

## Dialogue between Audit & Supervisory Board Members: "Audit 3.0" to Strengthen Resilience in the Face of Headwinds



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### Full-time Audit & Supervisory Board Members Contributing to the Enhancement of Corporate Value by Leveraging Their Information-Gathering Capabilities to Deep-Dive into Fundamental Issues

— In addition to the outside Audit & Supervisory Board Members, this discussion also features two full-time Audit & Supervisory Board Members. Please remind us of the roles of the full-time Audit & Supervisory Board Members at OMRON.

**Tamaki:** The Corporate Governance Code stipulates that "effectiveness should be enhanced by organically combining the strong independence provided by outside audit & supervisory board members with the advanced information gathering capabilities possessed by full-time audit & supervisory board members." As the full-time Audit & Supervisory Board Members at OMRON, we have always abide by those words. Gathering internal information and sharing it with the Outside Audit & Supervisory Board Members to enhance the effectiveness of governance is a key role for the full-time Audit & Supervisory Board Members. Last year's dialogue between two Outside Audit & Supervisory Board Members focused on the demonstration of independence, but this time we would like to give you a complete picture of the audits conducted by OMRON's Audit & Supervisory Board Members, including the work of the full-time Audit & Supervisory Board Members.

**Hosoi:** We, the four Audit & Supervisory Board Members are constantly striving to increase OMRON's corporate value through the achievement of sustainable growth. However, auditing activities cannot be carried out fully by just the four of us or our staff. By transparently and effectively communicating the activities of the Audit & Supervisory Board to external stakeholders and taking various opinions

on board, we hope to enhance the quality of audit activities.

— At the meetings of OMRON's Audit & Supervisory Board, what is the format for your discussions?

**Hosoi:** At the meetings, the independence of Outside Audit & Supervisory Board Members constitutes an "Outer Eye," while the information-gathering power of the full-time Audit & Supervisory Board Members constitutes an "Inner Eye." We aim to create synergies between the two and produce results by multiplying the two together rather than simply adding one to the other. Although we all come from different backgrounds, we work together as one to achieve the shared objective of maintaining and enhancing corporate value. To come up with best ideas within a limited time, it is important that everyone is moving in the same direction. In this way, we combine our respective perspectives and operate with a solid foundation.

**Kunihiro:** When I look around at other companies in Japan, I feel that their full-time audit & supervisory board members tend to avoid proactively speaking up at the meetings of the board of directors. So one thing that makes OMRON distinctive is the way the full-time Audit & Supervisory Board Members also actively express their opinions. In addition, at each meeting of the Audit & Supervisory Board, we also have time for free discussion. This aims to ensure thorough discussion that is not limited to a specific theme. The topics of discussion are management issues for which there are no clear-cut answers. The subjects are raised mainly by the full-time Audit & Supervisory Board Members, and the issues brought up at the Audit & Supervisory Board meetings are shared by the Outside Audit & Supervisory Board Members at the meetings of the Board of Directors. To create this cycle, thorough information-gathering skills are vital. Since the Outside Audit & Supervisory Board Members have

limited time at the Company and the information they can obtain is limited, the ability to identify issues is a prerequisite for the full-time Audit & Supervisory Board Members.

## Evolution to "Audit 3.0" to Enhance Corporate Value

— In last year's dialogue, there was talk about the Audit & Supervisory Board's position in leading "Audit 3.0." In what form is Audit 3.0 functioning right now?

**Kunihiko:** At OMRON, the Audit & Supervisory Board has established its own principles of conduct for Audit & Supervisory Board Members\*. At the top of the document are these words: "We not only conduct compliance audits (Audit 1.0) and point out deficiencies; but also conduct risk-based, internal control audits (Audit 2.0) and state our views; and conduct management issue audits (Audit 3.0) and provide advice." In other words, the Audit & Supervisory Board is also committed to raising questions about the sound development of OMRON's business and the enhancement of its corporate value. At many companies in Japan, there tends to be an unspoken rule that "audit & supervisory board members should keep quiet when it comes to matters of corporate management," but at OMRON it is the opposite, we are also expected to state our views. A unique feature of OMRON is that we're required to adopt a proactive stance that goes beyond just pointing out deficiencies. For example, Directors have asked us to be more forthright in expressing opinions on management issues.

\* For details of the Principles of Conduct for Audit & Supervisory Board Members, please see the OMRON website.

Corporate Governance Framework

**Tamaki:** However, there is something about "Audit 3.0" that mustn't be misunderstood. This is that as a result of evolving from 1.0 to 2.0 and then 3.0, we're constantly tackling three audit areas, not just Audit 3.0. We're covering all the areas

from 1.0 to 3.0. In a nutshell, the purpose of "Audit 1.0" is to point out deficiencies and discover issues. So it is what's described as a compliance audit. But we do not stop there. Next, we have "Audit 2.0", where we endeavor to prevent recurrences and pinpoint risks. For example, we might consider the possibility that the same problem is also occurring in other departments. However, fundamental management issues, such as insufficient personnel or budgets, may be lurking in the background to that issue. And this is where "Audit 3.0" comes in. Because it's integrated with Audit 1.0 and 2.0, we're able to clearly state our opinions to the management team.

**Kunihiko:** If there is a difference between Audit & Supervisory Board Members and Directors, it is in the way they deal with issues. While Directors are responsible for driving the business forward, the Audit & Supervisory Board Members must focus on what the issues with that approach to business might be. What can we do as Audit & Supervisory Board Members to increase OMRON's corporate value? Our mission is to seek and present optimal solutions, without shying away from discovering issues. And of course, we must not slack off with Audit 1.0 or 2.0.

**Tamaki:** Looking at it from another angle, I think that precisely because we are conscious of Audit 3.0, and probe management issues such as the adequacy of resources on the frontline, the meanings of deficiencies and risks in the corporate management context become clearer. If a lack of resources is the cause of deficiencies and risks, and you try to prevent recurrences without addressing the underlying issue, sooner or later the same thing will happen again. I believe that only when Audit 1.0-3.0 are implemented as a set can true governance be achieved.

— How would you rate the progress made so far with "Audit 3.0"?

**Hosoi:** Comparing the progress we have made so far to

climbing a mountain, I would say we have reached the third station. So while it's still nothing to write home about, we have been making steady advances with our activities. The aim of Audit 3.0 is to examine the health condition of the company, and take steps to prevent it from getting sick and strengthen its constitution. The company's financial performance in FY23 left a lot to be desired, but we, the Audit & Supervisory Board Members identified two challenges as we discussed its health condition. One is to build a foundation for ensuring that the new restructuring-related measures take root, and the other is to transform OMRON's corporate culture, which has been handed down over many years. To tackle these challenges, the Audit & Supervisory Board has been working with the management team since FY23, providing back-up for reform. In the sense that we have been able to advance our Audit 3.0 activities, I view this as a big step.

**Kunihiko:** To bring management issues to light, it is also essential to learn from other companies. There is no single form of governance. Diversity is now crucial. Objectively grasping OMRON's flaws is another important role of Audit & Supervisory Board Members.



**Hosoi:** I feel that to evolve Audit 3.0, it is critical to learn from other companies. In FY23, we actively exchanged opinions with CEOs and audit & supervisory board members from eight companies. This exposed us to a variety of perspectives and ideas, and it was a valuable opportunity to reaffirm our own strengths and challenges. To continue to evolve further, I would like to learn from the examples of other companies and look ahead to a new way forward.

**Tamaki:** The Company's Principles of Conduct for Audit & Supervisory Board Members also states that we should "strive for self-improvement, be trustworthy at all times." To make this attitude a part of us, learning from other companies is imperative.

**Hosoi:** Going forward, we on the Audit & Supervisory Board will be observing the company not only from ground level but also from above, and digging beneath the surface to dive deep into the organization. We will keep striving to uncover management issues and address them through the evolution of Audit 3.0.

### Collaborative Risk Management and Shared Awareness Essential for Governance of a Large Organization

— Mr. Miura, you became an Outside Audit & Supervisory Board Member in June 2024, so what have been your impressions of OMRON's audit and governance frameworks?

**Miura:** To be honest, I do not think I have ever come across audit & supervisory board members who conduct themselves so courageously. Given the nature of their responsibilities, audit & supervisory board members normally find just asking themselves how they can contribute to the enhancement of corporate value to be an immense challenge. At many companies, even just assessing the compliance status of operations and the effectiveness of

internal control systems, which is their basic mission, is actually not easy. So three to five audit & supervisory board members, working in cooperation and receiving help from the internal audit division, department, the accounting auditors, and so on, are tasked with gauging the status of a huge corporate group, including its subsidiaries and affiliates domestic and overseas. But at OMRON, they are intent on doing even more, assessing risk management processes and even recommending solutions to management issues. I feel that this corporate culture, in which management seeks the views of the Audit & Supervisory Board Members and they endeavor to respond to such requests, is illustrative of an excellent governance framework.

**Kunihiro:** In a sense, fundamental topics such as management issues are where we are finally going to end up no matter what we are talking about. One of our strengths is a structure whereby not only the Outside Audit & Supervisory Board Members but also the full-time Audit & Supervisory Board Members bring up issues based on facts. I think we have gone one step beyond just a simple atmosphere of it being "easy to speak up," and represents a step forward in terms of sharing a common understanding.

**Miura:** I agree. It is certainly true that the world of corporate management is one in which there are no single right answers. There are always multiple options for the future, and managers must ultimately reject indecisiveness and choose one path with conviction. And during this process, it might be the Audit & Supervisory Board Members who can give objective advice from a slightly different perspective than on the executive side. There's a concept called the "Three Lines Model", which divides the organization into the Governing Body, Management, and Internal Audit, with each conducting monitoring from their respective standpoints, but audit & supervisory board members are in a position to make recommendations to management based on the

overall picture, rather than from the third line. In fact, for executives to make appropriate management decisions, it is also important to adopt macro perspectives, asking questions like "Does this meet the needs of society?" and "Does this meet the expectations of stakeholders?" The fact that the Audit & Supervisory Board Members fulfill this role in cooperation with the Outside Directors can be regarded as demonstrative of OMRON's pioneering approach to governance.

### The Ideal Situation is for Directors and Audit & Supervisory Board Members to Work Together and Blurring the Boundaries between "Offense" and "Defense"

— How do the Outside Audit & Supervisory Board Members function within the governance framework? Please tell us what makes OMRON distinctive.

**Kunihiro:** OMRON's Board of Directors shares the view that governance is a function for enhancing corporate value, and cooperation between Outside Directors and Outside Audit & Supervisory Board Members is very strong. The Corporate Governance Committee also includes members from both groups, and provides a forum for close information exchange and discussion. I think with monitoring, which is among the tasks of the Outside Directors, there is a lot of overlap with the Audit & Supervisory Board Members. Personally, in my own work, I do not think much about whether I am an Outside Director or an Outside Audit & Supervisory Board Member. At the meeting of the Board of Directors or the Corporate Governance Committee, everyone speaks freely without imposing constraints on their own roles. No one says things like "I am a Director so ..." or "I am an Audit & Supervisory Board Member so ..." Although a distinction is made in the text of the Companies Act, the reality is that we just have different perspectives and backgrounds. A characteristic of OMRON is that both Outside Directors and Outside Audit & Supervisory Board

Members are committed to sharing their wisdom to the greatest extent possible in order to enhance corporate value.

**Miura:** Yes, I have really noticed that myself. A general view is that within a governance framework, the Audit & Supervisory Board Members are responsible for "Defense" while the Outside Directors handle "Offense". This binary distinction makes the roles easy to understand. However, in the case of a big M&A deal, for instance, the Outside Directors may take a cautious approach. And given that the Audit & Supervisory Board Members sometimes support the hefty capital expenditures required for growth businesses, I think that a sound governance framework entails both groups being conscious of both the defense and offense sides. I think OMRON is a good example of this happening naturally.

**Kunihiro:** Especially when responding to emergencies, action that straddles the boundary between the two is essential. When it comes to managing risks, it is not enough to simply leave it to the Audit & Supervisory Board Members.

**Tamaki:** "Defense" and "Offense" is a frequent topic of discussion in governance, and it is easy to understand if you compare it to soccer. During a spell when you're scoring a lot of goals (which can be compared to increasing corporate value), it's usually the forwards who are attacking, but sometimes the defenders take shots, too. Conversely, when you're under attack (protecting corporate value), even the forwards have to drop back and help out with the defense. You will never have a strong team if your attackers are saying, "I am an attacker so I will not go the defense."

**Miura:** When the Corporate Governance Code was first announced, it was said that the authorities' aim was to reverse the recent tendency of Japanese companies to overemphasize "Defense", and instead to promote "Offense"

in management through sensible risk-taking. So it was viewed as strategy for reviving Japan. The renewed emphasis that was put on "Offense" reflected a mood of crisis, as many companies that had grown large were being shackled by their past glories, and were lagging behind in transforming their business models to respond to the changes of the times, causing their international competitiveness to decline. During that period, however, corporate scandals were occurring one after another, and this became a national talking point. Nowadays, the concern is that most companies consider governance to be synonymous with internal control, and that little progress has been made with the discussion of "Offense-Oriented Governance".

### To Avoid a Repeat Deterioration in Financial Performance, Essential to Have Wild Attitude, Rather Than Being a Straight-A Student

— FY23 saw earnings forecasts revised downward twice. Looking back on that as the Audit & Supervisory Board Members, what do you think some of the issues were?

**Hosoi:** We on the Audit & Supervisory Board also regret the fact that the Company did not grasp market and internal changes and take action at an early stage. By studying the past, I have discovered that when a downward revision was made, it was sometimes due to the lack of a swift response to signs of trouble. So there had been a failure to take lessons from the past. Looking ahead, discussions are currently ongoing about how to collect and analyze information more speedily and accurately, identify risks at an early stage, and take appropriate measures to enable more proactive responses.

**Tamaki:** During our free discussions, we ask ourselves, "What could have been done?" Communicating this experience to future generations is another responsibility of the Audit & Supervisory Board Members. We have to analyze

what happened so that we can become the storytellers. Right now, we still don't have any clear answers, but multiple hypotheses are beginning to emerge through our honest discussions.

**Kunihiro:** Discussing these hypotheses, I have come to believe that it was OMRON's weakness that led to the deterioration in financial performance. Specifically, an excessive preoccupation with "scoring 100% in all aspects of governance" resulted in sanitized presentations and reports, which ultimately shielded underlying issues from view. The times are changing dramatically. To earn money in this challenging operating environment, it is vital to have a wild and aggressive attitude, even if that means being a bit rough and ready, rather than being a serious, straight-A student. Unless OMRON adopts a hungry spirit, keeps an eye on competitive fundamentals, and engages in thorough discussions, it will probably make the same mistake again.

### Transforming the Constitution of OMRON, Which Has Lost the Venture Spirit Exhibited by JMDC Inc.

— Another big topic last fiscal year was making JMDC Inc. a subsidiary. Please give us your current assessments.





**Tamaki:** JMDC Inc. is a fast-growing company. And from the perspective of "Audit 3.0", too, we have a lot to learn from them. Meanwhile, OMRON, which has acquired the shares, needs to fulfill its responsibilities to investors and other stakeholders by taking a firm approach to grasping risks, and that falls under the heading of "Audit 2.0". I have been trying to analyze JMDC Inc. myself in my own way, for example, by carefully reading the securities reports it has filed since it was listed. And I intend to keep working to gain a full understanding of the company and the challenges it faces.

**Kunihiro:** OMRON was once a start-up company, but gradually turned into a dignified large corporation without even realizing it. A culture that has been built up over many years is difficult to change from the inside. What kind of chemical reaction will JMDC Inc., with its venture spirit, bring to OMRON's corporate culture? I am really looking forward to finding out. For JMDC Inc. to be a catalyst, it should not be restricted to being a "little OMRON." I want it to demonstrate uniqueness as a transmitter of different cultures, much like the island of Dejima did during Japan's long period of isolation during the Edo period.

**Hosoi:** It's important that OMRON and JMDC Inc. collaborate by leveraging and synergizing their respective traits. I believe that making the most of the unique strengths of both companies and building a cooperative relationship that allows them to complement each other will lead to an increase in corporate value. By working with JMDC Inc.'s Director Audit & Supervisory Committee Members, we hope to unlock the full potential of both companies and contribute to building a foundation for achieving sustainable growth.

**Miura:** Changing the corporate culture is important. If the corporate culture can be evolved to take it to the next level, it can also bring about a change in the business model. Facilitating a transformation from "Selling Product Value" to "Selling Essential Value (products + services)" is a key

objective of the collaboration with the JMDC Inc. Group. I believe that the data sales style, which involves not only selling products but also providing solutions tailored to customer needs, can be utilized not only in JMDC Inc.'s data solution business, but also in the Industrial Automation Business, Healthcare Business, and Social Solution Business, and that synergies with JMDC Inc. will be maximized. I think the success of business acquisitions is measured by these sorts of intrinsic synergies.

**Kunihiro:** The success of the transformation from "Products" to "Products + Services" may also help with the transformation of the corporate culture. The next step should be to create a new cycle in which businesses and organizations have a positive impact on each other.

### Monitoring of Structural Reform Programs Should Be Approached from Two Axes: "Present Perspective" and "Future Perspective"

— OMRON is currently pursuing a structural reform program called "NEXT2025," but it must also balance that with medium- to long-term growth. Given these circumstances, please share your thoughts on how the Audit & Supervisory Board Members should contribute to the enhancement of corporate value.

**Hosoi:** For the Audit & Supervisory Board members to contribute to the enhancement of corporate value, they will need to approach it not only from the perspective of restructuring, but also from the perspective of balancing that with medium- to long-term growth. One of the priorities for the Audit & Supervisory Board this fiscal year is to check on the progress with restructuring. And we're going to be approaching that from two perspectives: a "Present Perspective" to check whether there are any omissions in the content of the measures and whether they are taking root, and a "Future Perspective" to ascertain what kinds of results will appear over the medium to long term. With a

restructuring program, we should not only observe short-term outcomes, but also rigorously follow up on medium- to long-term themes. Furthermore, from FY26, the company will be implementing a new medium-term management plan to take it closer to its long-term vision, "SF2030." A crucial role of the Audit & Supervisory Board Members is to contribute to the development of strategies for the maximization of corporate value while keeping an eye on the future and properly assessing risks.

**Kunihiro:** The key question is how monitoring should be conducted. Medium- to long-term monitoring by the Audit & Supervisory Board alone is insufficient. The Outside Directors should also be involved, so as to allow the executive side to be observed from a range of perspectives. The forwards and the defenders must work together to deploy a variety of approaches for optimizing governance.

**Tamaki:** Ultimately, I think there ought to be a break from "scoring 100% for governance." Choices about what to focus on should be made, and flexible thinking should be the order of the day. OMRON's corporate climate is characterized by seriousness, but the founder, Kazuma Tateishi, advocated the "7:3 principle," which states that if



there's a 70% chance of success, you should go for it. So instead of waiting till the probability is 100%, you get going when it's 70%, and then gradually eliminate the 30% failure risk as you move forward. OMRON ought to revisit that spirit and regain the eagerness to take on challenges.

### "Flexible" as the Keyword for Transforming the Corporate Culture to Realize SF2030

— How should the Audit & Supervisory Board evolve as OMRON restructures en route to SF2030? Please tell us how you envisage the future?

**Miura:** Generally in Japan, the larger a company grows, the greater the pressure it comes under to meet societal expectations, and it tends to fall back into a defensive approach to management in order to avoid failure. Of course, fatal mistakes cannot be tolerated, but the fact is that achieving resounding success entails taking on risk. Minor missteps can be corrected while on the go, and a corporate culture of proactively embracing risk will be a powerful weapon in the future. Faced with financial under-performance right now, tough situations will keep coming up, but I hope that this period will be valued as an

opportunity to make necessary changes. To that end, I think the Audit & Supervisory Board should evolve so that it can help the company take a new step forward.

**Kunihiro:** Hard times are opportunities for change, aren't they? The keyword might be "flexible." With flexibility the preoccupation with "scoring 100% for governance" as the starting point, excess, duplication, and waste must be discarded, and the focus must be narrowed. I have also seen numerous examples of companies being reborn after running into difficulties. For OMRON, this is an opportunity.

**Tamaki:** To abandon the pursuit of "scoring 100% for governance," the Audit & Supervisory Board must also not permit its meetings to be clean and cordial. My aim is for the Audit & Supervisory Board to also explore a new governance model that is not constrained by pre-existing notions, and to present that to the world.

**Hosoi:** We are going to keep striving to evolve the Audit & Supervisory Board so that when its members a decade from now look back on today, there will be no regrets. With a venture spirit, we will actively incorporate AI utilization and

collaboration with other companies to build an "Audit 4.0" future that puts us a step ahead of the pack. As a future-oriented audit team, we intend to deliver more valuable audits by constantly taking on challenges and adapting to changes.

— Mr. Miura, you've just started your first year as an Outside Audit & Supervisory Board Member, but please remind us of your future aspirations.

**Miura:** I became an Outside Audit & Supervisory Board Member in June 2024, so I have only recently joined the Audit & Supervisory Board, but the spirit of OMRON's Audit & Supervisory Board Members, which has been created by all of the previous Audit & Supervisory Board Members, is already infusing me. The immediate challenge is to analyze the causes of the deterioration in financial performance, create a scenario for recovery, and transform the corporate culture for the next stage of growth. While making use of my "Outer Eye" as an Outside Audit & Supervisory Board Member, I intend to work closely with the "Inner Eye" of the Full-time Audit & Supervisory Board Members and the Directors to contribute to the enhancement of OMRON's corporate value.

