Directors. Under Japan’s Companies Act, the role of Audit & Supervisory Board Members is to supervise the execution of duties by Directors, so the Committee engages both those who are supervising and being supervised. We are aware that the expectations of our stakeholders can be met by frankly exchanging opinions to improve OMRON’s governance functions, regardless of our respective positions.

In addition, regular meetings are held between Outside Directors and executive division managers, and information is exchanged among Outside Directors based on questions and answers concerning the business handled by executive division managers. While Audit & Supervisory Board Members are single-person organs that they can exercise their authority independently, and Independent Audit & Supervisory Board Members generally work on company issues based on their individual expertise and experience, it is also necessary for them to fully understand the role of Outside Directors in dealing with company issues in order to ensure the effectiveness of monitoring.

When I was appointed as an Independent Audit & Supervisory Board Member for OMRON, Chairman Tateishi sent me a message saying, “Welcome to Team OMRON.” I understand now that it is important for both Outside Directors and Independent Audit & Supervisory Board Members to think about how they should function as a team to improve corporate value while fully understanding their own positions. The OMRON approach of mutual understanding and discussing as a team is also an excellent point from the viewpoint of ensuring the effectiveness of governance.

— Meaningful communication also leads to strengthened governance. How would you describe the effectiveness of Audit & Supervisory Board Member functions at OMRON?

I believe that there are a number of factors that can improve the effectiveness of Audit & Supervisory Board Member functions. It is often asked whether there are proper structures in place to support activities of Audit & Supervisory Members, cooperation between the Internal Audit Division and the Audit & Supervisory Board, and cooperation with an independent Accounting Auditor. Rather than being inferior, I feel that OMRON’s infrastructure is in fact superior when compared to other companies in many ways. However, the important thing is how effective Audit & Supervisory Board Members in such an infrastructure. Independent Audit & Supervisory Board Members are required naturally to be prepared to express opinions that are necessary for governance. I think that the quality they should have is “inquisitiveness based on healthy skepticism.” Because Audit & Supervisory Board Members are elected at the Shareholders’ Meeting, it is essential for them to maintain the viewpoint of shareholders and to think and make proposals based on social norms and with an appropriate problem-solving perspective. I believe that what enables OMRON to do this is the fact that information is appropriately provided to Outside Executives so that their opinions are meaningful and useful to management, and most importantly, because its Corporate Philosophy is firmly rooted and forms the backbone of the company. Our Corporate Philosophy is always shared as the basis and serves as the benchmark for decisions even in the various discussions we have. I feel that this has strengthened OMRON’s governance.

— What is the kind of organization that you think is ideal for the Internal Audit Division at OMRON from the perspective of “inquisitiveness based on healthy skepticism”?

At OMRON, the Global Auditing Office checks the maintenance and operational status of the internal control system throughout the company. Their work is carried out under the direction of the President, and they must have the attitude and ability to detect, analyze, and solve management issues in order to function as the hands, feet, eyes, and ears of the
President.
For quite a while, it has been suggested to management that this kind of internal audit work should be positioned as a career plan for human resources they want to cultivate in the future.
Auditing is often regarded as a compliance role that checks the consistency with internal regulations and the status of legal compliance. While this is important, at the same time, I would like internal audit managers to have the perspective of how to appropriately manage the potential and emerging management issues faced by each business segment, and to gain experience so that they can acquire this perspective.
People grow by encountering and acquiring ideas from perspectives that are not their own. How things appear are very different at the foot of Mt. Fuji, the 5th station, and the summit. When in charge of internal auditing, you are in an environment where you can be in constant contact with superiors. This makes it an attractive division where you have the opportunity to grow within the company.

OMRON Governance Effectiveness through KAM Implementation

—— KAM has been newly implemented in Japan, although a similar system had been used earlier in other countries. What are your thoughts about OMRON’s response to KAM and its significance?
Continuity, identical conditions, and identical treatment are emphasized in the world of auditing and accounting. In particular, audit reports have maintained the same format in every detail, including wording, throughout the history of legal proceedings. Triggered by the Lehman crisis, questions were raised about the usefulness of the traditional, self-serving audit reports to stakeholders, and KAM was introduced in order to improve audit transparency.
Even so, KAM is not concluded just in audit reports, but also needs to be disclosed in a consistent manner so that it can be read together with the non-financial information released by OMRON. For example, it is important to disclose information about business risks disclosed by the company as non-financial information, including what kind of problems occur in accounting, how to handle this awareness in auditing, and how to communicate this externally as KAM in the audit report.
This fiscal year, the Accounting Auditor described the evaluation of goodwill and other items associated with investments in the Industrial Automation Business and the Healthcare Business as KAM on a consolidated basis for OMRON. As strategic investments during the period of VG2020, they are recognized as having a key impact on management strategies and the Consolidated Financial Statements, and are disclosed in the securities report as items related to M&A given an A rating by OMRON, which conducts integrated risk management.
Although the Audit & Supervisory Board Members determined the Accounting Auditor’s recognition and disclosure of OMRON’s awareness of these events were comprehensive and appropriate in KAM, the wording was repeatedly discussed between the Accounting Auditor and executives, and efforts were made to connect it with non-financial information as much as possible and to present it in an understandable way to readers. Accordingly, OMRON’s securities report itself has also changed significantly, and I think the content has become easier to understand. I particularly emphasized that the content should have a sufficient understanding of the original significance of KAM, while being from the perspective of shareholders, investors, and stakeholders. There are concerns that KAM will just become boilerplate, but I believe that this is groundless if a stance like OMRON is taken. Those involved in auditing should also properly utilize KAM as a communication tool in order to discover how to increase the information value of audit reports. Going forward, I expect that KAM will be a point to evaluate a company’s stance toward information disclosure and, by extension, to also evaluate its governance.

—— Finally, please tell us your own thoughts about OMRON’s future governance structure?
OMRON constantly evolves and tailors its governance structure for the changing times, and as previously mentioned, it is close to being the culmination of a company with an Audit & Supervisory Board. However, what is important is to maintain an attitude of not
Key Audit Matters

Key Audit Matters are matters that the auditor considers to be particularly important as a professional expert in the audit of the Consolidated Financial Statements for the consolidated fiscal year. The KAM are addressed in the auditing process of the Consolidated Financial Statements and in forming the audit opinion, and the auditing firm does not express individual opinions on these matters.

Key Audit Matters for Fiscal Year Ended March 31, 2021

1. Evaluation of goodwill associated with investments in the industrial automation business and recoverability of deferred income tax assets of U.S. consolidated corporations

As part of strategic investments in the long-term vision “Value Generation 2020 (VG2020),” OMRON acquired shares of Delta Tau Data Systems, Inc. and Adept Technology, Inc. in 2015, and Microscan Systems, Inc. in 2017 to make them consolidated subsidiaries in the Industrial Automation Business (IAB). (Hereinafter, these transactions are collectively called “business combination transactions.”)

All of these consolidated subsidiaries are U.S.-based companies.

OMRON has recorded goodwill on its Consolidated Balance Sheets through these important business combination transactions.

In addition, mainly as a result of focused R&D investment and customer development activities to achieve advanced applications through matching acquired product technologies with existing ones from OMRON, the U.S. consolidated tax payment group, which includes the subsidiaries acquired through the above business combination transactions, incurred a tax loss carried forward in previous fiscal years.

For the loss carried forward, deferred income tax assets for future tax benefits are recorded on the Consolidated Balance Sheets.

2. Evaluation of goodwill associated with investments in the healthcare business and evaluation of investments in affiliates

As part of strategic investments in the long-term vision “Value Generation 2020 (VG2020),” OMRON acquired shares of NS Industria de Aparelhos Medicos Ltda. in 2014 to make it a consolidated subsidiary in the Healthcare Business (HCB).

In addition, OMRON gradually acquired shares of AliveCor, Inc. starting in 2017, and made it an affiliate accounted for using the equity method in 2020.

Through these investment activities, OMRON records goodwill on its Consolidated Balance Sheets, as well as investments in and advances to affiliates, which include goodwill under the equity method.