KPMG

Corporate Governance Overview 2019

The Essence of Enhancing Disclosure in Annual Securities Reports and Challenges of Corporate Governance Reforms from the Perspective of External Directors

November 2019

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On the Publication of Corporate Governance Overview 2019

The Corporate Governance Code was revised in 2018 which aimed to ensure diversity in the members of the Board of Directors, strengthen the procedures for appointment and dismissal of CEO, CEO succession plan and determination of CEO remuneration, promote management's awareness of cost of capital, reduce cross-shareholdings and enhance the effectiveness of the role of corporate pension funds as the asset owner. The revision of the Corporate Governance Code also indicates that Japan's corporate governance reforms have entered into the second phase.

One year has passed since the revision of the Code in 2018, the initiatives to shift the core of the corporate governance reforms from form to substance are still ongoing. In January 2019, the amendments to Cabinet Office Order on Disclosure of Corporate Affairs ("Cabinet Office Order on Disclosure", hereafter) were promulgated with the aim of enhancing information disclosure in annual securities reports. In March 2019, "Principles regarding the Disclosure of Narrative Information" and "a reference casebook of good practices on the disclosure of narrative information based on the Principles" were published. In June 2019, the "Practical Guidelines on Group Governance System" was published with aims to promote preventive functions of governance, such as strengthening the governance of the subsidiaries, as well as facilitative functions such as an appropriate allocation of management resources by reviewing of business portfolio and enhancement of the group's corporate value. In addition, the Stewardship Code is scheduled for revision in 2020. The market structure revamp of the Tokyo Stock Exchange is also under discussion. These actions will take Japan's corporate governance reforms even further to the third and fourth phases.

Corporate Governance Overview 2019 covers the recent trends in corporate governance reforms during the past year as well as highlights the initiatives in enhancing information disclosure in annual securities reports. In order to identify challenges faced by Japanese companies from the perspective of external directors, we conducted a questionnaire-based survey about the points raised in the Cabinet Office Order on Disclosure. In this edition, KPMG Japan's experts provide recommendations based on the analyses of the survey results and explain the essence of corporate governance reforms required by the Cabinet Office Order on Disclosure. It is expected that companies, mainly the Board of Directors, will enhance the effectiveness of corporate governance, and at the same time, the quality of the dialogue between companies and investors through enhanced information disclosure, which will lead to the realization of sustainable corporate value.
We hope our recommendations and analyses will bring you insights into the corporate governance reform in your company.

November 2019

Hiroyuki Takanami

CEO of KPMG Japan

Key Findings and Our Recommendations

The essence of enhancing disclosure in annual securities reports is to improve the effectiveness of corporate governance through efforts taken to enhance information disclosure. Key findings from the results of the survey for external directors regarding the key points addressed by the Cabinet Office Order on Disclosure and our recommendations are as follows:

1 Management policies and issues to be addressed

Key Findings

- Only 20% of the external directors responded that they were able to sufficiently discuss management policies and issues to be addressed. In particular, the smaller the company, the more external directors felt that the discussions were insufficient.
- The lack of discussions is due to the insufficiency of information provided to external directors about changes in business environment over the medium to long-term, which should serve as a basis for formulating management policies, and a number of issues they need to address in the short term which steal time to discuss long-term management policies (Refer to page 29)

Our Recommendation

- When considering management policies and issues to be addressed, it is necessary to clarify short, medium, and long-term management issues with an evaluation axis with reference to what the company considers to be material. Materiality is the basis for considering management policies and formulating medium-term management plan. As such, when identifying materiality, it is necessary for the Board of Directors to thoroughly discuss changes in business environment over the medium to long-term. Based on these discussions, the company's management issues are identified, and the Board of Directors can further discuss on the management policies.

2 Business risks

Key Findings

- Only 20% of the external directors responded that they were able to have sufficient discussion on business risks. On the other hand, another 20% of the external directors indicated that there was not much discussion.
- The result reveals that the challenges for carrying out in-depth discussion on risks include the lack of focus on potential risks and the lack of discussion on future outlook of business environment because discussions currently taken place were focused on identified risks discussed based on current business environment. (Refer to page 31)

Our Recommendation

- In order to intensifying the discussion of business risks at the Board of Directors, it is necessary to narrow down the major risks of the company by not only collecting information of major risks in the business units and their potential impact using the bottom up approach but also taking the top-down approach to identify risk scenarios and impacts of expected changes in business environment to the business. As such, it is essential to establish a structure which the Board of Director sits in the core of risk management.

3 Financial strategies and cash flow allocation policy

Key Findings

- 20% of the external directors considered that they have been able to sufficiently discuss financial strategies. However, the smaller the company, the more external directors felt that the discussion was insufficient.
- Regardless of the size of the company, many external directors indicated that the challenge is to promote management's awareness of cost of capital. It has also been pointed out that there is insufficient discussion about the cash flow allocation policy, which sets priorities among investments and shareholder returns, the use of surplus cash and deposits, and the formulation of policy for optimal capital structure. (Refer to page 33)

Our Recommendation

- In promoting management's awareness of cost of capital, it is not enough to simply set ROIC and ROE targets and shareholder return policy sporadically. It is necessary for the Board of Directors to have sufficient discussion on an integrated "financial framework" which includes cash returns, "quality" of profit (cash conversion), optimal capital structure, and cash flow allocation. As such, it is necessary to enhance financial literacy among the members of the Board of Directors.

4 Executive remuneration

Key Findings

- About 30% of the external directors, in particular those from smaller companies, indicated that they were not able to discuss sufficiently about executive remuneration.
- The result also indicated that determination of executive remuneration was entrusted to the President and CEO and the information shared with the Board of Directors was insufficient. (Refer to page 35)

Our Recommendation

- A decrease can be seen in the compliance rate of the principle in relation to determination of management remuneration (Supplementary Principle 4.2.1) and establishment of independent advisory committee such as an optional nomination committee or remuneration committee (Supplementary Principle 4.10.1). Under this current situation, it is important to actively utilize the optional remuneration committee led by independent external directors. It is also important for companies that have already established such committees to evaluate whether they are functioning effectively, such as ensuring the independence of the chairperson.

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I.

Trends in Corporate Governance

1 Corporate governance reforms —Changes in 2019

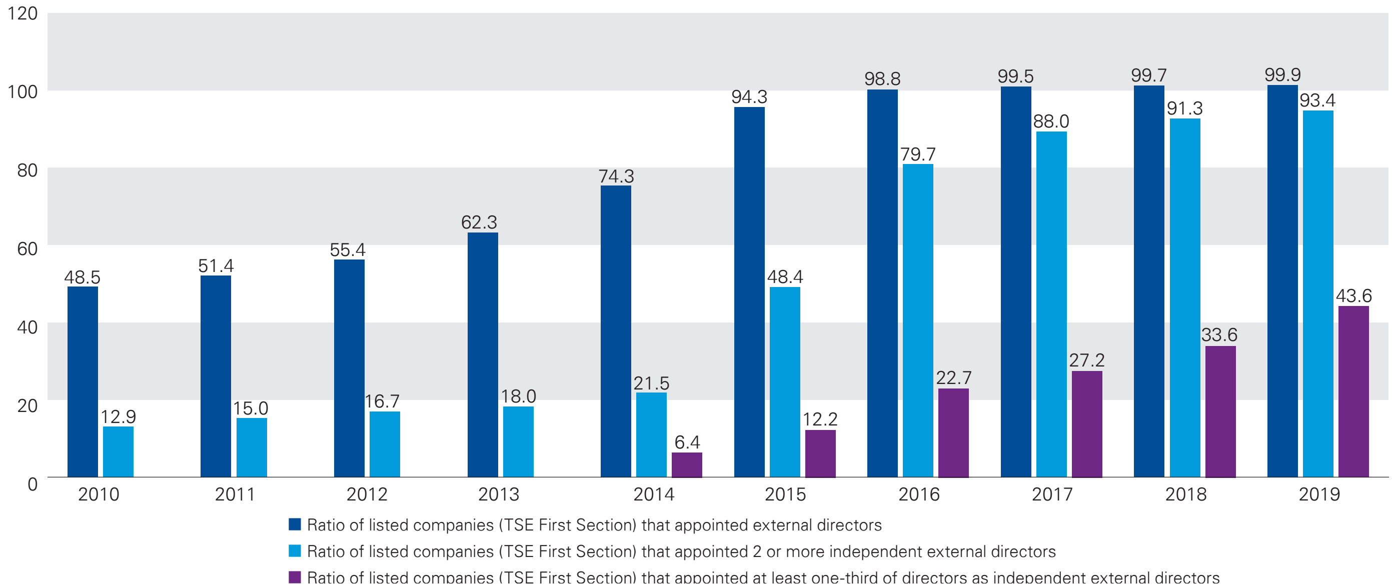
1-1 Changes in 2019

Five years have passed since the introduction of the Stewardship Code in 2014, and four years have passed since the implementation of the Corporate Governance Code in 2015. In 2018, the Corporate Governance Code was revised. The effect of the revision is being seen in 2019. First, it is more common for listed companies to appoint more than one external director, and about a half of the companies listed on TSE First Section appointed at least one-third of directors as external directors (Figure I-1). Among the board systems permitted by the Companies Act, more than 1,000 listed companies choose "Company with Supervisory Committee" (Figure I-2). Also, the number of companies which set up optional advisory committees has increased dramatically, and nearly half of the companies listed on TSE First Section have voluntarily established nomination and remuneration committees (Figure I-3).

On the other hand, the compliance rate of the Corporate Governance Code has, in general, declined (Figure I-4). The compliance rate declined due to the low compliance rate of principles related to the newly introduced principles by the revision in 2018, for example, involvement in the establishment and implementation of a succession plan for the CEO and other executives (supplementary principle 4.1.3), design of remuneration system along with objective and transparent procedures (Supplementary Principle 4.2.1), and establishment of independent advisory committees such as an optional nomination committee or remuneration committee which consists independent external directors (Supplementary Principle 4.10.1) and Diversity of the Board of Directors (Supplementary Principle 4.11) (Figure I-5).
Unless a company is shifting to a company with Three Committees (Nomination, Audit, and Remuneration) to comply with principles in relation to succession plan and management remuneration, a viable option is to establish an optional advisory committee consisting mainly with independent external directors to address these matters in an integrated manner. In addition, even if an optional committee has already been established, it is necessary to continually evaluate effectiveness of the committee in terms of the balance between internal and external members and the independence of the chairperson.

■ Figure I-1 Increase in the number of independent external directors

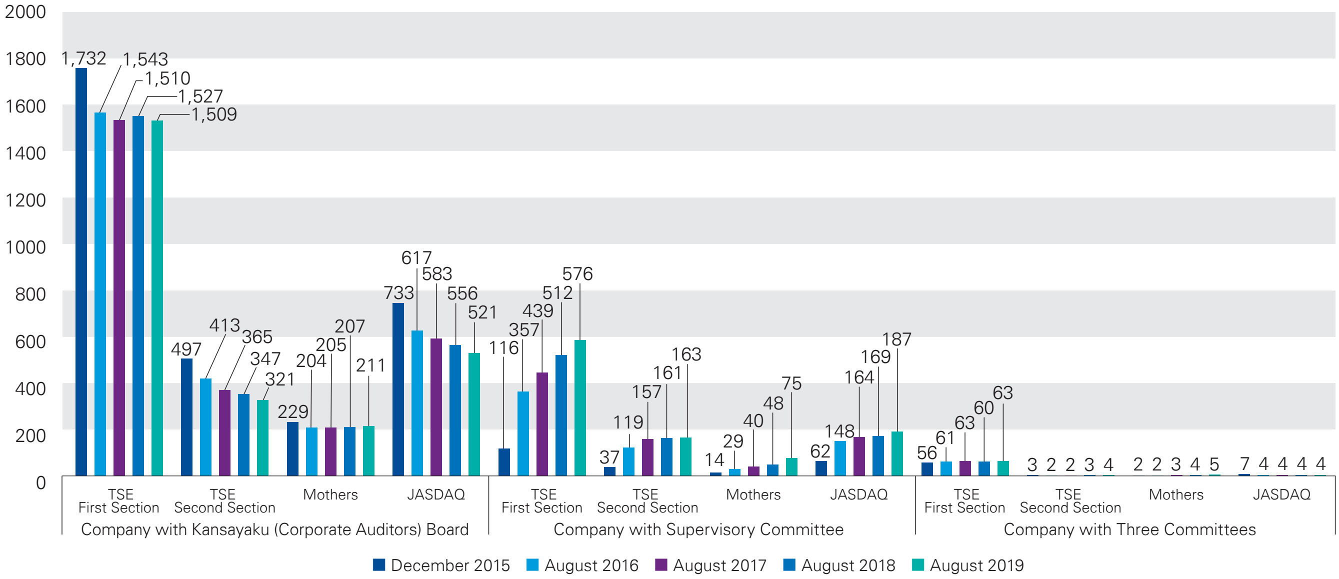
The percentage of companies (TSE First Section) that appointed multiple independent external directors and that appointed at least one-third of directors as external directors has increased to 93.4% and to 43.6% respectively.



Source: Compiled by KPMG based on Tokyo Stock Exchange's "Appointment of Independent Directors and Establishment of Nomination/Remuneration Committees by TSE-Listed Companies" (August 1, 2019 and past editions)

■ Figure I-2 Choice of board system

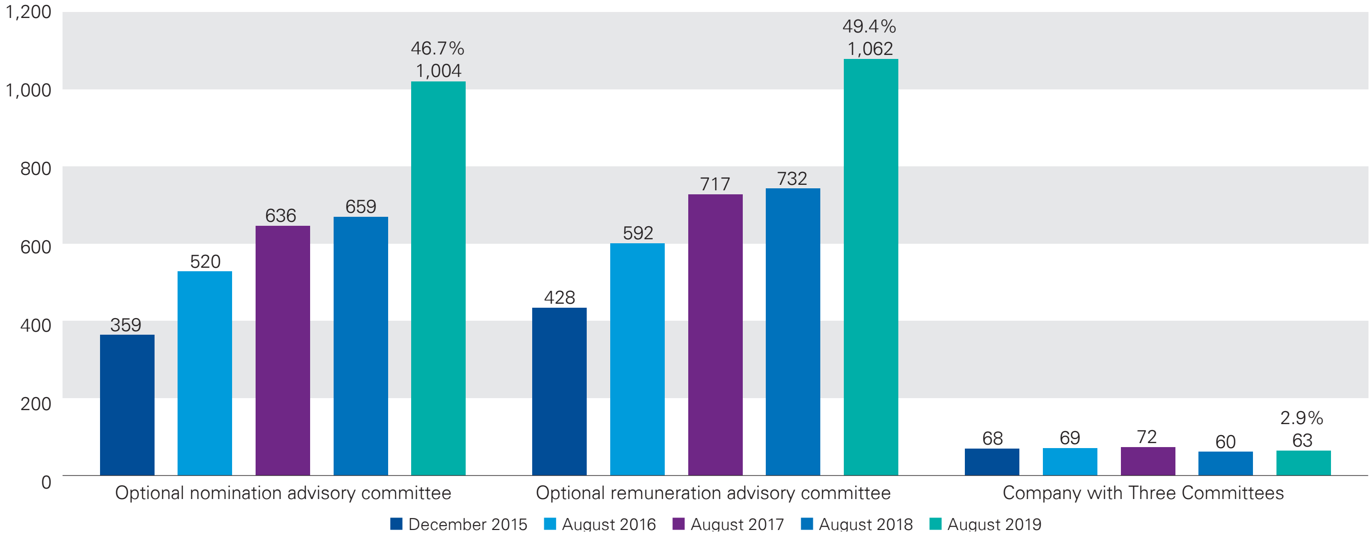
Choice of board system by listed companies (as of August 2019)
The trend of shifting to company with Supervisory Committee continued and now it exceeds 1,000 companies.



Source: Compiled by KPMG based on Tokyo Stock Exchange's "A Appointment of Independent Directors and Establishment of Nomination/Remuneration Committees by TSE-Listed Companies" (August 1, 2019)

■ Figure I-3 Increase in companies with optional advisory committees

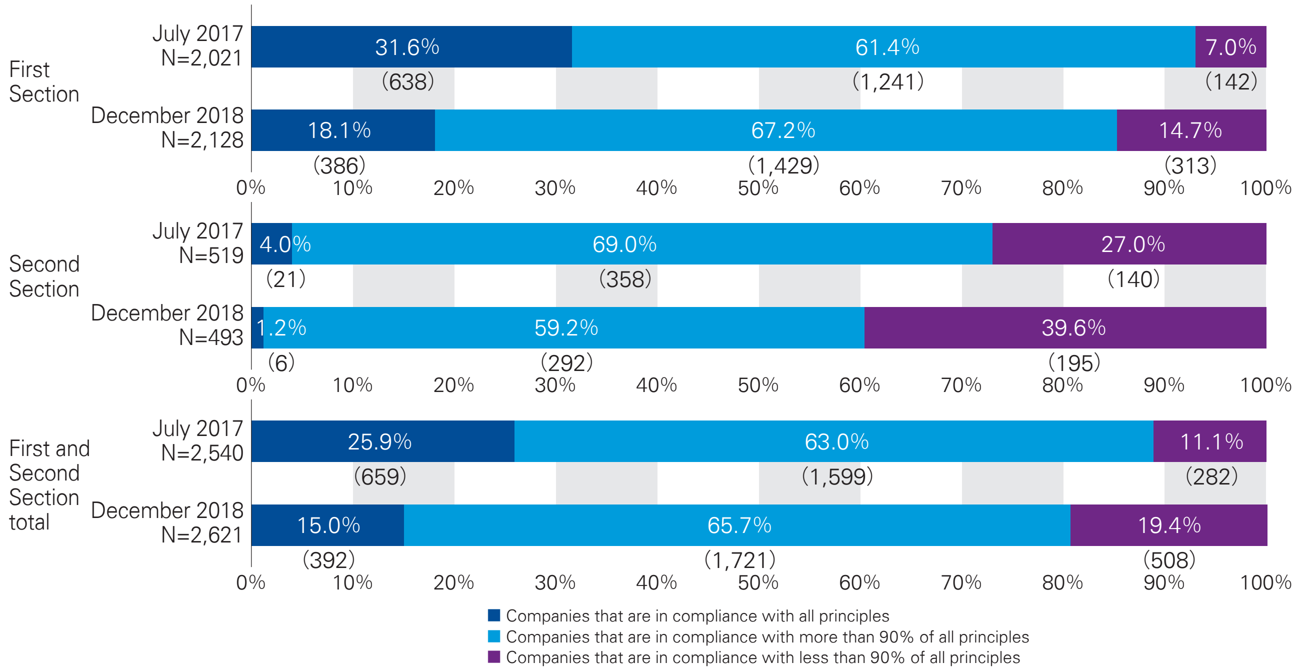
Companies with optional advisory committees (TSE First Section) has increased dramatically in 2019.



Source: Compiled by KPMG based on KPMG's "Corporate Governance Survey 2017" and Tokyo Stock Exchange's "Appointment of Independent Directors and Establishment of Nomination/Remuneration Committees by TSE-Listed Companies" (August 1, 2019 and past editions)

■ Figure I-4 Decrease in compliance rate

**Overall compliancy rate decreased compared to that of July 2017.
In the First Section, 18.1% (-13.4pt) of the companies are in compliance with all principles, 85.3% (-7.7pt) of the companies are in compliance with at least 90% of all principles.**



Source: Tokyo Stock Exchange's "How Listed Companies Have Addressed Japan's Corporate Governance Code (as of December 31, 2018)" (February 21, 2019)

■ Figure I-5 2018 revision code and compliance rate

	Points	Principles introduced by 2018 revision	Compliance rate* Lower row compared to the previous year
1	Management's awareness of cost of capital	Clarification of cost of capital and review of business portfolio as matters to be explained to shareholders (Principle 5.2)	79.8% -10.9pt
2	Strengthen the procedures for CEO appointment/dismissal and determination of CEO remuneration and use of independent nomination and remu-neration committee	Disclosure of policies and procedures of the dismissal of senior management and explanation with respect to each dismissal (Principle 3.1)	91.5% -0.9pt
		Appointment of CEO through objective, timely and transparent procedures (Supplementary Principle 4.3.2)	83.2% —
		Establishment of objective, timely, and transparent procedures for the dismissal CEO when it is determined that the CEO is not adequately fulfilling its responsibilities (Supplementary Principle 4.3.3)	85.8% —
		Involvement in the establishment and implementation of succession plans for executive officers, and oversight on the systematic development of succession candidates (Supplementary Principle 4.1.3)	68.6% -18.0pt
		Design of remuneration system with objective and transparent procedures for management remuneration and determination of specific remuneration amounts (Supplementary Principle 4.2.1)	66.6% -4.9pt
		Establishment of independent advisory committees, such as an optional nomination committee or remuneration committee which mainly consists of independent external directors (Supplementary Principle 4.10.1)	48.3% -28.4pt
3	Ensuring diversity in the Board members	Constitution of the Board of Directors that achieves both diversity, including gender and international experience, and appropriate size, and the appointment of corporate auditors with appropriate experience and skills as well as necessary knowledge on finance, accounting and legal aspect (Principles 4.11)	68.9% -27.6pt
		Appointment of a sufficient number of independent external directors at companies that believe they need to appoint at least one-third of directors as independent directors (Principle 4.8)	87.2% +2.5%
4	Disclosure of policies and approach in relation to reduction of cross-shareholdings	Disclosure of policies and approach in relation to reduction of cross-shareholdings, assessment of holding individual cross-shareholdings and the disclosure about such assessment, establishment and disclosure of specific voting policies (Principles 1.4)	85.8% -11.0%
		Prohibition of hindering sales of cross-shareholdings through means such as possible reduction of business transactions (Supplementary Principle 1.4.1)	99.5% —
		Ensuring the appropriateness of transactions with cross-shareholders (Supplementary Principle 1.4.2)	99.7% —
5	Initiatives to enhance the function of corporate pension fund	Support by companies to ensure that corporate pension funds perform their roles as asset owner and management of conflicts of interest (Principle 2.6)	95.1% —

* As of the end of December 2018, TSE First and Second Section Total (Tokyo Stock Exchange "How Listed Companies Have Addressed Japan's Corporate Governance Code (as of the end of December 2018)") (From February 21, 2019)

1-2 Issues in ensuring group governance and audit reliability

Group Guidelines

Foreign direct investments and cross-border M&A by Japanese companies increased significantly, and globalization progressed rapidly in the 2000s. However, the profitability of Japanese companies is lower than that of the companies in the European countries and the United States. There has been criticism about management resources allocation such as insufficiently evaluated business portfolio. In addition, other issues with preventive function of governance have been recognized, such as scandal happened at the foreign subsidiary. In response to these issues, in June 2019, the Ministry of Economy, Trade and Industry published the “Practical Guidelines on Group Governance System” (Group Guidelines) as the guidelines for establishing governance that underpin enhancement of corporate value as a group. The Group Guidelines describe the basic concept regarding group design, role of group headquarters, business portfolio management, internal control system, and the nomination and remuneration of subsidiary management.
Also, in Japan, the number of parent-subsidiary listing and their share in the market are higher than that in the European countries and the United States. There has been criticism that listed subsidiaries are not independent of controlling shareholders. The Group Guidelines also address the issue about governance of the listed subsidiaries.

Ensuring the reliability of audits

In addition to the aforementioned issues about group governance and listed subsidiaries, the challenge in establishing a mechanism for internal audit department to report directly to supervisory bodies as well as to CEO (so called “dual reporting line”) was also indicated in relation to ensuring the reliability of audits in the meeting of Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code of the Financial Services Agency.
It is expected that intensive discussions will take place toward the next revision of the Corporate Governance Code with progress of actual practices which follow the Group Guidelines taken into consideration.

1-3 Issues for the next revision of the Stewardship Code

With regards to the Stewardship Code, there are also concerns about promoting constructive dialogues between investors and companies. To be specific, the issues are expansion of information disclosure by asset managers, promotion of stewardship activities by corporate pension funds, and provision of information by proxy advisors and investment consultant.
In the next revision of the Stewardship Code, such issues will be considered and expected to be finalized by the end of the fiscal year 2020.

1-4 Discussion on market structure review

The Corporate Governance Code is applicable for all listed companies*[1]. However, there is an opinion that the Corporate Governance Code is not necessarily working well enough to motivate companies to continuously increase corporate value under the current market structure, which consists of First Section, Second Section, Mothers and JASDAQ. For example, because companies listed on the First Section of TSE are linked to TOPIX, there are criticism that companies with low profits, market capitalization, liquidity, management system, governance, and information disclosure are valued higher than their actual value.
As such, the Tokyo Stock Exchange established the “Advisory Group to Review the TSE Cash Equity Market Structure”. Based on the discussions with the experts in the Advisory Group, the Tokyo Stock Exchange announced the plan to restructure the existing four market segments into three.
Three market segments are tentatively named Market A, B, and C. The listing criteria for Markets A and C are based on governance structure, liquidity, profit, market capitalization, etc. The listing criteria for Market B, which is for start-up companies, is less stringent. Companies listed on Market A are those with proven track record and for general investors whereas companies listed on Market C are those meet the requirements for investment by a wider range of investors including international institutional investors.
In response to this, the Expert Study Group on Capital Markets of the Financial System Council at the Financial Services Agency has started the discussion since May 2019 and attention should be paid to its future discussions.

*1 However, certain considerations have been made with respect to the size and characteristics etc. of the companies, for example, for listed companies other than those listed on the main markets (that is, First Section and Second Section), it is acceptable if the reasons for only complying with the five fundamental principles of the Code are stated.

2 Issues of increasing corporate value through disclosure of narrative information

2-1 Overview

In order to promote constructive dialogues between companies and investors, the companies should disclose information about management strategies and governance to facilitate the dialogues.
In view of this, the Disclosure Working Group of the Financial Services Agency's Financial System Council conducted a comprehensive review related to corporate information disclosure in annual securities reports. Their proposals are, 1) enhancement of narrative information, 2) provision of governance information, 3) ensuring reliability and timeliness of information, 4) Improvement of convenience of EDINET and recommendation to disclose the English version of annual securities reports.

Among these proposed by the Disclosure Working Group, the new disclosure items became mandatory as per the Cabinet Office Order on Disclosure of Corporate Affairs amended in January 2019. (Figure I-6).
Regarding the disclosure of narrative information, the Financial Services Agency published the "Principles regarding the Disclosure of Narrative Information" as a principle-based guidance in March 2019. The Principles are intended to promote companies to enhance disclosures of narrative information in annual securities reports, especially management policies and strategies, analysis of operating results as well as risk information, in order to provide useful information beyond a minimal response to the rules. Also, in order to build up appropriate disclosure practices and to promote good practices, the "Casebook of Good Practices on Narrative Disclosures" was published and to be updated as necessary.

■ Figure I-6 Major items of the amended Cabinet Office Order on Disclosure and their effective date

Enhancement of financial information and narrative information	Effective date
Management policies and strategies which include explanations of management's understanding of market conditions, competitive advantage, major products and services, customer base, etc.	Fiscal year ending March 31,2020
Degree of possibility and anticipated timing of occurrence of business risks, details of expected impacts on the business, and the measures to mitigate these risks	
Information in MD&A including management's understanding about the uncertainties and impact a fluctuation will have on management results regarding important items in the relevant estimates and assumptions	
Governance information to facilitate constructive dialogues	
Description of remuneration program, such as information on performance-based remuneration, remuneration policy for each position, etc., and the actual amount of remuneration determined in accordance with the program	Fiscal year ending March 31,2020
Methods to verify the reasonableness of holding of cross-held shares as well as the 60 stocks held by the company from the fiscal year ended March 31, 2019, the number of stocks increased from 30 previously.	
Enhancement and provision of other governance information	
Enhancement of credibility and timeliness of infomration	
Activities of the audit committee, auditor tenure and audit fees as well as non-audit fees to the external auditors and their member firms	Fiscal year ended March 31, 2019 or fiscal year ending March 31, 2020

(Note) For items which are effective from fiscal year ending March 31, 2020, early adoption is permitted for the fiscal year ended March 31, 2019

Principles Regarding the Disclosure of Narrative Information

The Principles are divided into two sections, namely "General Remarks" and "Itemized details". "General Remarks" set out the overall principles for disclosure of narrative information, concepts and efforts expected in preferred contents of disclosure. Concepts and preferred contents in disclosure regarding "Business policies and environment as well as issues to be addressed", "Business risks", "Analysis by management of financial conditions, operating results and the cash flows status (MD&A)" are set out in the "Itemized details" section. The overview of the five Principles set out in "General Remarks" are as follows.
The first Principle is about the role of narrative information in disclosure of corporate information. Narrative information is considered to be important from the perspective of continuous improvement of corporate value as narrative information supplements financial information and it allows investors to make appropriate investment decision, promotes constructive dialogues between investors and companies, and lead to the enhancement of the quality of corporate management. Companies are required to acknowledge the functions of narrative information and make substantial disclosure. (Principle 1)
In addition, the following four Principles are set forth as common items for disclosure of narrative information.

- **Appropriate reflection of discussions at the Board of Directors and the Executive Committee** (Principle 2.1)
  Narrative information should reflect discussions at the Board of Directors and the Executive Committee, in order to enable investors to understand the company through the eyes of the management.
- **Disclosure of material information** (Principle 2.2)
  Each company should have its standard to make judgement on the materiality regarding narrative information.
- **Disclosure by segment** (Principle 2.3)
  In order for investors to understand the overall company through the eyes of management, companies should disclose narrative information in appropriate segment categories.
- **Clear disclosure** (Principle 2.4)
  Companies should disclose narrative information in a clear way in order to allow deeper understanding.

Enhancement of disclosure of annual securities reports and intensifying discussions at Board of Directors

Annual securities report is a statutory report. However, it does not mean that it is sufficient to merely make the minimum disclosures as required by laws and regulations. It is necessary to have an attitude of providing investors with useful information from management's perspective in an ingenious and easy-to-understand way while supplementing financial information with reference to the intent of the disclosure requirements. As such, it is necessary to sophisticate the discussions at the Board of Directors and the Executive Committee while considering viewpoints of investors.

2-2 Concept and the judgement of materiality

Materiality differs from company to company and should be determined by the company itself

Materiality, which is required by the Principles regarding the Disclosure of Narrative Information, varies from company to company. It is not the general concept of “importance”. Companies should assess materiality from the perspective of what affects the overall value including the social value that the company creates. Then, based on the results of the assessment, companies should decide what to disclose and explain. This is referred to as having the judgement standard of materiality.
One of the frequently referred definitions of materiality is the precedent of the U.S. Supreme Court that defined materiality as “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available”. The Principles regarding Disclosure of Narrative Information also state that the materiality of narrative information should be judged based on “whether or not it is material to investors’ investment decisions”
Investors make decisions in view of the corporate value that is expected to be realized in the future and the value in the current market. Management makes and executes decisions while taking the responsibilities for employees and customers regarding the company’s strengths and weaknesses, state of management resources owned by the company, actual business processes and risks handling. When making decisions, factors such as “elements which are regarded as important for the company’s value”, “factors that have an impact on value creation”, and “necessary management resources and the costs required” are to be considered, then specific measures are implemented. The improvement in the quality of dialogues between management and investors can be expected if the elements that assumed to affect value creation of the company are shared through the enhancement of disclosure of material information. Both management and investors care about the company and aim to obtain benefits and realize social impact out of values created by the company. For this reason, through dialogues on factors which need considerations, management can identify the existence of risks and potential opportunities while investors can make better decision based on the understanding of the company.

Assessing time horizon

Assessment of time horizon is indispensable when considering materiality. One of the frequently asked question is how many years are considered long term. The answer is, similarly to materiality, that it varies form company to company and shall be determined by the company. Investors also have their own time horizon for judgment based on their investment philosophy.
Material issues change over the short, medium and long term. Materiality that affects the key sources of value creation of the company will remain throughout the corporate history and be the basis for their decision making. On the other hand, issues to be assessed when considering the long-term vision and formulating a medium-term management plan or planning for the next term should be different.
For example, the magnitude and the scope of impacts of greenhouse gases on balance sheet depends on when companies expect they are affected. Similarly, when discussing the risks regarding climate change at the Board of Directors, the content of the discussion will vary depending on the time horizon they set. When considering supply chain, there will be differences in the types of risks or opportunities that need to be considered in making decisions about product development. It is important to keep in mind the time horizon when making explanation based on “diversified consideration” and “business environment at a time” as required by “Disclosure of Narrative Information”

Considering the magnitude and likelihood of occurrence of the impact

The Principles regarding the Disclosure of Narrative Information states that judgements on the materiality of narrative information should take into account the degree of impact that the matter will have on corporate value and operating results, and the likelihood of occurrence of the matter should be considered as well.
Similarly, to the time horizon described in the previous section, even if the material issues of one company coincide with these of other companies, the impact and likelihood may be different depending on the uniqueness of each company. In order to determine them, it is

necessary for management to have as realistic as possible understanding about the company's target value, business models and processes to achieve it, as well as the characteristics of the resources it uses to create value (such as cost, uniqueness and advantages of intellectual capitals they own, and relationship with suppliers)
For narrative information based on the impact and the likelihood of occurrence of "the matter", the views of the company and the investors can sometimes be different. Therefore, the explanation which includes these details will be helpful to better understand the management's views on business strategies. You can find various examples of efforts to explain the magnitude and the likelihood of occurrence of impact in the disclosure of overseas companies. Some indicate the magnitude of impacts in the form of a heatmap, and the likelihood of occurrence in a diagram using an axis.
A better example is that each material issue is explained with metrics (indicators). Sustainability Accounting Standards Board (SASB) develops metrics which take into consideration the fact that materiality differs from company to company. Since it is difficult to ensure comparability, transparency and reliability of material matters, industry-specified metrics as a "common language" to promote corporate reporting and utilization by investors, and to contribute to the improvement of usefulness of narrative information.

Examine information to report

Having the focus of materiality in disclosure leads to an accurate selection of items to be reported.
It does not necessarily mean that more information is better. At the same time, hesitation to disclose information that affects corporate value should be avoided. With the evolution of information and communication technologies such as SNS, there have been many cases where omission of disclosure or failure in disclosure caused significant losses in business.
In order to avoid risks associated with reporting and the negative impact on corporate value, it is essential for the Board of Directors to activate discussion on materiality which forms the basis of disclosure and realizes clear reporting with sufficient information.

2-3 Business risk identification and discussion at the Board of Directors

Business risks have been required to disclosure in the annual securities reports, but the amendment of the Cabinet Office Order on Disclosure has required more detailed disclosure. In particular, with regards to the major risks that management considers that could have significant impacts on the company's financial position, operating results and cash flow status, it is required to specifically describe the extent and timing of the possibility that the risks will occur, the impact of risks on operating results, and the measures to mitigate risks. In addition, the importance of risks and the degree of relevance to management policies and management strategies need to be clearly disclosed.
Furthermore, according to the Principles regarding the Disclosure of Narrative Information, it is expected that investors should be able to understand how the Board of Directors and the Executive Committee determine the materiality of risks. In order to disclose risk information in line with the purpose of this revision, it is necessary to create a framework for discussions at the Board of Directors with the aim of collecting appropriate risk information and assessing materiality.

Collection of risk information

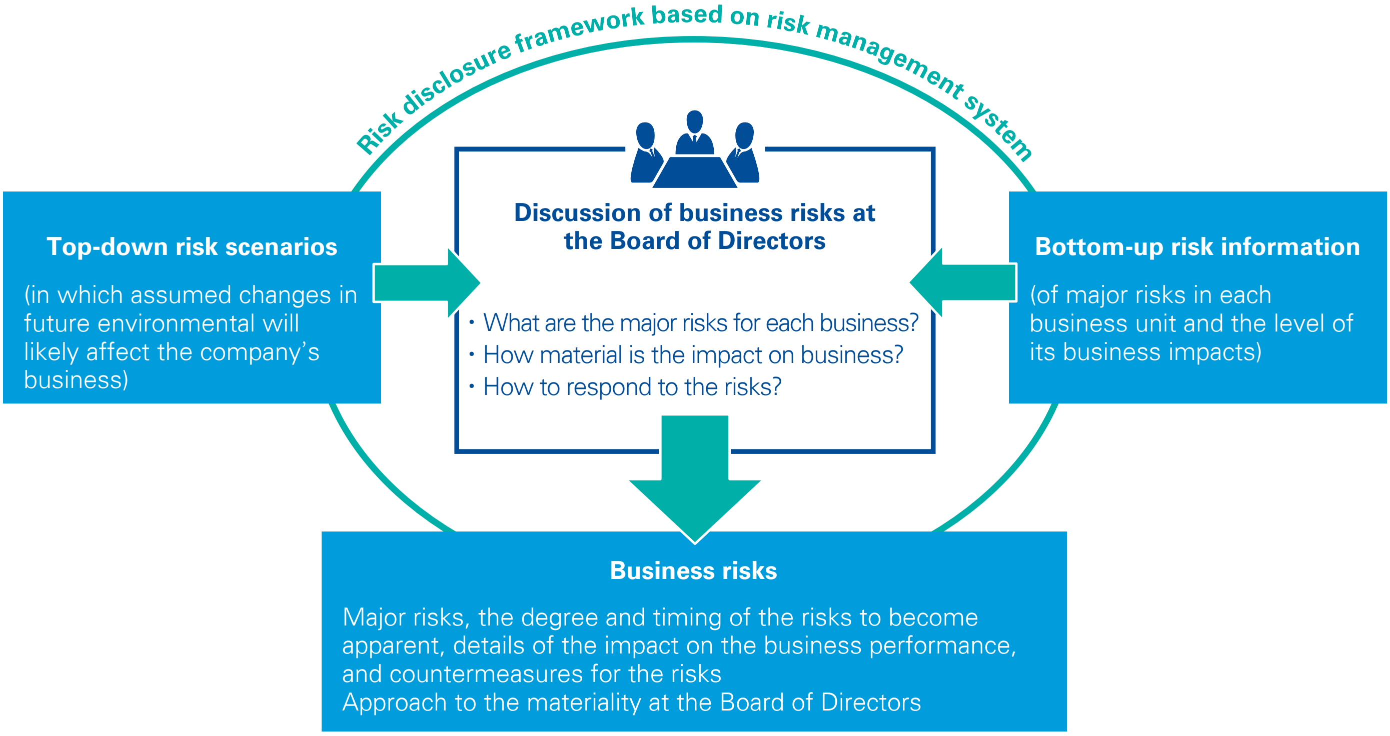
According to the Principles regarding the Disclosure of Narrative Information, risks to be disclosed are material risks from management's perspective that may affect business operations in and after the subsequent fiscal years. In other words, disclosure should include factors such as (1) expected changes in external environment in the next fiscal year and onward, (2) the impact on business operations, and (3) the management's judgment of materiality.
Firstly, regarding (1) expected changes in external environment, as mentioned in the report of the Disclosure Working Group, there are many cases with disclosure of Japanese companies where the same explanation about external environment are used over several years although there actually were changes in external environment. What is important for investors is the risk that affects future business results. Among the excellent disclosures, there are some companies that describe a risk scenario which assumed the impact of changes in future environment on the company's business performance in the form of a story. In order to develop risk scenario, it is necessary to predict and consider how the environmental change will affect the company's competitive advantage and business continuity. For example, a workshop that gathers executives across different departments to have discussion together is one possible way to take. By collaborating across departments, it is possible to identify risk scenarios using top-down thinking which is not bound by self-interests of individual department and existing operations.
Next, regarding (2) the impact on business operations, in the conventional disclosure of business risks, there are many cases where it is not clearly indicated which business will be affected and what the impact will be. For example, information security risk is one of the commonly disclosed risks, but it is often the case that you cannot understand exactly how the business is affected by system failure or cyberattack. It is presumed that the impact of those risks on the business cannot be explained probably because there is no involvement of subject matter experts in the business departments in collecting risk information, thus all that can be disclosed are general explanation of risks. To respond to the revised disclosure requirement for business risks, it is necessary to collect specific information such as the major risks identified by each business unit, the impact of such risks on the business, the likelihood of occurrence of risks, and countermeasures.
In addition, regarding (3) management's judgment of materiality, it is necessary to collect information accordingly to criteria and method for assessing materiality set in advance. The materiality of risk is determined by the magnitude of impact when it occurs and the likelihood of occurrence. However, as it is practically difficult to accurately estimate the likelihood of occurrence of risk, emphasis is placed on the degree of impact. It is common to measure the degree of impact from multiple dimensions such as financial impact, impact on human life and health, or impact on reputation. In addition, the scope of the impact, the speed of expansion, the length of duration, and the complexity of the impact (such as ripple effect of risks) may also be considered. By having discussion on the materiality of risks in these dimensions, it will be easier to explain to the investors how the Board of Directors and the Executive Committee judge the materiality of risks.

Discussion of materiality of risk at the Board of Directors

In order for the Board of Directors to discuss business risks and their materiality, it is necessary to have an organization (risk management system) to collect the abovementioned risk information and report to the Board of Directors. Organization, such as the risk management division and the secretariat of the risk management committee, plays a core role in setting up a platform for collecting, compiling, and evaluating risk information, and reports to the Board of Directors. Although the risk management division in many companies collects internal risk information and reports to management, information about future outlook and specific impact analysis on business is often insufficient. In such case, it is necessary to upgrade the risk management system so that these extra viewpoints can be taken into consideration while using the existing system. In addition, according to the Principle Regarding the Disclosure of Narrative Information, it is recommended to include the disclosure in relation to the risk management system.

The Board of Directors narrows down the major risks and assesses materiality of such risks based on the risk scenario using a top-down approach and the risk information collected from each business unit using a bottom-up approach. In order to make it work, it is necessary to share the same understanding of business and value among board members. There are some companies which hold off-site meetings with all of the board members to discuss business risks. (Figure I-7) As mentioned above, the risks that will be discussed are those that have significant impact on the business operations. The discussion of these risks is about discussing the key factors that hinder business strategies. Enhancement of disclosure of business risks aims at enhancing the provision of information to investors. However, for the Board of Directors to effectively oversight the business, discussing business risks is also important. In order to strengthen the function of the Board of Directors, it is expected that disclosure of risk information under the risk management system will be further enhanced.

■ Figure I-7 Risk information disclosure framework based on risk management system



2-4 MD&A— Developing financial strategies and cash flow allocation policy

In MD&A section, in addition to an in-depth analysis about fluctuation in financial information for the entire business and segments, it is required to disclose the analysis and examination of cash flow status, capital resources and liquidity of funds.
In disclosing such information, it is necessary to mainly explain (1) how to allocate the funds among growth investment, cash on hand, and shareholder return, and (2) financing policies. It is also helpful to explain the company's definition and concept of cost of capital along with efforts made to optimize it.
Corporate governance reforms in Japan require companies to be aware of the cost of capital in order to achieve improvement in sustainable and medium- to long-term corporate value. With cost of capital as a starting point, it is important to disclose policies in relation to growth investment, cash on hand, shareholder return, and fund raising as required by the Cabinet Office Order on Disclosure. It is not meaningful to show these policies sporadically, thus it is required to disclose these policies together as streamlined "financial framework" (Figure I-8).

Financial framework

"Financial Framework" is framework of a financial strategy which is developed to execute medium-term business plan and that integrates evaluation of returns based on cost of capital for business strategies, policy on optimal capital structure, and policy on cash flow allocation. Enhancement of corporate value is achieved by continuous increase in return on invested capital (ROIC) and return on equity (ROE) by exceeding their respective cost of capital (WACC and cost of equity).
On the other hand, ROIC and ROE are based on accounting profit. In order to increase corporate value, it is insufficient only to accumulate accounting profit, it is also necessary to increase the ability to generate free cash flow. No matter how much ROIC or ROE rises, corporate value will not essentially increase if there is insufficient cash to match with the rise. In other words, for return that exceeds cost of capital, it is extremely important to raise cash-based return, so called "cash return".
The key to cash return is the "quality" of profit. The "quality" of profit refers to the ratio at which profit earned is actually converted to cash flow and is measured by Cash Conversion Ratio (CCR). In Japan, equity investments are increasing as companies are seeking growth in overseas markets and there are many companies which are unable to collect cash immediately. Although accounting profit is increasing, the reality is that the number of companies with declining CCR and low profit "quality"is increasing gradually.

[CCR calculation formula]

$$\text{Cash Conversion Ratio (CCR)} = \frac{\text{Operating cash flows}}{\text{EBITDA}}$$

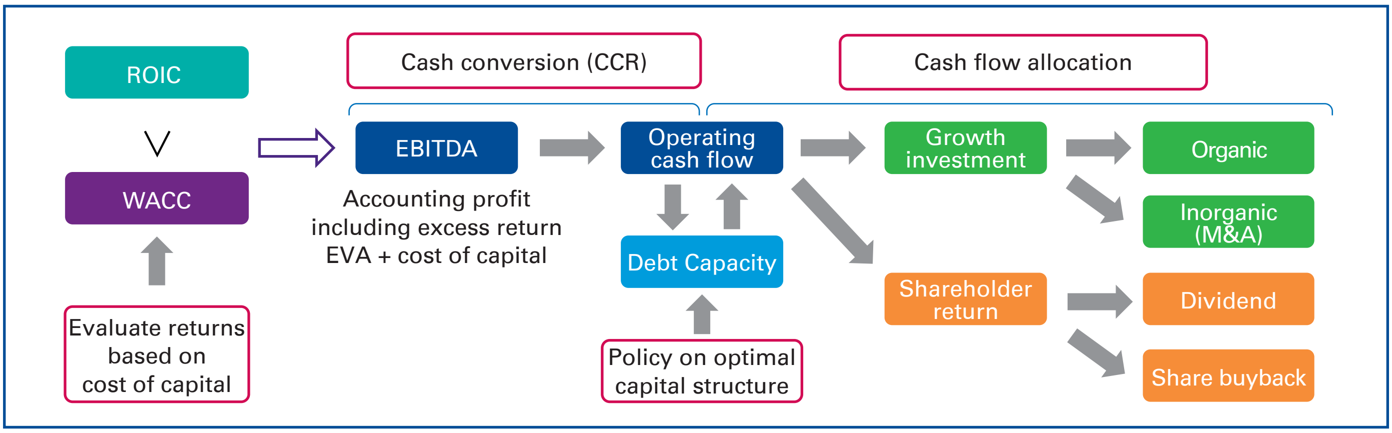
* CCR is a non-GAAP measure, and its definition varies from company to company

In order to enhance corporate value, it is necessary to allocate profits earned (approximately equal to operating cash flow) to growth investment and shareholder return. What is important here is optimal capital structure and cash flow allocation policy.
Optimal capital structure is the composition ratio of D (interest-bearing debt) / E (equity capital) that matches business risk, and the Debt Capacity (maximum amount possible of interest-bearing debt) is also determined by optimal capital structure policy. How to underpin the growth strategies by the balance sheet and to control excessive growth investment from a financial perspective depends on the optimal capital structure policy. Cash flow allocation refers to the policy of using "Operating Cash Flow + Debt Capacity" as the source of capital to allocate to growth investments and shareholder return. This means that growth investment and shareholder return can only be allocated within the range of "Operating Cash Flow + Debt Capacity". Given this constraint, it is necessary to prioritize allocation, such as for growth investment and shareholder return, and thus the allocation policy represents the company's thinking regarding the use of funds for increasing corporate value. Cash flow allocation differs depending on business strategy, but it is important to consider the balance between growth investment and shareholder return.
As a general rule, if it is possible to continuously increase returns that exceed the cost of capital, reinvestment as cash flow allocation should be prioritized. On the other hand, growth investment can be further divided into organic growth investment and inorganic growth investment. Inorganic growth investments, such as M&A, are high risk and the timing of occurrence is often uncertain, so it is generally considered separately from organic growth investments.
The amount allocated to shareholder return depends on

the amount of growth investment, and there is a trade-off between the two. In accelerating growth investment, the amount devoted to shareholder return naturally goes down. It is often pointed out that many Japanese companies are paying attention to the payout ratio, and having a dividend policy with less fluctuation. This is probably because there is less attentions to cash flow allocation policy, and it cannot capture shareholder return from the viewpoint of distributable cash flow.
Due to the strong tendency of shareholders' sentiment to dislike dividends reduction, many companies in the United States and Europe focus on the growth of dividend per share (DPS) instead of payout ratio. The increase in dividend itself is not large but the amounts of dividends paid to the shareholders increase every year, at the same time, companies buy back their own shares by making use of the available cash flow allocation capacity. Share buybacks also have a capital adjustment aspect to maintain an optimal capital structure.
It is essential to describe policies regarding returns above cost of capital (ROIC> WACC, ROE> Cost of equity), quality of "profit" = conversion to cash (cash conversion), Debt Capacity based on the optimal capital structure, operating cash flows generated through the business and allocation policy of Debt Capacity as a single set of "Financial Framework" to meet the requirement by the Cabinet Office Order on Disclosure to disclose "information on analysis and examination of cash flow status as well as information on resources of fund and capital liquidity."

In the process of considering such disclosures, it is expected that dialogues with investors will be intensified as a result of the improvement in companies' financial management and the disclosure of the "Financial Framework".

Figure I-8 Overview of Financial Framework



I.

Column — Issues regarding KPI

When providing narrative information, it is encouraged to use charts, graphs, and photographs and be more creative to help deeper and more accurate understanding of the contents. For this purpose, specific metrics are useful especially for deepening dialogues with investors.

KPIs to supplement narrative information

KPIs supplement the narrative information which are provided in a descriptive manner and increase the reliability of such contents. It does not mean that there are KPIs which must be included or disclosed.
Companies are expected to report KPIs to show that the content of narrative information is not a fabrication.
KPIs that are selected and reported by companies help explaining the argument and the rationale behind the contents described in the report based on materiality we discuss in the previous section.
For example, if the introduction of new environmental regulations is a factor which affects the ability to create value hence extra R&D activities to meet the new regulations are need, the readers will find it more convincing (in some cases, even made aware of the issue) when an increase ratio in the R&D budget is provided along with the fact that an additional investment is needed. In addition, information such as "aiming to complete by year XXXX" or "establishing new alliance with XX Research Laboratories" will add credibility to its feasibility. We see some reports show a long list of KPIs. However, it is more important to explain the reasons why such KPIs were selected. Instead of following peers in disclosing KPIs, what is more effective is to show company-specific KPIs from management's perspective, together with its definition and formulas.
Also, it is necessary to consider continuity. If certain information provided in previous years is not disclosed this year because the figures were not positive even though the indicator is closely related to the ability of value creation, it may cause doubt for the readers and they may question about managements' attitudes toward the integrity of disclosure.

KPIs are not merely numbers

KPIs are not merely numbers. KPIs that are included for better understanding of narrative information have the following characteristics:

- It functions as leading indicators which will link to future financial performance
- It indicates the content of business processes instead of results
- It can be qualitative
- It sometimes utilizes publicly available information

When talking about KPIs, people tend to think of "quantitative" and "numerical" information. However, much of the narrative information is about explaining sustainable value enhancement towards the future. For this reason, it is difficult to provide easy-to-understand explanations only with the information based on the past and results.
Disclosure of KPIs which are used for internal management and personnel evaluation may become effective.

KPIs as a social license to operate

Some KPIs are mandated by laws which are enacted in response to requirements for corporate social responsibility. However, companies can sublimate mandatory disclosure into a communication to demonstrate differentiating factors and competitive advantage of the company. A kind of disclosure such as the one which is recommended by the Task Force on Climate-Related Financial Disclosure (TCFD) used to be forced by law but now is advocated by the leadership of the Financial Stability Board because of the expansion of long-term perspective and impact investments.
There is an increasing necessity to consider social impact in various decision-making situations. It is essential to integrate social and environmental aspects into management, for example, by reviewing the reporting boundary to expanding to overseas subsidiaries and to widen the coverage of supply chain. Similarly, it is expected that the discussion based on materiality about the processes underlying the reported KPIs and the link to sustainable value enhancement at the Board of Directors shall be increasing.

Remaining issues: how to utilize KPIs

Presentation of KPIs alone should be avoided. In the future, the reliability of the reported KPIs will be considered. Currently, it cannot say that a widely agreed definition and formula for a set of non-financial KPIs are maintained.
In order to promote the use of narrative information, there is a demand for a standardized KPI library and to enhance the use of it.

II.
Survey for External Directors

Following the revision of the Corporate Governance Code in June 2018, the Cabinet Office Order on Disclosure of Corporate Affairs (hereinafter the “Cabinet Office Order on Disclosure”) was amended in January 2019 to enhance disclosure in annual securities reports. The essence of the amendments to the Cabinet Office Order on Disclosure is to further promote corporate governance reforms and to enhance the effectiveness of the disclosure in annual securities reports. In this regard, there will be increasing expectation on the role of external directors. In the previous chapter, we discussed the trends in corporate governance reforms over the past year and the key points related to the amended Cabinet Office Order on Disclosure and explained how the companies should address each of these points.
With respect to these trends and issues, it is important to understand the current situation and issues from an objective perspective of the external directors in order to enhance the effectiveness of corporate governance and to consider the ways to increase corporate value.
In this chapter, based on the results of the survey conducted by KPMG for external directors, we analyze how external directors deal with the revision of the Corporate Governance Code and the issues which they identified with respect to the revision of the Cabinet Office Order on Disclosure.

<Survey methodology>

In this year’s survey, respondents are external directors. If they serve as external directors for more than one company, we ask them to respond based on the situation at the company with the largest amount of sales amongst the companies they serve. For the purpose of capturing trends by the size of the companies, respondents are divided into four groups according to sales amount of the company they serve.

Group 1: Companies within 25th percentile in terms of sales (sales of 274.3 billion yen and above)
Group 2: Companies between 25th to 50th percentile in terms of sales (sales of 90.7 to 273.3 billion yen)
Group 3: Companies between 50th to 75th percentile in terms of sales (sales of 34.4 to 90.3 billion yen)
Group 4: Companies between 75th to 100th percentile in terms of sales (sales of less than 33.5 billion yen)

1. Progress of corporate governance reforms in Japan

Summary of survey result

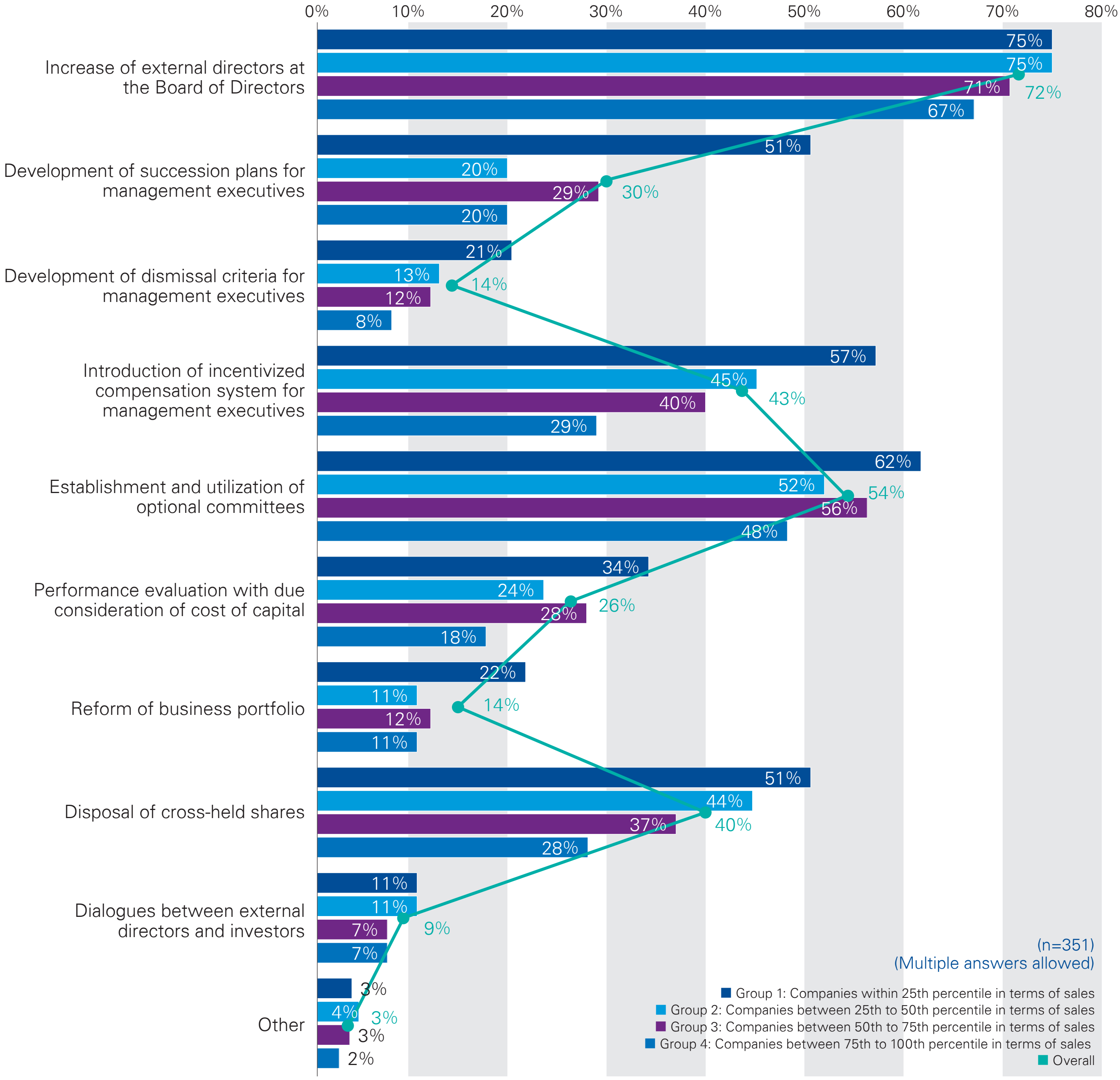
As more companies increase the number of external directors as a result of corporate governance reforms, many external directors are concerned about succession planning and introduction of performance evaluation with due consideration of cost of capital. Issues recognized by external directors vary depending on the size of the company. External directors of large companies regarded reform of business portfolio as an issue, whereas those of smaller companies concerned that the Board of Directors has not been fully utilized board evaluation to enhance their function. In order to improve the effectiveness of corporate governance, further contributions by external directors are necessary in addressing identified issue in each company.

Items for which the corporate governance reforms have advanced (Figure II-1)

Regardless of the size of the company, external directors considered "increase of external directors at the Board of Directors" has made the most progress in the reforms, followed by "establishment and utilization of optional committees", "implementation of incentivized remuneration for management executives" and "disposal of cross-held shares". On the other hand, only a small number of respondents indicated that progress has been made in "performance evaluation with due consideration of cost of capital", "reform of business portfolio", "development of criteria for dismissal of management executives" and "dialogues between external directors and investors". Although some progress has been made on formality aspect of the reforms such as "increase of external directors at the Board of Directors" and "establishment and utilization of optional committees", many external directors still felt that the operational initiatives to increase corporate value are not sufficient. More external directors in Group 1, that represents large companies, recognize the progress with "remuneration system" and "successor plan". However, "successor plan" has the largest variance depending on the size of the company. The smaller the company, the more external directors felt that there has been no progress in this part of the reform.

■ Figure II-1 Items for which the corporate governance reforms have advanced

Q. With reference to the revision of the Corporate Governance Code, please select the items which you, as an external director, consider have advanced. (Multiple answers allowed)

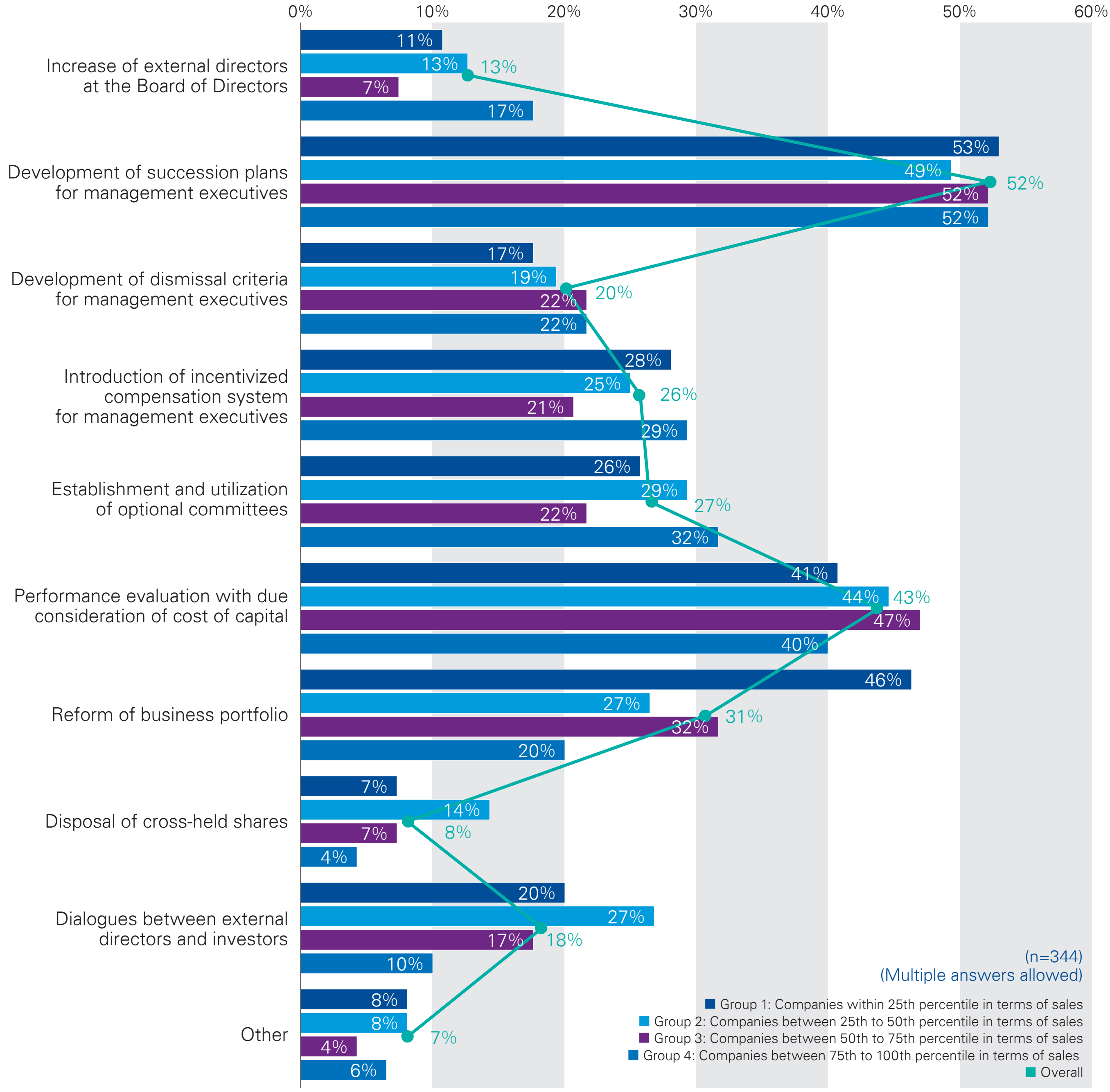


Issues which the Board of Directors have to start or intensify the discussions (Figure II-2)

Issues which the highest number of external directors considered that the Board of Directors have to start or intensify the discussions was "Development of succession plans for management executives". Development of succession plans is one of the items in the Corporate Governance Code which got the lowest compliance rate of 68.6%, and the compliance rate declined by 18 points after the revision of the Code ("TSE-Listed Companies White Paper on Corporate Governance 2019"). In the revised Code, in addition to the appointment of directors, it is required to establish and disclose policies and procedures for dismissal of them. The result indicated that external directors also strongly believe that it is necessary to have further discussion at the Board of Directors about this issue.
External directors have also cited "performance evaluation with due consideration of cost of capital" as an issue that discussion should be started or intensified. In addition, it is noted that "reform of business portfolio" was considered to be an issue in Group 1, that represents large companies. Larger companies tend to have more businesses, so it is presumed that more external directors considered selection and concentration as an issue.

■ Figure II-2 Issues which the Board of Directors have to start or intensify the discussions

Q. Please select the items which the Board of Directors have to start the discussions promptly (or deeper discussions if the matters have already been discussed) in order to enhance the effectiveness of corporate governance. (Multiple answers allowed)



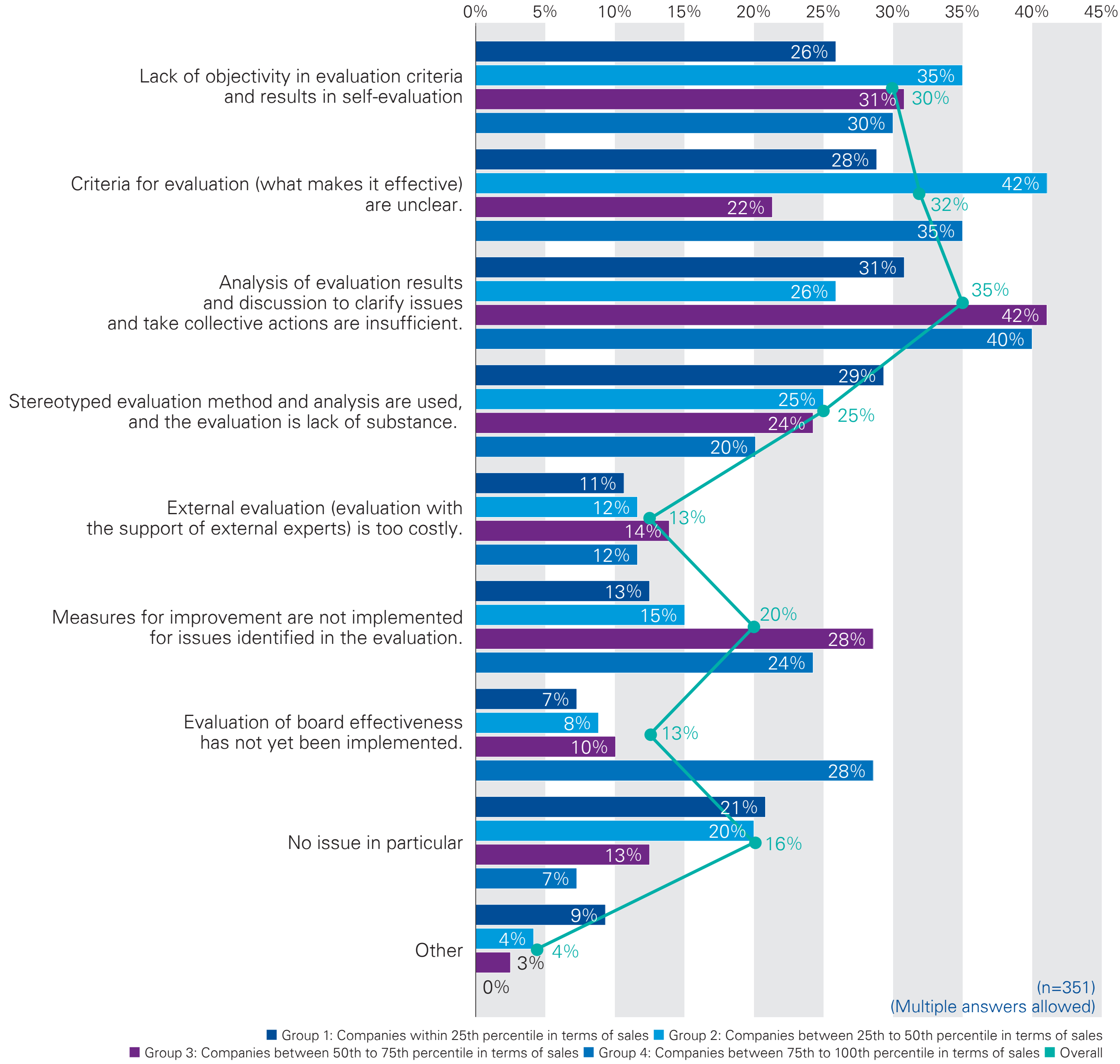
(n=344)
(Multiple answers allowed)

Issues with evaluation of board effectiveness (Figure II-3)

Regarding issues with evaluation of board effectiveness, the difference in responses among the size of the company was relatively noticeable. In particular, the response rate for “Analysis of evaluation results and discussion to clarify issues and take collective actions are insufficient” and “Measures for improvement are not implemented for issues identified in the evaluation” is higher with external directors from small companies in Groups 3 and 4. According to “TSE-Listed Companies White Paper on Corporate Governance 2019”, 78.9% of companies listed on the First and Second Sections of TSE have implemented evaluation of the board effectiveness. However, the smaller the company, the more external directors realize that the results of the evaluation are not fully utilized.

■ Figure II-3 Issues with evaluation of board effectiveness

Q. Please select all that apply in relation to issues with evaluation of board effectiveness. (Multiple answers allowed)

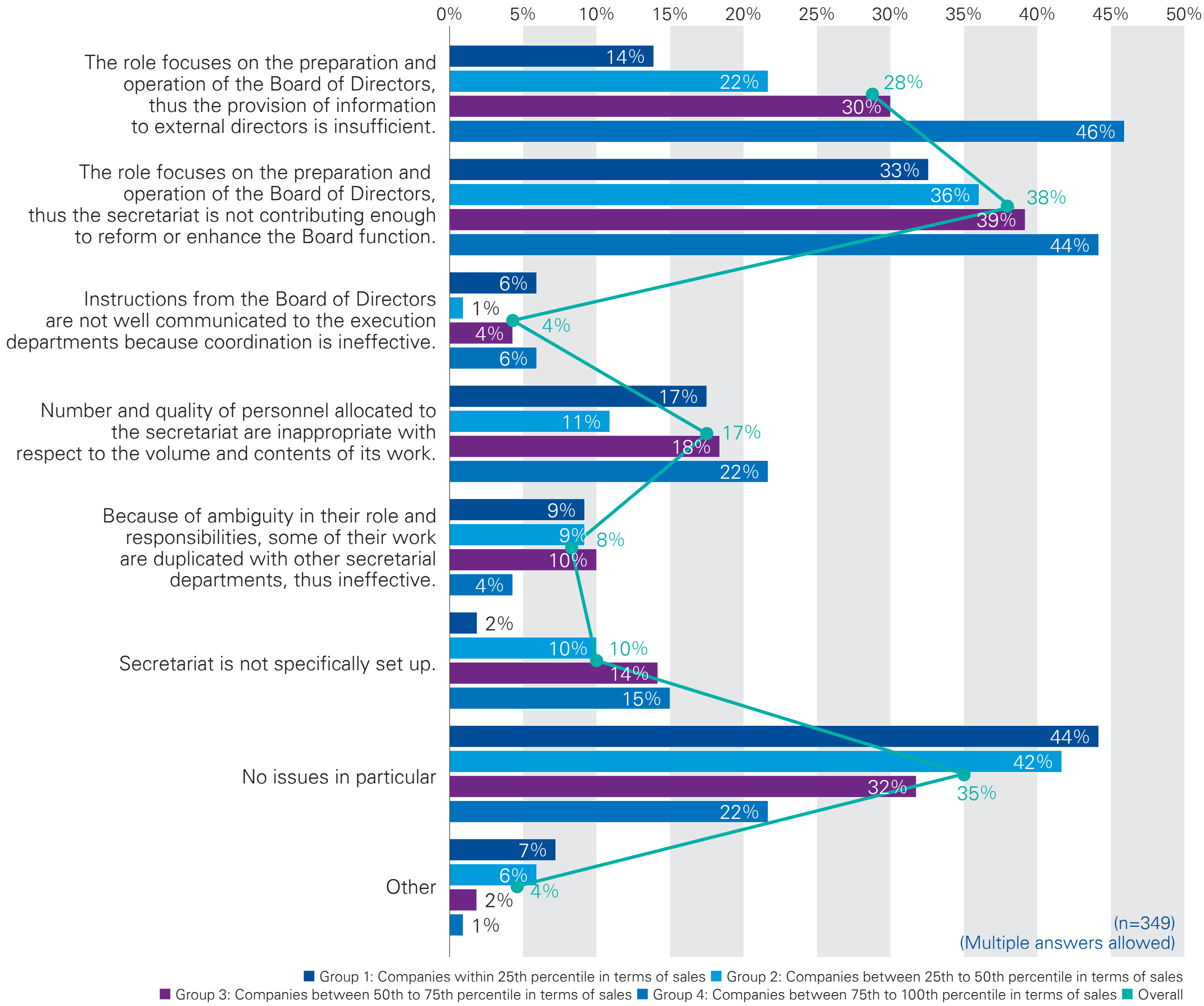


Issues regarding the secretariat of the Board of Directors (Figure II -4)

The issues around the secretariat of the Board of Directors vary greatly depending on the size of the company. More external directors think there are “no special issues” as the size of the company increases, while the smaller the size of the company, the more responses point out the issues with it.
The issues which the most of those in the small companies responded was “The role focusses on the preparation and operation of the Board of Directors, thus the provision of information to external directors is insufficient.” Although it is assumed that the number of staff available for the secretariat is normally limited in smaller companies, external directors see their efforts are not necessarily sufficient.
One of the issues faced by external directors of large companies is that “The role focuses on the preparation and operation of the Board of Directors, thus the secretariat is not contributing enough to reform or enhance the Board function.” It is necessary to review the mission of the Board secretariat and enforce its workforce to contribute to resolving issues.

■ Figure II-4 Issues regarding the secretariat of the Board of Directors

Q. Please select all that apply with respect to issues regarding the secretariat of the Board of Directors. (Multiple answers allowed)



2. Current status and issues in improving the effectiveness of corporate governance

Summary of survey result

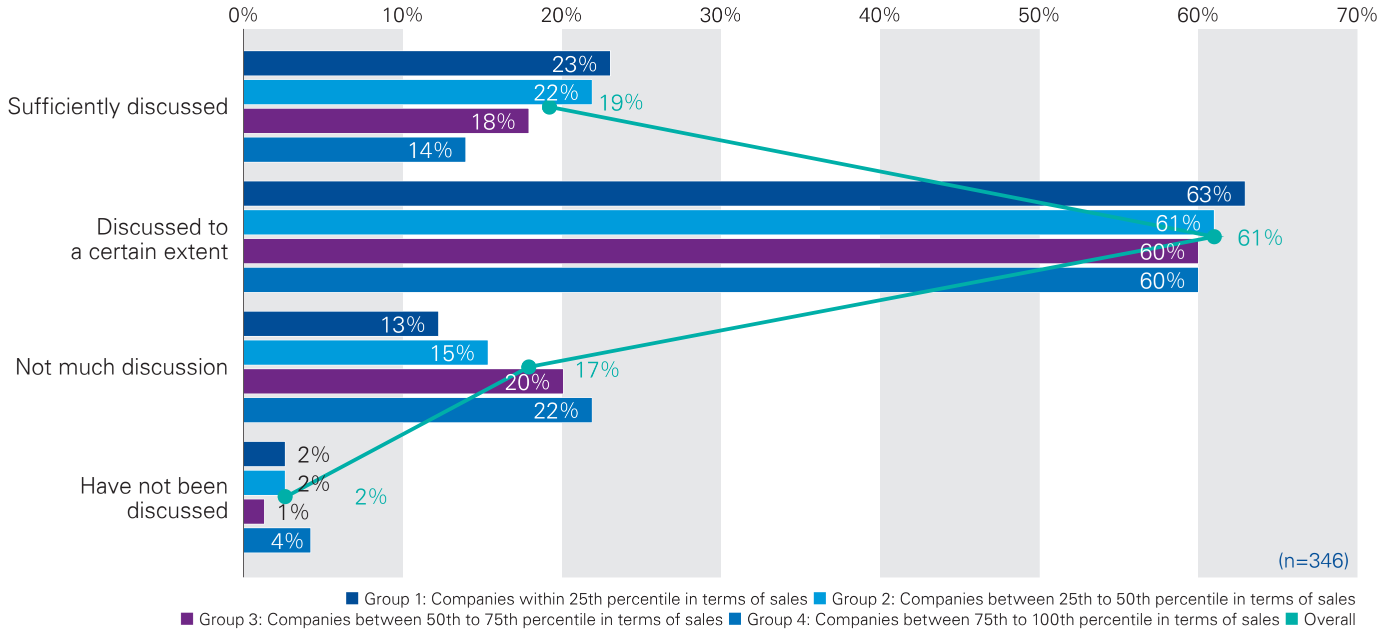
External directors have responded that they have been able to discuss to a certain extent the issues of corporate governance required by the revision of the Cabinet Office Order on Disclosure. However, as a general trend, the smaller the company, the higher the percentage of external directors felt that the discussions on each of the issues were insufficient.
In order to enhance the effectiveness of corporate governance, four issues which external directors should have intensive discussions are (1) collection of information on changes in business environment over the medium to long term and formulating long-term management policies, (2) analysis of business risks that may occur in the future and consideration of countermeasures, (3) penetration of performance management with due consideration of cost of capital, and (4) deepen discussions on executive remuneration.

Management policies and issues to be addressed (Figure II-5)

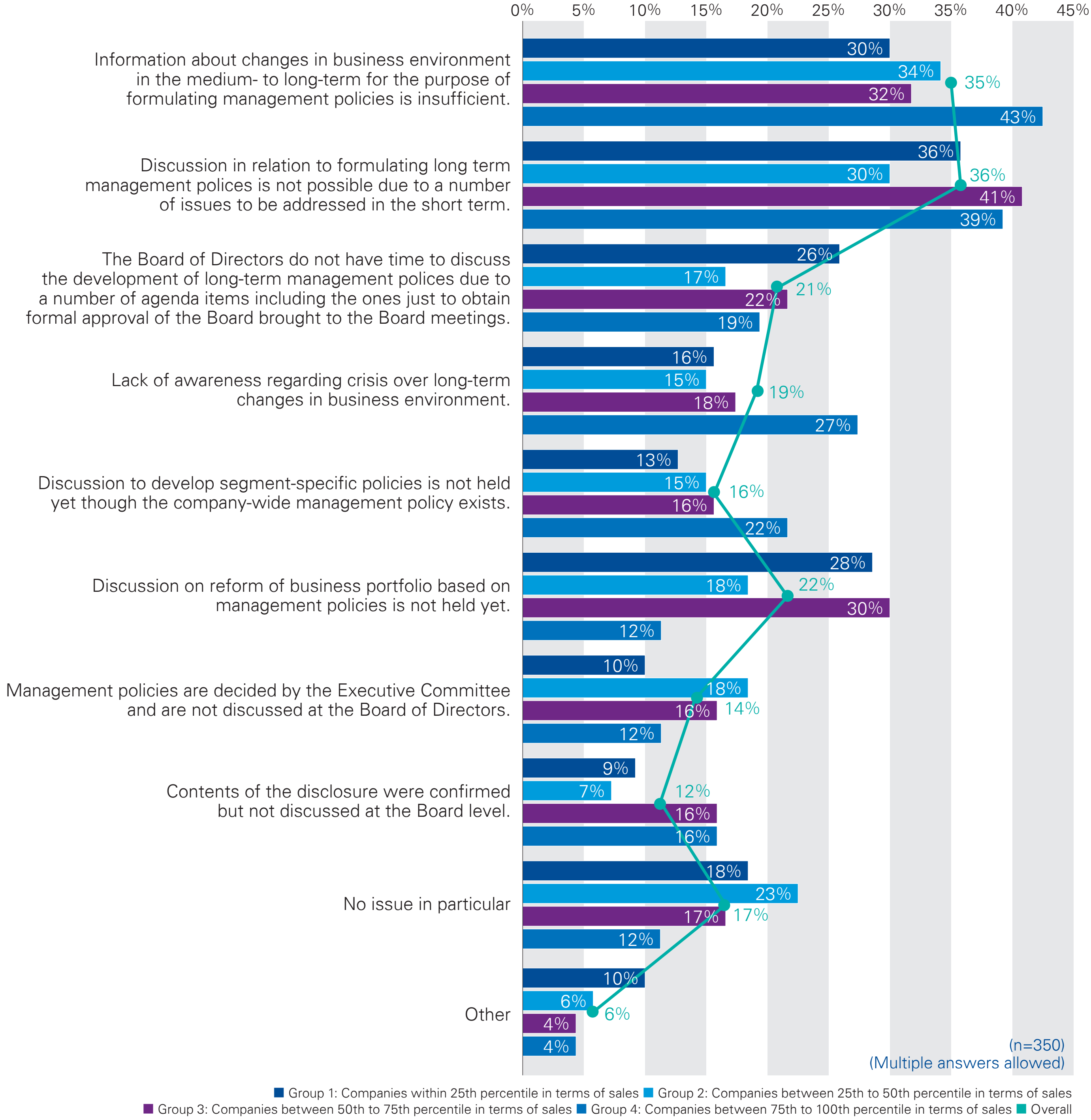
Approximately 60% of external director indicated that they discussed to a certain extent about management policies and issues to be addressed, but only about 20% responded that the matters were sufficiently discussed. In particular, the smaller the company, the more external directors felt that discussions were insufficient.
With respect to the issues with intensifying the discussions, the common responses were "there is insufficient information about changes in the business environment over the medium to long term" and "there are many issues to be addressed in the short term, thus not possible to discuss the long-term management polices" Furthermore, there is a distinctive comment from companies in Group 4 that management lacks awareness of crisis over long-term changes in business environment.

■ Figure II-5 Management policies and issues to be addressed

Q. Have the management policies and issues to be addressed been sufficiently discussed at the Board of Directors?



Q. What do you think are the issues in discussing management policies and issues to be addressed at the Board of Directors? (Multiple answers allowed)

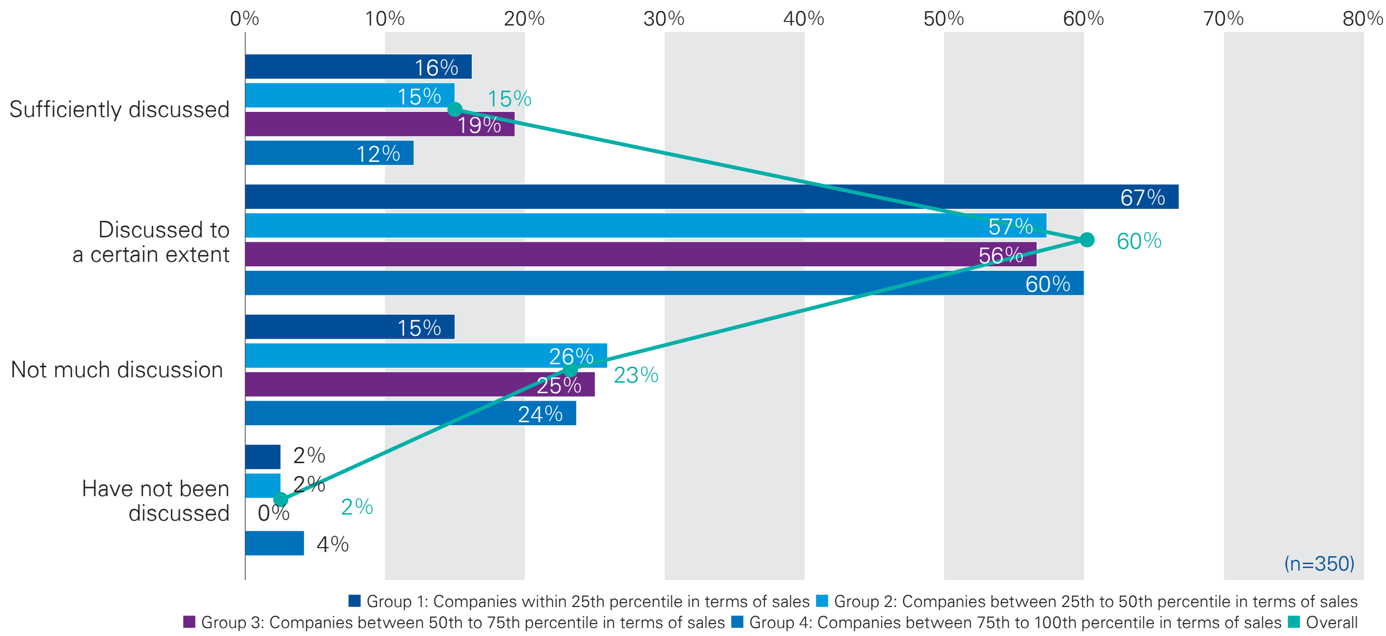


Business risks (Figure II-6)

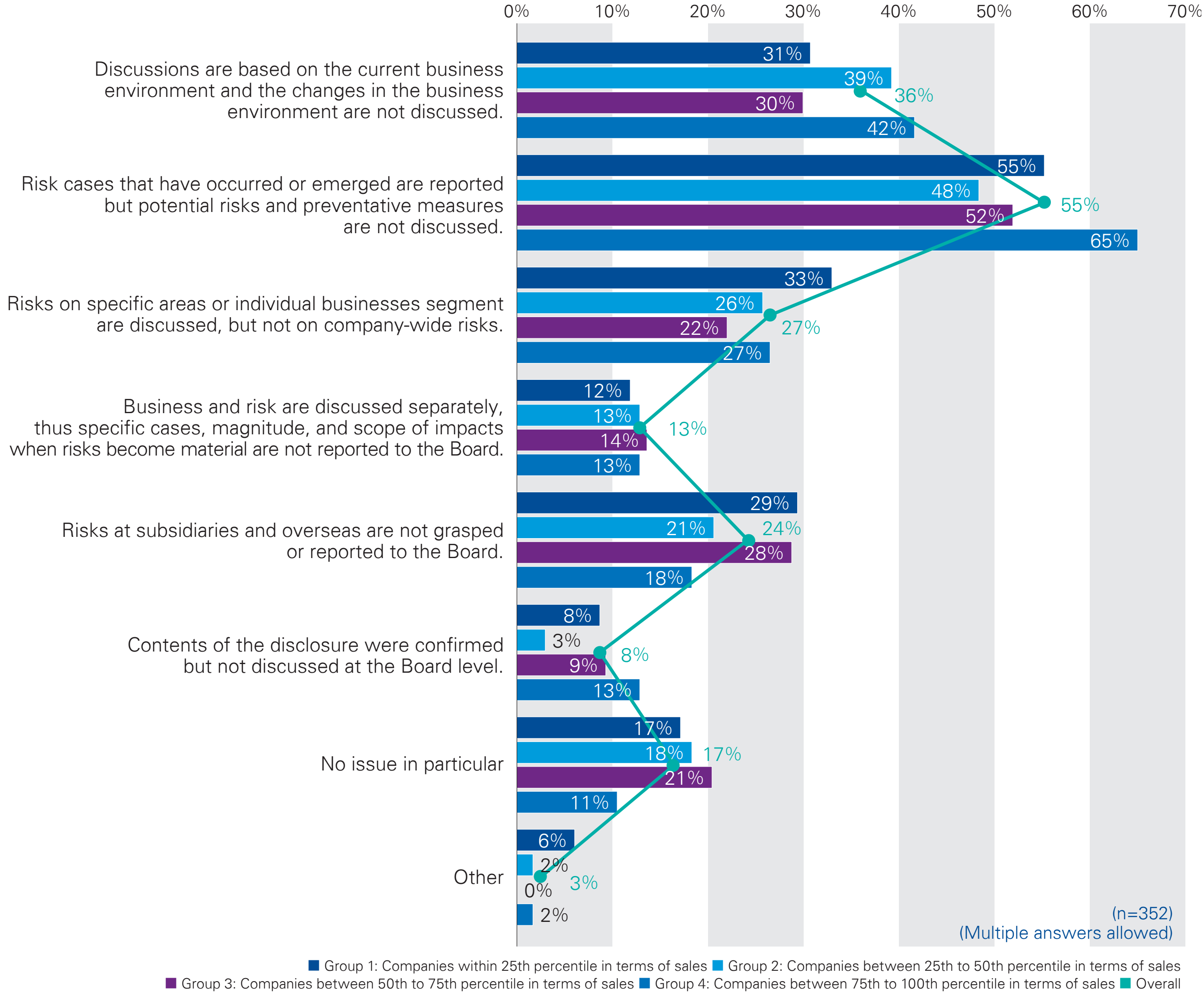
Approximately 60% of external directors responded that they discussed business risks to a certain extent, but only about 15% of the respondents indicated that the matters were sufficiently discussed. Approximately 20% of the external directors answered that there was not much discussion on business risks.
As an issue to intensify discussion on business risks, more than half of external directors indicated that "Risk cases that have occurred or emerged are reported but potential risks and preventative measures are not discussed". In addition, more than 30% of external directors responded that "discussions are based on the current business environment and the changes in the business environment are not discussed". As business environment changes drastically, it is necessary of the Board of Directors to predict risks that are likely to occur and take preventative and control measures.

■ Figure II-6 Business risks

Q. Have business risks been sufficiently discussed at the Board of Directors?



Q. What do you think are the issues about discussing business risks at the Board of Directors?
Please select all that apply. (Multiple answers allowed)



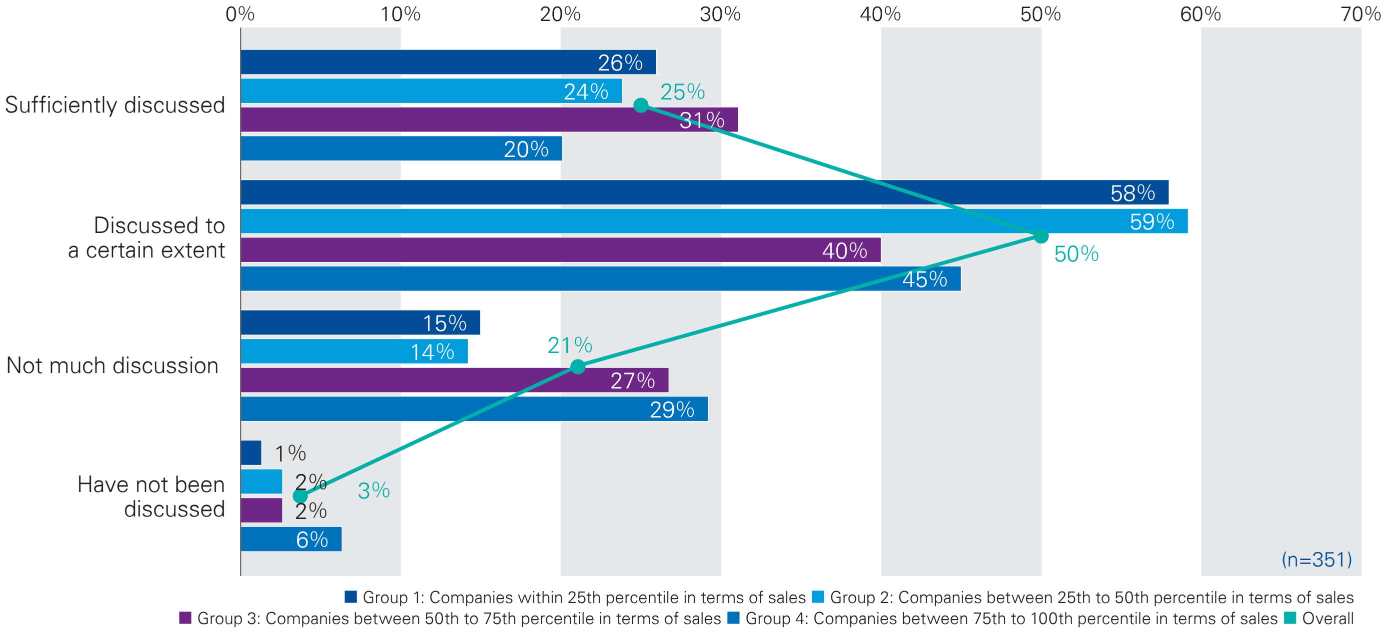
Financial strategies, etc. (Figure II-7)

A little more than 20% of external directors mainly from large companies responded that the matters relating to financial strategies such as cash flow status were sufficiently discussed and about 60% responded that the matters were discussed to a certain extent. The smaller the company is, the more answered "not much discussion" or "not discussed".

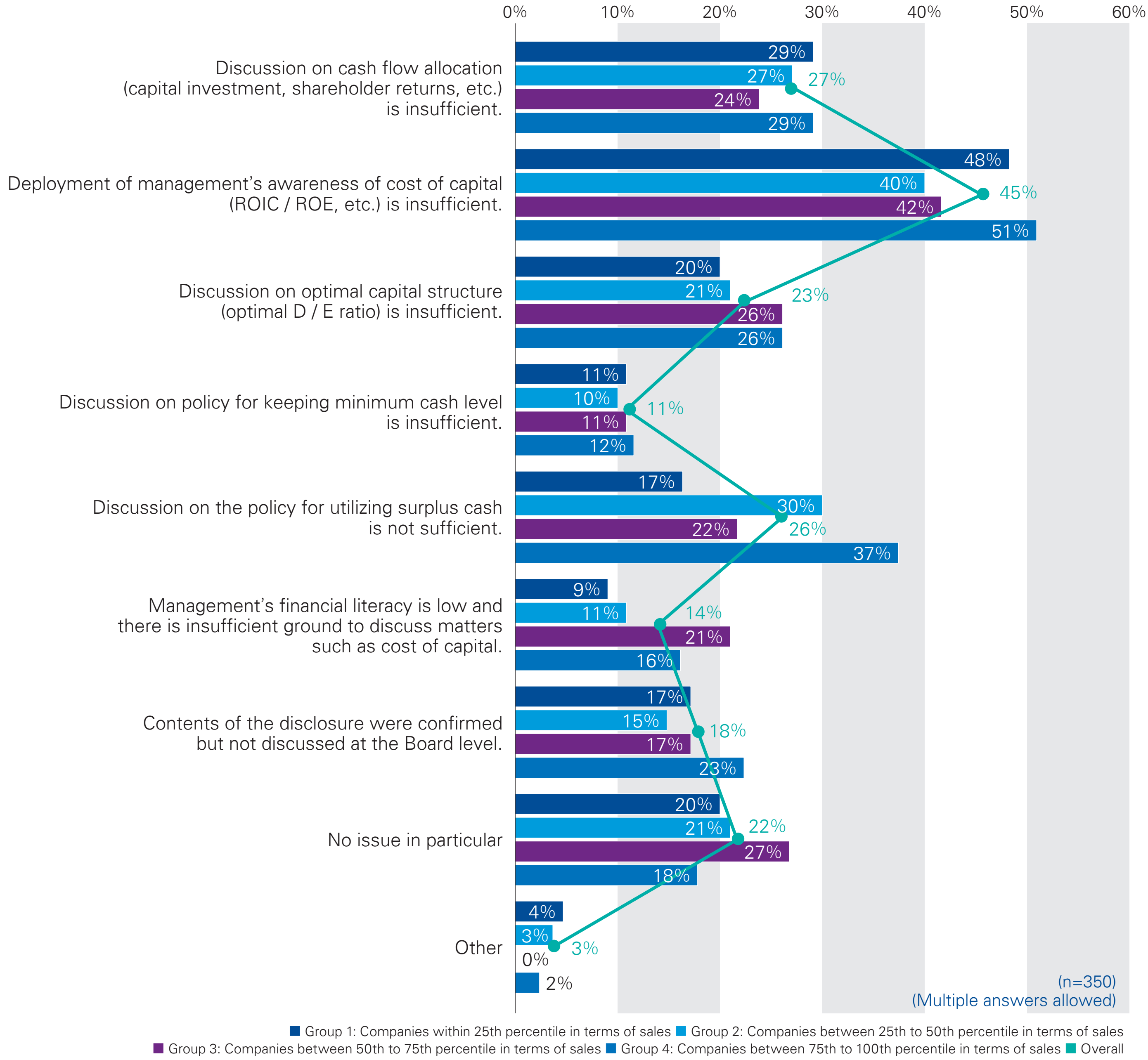
Regarding the issues about intensifying the discussion on financial strategies, approximately 50% of external directors indicated that promotion of management's awareness of cost of capital (ROIC, ROE etc.) was insufficient. Others responded that there was insufficiency in discussion about "allocation of cash flow", "policy on utilization of surplus cash deposit" and "optimal capital structure". It is necessary for companies to further discuss the policy for practical use of balance sheet.

■ Figure II-7 Financial Strategies

Q. Have financial matters such as cash flow status been sufficiently discussed at the Board of Directors?



Q. What do you think are the issues about discussing financial strategies such as cash flow status at the Board of Directors? Please select all that apply. (Multiple answers allowed)



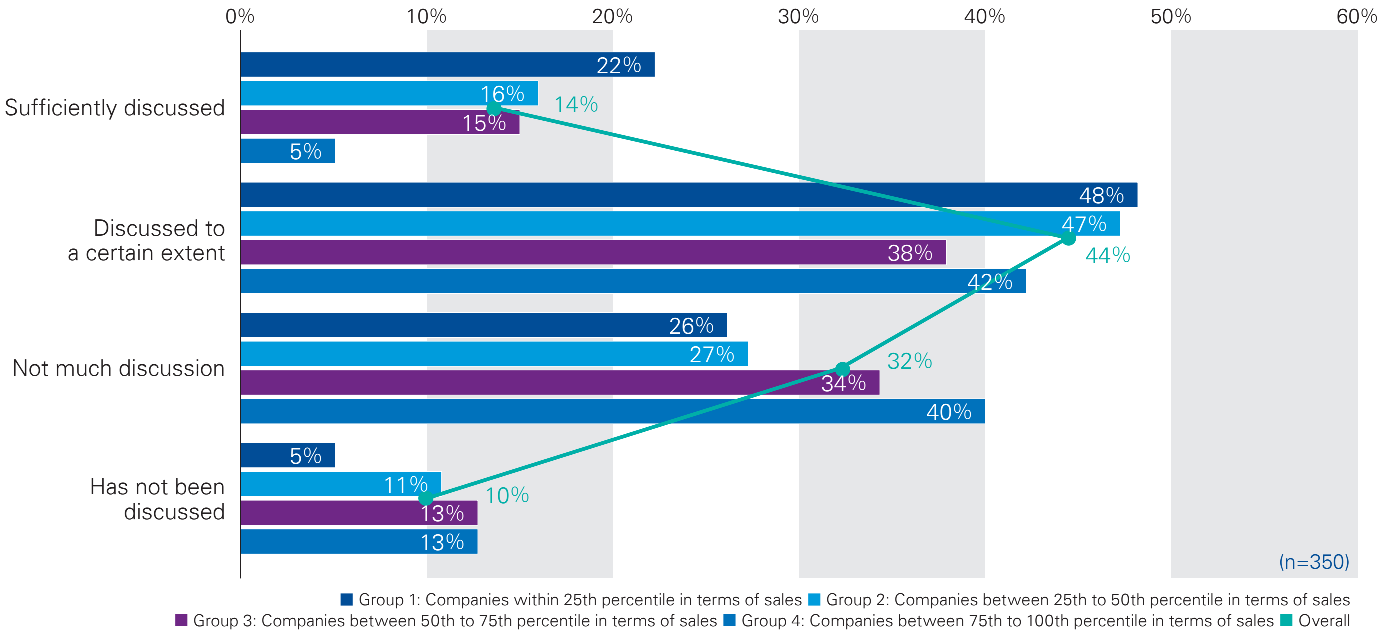
II.

Executive remuneration system (Figure II-8)

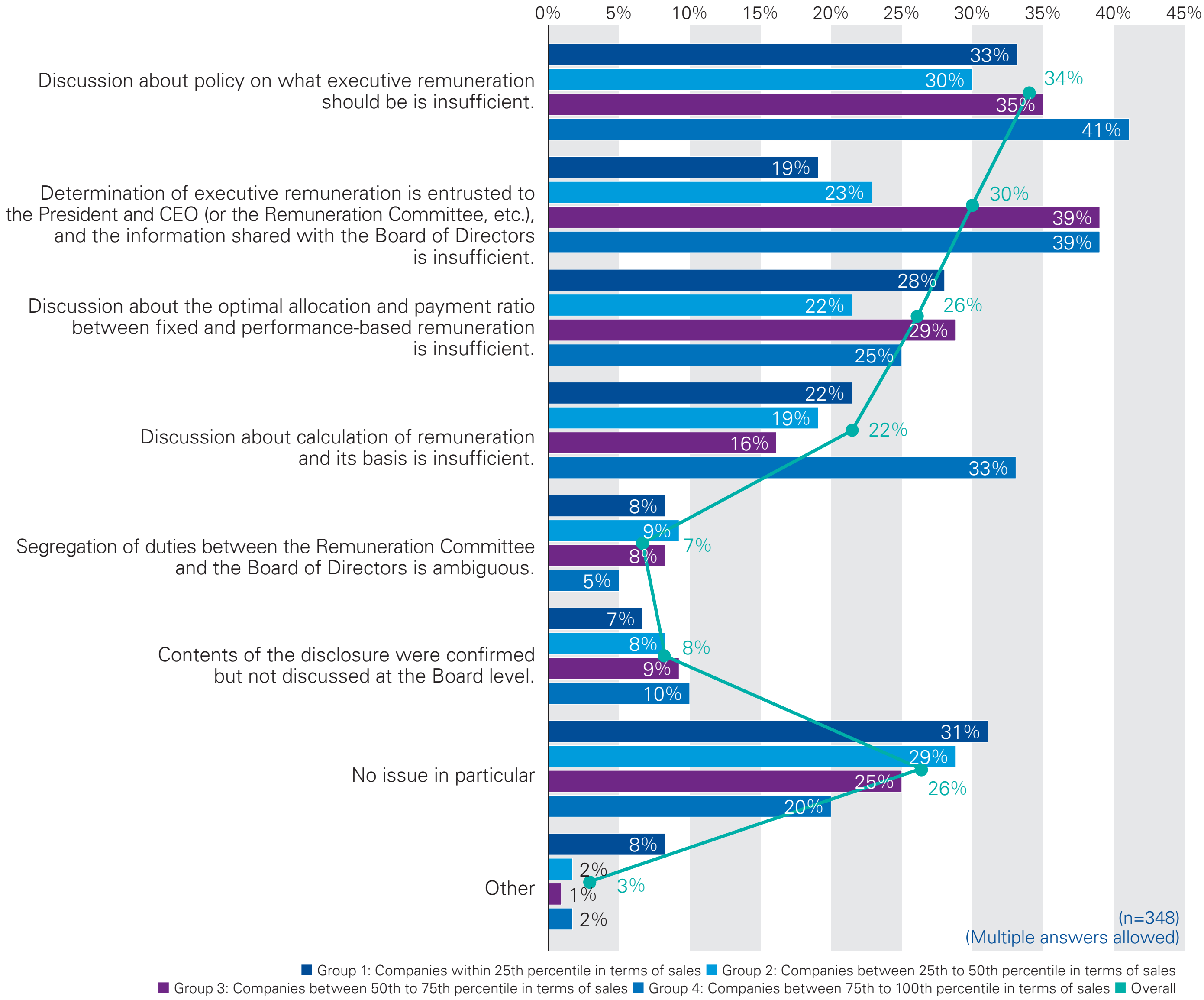
With respect to executive remuneration system, there are many variations in response depending on the size of the companies. Overall, there are more than 40% of external directors responded that there was "not much discussion" or the matter was "not discussed" especially among those of smaller companies. Approximately 40% of external directors from companies in Groups 3 and 4 considered "determination of executive remuneration is delegated to the CEO (or the Remuneration Committee, etc.), and the information shared with the Board of Directors is insufficient" was an issue.
Because decisions regarding executive remuneration in Japan has long been a prerogative of the CEO, it is assumed that, especially in the small companies, the discussion and information sharing at the Board of Directors are difficult. On the other hand, although institutional investors criticized that the linkage of remuneration system in Japan to business performance and shareholders value was low, approximately 30% of external directors indicated there was "insufficient discussion about the optimal allocation and payment ratio between fixed and performance-based remuneration". While formal measures, such as establishment of remuneration committee, are progressing, it is halfway down the road for the discussions on remuneration system to reflect investors' perspective.

■ Figure II-8 Executive remuneration system

Q. Has the executive remuneration system been sufficiently discussed at the Board of Directors?



Q. What are the issues of discussing executive remuneration system at the Board of Directors?
Please select the all that apply. (Multiple answers allowed)

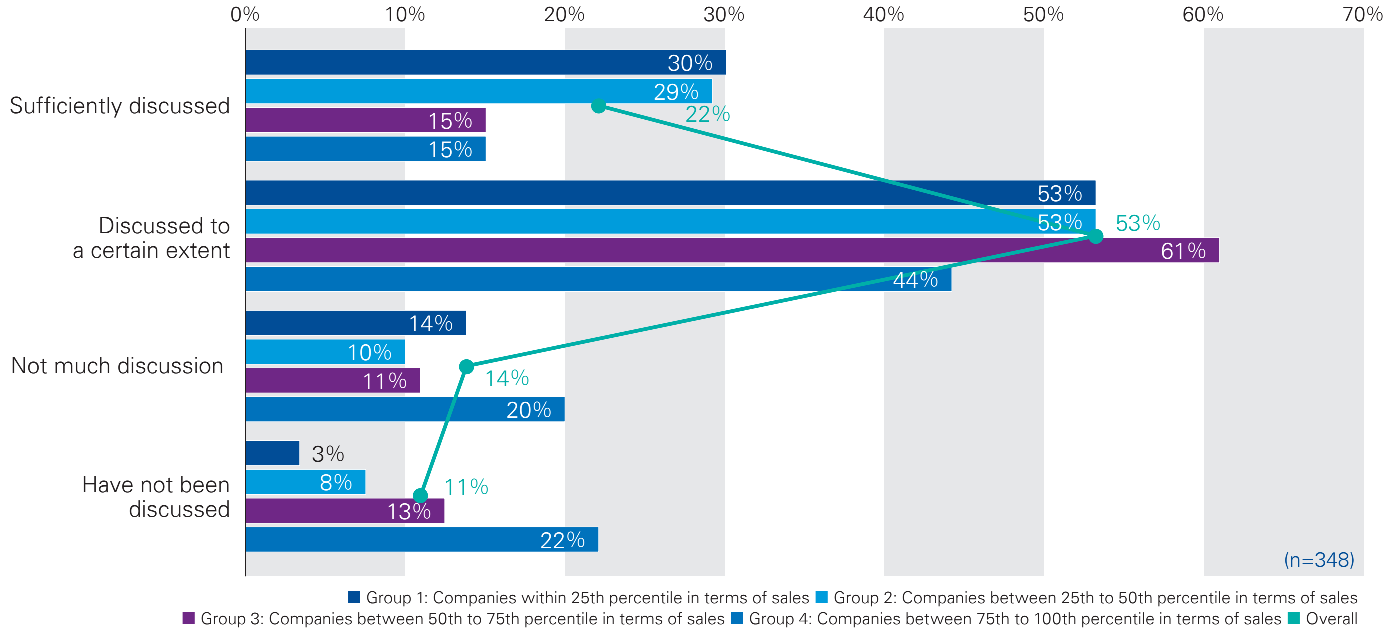


Cross-shareholdings (Figure II-9)

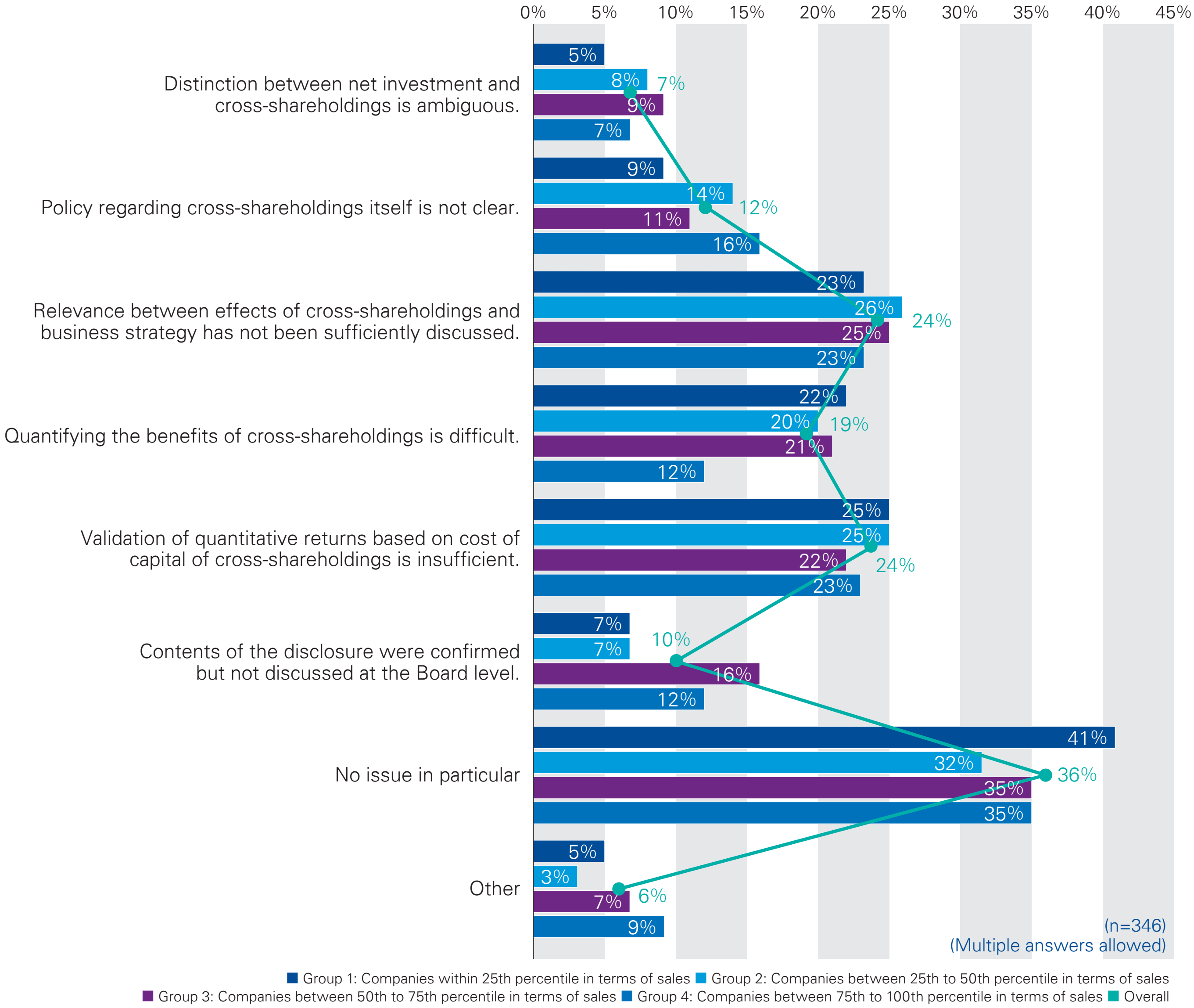
About 30% of the external directors mainly from large companies responded that cross-shareholdings was "sufficiently discussed" while about 50% answered that the topic was "discussed to a certain extent". Since detailed disclosure of cross-shareholdings in annual securities reports, such as the purpose of holdings, became mandatory from the fiscal year ended March 31, 2019 as per the revision of the Cabinet Office of Order, it is presumed that the discussions are in progress mainly in large companies which have a large number of cross-held stocks.
The most common response in each of the groups was "no issue in particular" while some see "relevance to business strategy" and "validation of quantitative returns based on cost of capital of cross-shareholdings" as issues of cross-shareholdings.

■ Figure II-9 Cross-shareholdings

Q. Have cross-shareholdings been sufficiently discussed at the Board of Directors?



Q. What are the issues of discussing cross-shareholdings at the Board of Directors?
Please select all that apply. (Multiple answers allowed)

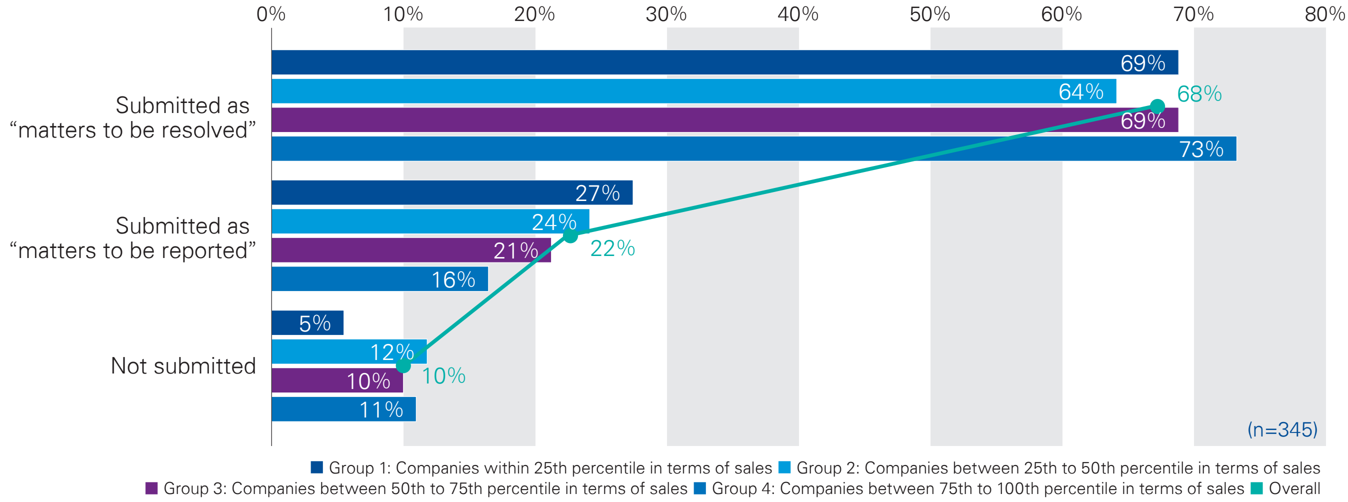


Involvement of the Board of Directors in the preparation of annual securities reports (Figure II-10)

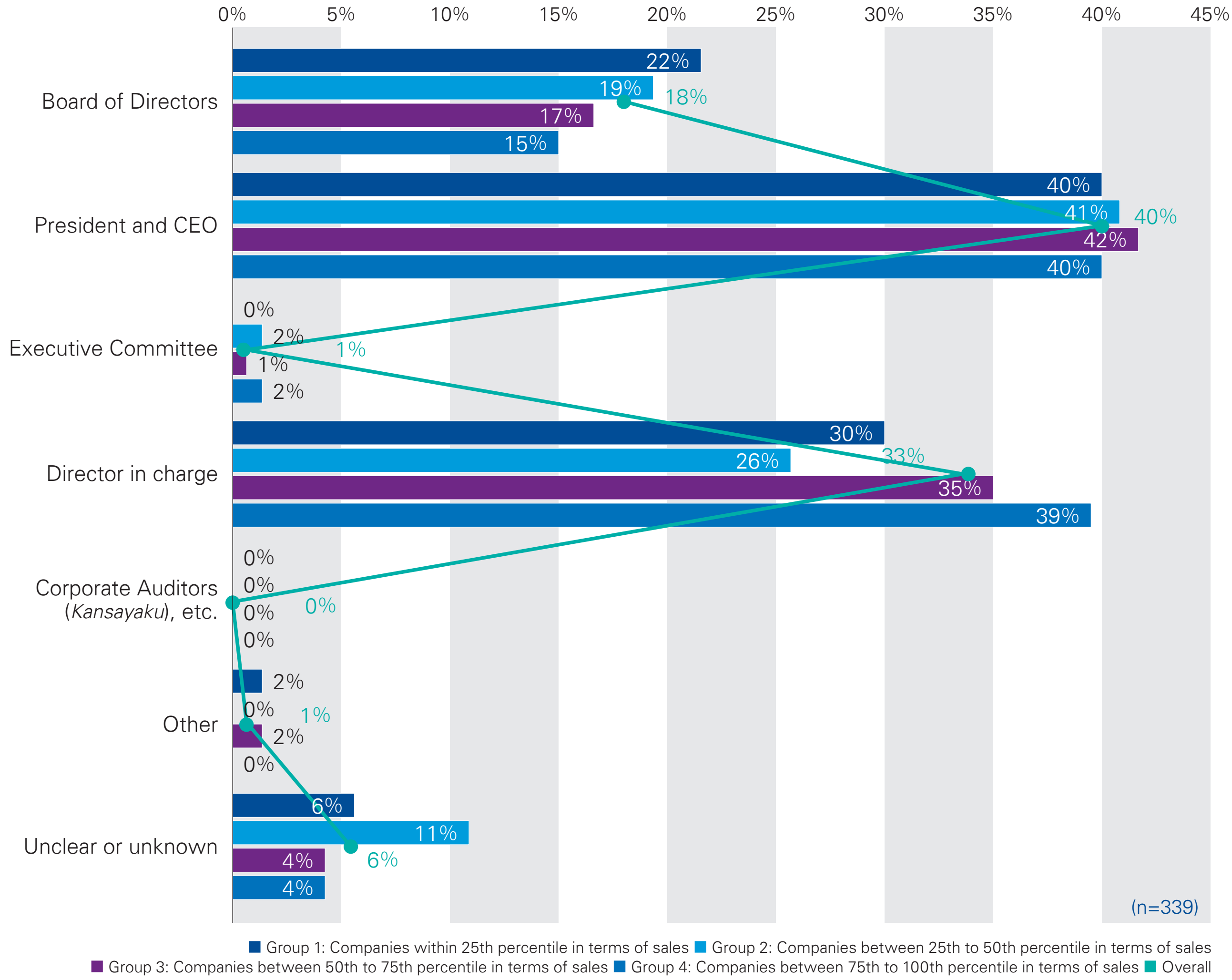
More than 90% of the external directors responded that annual securities reports were put on the agenda of the Board of Directors as either “matters to be resolved” or “matters to be reported”.
In addition, about 40% of the respondents considered that the President and CEO is substantially responsible for the disclosures in annual securities reports while about 30% answered that the Director in charge is substantially responsible. Slightly less than 20% of the external directors responded that the Board of Directors has the substantial responsibility.
Although it does not represent the vast majority, approximately 10% of the external directors indicated that annual securities reports were not submitted to the Board of Directors and approximately 6% answered that they were either unclear or did not know who is substantially responsible for the disclosures. The result shows that some external directors are concerned about the topic.

■ Figure II-10 Involvement of the Board of Directors in the preparation of annual securities report

Q. Has a draft annual securities report been submitted to the Board of Directors?



Q. Who is substantially responsible for the disclosures in annual securities reports? Please select the one that applies.



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