

Outline of the Interim Report by the Study Group on Disclosure Policies for Non-financial Information

- Toward a virtuous cycle of sustainability-related information disclosure and enterprise value creation -

November 2021

**Study Group on Disclosure Policies for Non-financial Information
(Corporate Accounting, Disclosure and CSR Policy Office, METI)**

Four Recommendations for Achieving High-Quality Sustainability-Related Information Disclosure (1) - to Realize Dialogues toward the Creation of Sustainable Enterprise Value -

1. Focus on value relevance in sustainability-related information disclosures

- In dialogues through sustainability-related information disclosures between preparers and users, focus should be placed on relevance to the enterprise value.
- When doing sustainability-related information disclosure, it is necessary to take into account the following two points and make an integrated, continuous effort as an integral part of management decision-making and strategy:
 - ① Issues that are material to the sustainability of corporate activities should be identified not only on short-term but also on medium- to long-term bases
 - ② Value relevance and importance change dynamically with the market's viewpoints on evaluating enterprises and changes in society, the environment, and the economy

2. Demonstrate ownership in the application of sustainability disclosure standards

- Taking into consideration the fact that each enterprise has different business characteristics and material issues, it is effective to maintain the a breadth of originality regarding sustainability-related information disclosure.
- At the same time, it is also important to respect standards-based normativity and ensure comparability and objectivity, as international sustainability-related disclosure standards will be defined in the coming future.



- Demonstrating ownership in the application of disclosure standards and **being aware of the balance between "originality" and "normativity"** is important (it should not be a box ticking (too standardized) disclosure that lacks originality due to trying to be normative)
- Take the **"apply or explain" approach** and be proactive in explaining

3. Deepen understanding of the relevance between enterprise value and sustainability information

4. Disclose sustainability-related information in a manner that leads to dialogues with investors and stakeholders

Four Recommendations for Achieving High-Quality Sustainability-Related Information Disclosure (2) - to Realize Dialogues toward the Creation of Sustainable Enterprise Value -

1. Focus on value relevance in sustainability-related information disclosures

2. Demonstrate ownership in the application of sustainability disclosure standards

3. **Deepen understanding of the relevance** between enterprise value and sustainability information

- Common understanding among information preparers and users about the relevance between enterprise value and financial information and sustainability-related information is still developing
- It is expected that such relevance will be further discussed through the development of international sustainability standards
- It is also expected that preparers of sustainability information (i.e., enterprises) and its users (i.e., researchers, investors and other stakeholders, etc.) will make progress on and share the results of analyzing and examining information's relevance to enterprise value and financial information.

4. Disclose sustainability-related information in a manner that leads to **dialogues with investors and stakeholders**

- (As a direction for implementing the recommendations 1 to 3,) preparers of information can create a virtuous cycle of sustainability-related information disclosure and enterprise value creation by identifying key stakeholders and deepening the dialogues (engagement)
- There are two things to be aware of when dialoguing (engaging)
 - ① Recognize a wide variety of key stakeholders in value creation (e.g., employees, suppliers, consumers)
 - ② Be aware of differences in investors' stances, timeframes, ways of thinking, etc. and consider what kind of disclosures and dialogues are important (e.g., investment policy [passive or active], asset owners' investment policies, differences between departments to which investors belong)
- It is important for investors to clearly communicate their investment policies and ideas when dialoguing with enterprises

Background of the Four Recommendations

- Three issues generating diverse views concerning sustainability-related information disclosure -

Premises of the issues generating diverse views: Wider range of information needed to understand enterprise value

- In addition to financial information, non-financial information (e.g., management strategy) is becoming increasingly important in understanding enterprise value
- Also, it is a growing trend to reflect information on the positive and negative external influences that enterprise activities have on the environment, society, and the economy as a whole in investment evaluation
- Against this background, the kinds of information related to enterprise value are changing dynamically.

Three issues generating diverse views concerning sustainability-related information disclosure

1. Balance between “uniformity” and “originality”

- As international sustainability information standards are being developed, how should we ensure uniformity and comparability and balance them with enterprises' originality and diversity?

2. “Materiality”

- Given that many different disclosure standards are established, and the readers, the materiality expected by each disclosure standard, and the disclosure items specified all vary, how should we identify and determine what to communicate and who to communicate it to?

3. “Relationship” between financial, non-financial, and sustainability information

- As a common understanding of terms and concepts related to financial, non-financial, and sustainability information is not really developed, how do we understand how they are related to and included within each other?

These four recommendations have been compiled as a solution to overcome these three issues and create a virtuous cycle of sustainability-related information disclosure and enterprise value creation. Discussions to solve these issues will continue.

Approach to Disclosures in Individual Fields (Human Capital)

The background leading up to discussing human capital information disclosure:

- Disclosure is seen as increasingly important (e.g., the CG Code published in June 2012 included a mention of human capital investment)
 - Disclosure-related schemes are being developed overseas (e.g., the U.S. SEC obligated listed companies to disclose human capital information in August 2020)
- The matter was discussed taking into consideration that that information was the second most discussed area of sustainability-related disclosure after climate-related information



Disclose based on human capital information characteristics

- Disclosure of human capital information is divided into disclosure for the purposes of "value enhancement" and "risk management" When disclosing human capital information, communicating it with the characteristics of each disclosed item in mind will make for effective disclosure.

Link human capital information with the value creation process

- When disclosing human capital information, clarifying how the company's human resource strategy will contribute to the creation of enterprise value is desired. In addition, disclosing information and indicators that show the progress of human capital efforts (KPIs) will lead to effective dialogues toward the creation of enterprise value.

Explain the qualitative information that helps cultivate understanding of KPIs

- When disclosing indicators (KPIs), disclosing the reasons for setting those indicators together with target levels is desired.

Members of the Study Group

Chair

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- Financial Services Agency
- Financial Accounting Standards Foundation
- Intellectual Property Strategy Headquarters, Cabinet Office
- Japan Business Federation (KEIDANREN)
- The Japanese Institute of Certified Public Accountants
- The Securities Analysts Association of Japan
- Tokyo Stock Exchange, Inc.
- Ministry of Justice

Meetings

	Agenda
1 st meeting (Jun. 10, 2021)	<p><u>Understanding global trends in disclosure policies</u></p> <ul style="list-style-type: none"> ✓ Outline of the proposed amendments to the IFRS Foundation constitution related to the establishment of an international sustainability standards board ✓ Outline of the revision of the EU Non-Financial Reporting Directive ✓ Developments in non-financial standards-setters <ul style="list-style-type: none"> ➤ Collaboration among non-financial standard setters and the Value Reporting Foundation ➤ International trends in non-financial disclosure as seen through CDP
2 nd meeting (Jul. 16, 2021)	<p><u>Analysis of disclosure policies</u></p> <ul style="list-style-type: none"> ✓ Developments since the first meeting ✓ In response to the first meeting's discussion ✓ “Reporting on enterprise value –Illustrated with a prototype climate-related financial disclosure standard”
3 rd meeting (Sep. 1, 2021)	<p><u>Discussion on human capital disclosure based on disclosure cases</u></p> <ul style="list-style-type: none"> ✓ Developments since the second meeting ✓ Review on the second meeting's discussion ✓ Consideration of issues related to human capital disclosure
4 th meeting (Oct. 4, 2021)	<p><u>Discussion on disclosure based on the prototype climate-related financial disclosure standard</u></p> <ul style="list-style-type: none"> ✓ Developments since the third meeting ✓ Discussion on disclosure based on the prototype climate-related financial disclosure standard, building on the second meeting's discussion
5 th meeting (Nov. 5, 2021)	<p><u>Draft interim report</u></p> <ul style="list-style-type: none"> ✓ Disclosure of non-financial information in light of the discussions so far

● The study group will continue to have meetings based on the global trends regarding the disclosure policies for non-financial information after the 6th meeting.

● In addition to the above, presentations by experts from Japan and abroad were made according to the agenda.