KPMG Japan CFO Survey 2021

December 2021

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Contents

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Foreword

This marks the third KPMG Japan CFO survey since its launch in 2019. It has been a busy year for CFOs, who have had to grapple with the prolonged impacts of COVID-19 while paving the way to a new normal for running their business and communicating with employees. We are extremely grateful for the time they have made to participate in this survey.

In 2021, a major challenge faced by CFOs has been that of redefining their corporate purpose in light of the Build Back Better agenda, and in anticipation of a steady growth strategy for a post-pandemic era that continues to be complicated by COVID-19 variants.

This survey looks at how CFOs currently view sustainability transformation (SX) as a means of making their business models more resilient, and how they integrate sustainability into their strategic decision-making with the aim of enhancing corporate value in the medium to long term. We also look at the challenges CFOs face in implementing SX.

The survey results indicate that CFOs now have a better understanding of how their response to sustainability issues impacts mid- and long-term corporate values. They also show polarized responses with regard to how they analyze sustainability issues that need to be addressed, and the implementation status of specific measures in the CFO agenda.

Various rules and systems are now being introduced with the aim of urging action on pressing global environmental and social issues, an initiative in which Europe is taking a lead. In Japan, the Suga Cabinet announced in November 2020 its goal of reducing greenhouse gas emissions to net zero by 2050. Japan's Corporate Governance Code (revised June 2021) now clearly states that companies listed on the Prime Market should enhance the quality and quantity of climate-related disclosures. As a result, I am sure many companies in Japan have found themselves facing a wave of new legislation related to sustainability.

Companies are expected to redefine their purpose so as to clearly reflect their commitment to this purpose in their SX initiatives. A simple response to system requirements will not suffice. In order to truly achieve SX, companies need to identify which elements of sustainability to prioritize according to their particular characteristics and environment, and then integrate these elements into their corporate strategy and decision-making.

We hope that this report will provide useful insights for companies tackling the complex challenges that continue to come their way.

KPMG Japan Chairman
Toshiya Mori

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Survey Methodology

Survey period

Sep. 1 to Oct. 8, 2021

Survey contents

29 questions relating to the impacts SX* will likely have on the CFO agenda

Number of valid responses

461 listed companies

Presentation of survey results as a ratio

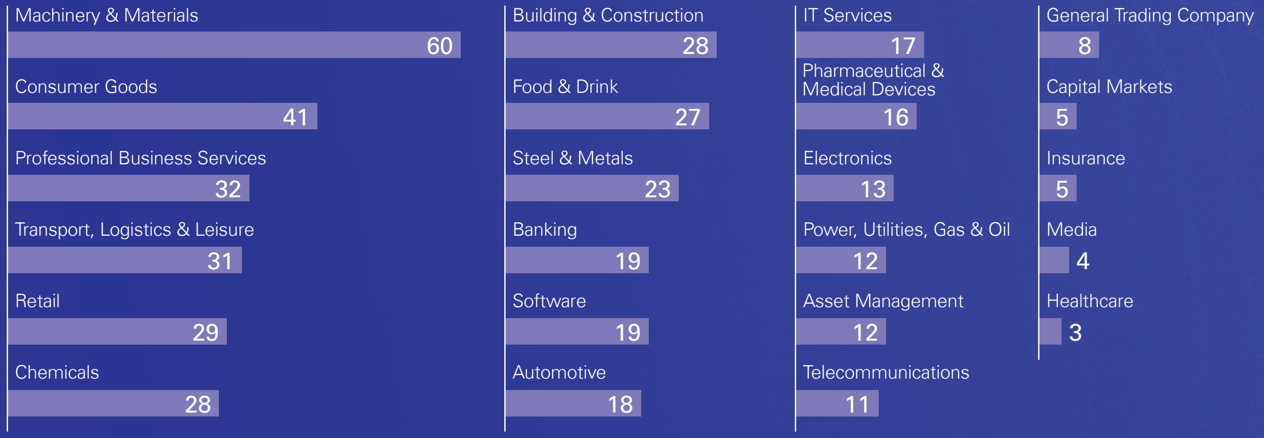
Survey results as a ratio are rounded to the nearest whole number and may not add up to 100 percent.

*SX
Sustainability transformation refers to the integration of sustainability into strategic decision-making, increasing business resiliency, and improving mid- and long-term corporate value.

Breakdown of 461 companies by annual revenue

*Consolidated revenues for the most recent fiscal year ended between April 2020 and March 2021

Breakdown of 461 companies by sector



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Industry classification

Building & Construction
Construction services, engineering & construction

Food & Drink
Agribusiness, food and beverages, tobacco

Chemicals
Chemicals, chemical industry

Pharmaceuticals & Medical Devices
Brand-name drugs, generics, medical devices manufacturing, pharmaceuticals & medical devices wholesaling, biotechnology, nutritional supplements, medical research

Power, Utilities, Gas & Oil
Electricity, water supply, oil, coal, gas, mining

Steel & Metals
Steel, metal products, nonferrous metals industry

Machinery & Materials
Machinery manufacturing, construction manufacturing, industrial manufacturing, rubber, glass, soil & stone, textile products, pulp & paper

Electronics
Electric appliances, electronic devices

Automotive
Automobile OEMs, automotive industry suppliers, commercial vehicles

Consumer Goods
Furniture, apparel, household goods

Transport, Logistics & Leisure
Ground transportation, sea freight transportation, air transportation, warehousing, railroads, leisure

Telecommunications
Wireline and wireless

Software
Software

IT Services
IT services

Media
Advertising, television, radio, movies, music, publishing, newspapers

General Trading Company
General trading company

Retail
Grocery retail, department stores, other retail shops, e-commerce, restaurants

Banking
Banking

Insurance
Insurance

Capital Markets
Capital Markets

Asset Management
Real estate, REIT, asset management, leasing

Professional Business Services
Professional business services

Healthcare Services
Hospitals, nursing facilities

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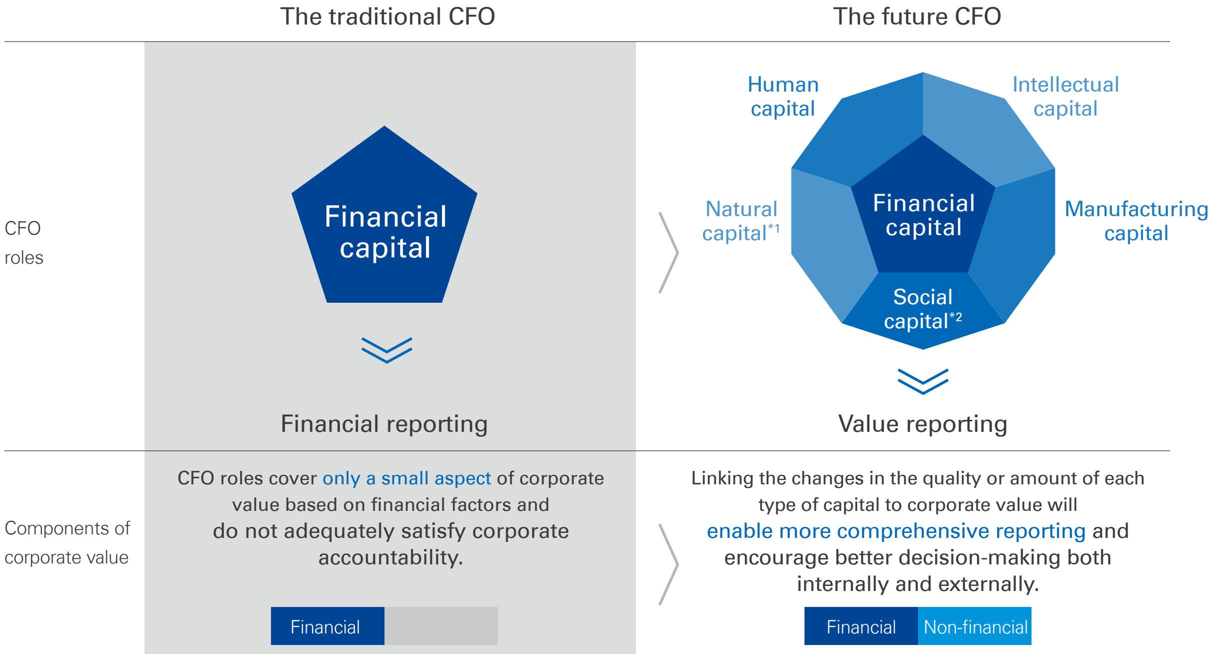
Executive Summary

The roles required of a CFO are changing as the concept of corporate values become more expansive

Yoshihide Takehisa

Head of Sustainable Value
Headquarters,
KPMG AZSA LLC



CFO roles cover only a small aspect of corporate value based on financial factors and do not adequately satisfy corporate accountability.

Linking the changes in the quality or amount of each type of capital to corporate value will enable more comprehensive reporting and encourage better decision-making both internally and externally.

Regulations aimed at achieving a sustainable society are being introduced to push companies to address environmental and social issues. Companies will only be able to stay relevant in this new environment if CFOs evolve from their traditional role of controlling financial capital to one that encompasses comprehensive control of a broad range of corporate capital, including non-financial capital (i.e., natural capital[*1], social capital[*2], human capital, intellectual capital, manufacturing capital and financial capital).

*1 Natural capital: Environmental resources including air, water, minerals, and ecosystems
*2 Social capital: Trusting relationships, relationships with stakeholders, etc.

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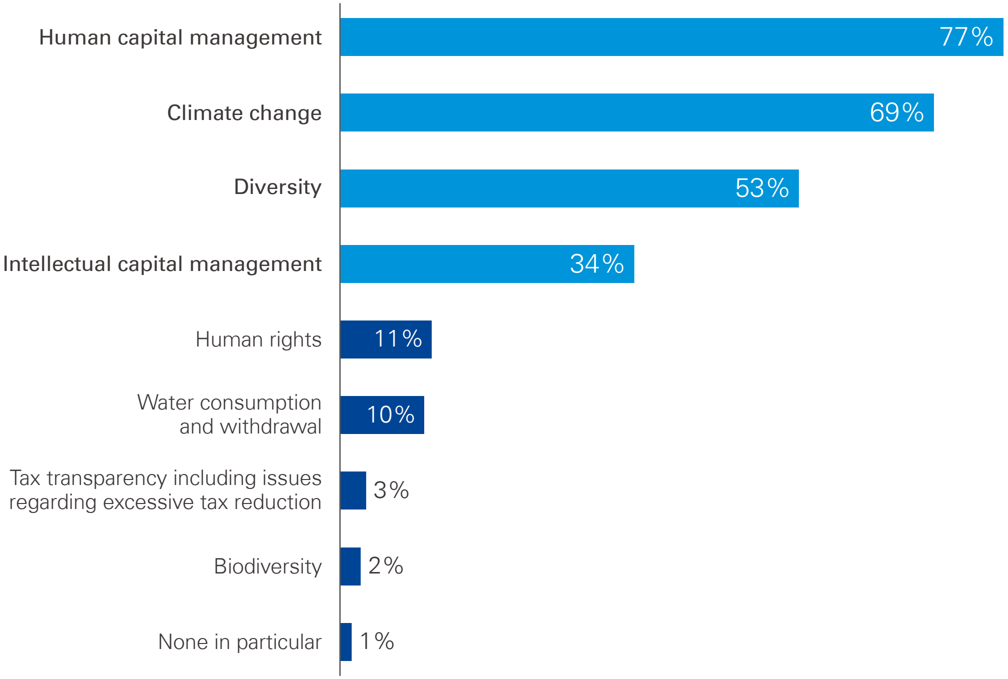
Many CFOs are beginning to see non-financial factors as an essential component of corporate value.

When asked what issues have significant impact on corporate value now or in the future, a majority of CFOs responded human capital management, climate change and diversity, while over a third also responded intellectual capital management.

This indicates that CFOs are becoming more aware of the impact of sustainability initiatives to address these issues on corporate value. This indicates that many CFOs are becoming more aware that such sustainability initiatives that traditionally did not appear on balance sheets are essential components of corporate value.

Sustainability issues CFOs expect to have a significant impact on their current or future corporate value (multiple choice)



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Three roles expected of CFOs for SX* promotion

Three roles of the CFO

01 Partner

Value creation partner

As a partner to the CEO, provide information for decision-making based on non-financial factors

02 Enabler

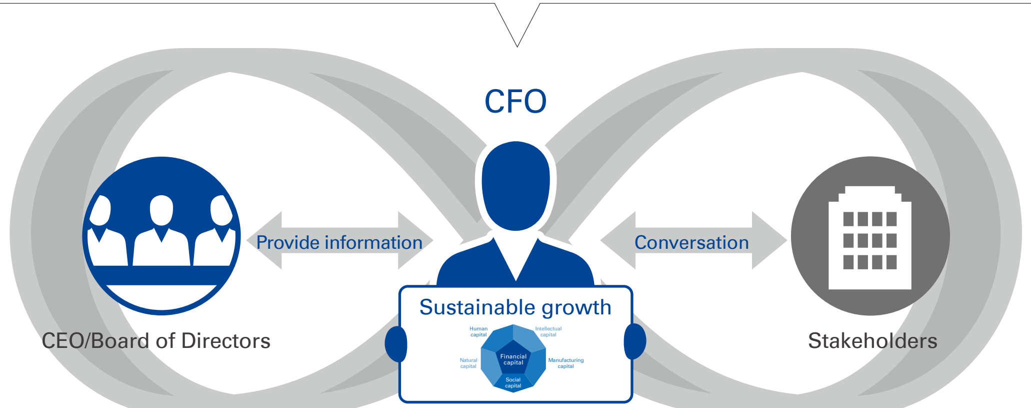
Transformation enabler

Promote and accelerate SX initiatives by establishing frameworks and visualizing information

03 Presenter

Corporate value presenter

Report corporate sustainability and growth initiatives to stakeholders, and provide feedback to management



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*SX
Sustainability transformation refers to the integration of sustainability into strategic decision-making, increasing business resiliency, and improving mid- and long-term corporate value.

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Now that the definition of corporate value is expanding to include non-financial factors, CFOs will need to adapt their role as they oversee a broader range of corporate activities.

CFOs play a significant role in the success of SX and achieving sustainable growth for their company. CFOs are expected to drive value creation, enable transformation, and present corporate value in the context of SX.

Whether or not companies are able to achieve sustainable growth will depend on the ability of CFOs to redefine their own roles and demonstrate strong leadership in promoting the company's SX agenda.

1. Value creation partner

The CFO is expected to provide the CEO and board of directors information including non-financial factors to support their decision-making for increasing mid- and long-term corporate value. For example, mid- and long-term strategies and planning need to consider ESG factors from the viewpoint of the entire value chain, including suppliers and vendors. It is also effective for CFOs to reevaluate and update decision-making rules, including a framework for formulating strategies and standards for investing in or exiting a business.

This survey revealed that many CFOs view mid- and long-term strategies and planning including corporate strategy (45 percent) and management plan (39 percent) as areas that are considered to be of greater importance for SX promotion (see page 50). We can see that CFOs are embracing the increasing expectations for their role of driving value creation. With regard to comprehensive reporting covering both financial and sustainability information, many CFOs view "selecting sustainability-related metrics that should be monitored and setting goals (50 percent)" and "connecting sustainability-related measures with corporate value creation (47 percent)" as major challenges (see page 44).

This shows that CFOs are beginning to recognize their role of supporting the CEO by setting and managing sustainability-related metrics and goals aimed at enhancing corporate value.

2. Transformation enabler

It is also the CFO's role to monitor the execution of strategies and plans according to KPI (key performance indicators) and establish a framework for making necessary evaluations. Companies need to appropriately control potential damage to corporate value through risk management that takes into consideration the impact of corporate activities on the environment and society. The CFO is also expected to take on the role of promoting and accelerating SX initiatives through the visualization of non-financial information, and its integration into financial information-based corporate management.

The survey also shows that almost half of CFOs recognize the need for the sustainability department and risk management department to collaborate or integrate as a risk management initiative in promoting SX (see page 36). 77 percent of CFOs also feel that improvements are needed in the current structure of the accounting and finance department in order to achieve SX (see page 52). Many CFOs show a willingness to embrace SX by transforming the accounting and finance department under their control to meet the new challenges of integrating non-financial information.

3. Corporate value presenter

The CFO will also play an important role in reporting SX initiatives and outcomes as well as engaging in conversations with investors and stakeholders.

We asked CFOs the level of impact they expect ESG ratings to have on corporate funding other than ESG bonds. More than half of CFOs believe either that there will be considerable impact including a rise in funding costs (46 percent), or that there will be significant impact if an ESG rating is not maintained (14 percent) (see page 26). To prepare for this rise in funding costs, CFOs need to have conversations with stakeholders including financial institutions and investors, and clearly communicate their sustainability initiatives and outcomes. When asked about their involvement in sustainability reporting, 63 percent of CFOs responded that they will increase their involvement in the future (see page 45), showing a stronger commitment than ever before to the conversation with stakeholders in their role of corporate value presenter.

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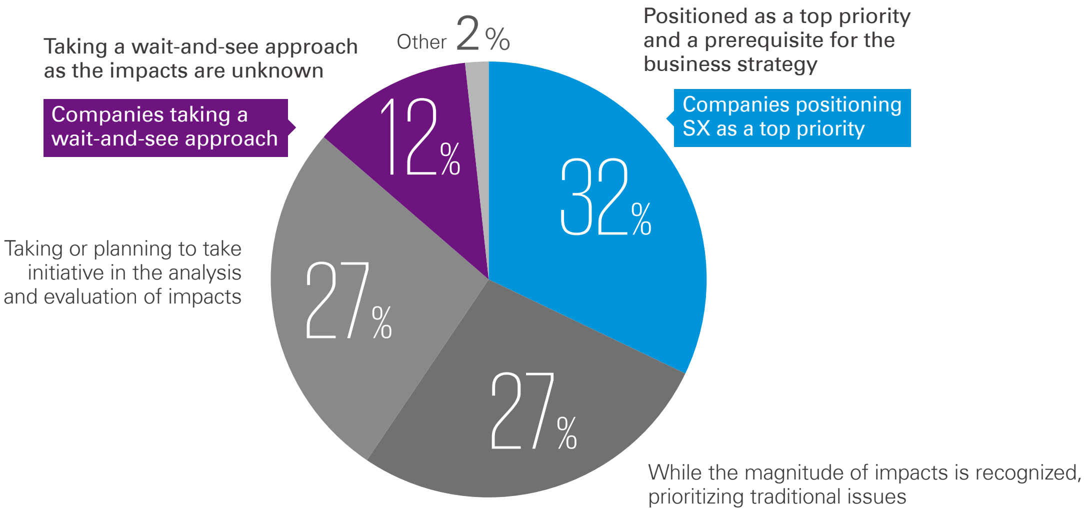
The priority given to SX as a management issue is key

Companies prioritizing SX as a management issue have a high level of awareness and responsiveness

Approximately one third of the companies surveyed regard SX as a top-priority management issue and a prerequisite for their business strategy, demonstrating a high level of awareness and responsiveness.

The following page indicates a big gap in the level of SX awareness and responsiveness between companies prioritizing SX as a management issue and companies taking a wait-and-see approach as they are still unsure of the impacts.

Which statement best reflects the positioning of SX as a management issue? (Single choice)



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There is a big gap in the level of awareness and response between companies positioning SX as a top priority and companies taking a wait-and-see approach

As you can see from responses to the questions below, there is a big difference in the level of awareness and responsiveness depending on how a company positions SX as a management issue. Companies positioning SX as a top priority and prerequisite for their business strategy have a solid understanding of sustainability issues. While there has been a polarized response for some time, it appears the gap has further widened due to the significant progress made by companies prioritizing SX in the past few years.

We can infer from the results that the priority of SX as a management issue is key. How companies position SX will affect the speed at which it is achieved, which in turn will affect the mid- and long-term corporate value.

SX Responses from top-priority companies

What are your company's SX issues?	Executing strategies (30%)/ planning strategies (29%) to achieve SX	Understanding and evaluating sustainability issues (62%)
How will you change your investment strategy to drive SX?	Increasing DX investments (69%)/ investments in environmental measures(65%)/investments in human resources (55%)	Still undecided (51%)
Are your risk management activities designed and executed in association with key sustainability issues?	They are associated (68%)	They are not sufficiently associated (76%)
What tax-related measures or considerations have you implemented or do you plan to implement in promoting SX?	Future tax impacts such as carbon tax (53%)/Measures to provide tax incentives for investment (44%)	No considerations made or expected to be made in particular (78%)
What is the current level of CFO involvement in sustainability reporting?	Fair amount of current involvement, expected to increase (41%)/Sufficient involvement to date (26%)	None currently but plan to increase involvement in the future (55%)/none currently and do not expect any future involvement (22%)

Responses of wait-and-see companies

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KPMG's Specialist Insights

A roadmap to achieving SX

The survey asked CFOs what potential impacts SX may have on their day-to-day agenda. KPMG's specialists provide their insights based on survey responses.

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Business Strategy

Initiatives need to consider regulations and policies that encourage addressing sustainability issues

Page 21

Investment Strategy

Establishing an integrated roadmap for investments in human resources, environmental measures, and digital transformation to achieve SX

Corporate Funding

We are fast approaching a time when companies will be held accountable for ESG discipline by markets and financial institutions

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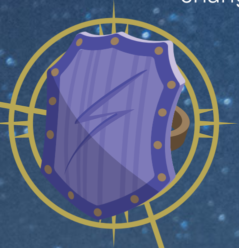
Corporate Governance

Developing effective corporate governance toward achieving SX



Page 33

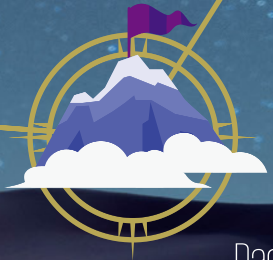
Risk Management

Developing a risk management system capable of dealing with changing sustainability issues

Tax

Page 39

Responding to increasing expectations by addressing tax governance as a sustainability issue



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Comprehensive Reporting

Committing to providing sustainability information as a factor that impacts corporate value

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Accounting and Finance

Transforming the accounting and finance department in response to expanding CFO roles

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Spotlights

Introduction of Spotlights

The survey asked CFOs to share their views on the status of corporate funding amid ongoing impacts of COVID-19, and on the introduction of KAMs (Key Audit Matters) from the fiscal year ended March 2021.

01

Change in response to climate change risk from 2020 survey results
Companies are taking a more practical approach to climate change risk.
Page 20

02

Change in financial measures amid COVID-19 from 2020 survey results
Interest has shifted from reviewing the level of cash and deposits to strengthening fund management of subsidiaries and financial governance.
Page 28

03

Response to first year following introduction of KAMs (Key Audit Matters)
Responses were mixed, with both positive views that KAMs allowed a deeper understanding of financial risks, and negative views that it took a considerable amount of time.
Page 48

04

Change in CFO roles from 2019 survey results
CFO roles are expanding, in the areas of "IT strategy and system planning" and "risk management."
Page 51

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KPMG's Specialist Insights

Business Strategy

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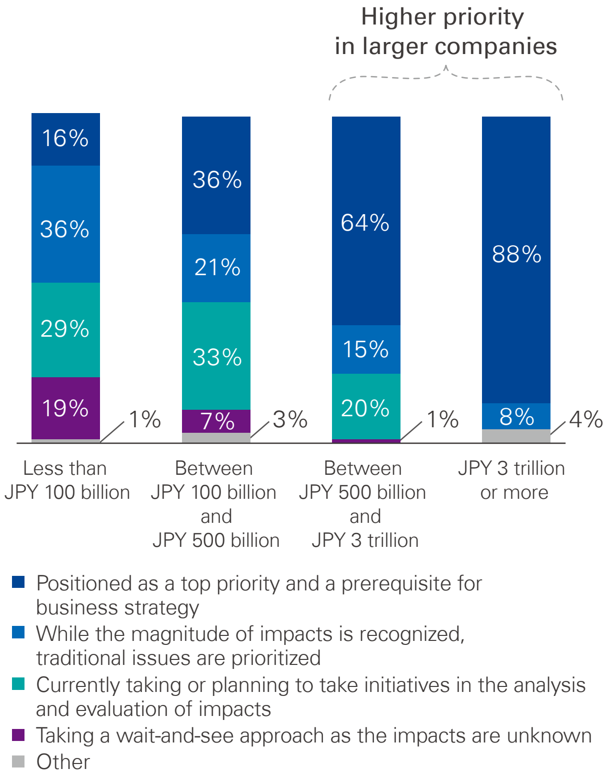
Initiatives need to consider regulations and policies that encourage addressing sustainability issues

Kaoru Mano

Partner
KPMG FAS

The positioning of SX as a management issue that best reflects your company (single choice)



Larger companies have a stronger commitment to SX

Sustainability has recently been attracting public attention in Japan, especially following then-Prime Minister Suga's 2050 Carbon Neutrality Declaration in October 2020, and it is now being addressed as a management issue at many companies. Europe has been leading the rest of the world in pushing companies to embrace sustainability through imposing regulations and policies that encourage economically rational decisions, such as a relatively high carbon tax.

Japan meanwhile lags behind in the establishment of similar regulations and policies, where carbon tax is still low compared to Europe. The survey revealed that larger companies however place higher priority on sustainability, with this trend increasing in proportion to company size.

Larger Japanese companies may be more sensitive to this matter as they are likely to have global businesses that are already affected by regulations and policies in Europe. They also need to consider the economic impacts of future regulations and policies imposed in Japan on their corporate performance.

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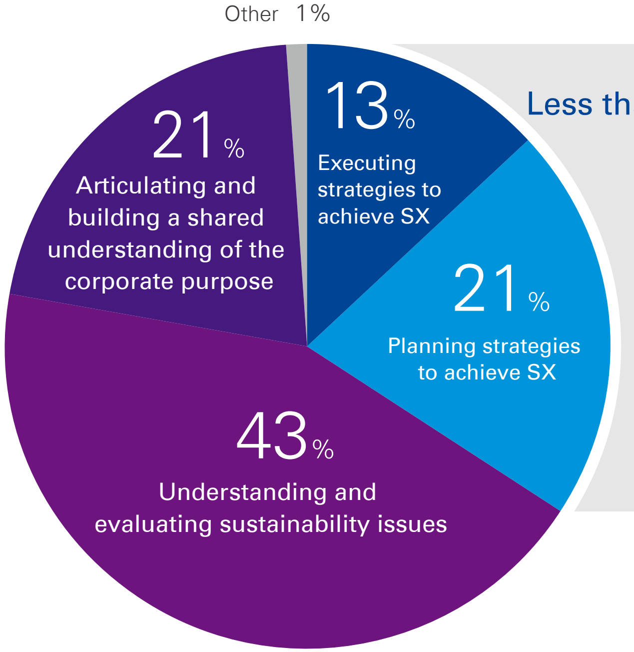
What is the most critical issue your company faces in promoting SX? (Single choice)



Less than half of companies are at the stage of integrating SX into their strategies

A majority of Japanese companies are not yet integrating SX into their strategies

While some companies in leading industries are at a stage of planning and executing SX strategies, 43 percent responded that they are still in the process of understanding and evaluating sustainability issues. It appears a majority of companies are still assessing the direction of future regulations and policies, and their economic impacts on corporate performance.

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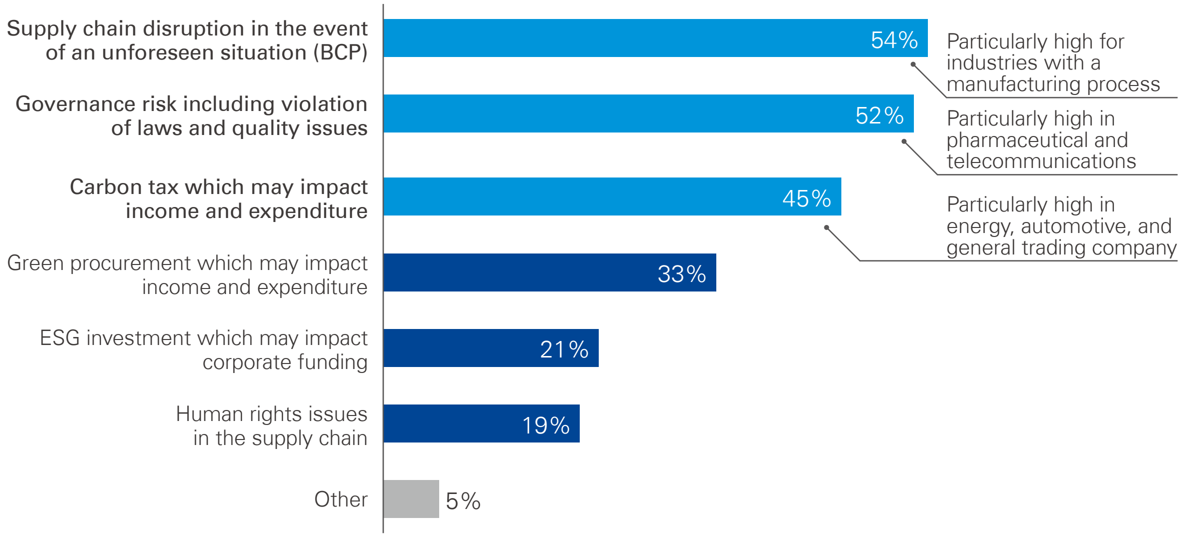
Business Strategy

Concerns that may have a major impact on the current business strategy (Multiple choice)



While there is a high level of concern regarding BCP, governance risk, and carbon tax, trends differ by industry

There are differences by industry in CFO views of sustainability issues that may impact business strategy—in general, industries such as automotive, machinery and materials, consumer goods and pharmaceuticals which have a manufacturing process are concerned about potential disruptions in their supply chain caused by unforeseen events, or their BCP, while regulated industries such as pharmaceuticals and telecommunications are more concerned about governance risk. For energy, automotive, and general trading companies, carbon tax and its impact on income and expenditure are major concerns.

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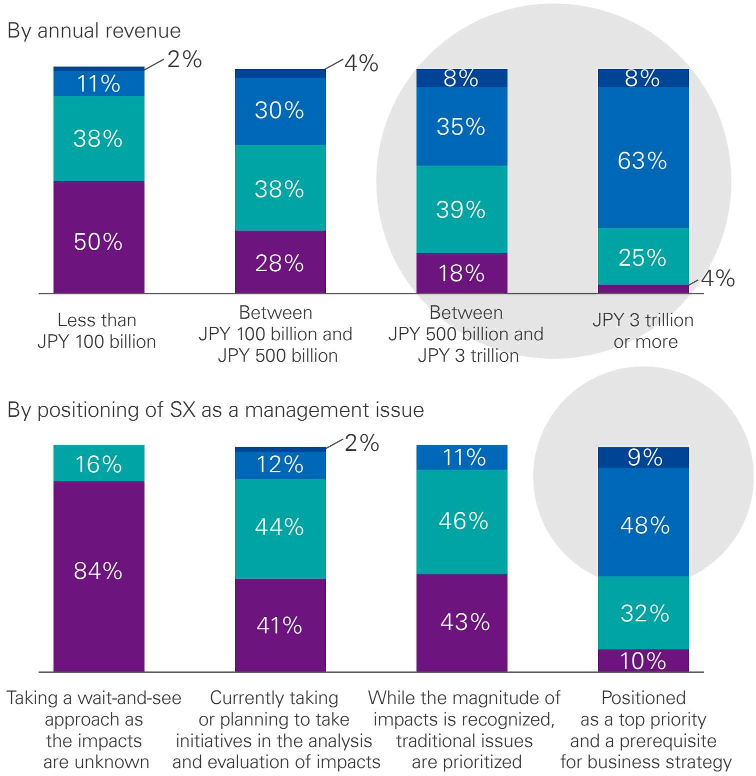
What is the status of reviewing and reorganizing the business portfolio on the premise of SX? (Single choice)



PX* initiatives can be seen

among larger companies and companies for which SX is a top priority.

*Portfolio transformation

- Completed
- In progress
- Under consideration
- Not under consideration

Responding flexibly to changing sustainability issues while considering the financial and non-financial impacts

As a final question, we asked CFOs about the relationship between SX and PX (portfolio transformation) which refers to the process of reviewing and reorganizing the business portfolio on the premise of SX. Companies with relatively large revenues are more progressive with their portfolio review and reorganization, with half of companies with revenues of JPY 500 billion or more responding that this has been completed or is in progress. More than half of companies prioritizing SX responded "Completed" or "In progress." These responses suggest that larger companies or companies building a portfolio based on multiple businesses are more sensitive to future regulations and policies given the greater impact they have on their business, and therefore accelerate their initiatives.

While human capital management, climate change, and diversity are important issues cited in this survey (see page 5), the impacts of biodiversity, water consumption and withdrawal, and human rights are expected to increase in the near future.

A flexible response to changing sustainability issues while considering the financial and non-financial impacts on corporate management will continue to be required in the future.

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Business Strategy

Sector Insights

Koichi Iguchi

Automotive Partner,
KPMG Japan

It is an urgent task for the automotive industry to define a specific approach to addressing the shift to electrification

The survey clearly indicates that SX is a top-priority management concern in the automotive industry, and that there is a growing awareness of the impacts of climate change and environmental issues on corporate value. This stance is supported by the trend among automotive companies of increasing future investment in the environment rather than in M&A strategies. This trend is consistent with successive recent announcements by automotive manufacturers of their shift to electrification with a focus on EV, in a move toward a decarbonized society.

On the other hand, there seems to be a low level of awareness regarding analysis and evaluation of sustainability impacts, despite positioning SX as a top priority. This may be a reflection of the fact that while Japanese automobile manufacturers have plans for a shift to electrification, concrete strategies will only gradually emerge.

The automotive industry is built upon a vast vertically integrated supply chain model; a transformation of the business model will disrupt the entire supply chain, and will be an immense undertaking. It is therefore clear why companies may want to take a wait-and-see approach although they have a sense of urgency regarding a shift to electrification. However, an early agreement on a collective approach by the entire industry is expected in view of the enormous impact on the supply chain, both upstream and downstream, that would be caused by a major change in direction such as a lateral division of labor.

Yuji Ito

Head of Consumer & Retail,
KPMG Japan

New initiatives to prepare for supply chain disruptions caused by climate change

In the consumer goods and retail industry, the percentage of CFOs who selected "supply chain disruption in the event of an unforeseen situation (BCP)" as a major concern that may impact business strategy was higher than for other industries.

Food and beverage manufacturers in particular are concerned about the impact of natural disasters and mid- and long-term climate change on food ingredients, agricultural products, livestock products and marine products, and their relevant production and supply chains. The retail industry is also highly conscious of supply chain disruption risk because of the role that their many stores will play as a regional lifeline in the event of an unforeseen situation.

As an example of specific measures to address climate change risks affecting the supply chain over the medium to long term, one climate risk initiative is the development and quality improvement of plant-based meats that use no or almost no livestock. Such plant-based meats are not prone to the impacts of climate change and may also reduce greenhouse gas emissions. Manufacturers, logistics companies and retailers have also begun to collaborate on an approach to cope with natural disasters, whereby weather forecasts and expressway information are incorporated into the analysis of internal data in order to formulate delivery plans based on a prediction of a disaster.

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Satoshi Wada

Technology, Media & Telecommunications Director,
KPMG Japan

Human capital management is key to enhancing corporate value

In technology, media, and telecommunications, most companies cited human capital management as a major sustainability issue that may impact corporate value in the future. This is consistent with KPMG International's Technology Industry CEO Outlook 2020, where "talent risk" was cited as a top obstacle to growth. CFOs are aware that securing professional talent is essential for keeping up with rapid technological changes in the industry and enabling sustainable growth of corporate value. Another industry characteristic is that many companies are actively working to create an attractive workplace that is inclusive and diverse.

KPMG

Technology Industry CEO Outlook

Digital transformation, ESG, and supply chain are in focus as new risks emerge

Meanwhile, we also noted a difference among the technology, media and telecommunications industries in the level of awareness regarding climate change, an issue for which awareness levels are high across all industries. In the technology industry, awareness was particularly high among electrical equipment manufacturers. This may be because of the extent of their global business, which is feeling the effects of global environmental and carbon-neutral efforts that are also impacting suppliers of giant IT companies. In contrast, the awareness level was low in the media and telecommunications industries. There are, however, growing expectations for new environmental initiatives in these industries as well, such as the introduction of green power in massive communication server groups and data centers.

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Spotlight 1

Change in response to climate change risk from 2020 survey results

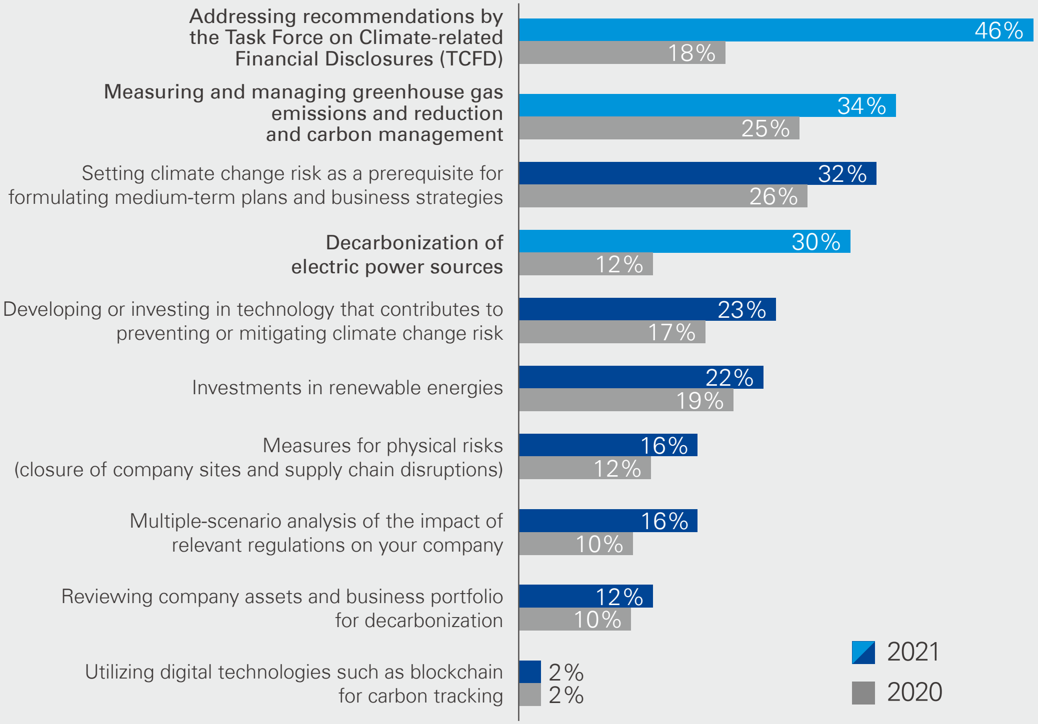
Companies are taking a more practical approach to climate change risk

Not a day goes by without the media covering the issue of climate change. Compared with survey results in 2020, as measures related to this pressing topic that have been or are planned to be implemented, more companies are now addressing recommendations made by the Task Force on Climate-related Financial Disclosures (TCFD). This is becoming an urgent issue for companies that will be listed on the Prime Market from April 2022.

The past year has also seen more companies taking initiatives for "measuring and managing greenhouse gas emissions and reduction" and the "decarbonization of electric power sources." CFOs are not only more cognizant of these issues, but are shifting to the implementation of specific and effective measures.

Companies are steadily beginning their corporate transformation to address climate change risk.

Measures related to climate change risk that are in progress or under consideration



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KPMG's Specialist Insights

Investment Strategy and Corporate Funding

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Investment Strategy and Corporate Funding

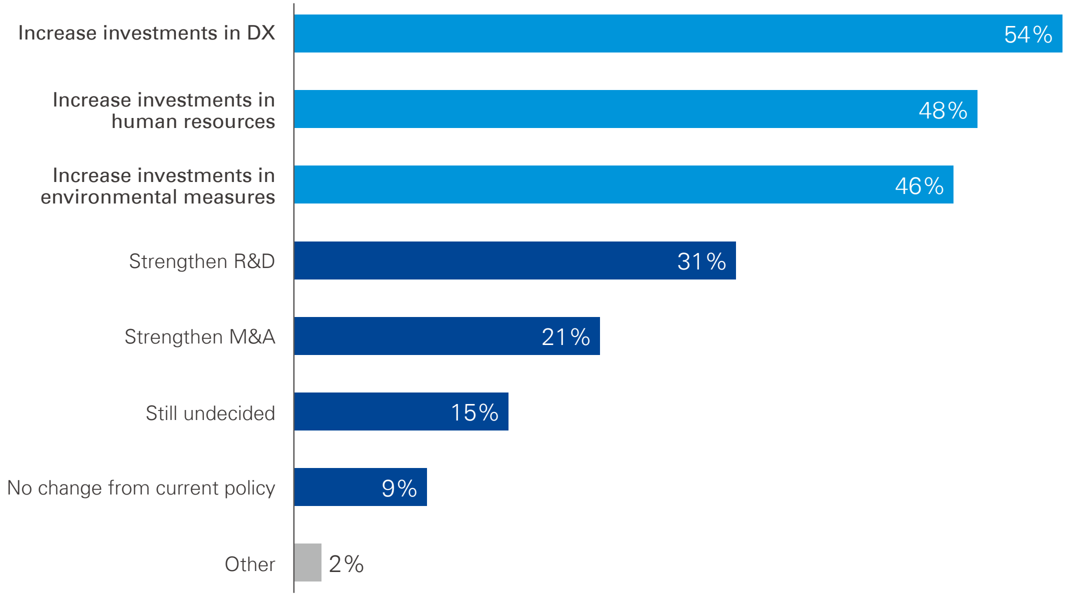
Investment Strategy

Establishing an integrated roadmap for investments in human resources, environmental measures, and digital transformation to achieve SX

Corporate Funding

We are fast approaching a time when companies will be held accountable for ESG discipline by markets and financial institutions

How will you change your investment strategy in promoting SX? (Multiple choice)



Daisuke Tsuchiya

Global Financial Management Director,
Financial Advisory Services
KPMG AZSA LLC

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Investments in human resources, environmental measures and digital transformation should be integrated

CFOs view investments in human resources, environmental measures and digital transformation (DX) as top priorities, and plan to increase these investments in the future.

Japan's Corporate Governance Code revised in June 2021 includes requirements for companies to address sustainability issues, reorganize business portfolios and reallocate management resources in addition to effective oversight of such initiatives by the board of directors, citing investments in human capital and intellectual capital as important pillars for achieving these initiatives.

Global investments of up to 8,000 trillion yen are required in order to realize the commitments stipulated in the Paris Agreement as measures against climate change. Major developed countries are introducing policies toward carbon neutrality, and huge investments are also expected in the private sector as companies accelerate their own carbon neutral efforts. The possibility of companies that do not adopt a net zero agenda being pushed out of supply chains makes environmental investments imperative for business continuity.

While DX tends to be seen as an extension of traditional IT investments such as for improving productivity, the actual aim of DX is for companies to transform business models and gain competitive advantages through the utilization of data and digital technologies. DX, however, is not effective on its own—it requires human resources capable of promoting and utilizing its potential. We also expect environmental measures to increasingly make use of DX. An example of this would be the use of blockchain technology to track carbon emissions.

CFOs have the role of accelerating investments in human resources, environmental measures and DX as an integrated initiative given their strong interrelationship.

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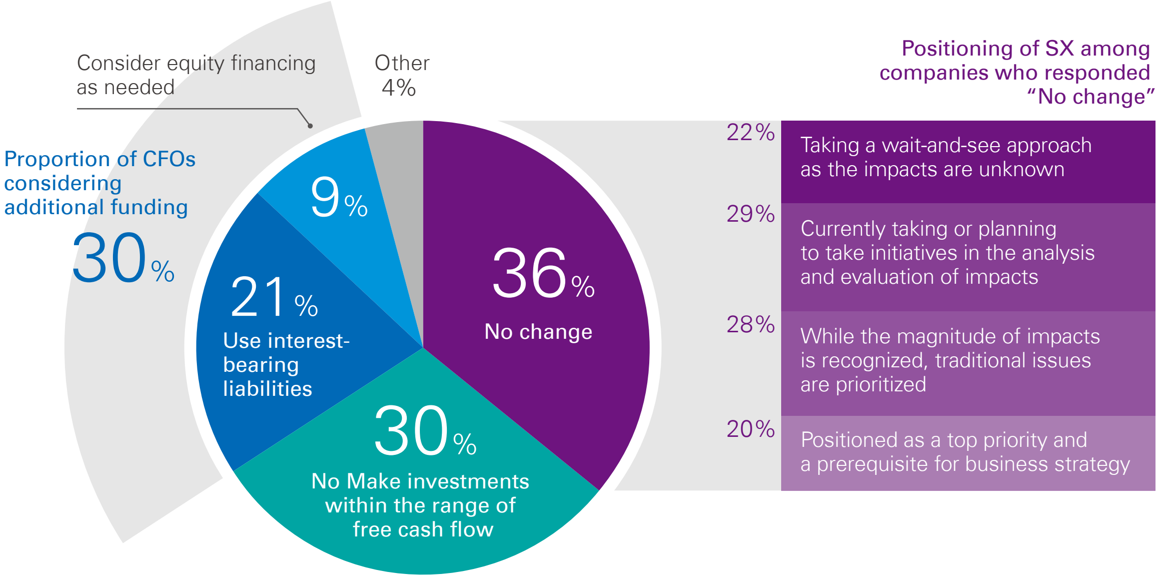
Investment Strategy and Corporate Funding

How the means of corporate funding will change in line with SX (Single choice)



CFOs voiced the need for assessing impacts on corporate funding

Funding measures are also required for making investments. 30 percent of CFOs responded that they would consider using interest-bearing liabilities or equity financing as needed in line with SX developments, while 30 percent responded that they would invest within their range of free cash flow. Another 36 percent responded that they would not be changing their means of funding. The results show that a third of all respondents are considering additional funding to promote SX, while two thirds plan to address SX but without any additional funding.

Of companies that do not plan to change their means of funding, however, in response to the positioning of SX as a management issue, 29 percent have just started analyzing and assessing the impacts of SX, while 22 percent are still uncertain of the impacts. This suggests that a number of CFOs are unsure of the amount of necessary funding as SX is not clearly linked to their management issues. Some companies may be struggling to assess SX investments and their effectiveness against a backdrop of drastic changes happening in their environment at a rapid pace.

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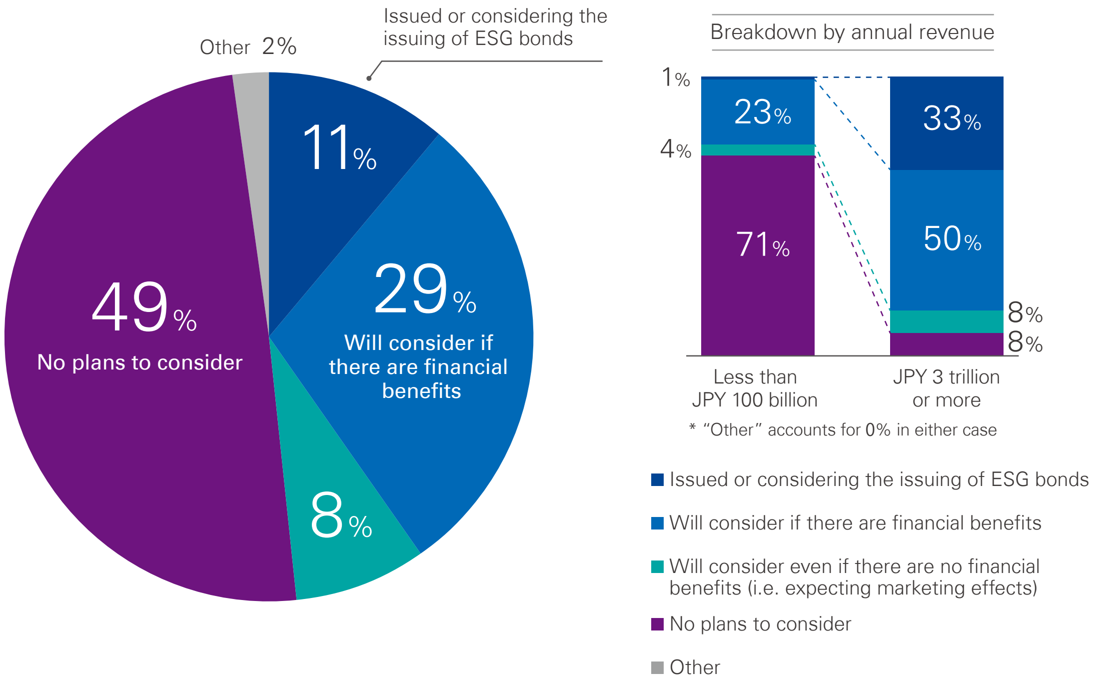
Will ESG bonds be utilized in line with SX? (Single choice)



* “Other” accounts for 0% in either case

A cautious and critical approach to the use of ESG bonds including interest rate benefits

While ESG bonds such as green bonds are a common means of corporate funding, only 11 percent of CFOs responded that they have issued or are considering issuing ESG bonds. CFOs of smaller companies were more likely to respond that they had no plans to issue ESG bonds, which is indicative of the current reality in which ESG bonds are mainly issued by larger companies. 29 percent of CFOs responded that they would “consider using ESG bonds if there are financial benefits.” This may be due to the current lack of a clear greenium (risk premium seen in green bonds) for ESG bonds, which means that the difference in interest rate levels from straight bonds is insignificant. The management and disclosures required for ESG bonds can also be more burdensome compared to normal funding as restrictions are imposed on how funds can be used, and usage needs to be traced and reported. The results indicate that CFOs take a cautious and critical position on the decision to utilize ESG bonds, including interest rate benefits.

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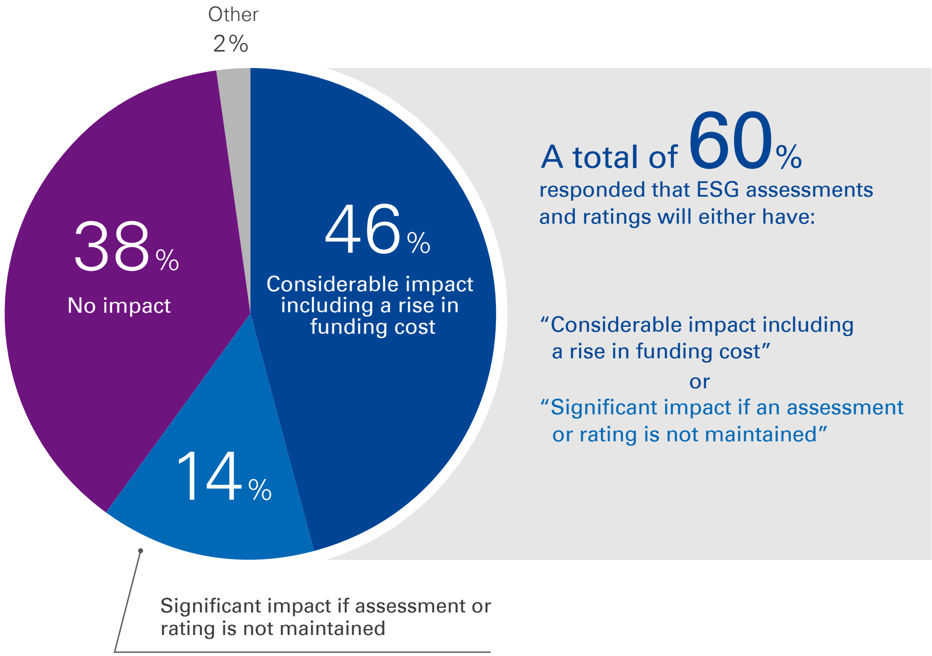
Investment Strategy and Corporate Funding

To what extent will ESG assessments and ratings affect corporate funding excluding ESG bonds in the future? (Single choice)



A total of 60% responded that ESG assessments and ratings will either have:

"Considerable impact including a rise in funding cost"
or
"Significant impact if an assessment or rating is not maintained"

Accountability for both financial and ESG discipline

The survey results show that some CFOs are cautious about utilizing ESG bonds. 60 percent of CFOs however believe that ESG assessments and ratings also affect bank loans and corporate bond issuance. ESG was first introduced as a way for institutional investors to assess the sustainability issues of companies they were investing in from an ESG perspective in their business evaluation. However, bond investors also integrate an ESG perspective into their investment decisions. Banks are also accelerating the move to incorporate assessment of ESG business feasibility into loan standards. As ordinary loans become greener, the breaking down of barriers between ESG and ordinary bonds seems inevitable. If a difference in ESG assessment reflects a difference in eligibility for corporate funding, CFOs will be held accountable not only for financial discipline, but also for ESG discipline (compliance with basic sustainability policies established by the company) by the markets and financial institutions. The scope of CFO accountability is expected to further expand in the future.

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Sector Insights

Yuta Tanaka

Financial Services Sector Director,
KPMG Japan

The financial sector taking ESG bonds to new heights

The survey results showed that a small percentage of overall respondents has positive appetite for the issuance of ESG bonds. On the contrary, the financial sector (including asset management business) had a higher response rate for support of ESG bond issuance relative to other sectors. A growing demand for investment in ESG bonds such as green bonds and sustainability bonds may be an underlying factor, with major banks and insurance companies in Japan being expected by society to increase ESG investments and financing. Bonds issued by banks and other financial institutions include those for financing green projects or investing in eco-friendly products. Meanwhile in the asset management industry, ESG bonds are likely to be issued for developing properties that contribute to solving environmental and social issues such as mitigating impact from natural disasters.

Financial institutions are expected to provide sufficient funding for corporate efforts aimed at decarbonization in accordance with the Basic Guidelines on Climate Transition Finance issued in May 2021. As the ESG bond market volume is expected to expand due to an increase in the issuance of transition bonds, issuing companies will need to be transparent about their use of funds, measuring and disclosing their contributions to decarbonization in order to prevent greenwashing.

Seiichi Ono

Energy & Infrastructure Director,
KPMG Japan

Having deeper dialogue with investors and financial institutions, and moving to the strategy execution phase

World politics and economies are shifting to decarbonization, with carbon taxes in particular impacting companies' income and expenditure, and corporate valuations by investors and financial institutions are rapidly changing. In these circumstances, financial measures including corporate funding will become a top-priority management issue for companies in the energy and chemical industries.

The SX phase is shifting from formulating strategies to executing them, especially among large companies, in a move to maintain and enhance corporate value. Another sector characteristic is that many companies are increasing environmental investments as a strategic option. It will become more important in the future to engage in deeper dialogue with investors and financial institutions, and demonstrate a clear consistency between information disclosures and strategies based on a long-term roadmap for business restructuring.

In the power, utilities, gas and oil sector, nearly half of CFOs responded that they are strengthening financial governance and relationships with financial institutions in response to the impacts of COVID-19. Companies are proactively making investments in renewable energies, and there is a steady move from consideration of action to execution of action toward transforming their business structure.

As for impacts on business strategy, companies in the chemical industry have concerns about supply chain disruption, in addition to the impact of carbon tax on their income and expenditure. Meanwhile, regarding their status on SX initiatives, many CFOs in the chemical industry are in the phase of understanding and assessing their own issues, and are making demonstrable efforts to address SX by investing in DX and environmental measures and strengthening R&D.

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Spotlight 2

Change in financial measures amid COVID-19 as compared with 2020 survey results

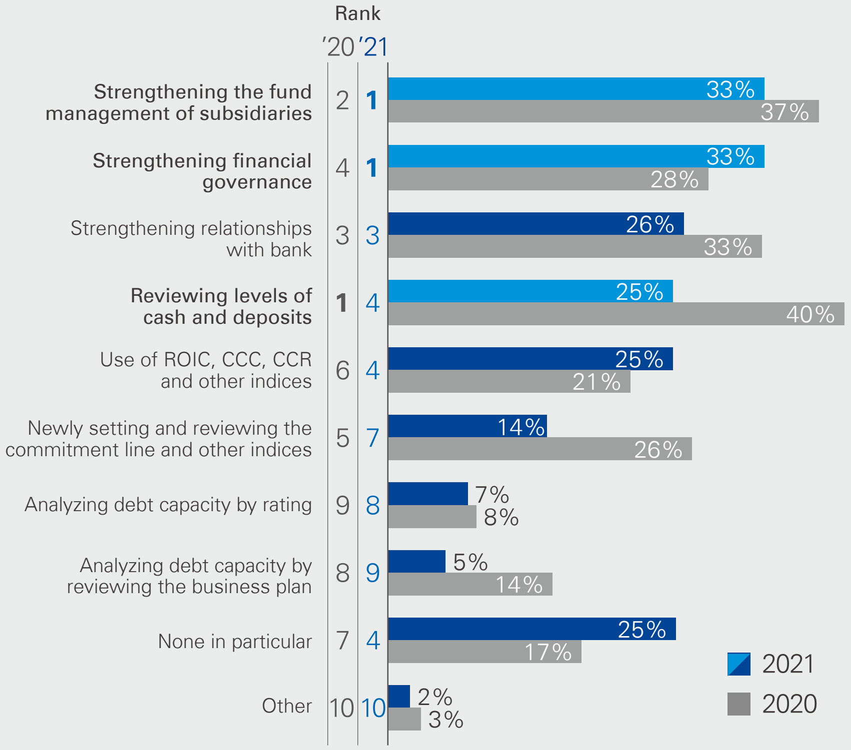
Interest has shifted from reviewing cash and deposits to strengthening fund management of subsidiaries and financial governance.

The impacts of COVID-19 on businesses were just becoming apparent when the 2020 survey was conducted, and many CFOs cited a "review of cash and deposits" as a top priority in terms of corporate funding and managing cash. One year later, the interest of CFOs, especially those of larger companies, is shifting to "strengthening the fund management of subsidiaries" and "strengthening financial governance," as more companies find a means of sourcing urgent funding.

Flexible collection and utilization of subsidiary funds by headquarters is a key issue for strengthening the fund management of subsidiaries and implementing effective group-wide financial governance. Companies in North America and Europe tend to have stronger authority and governance over their subsidiaries, developing a group-wide optimal framework in which funds are concentrated at headquarters by utilizing a cash management system (CMS) and dividend payments to subsidiaries. In contrast, some Japanese companies not only lack clear rules, but the rules currently in place are not well understood by subsidiaries. This essentially leads to strengthening of the authority of subsidiaries, making flexible collection of funds by headquarters difficult.

Many companies believe it is essential to gain the understanding of their subsidiaries before introducing a group-wide optimization framework. Such an introduction would require the formulation of standards supported by a clear rationale agreed upon by both headquarters and a subsidiary. Companies will need to establish optimal levels of cash and deposits as well as capital requirements which serve as the basis for dividends for each subsidiary, in order to gain their understanding and strengthen governance. There needs to be a shared understanding of the rationale behind these levels between headquarters and a subsidiary.

Measures implemented or planned to be implemented with regard to corporate funding and cash (Multiple choice)



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Corporate Governance

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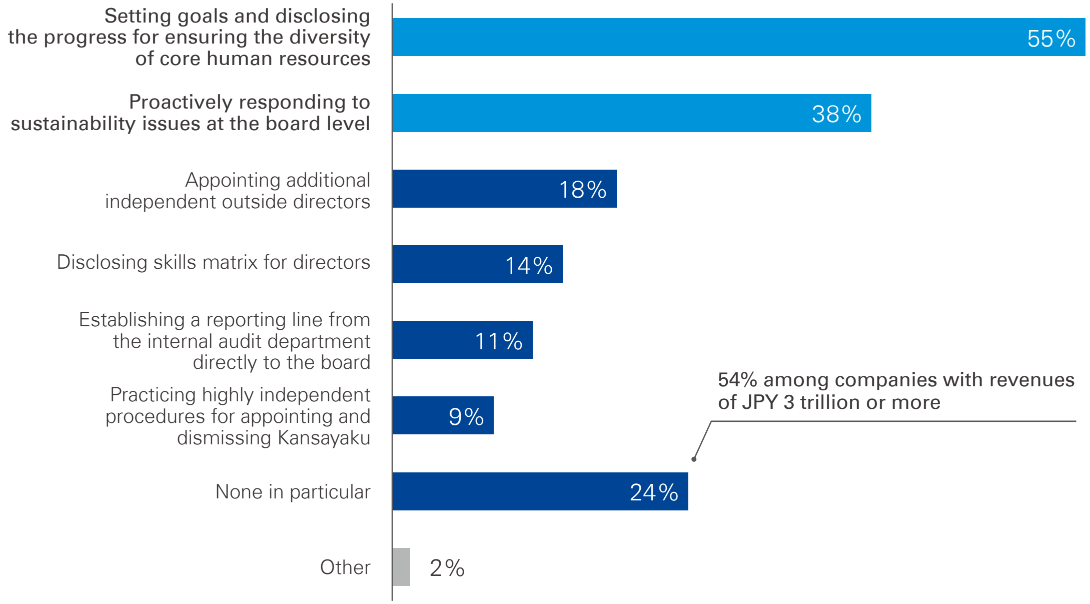
Corporate Governance

Developing effective corporate governance toward achieving SX



SX related principles added to Japan's Corporate Governance Code revised in June 2021 that CFOs find challenging (Multiple choice)

54% among companies with revenues of JPY 3 trillion or more

Tomoko Waku

Sustainable Value Japan
Partner,
KPMG AZSA LLC

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Developing effective corporate governance toward achieving SX

In June 2021, the Financial Services Agency and the Tokyo Stock Exchange (TSE) revised Japan's Corporate Governance Code for the second time. Against the backdrop of corporate transformations triggered by the COVID-19 pandemic, the revised Code presents governance issues that need to be addressed by companies toward achieving sustainable growth in the medium to long term. These include addressing sustainability issues, making the Board of Directors more effective, and promoting diversity in core human resources, all of which are also important elements in the integration of sustainability into strategic decision-making and making business models more resilient through SX.

In light of this, we asked CFOs which principles added to the Corporate Governance Code would be difficult to address in the survey. "Setting goals and disclosing the current status (progress) for securing diversity in core human resources" was the top response at 55 percent, followed by "proactively responding to sustainability issues at the board level" at 38 percent.

A high number of CFOs responded that they are challenging due to the need to address them in the medium to long term while tailoring measures to the unique circumstances of their company.

On the other hand, the third highest response was "none in particular" at 24 percent. Among companies with revenues of JPY 3 trillion or more, this was chosen by 54 percent, suggesting that larger companies are making more progress addressing these issues.

The purpose of the Corporate Governance Code is for companies to pursue sustainable growth in their corporate value. However, since the business environments are changing at a rapid pace and are increasingly difficult to predict, it is essential for companies to continue their efforts in the medium to long term even after they have once complied with the Corporate Governance Code. New risks will continue to arise in line with environmental changes, and companies need to be prepared to address such risks appropriately according to their individual circumstances.

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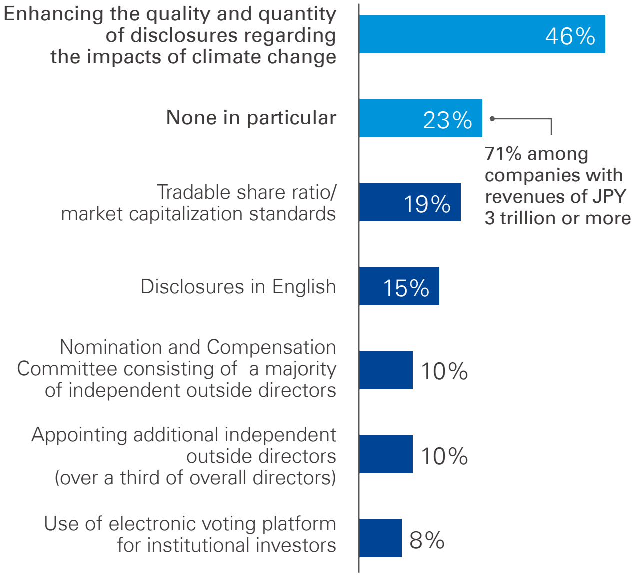
Corporate Governance

Criteria that CFOs expect to be challenging for a transition to the Prime Market (Multiple choice)



There needs to be a discussion at the board level regarding the impacts of climate change on mid- and long-term corporate value

Japan's revised Corporate Governance Code also clarifies requirements which will be specifically required of companies listed on the Prime Market. The Prime Market will be positioned as the highest-tier market replacing the current TSE First Section following a new segmentation of the TSE market scheduled for April 2022. The full range of requirements for the Prime Market have now been released, comprising issues raised in the revised code and the TSE's listing criteria. In light of this, we asked CFOs which requirements they expect will be difficult to meet for a transition to the Prime Market.

46 percent of CFOs expect "enhancing the quality and quantity of disclosures regarding the impacts of climate change" to be difficult. The second highest response was "none in particular" at 23 percent, with large companies having a higher response rate—this is a trend similar to that for addressing new issues raised in the Revised Corporate Governance Code.

Many companies in industries vulnerable to the effects of climate change have already begun analyzing the impacts of climate change and explaining them to external stakeholders.

Meanwhile, we believe many companies in other industries will only start working on the analysis and disclosure of climate-related impacts because of the Prime Market requirement. This is consistent with the high number of CEOs who responded that they are facing increasing demands for reporting on ESG issues in the KPMG 2021 CEO Outlook.

Climate change is expected to have a significant impact on business in general, and on financial systems in particular. This is why initiatives such as TCFD are progressing on a global scale, and there is strong demand for companies to disclose their climate related strategy. The revised Corporate Governance Code reflects this trend. Companies that have already started to analyze and disclose the impacts of climate change will also be expected to further improve both the quantity and quality of disclosures to meet global standards that will become increasingly stringent. The board needs to keep up with relevant information in a timely manner, and have broad and in-depth discussions concerning the potential impacts of climate change on corporate value and how to address them in the medium to long term.

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KPMG's Specialist Insights

Risk Management

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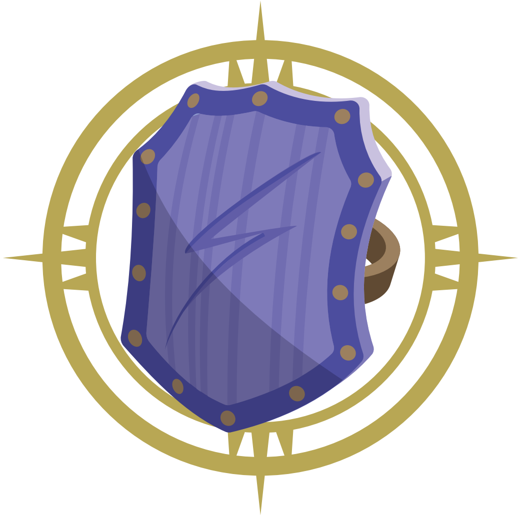
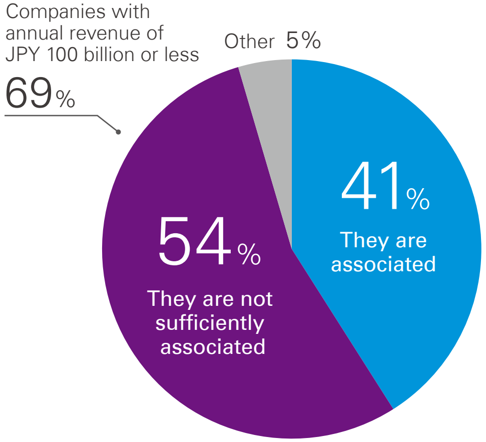
Developing a risk management system capable of dealing with changing sustainability issues



Keisuke Adachi

Partner,
KPMG Consulting

Are your risk management activities designed and executed in association with key sustainability issues? (Single choice)



Despite organizations and activities dedicated to risk management now being common, management often voice concerns that their risk management may be becoming a dead letter, and that they may not be having the appropriate discussions about risks that are actually important to the company.

Such concerns are growing stronger amid the current trend of sustainability. There is a growing need to view key sustainability issues as a risk management agenda, and integrate them into the PDCA of respective risk management activities.

We asked CFOs whether they associate risk management with sustainability issues, to which more than half responded that the association was not sufficient. This trend was particularly distinct for companies with revenues of JPY100 billion or less, indicating that responses to sustainability issues and the maturity level of a company's risk management activities vary depending on company or business size.

By industry, a lack of sufficient association appears to be more prevalent in the Automotive and Electronics industries, which face the significant changes and uncertainties in the business environment. This makes it difficult for companies to keep up with rapid changes in environmental and social issues and to link them to their risk management, which usually involves identifying and addressing key risks on an annual basis.

As the importance of addressing sustainability issues grows, companies will need to reexamine their risk management framework and ensure that dynamic and emerging sustainability risks are integrated into their management decision-making through risk management system.

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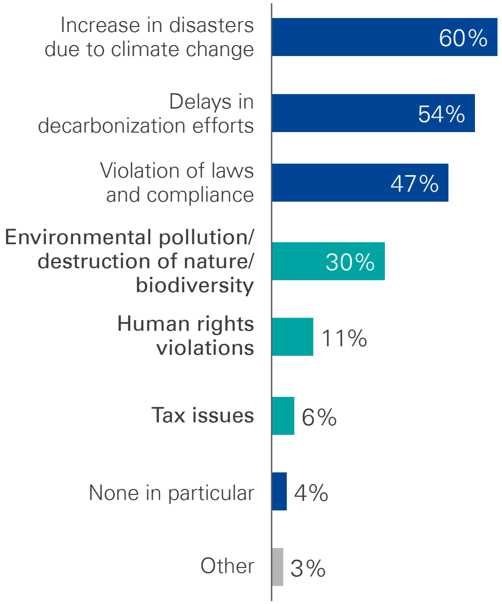
Sustainability risks that are of particular concern for business operations (Multiple choices)



Keeping up to date with changing sustainability risks

Sustainability management encompasses a wide range of topics which continue to evolve in response to changing social concerns. We asked CFOs to share sustainability risks which were of particular concern for their business operations.

Three concerns stood out in particular: An "increase in disasters due to climate change," "delays in decarbonization efforts," and "violation of laws and compliance."

Concerns about violating laws and compliance are expressed regardless of company size or industry. This reflects the overall awareness of code of conduct and legal compliance that is now ingrained among CFOs and other management in Japanese companies.

While human rights violation is a topic that garners growing attention, the number of companies that chose this as a concern fell short of our predictions. The response rate was relatively high from companies in the consumer goods and retail industries. This suggests that efforts to address human rights issues have thus far been limited to industries with a high sensitivity to brands and consumer awareness. We expect concerns regarding human rights issues will increase, including in the B2B manufacturing industry, in line with developments in sustainability initiatives throughout entire supply chains.

We expect concerns will also likely increase regarding tax governance for preventing tax issues, as well as biodiversity, particularly becoming increasingly important among environmental issues.

To promote sustainability management, companies need to be sensitive to their business environment and social concerns while identifying risks associated with key sustainability issues and aligning their understanding risks with that of their stakeholders.

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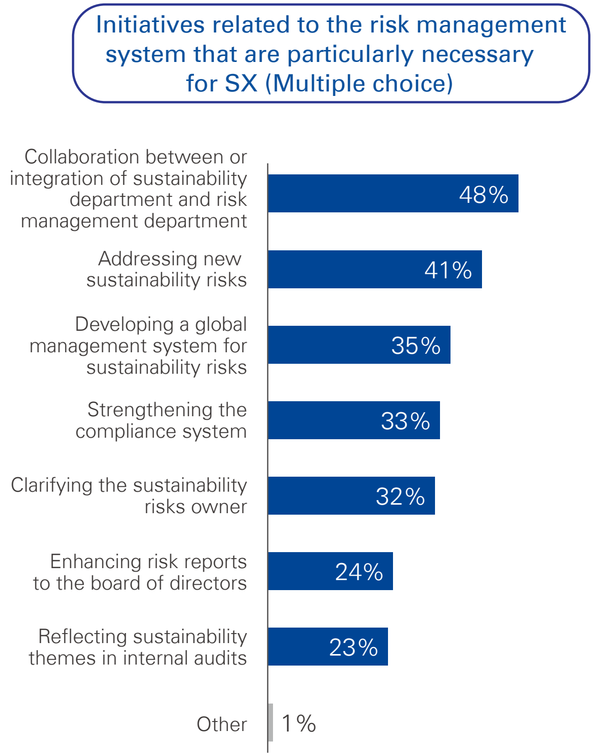
Risk Management



Continuously upgrading risk management system is the key to sustainability management

To promote sustainability management, companies need to establish a robust group-wide risk management system capable of responding to various risks that continue to evolve and expand. We asked CFOs which initiatives are most important for their risk management system.

The survey found that various issues are broadly recognized. Large companies in particular have a high interest in strengthening and reorganizing their systems in a way that enables a group-wide response to sustainability issues on a global basis. Interests included collaboration between or integration of their sustainability department and risk management department, and building a global management system capable of responding to sustainability risks.

Only a small number of companies chose “reflecting sustainability themes in internal audits” as an interest. This may be because initiatives aimed to addressing sustainability issues are currently work in progress, front office (first-line) and corporate office (second-line) in the companies are still in the process of assessing policies and specific measures. As the maturity level of sustainability initiatives increases and group-wide initiatives are implemented, internal audits, or monitoring by an independent department, will be required to evaluate the accuracy and appropriateness of a company’s sustainability information, as well as the effectiveness of its initiatives and operating systems.

Developing a risk management system is only the first step. Companies will need to continue upgrading their system to increase its effectiveness and facilitate corporate decision-making according to each stage of sustainability management.

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Sector Insights

Kazuya Kimura

Industrial Manufacturing Director,
KPMG Japan

The manufacturing sector has concerns about delays in decarbonization initiatives

As sustainability risk in business operations, 73 percent of CFOs in the manufacturing sector responded that they have concerns regarding a delay in decarbonization efforts, a higher percentage than the 54 percent overall. Companies in the manufacturing sector have reason to be more sensitive to decarbonization risk than in other sectors—any decarbonization delays in their manufacturing process could result in the exclusion of their company from the supply chain as they would not be deemed an appropriate business partner.

An increasing number of companies in the manufacturing sector not only view decarbonization as a risk but also as an opportunity for growth by announcing environmental goals for 2030 as a global commitment. Steady implementation of such decarbonization efforts requires management to provide clear CO_2 emission reduction targets and initiatives. Companies also need to integrate tools and infrastructure into their business management process to visualize group-wide CO_2 emissions and accurately measure the achievement of CO_2 reduction targets.

Another important initiative is to carry out a fundamental review of the company's business portfolio, and concentrate the company's management resources on businesses with low CO_2 emissions.

Junichi Kurihara

Head of Life Sciences,
KPMG Japan

The life sciences sector focuses on a robust compliance system and BCP

Life science companies have had a close association with the S (social) in ESG, given their social mission of curing diseases, sustaining life, and improving quality of life. The survey found that 63 percent of CFOs in the life sciences sector associate sustainability issues with risk management, compared to 41 percent overall. Against a backdrop of legal violations by generic drug companies and supply chain disruptions amid COVID-19, this result reflects an industry need to strengthen risk management systems for social issues including compliance and a stable supply chain.

In fact, more companies cited "violation of laws and compliance" as a concern for business operations than in other industries. This response was especially notable among medium-sized pharmaceutical companies, and medical device manufacturers and wholesalers. 66 percent also cited "strengthening the compliance system" (33 percent overall) as a particularly necessary risk management initiative for promoting SX.

Another industry characteristic is a trend toward focusing on the supply side as a risk management initiative. 94 percent (54 percent overall) of companies in the life sciences sector cited "supply chain disruption in the event of an unforeseen situation (BCP)" as a concern that may impact their business strategy. Companies are expected to reduce the dependence of their API supply system on other countries amid the COVID-19 pandemic, and shift to a system that ensures stable supplies.

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Risk Management

Sector Insights

Takuji Yamamoto

Financial Services Sector
Director,
KPMG Japan

Progressing with the integrated management of sustainability risk amid pressure from financial authorities

In the financial sector, the number of companies integrating sustainability strategies into their risk management was higher than in other industries. A high percentage also cited "violation of laws and compliance" as a relevant risk, which may reflect the public nature of financial institutions.

Financial authorities focus on climate change as an ESG risk that impacts corporate activities. For example, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) has expressed its expectation for companies to integrate climate change risk into their existing risk management framework linked to business strategies. The FSA's FY2021 Financial Administration Policy also states its plans to identify issues in the utilization of scenario analysis based on a quantitative understanding of climate risk by banks when providing loans, and to clarify points requiring monitoring to ensure risk management related to climate change. Financial institutions are expected to promote specific actions to meet the expectations of their stakeholders both in Japan and overseas.

Private financial institutions and institutional investors have been proactively expanding their investments in the form of sustainable finance. Their risk management awareness and actions as represented in financing trends may have a greater impact on the overall economic and social system.

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KPMG's Specialist Insights

Tax

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Responding to increasing expectations by addressing tax governance as a sustainability issue

Akihiro Miura

Partner,
KPMG Tax Corporation

Japan's tax governance measures lag behind those of global companies

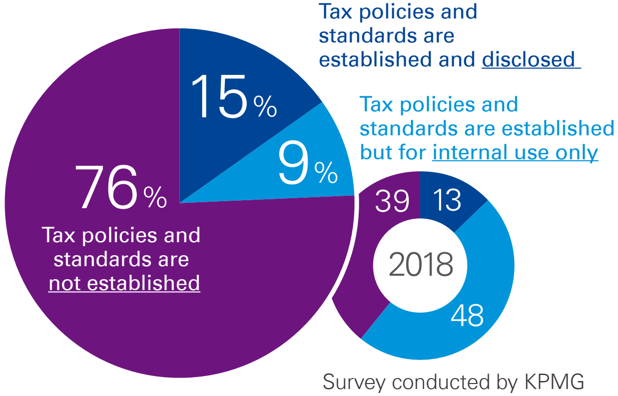
There has been a tendency for companies to minimize and optimize tax costs in order to maximize shareholder value, especially overseas. However, the BEPS (Base Erosion and Profit Shifting) Action Plan discussed at the OECD recently imposed restrictions on the excessive minimization of tax costs. Managing and controlling tax is becoming increasingly difficult in line with the growing complexity of tax policies, organizational structures and transactions of companies. At the same time, there is a heightened need for tax governance in response to the increasing scrutiny of national tax authorities.

Global ESG rating agencies are also assessing tax strategies and the payment status of income taxes by region and country as well as the disclosure of effective tax rates, suggesting that tax governance is recognized as a sustainability issue.

Against this backdrop, we asked CFOs what their status was regarding the establishment of tax policies and standards and monitoring of tax information.

A comparison of results with the Global Tax Department Benchmarking Survey conducted by KPMG International in 2018 reveals that there has been little progress in the establishment and disclosure of tax policies in Japan. An underlying factor for this is probably the fact that Japanese companies in general have not pursued overly aggressive tax positions, and there was therefore no urgency in actively pushing for the establishment and disclosure of tax policies. However, the increasing worldwide movement toward requiring companies to appropriately handle tax payments and establish and disclose their tax policies may lead to a heightened need for such polices in the future.

Does your company have tax policies and standards applying to risk tolerance and tax judgments that are disclosed? (Single choice)



Survey conducted by KPMG International (2018)*

Survey conducted by KPMG International (2018)*
Global Tax Department Benchmarking

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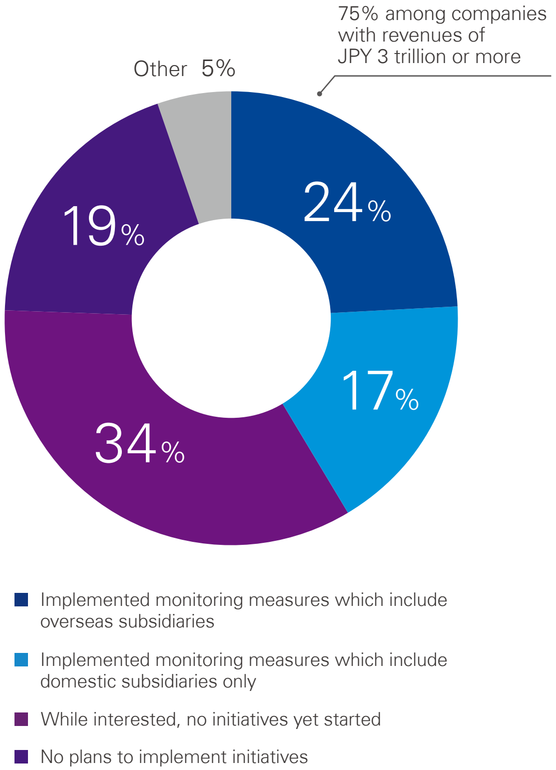
Which statement best describes the status of initiatives for visualizing your group companies' tax information? (Single choice)



Strengthening tax governance by visualizing tax information

There is a heightened risk of unexpected tax penalties and other tax liabilities for group companies: BEPS 2.0, a new framework for digital economy taxation, has been under consideration for a few years led by the OECD; a minimum global corporate tax rate is being promoted; and there is a possibility of stricter tax inspections in response to various countries undertaking aggressive fiscal stimulus as COVID-19 measures. Under such circumstances, the visualization of tax information of group companies is effective for enhancing tax governance, and we asked CFOs about where they stand in this respect. 24 percent responded that they are implementing monitoring measures that include overseas subsidiaries. Among larger group companies that are more progressive in their overseas businesses, this response was given by a much higher 75 percent.

While the survey found that larger companies with a higher exposure to overseas tax risks are making progress in the visualization and monitoring of tax information of their group companies, little progress has been made overall. It is important for companies to meet the growing expectations of strengthening their tax governance at a global level in order to achieve sustainable growth.

The co-operative compliance program is available in Japan as a way to address tax governance issues, whereby a taxpayer with a certain level of tax governance enters into an agreement with the tax authorities to voluntarily disclose any unclear tax issues on a timely basis. This allows authorities to express their views on tax issues in a timely manner, and adjust the frequency and depth of inspections accordingly. As a result, taxpayers are able to reduce man-hours required for tax inspections, while promoting tax transparency.

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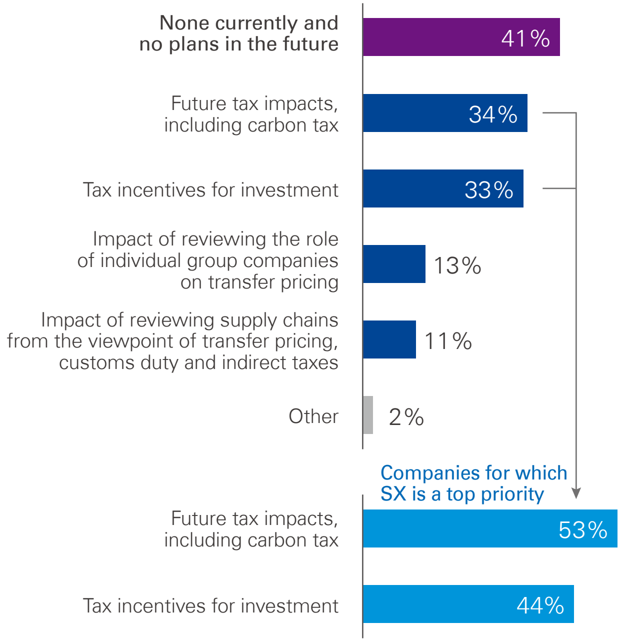
Tax

Consideration of tax measures or tax impacts in line with SX to date or in the future (Multiple choice)



Companies prioritizing the SX agenda are ahead in addressing and considering tax measures
Tax impacts of future changes in supply chain need to be considered carefully

To encourage companies toward carbon neutrality, some countries are introducing tax incentives for environmental investments such as the implementation of production facilities that contribute to decarbonization. At the same time, carbon taxes and the Carbon Border Adjustment Mechanism are being introduced and considered, and companies are being urged to review their supply chain, including changing their production bases.

Despite these moves, 41 percent of CFOs responded that they have not considered and have no plans to consider relevant tax measures and tax impacts. However, a higher percentage of companies that position SX as a top priority responded that they are considering the future impacts of introducing a tax relief for environmental investments and a carbon tax, and are actively working on tax measures as they progress with their SX agenda.

11 percent of companies plan to consider the impact of reviewing their supply chain on transfer pricing, customs duties, and indirect taxes. However, from the viewpoint of decarbonization, a change in supply chain will lead to CO_2 emissions resulting from energy consumption associated with transporting products and parts, as well as additional costs incurred due to the Carbon Border Adjustment Mechanism. A new supply chain will therefore probably lean toward "local production for local consumption," and differ significantly from the supply chain models currently used by multinational companies. A change in supply chain will force significant changes in the design of transfer pricing and customs duties imposed. These changes are expected to become an important issue, especially for companies in the manufacturing industry, and will require careful preparation.

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KPMG's Specialist Insights

Comprehensive Reporting

including non-financial information

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Committing to sustainability information as a factor that impacts corporate value

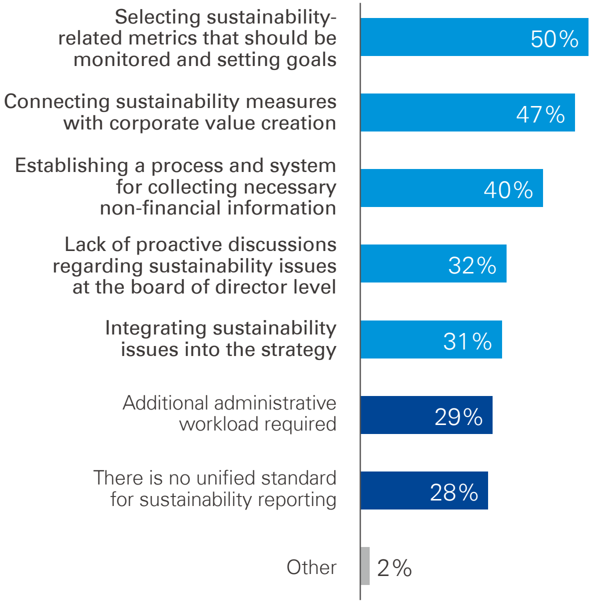
Tomokazu Sekiguchi

Sustainable Value Japan
Partner,
KPMG AZSA LLC

Effective from the fiscal year ended March 31, 2020, an enhancement of disclosures of narrative information is required in Annual Securities Reports. At the same time, the importance of sustainability issues is increasing. While climate change risk and other sustainability issues are expected to have a significant impact on corporate value over the medium to long term, they do not necessarily have an immediate impact on corporate profits, making it difficult to translate the degree of risk and the nature of corporate response into monetary values. Information on sustainability issues therefore tends to be reported as part of non-financial information, rather than financial information.

On the other hand, with the increasing importance of sustainability issues, questions are being raised about why information on sustainability issues is not included in financial information. How to integrate sustainability information into financial information and provide consistent reporting as a whole has become a major theme in corporate reporting.

Challenges in preparing a comprehensive report in which sustainability information is associated with financial information (Multiple choice)



Selecting sustainability-related metrics that should be monitored and setting goals	50%
Connecting sustainability measures with corporate value creation	47%
Establishing a process and system for collecting necessary non-financial information	40%
Lack of proactive discussions regarding sustainability issues at the board of director level	32%
Integrating sustainability issues into the strategy	31%
Additional administrative workload required	29%
There is no unified standard for sustainability reporting	28%
Other	2%

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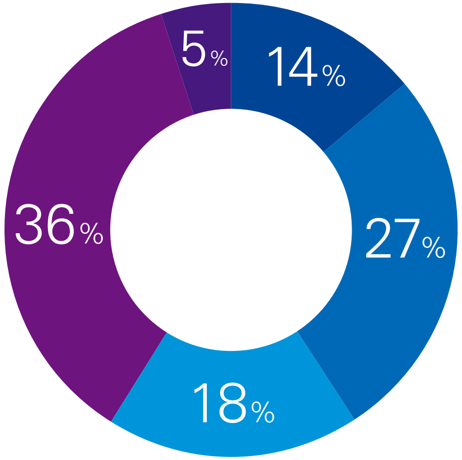
Discussions at the management and board level are lacking despite an urgent need for practical measures

The survey questioned the challenges CFOs face in the preparation of a comprehensive report which relates sustainability information to financial information. In response, 50 percent chose "selecting sustainability-related metrics that should be monitored and setting goals," 47 percent chose "connecting sustainability measures with corporate value creation," and 40 percent chose "establishing a process and system for collecting necessary non-financial information." This reflects an urgent need for many companies to implement practical measures to enable their disclosure of quantitative non-financial information. Against this background, some Japanese companies have recently adopted the SASB standards, which identify industry-specific metrics (indices) for the disclosure of sustainability information.

As challenges cited by CFOs, 32 percent also chose "lack of proactive discussions regarding sustainability issues at the board level" followed by "integrating material sustainability issues in the strategy" at 31 percent. This indicates that while many companies are promoting practical measures to enhance their disclosure of non-financial information, the management and board of companies need to improve their understanding of sustainability issues, and develop strategies based on a prioritization of actions.

What is the current level of CFO involvement in sustainability reporting? (Single choice)



- ■ Sufficient involvement to date
- ■ Fair amount of involvement to date and expect future involvement to increase
- ■ Fair amount of involvement to date and expect future involvement to remain the same
- ■ None currently but plan to increase future involvement
- ■ None currently and do not expect future involvement

Committing to sustainability information as a factor that impacts corporate value

What is the level of CFO commitment to addressing sustainability issues? Specifically, regarding their involvement in sustainability reporting, the top response was 36 percent, where CFOs have no current involvement, but plan to increase involvement in the future. Only 14 percent responded that they have sufficient involvement to date, while 5 percent responded that they have no current involvement, and do not plan to increase involvement in the future. The results indicate that while there is limited CFO involvement in sustainability reporting in many companies, they are aware of the need to increase their involvement.

Sustainability is now a top management issue, and it is only natural that CFOs increase their involvement in sustainability reporting given their role of corporate reporting. Without CFO involvement, the efforts of management and employees to enhance corporate value may not be appropriately communicated to stakeholders.

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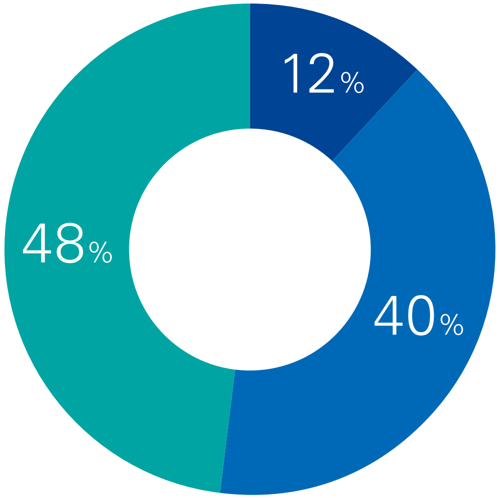
Comprehensive Reporting
including non-financial information

CFO views on using assurance services for improving the reliability of sustainability information (Single choice)



- 🟦 Would consider using for the entire report, including non-financial information
- 🟦 Would consider using some non-financial indicators, such as CO_2 emissions
- 🟩 No need for assurance services

How companies should increase the reliability of sustainability information in the future

With the heightened importance of sustainability issues, sustainability information is being considered in the decision-making of many organizations—more investors are integrating sustainability and financial information to make investment decisions. Individual consumers are also now questioning how companies are contributing to sustainability issues.

All such decisions are based on information disclosed by companies. The reliability of information is therefore crucial, and there is a growing need for providing assurance regarding non-financial information in the same way as for financial information. In fact, the European Commission's draft for a Corporate Sustainability Reporting Directive published in April 2021 proposes expanding the scope of sustainability reporting and requiring independent third-party assurance of reported information.

In light of this, we asked CFOs about their views on potential demand for assurance services regarding their information disclosures. 48 percent responded that there is no need for assurance services, while 40 percent showed interest in third-party assurance for some non-financial indicators such as CO_2 emissions, and 12 percent for the entire report including non-financial information. While we cannot say at present that a majority of respondents feel the need for third-party assurance regarding their non-financial information, many more CFOs appear to have a keen interest in improving the reliability of their information compared to just a few years ago.

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Sector Insights

Atsushi Nagata

Automotive Partner,
KPMG Japan

SX initiatives and timely disclosures are key management issues that affect business continuity

The automotive industry is facing an urgent need to address sustainability issues including carbon neutrality, and the survey results also show that awareness of relevant corporate reporting is on the rise.

The survey found many challenges for companies in the automotive industry: they are lagging behind in the integration of sustainability issues into their strategies to enhance corporate value; proactive discussions at the board level are lacking; and while they have established metrics for monitoring, they do not have any standards to integrate them into the reporting. As for improving reliability of sustainability information, CFOs have a relatively high level of awareness regarding the use of assurance services. Companies need to place sustainability reporting on the board agenda again and actively engage in conversations with stakeholders.

The challenges mentioned above, if not addressed, may impact corporate funding and stock prices, which will have a direct impact on business operations. Companies in the automotive industry need to formulate medium-term management plans by backcasting based on a long-term vision, while considering sustainability management initiatives and timely disclosures as a pillar of management issues for their business continuity.

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Spotlight 3

Response to first year following introduction of KAMs (Key Audit Matters)

Responses were mixed, with both positive views that KAMs allowed a deeper understanding of financial risks, and negative views that it took a considerable amount of time

Key Audit Matters (KAMs) are required to be included in the auditor's report from the audit of financial statements for the fiscal year ended March 31, 2021. KAMs are intended to shed light on audits, referred to as a black box by some stakeholders, and to enhance the informational value of the auditor's report. There are also expectations for KAMs to stimulate communication between users of financial statements and management, and among management, Kansayaku, and auditors.

In this survey, about half of CFOs shared the view that KAMs have led to a deeper understanding of the company's financial risks and to deeper communication with the auditor and Kansayaku or Audit Committee members. Many CFOs also felt however that it led to more man-hours resulting from meetings with the auditor.

Concerns have been voiced that KAMs will become meaningless in the audit of financial statements for the fiscal year ending March 31, 2022—with this being the second year of application, KAMs statements are expected to be routine and carried over from the first year.

KAMs are meant to serve as a catalyst for enhancing audit quality by stimulating communication with stakeholders on key audit matters, and it is a medium for enabling external parties to understand the value of audits. Therefore, there are expectations for the communication of KAMs descriptions to become more effective.

What effects did KAMs introduction have on your company? (Multiple choice)

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KPMG's Specialist Insights

Accounting and Finance

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Transforming the accounting and finance department in response to expanding CFO roles

Noboru Katori

Director,
KPMG AZSA LLC

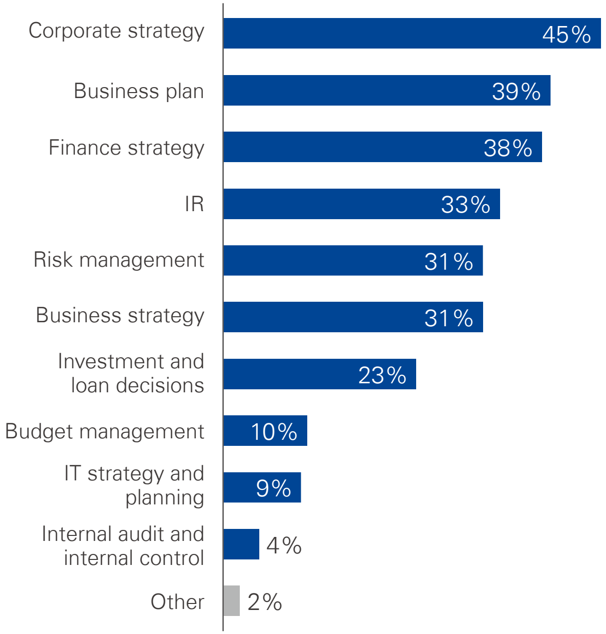
Developing a new process and system that encourages decision-making from a mid- and long-term perspective

As ESG investment becomes common to investors, companies are facing the management issue of enhancing corporate value by taking ESG into account. Companies are required to break away from the current management which focusing on financial information and move to new management that integrates ESG factors into their strategies and decision-making, which are then appropriately evaluated.

We asked CFOs which areas they consider to be of greater importance for promoting SX. The top response was corporate strategy, followed by others related or required to long-term growth of the company.

To enhance the corporate value in the medium and long term, accounting and finance department will face the challenge of providing a basis for judgment and insights to management by obtaining relevant non-financial information for assessing sustainability issues and setting goals, and developing business strategies(for example, reflecting ESG factors in business evaluation indicators). CFOs will need to establish rules for identifying, obtaining, quantifying, and visualizing non-financial information necessary for long-term (or mid- and long-term) decision-making, and the operational

CFO roles that are considered to be of greater importance in promoting SX (Multiple choice)



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process and IT system infrastructure necessary for implementing these rules.

The response rate for "investment and loan decisions" was lower than expected, at 23 percent. This may be because this role is considered important in current role regardless of the promotion of SX. Decarbonization initiatives, such as investments in improving energy efficiency, will require a large amount of capital. In order for companies to make appropriate decisions from the perspective of sustainability, mechanisms and information that encourage investment decisions by not only a short payback period, but also mid- and long-term impacts on the environment and society.

CFOs also view strengthening investor relations activities as important (33 percent). Investors want companies to integrate non-financial information, such as climate change risk, into their current financial disclosures, and companies need to improve their reporting and engage in more conversations with investors as their finance strategy. Moreover, the awareness of employees also needs to change in order to achieve SX. Enhancing the disclosure of non-financial information will encourage all employees to become more aware of this challenge and transform the organization which employees think themselves and act.

Spotlight 4

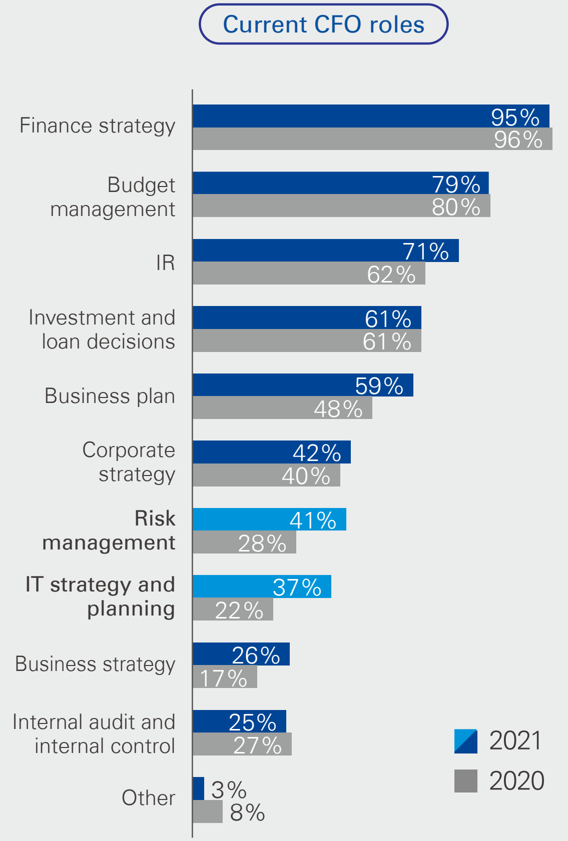
Comparison of CFO roles to 2019 survey results

CFO roles are expanding, mainly in the areas of "IT strategy and planning" and "risk management"

CFO roles now include "IT strategy and planning" and "risk management" for more companies, with responses increasing by 15 percent to 37 percent, and by 13 percent to 41 percent, respectively, when compared to the CFO survey conducted in 2019.

More CFOs are responding to the DX agenda with the aim of fundamentally transforming their business using digital technologies, and effectively applying this new approach to management.

As a background to the increase in "risk management," CFOs now recognize the extent to which non-financial information, including ESG factors, impacts corporate value, and that they are now responsible for the risk management of non-financial information in addition to financial information.



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An urgent need for reviewing the structure and capability of the accounting and finance department

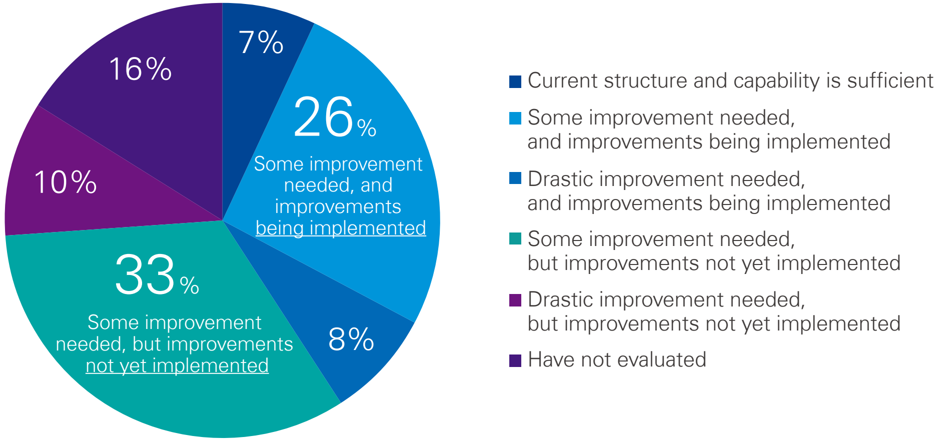
The accounting and finance department needs to do more than just improve the current accounting capabilities of their members to achieve SX—they also need to be able to measure, evaluate, and analyze sustainability information. The structure, business processes and IT systems of the department should be able to adapt to the environmental changes resulting from SX.

We asked CFOs how prepared their accounting and finance department is for promoting SX. 7 percent responded that their current structure and capability was sufficient, while 77 percent feel the need for some improvements. 16 percent have yet to assess this matter. The survey also found that 59 percent have yet to begin improvement initiatives, including those that have yet to assess their readiness.

Companies listed on the Prime Market in Japan, which is being created by a new segmentation of the TSE market scheduled for April 2022, will be expected to disclose the impacts of climate change on their business performance. There is also discussion, led by the FSA, on the subject of potentially expanding information disclosures in Securities Reports.

It is time for action. Companies need to understand and visualize how sustainability issues including climate change affect them, and implement solutions based on clear objectives and targets. The accounting and finance department of a company needs to have the function of collecting, quantifying, analyzing and reporting non-financial information related to sustainability in addition to the existing financial information.

Statement reflecting the current accounting and finance department structure and capability in terms of promoting SX in the future (Single choice)



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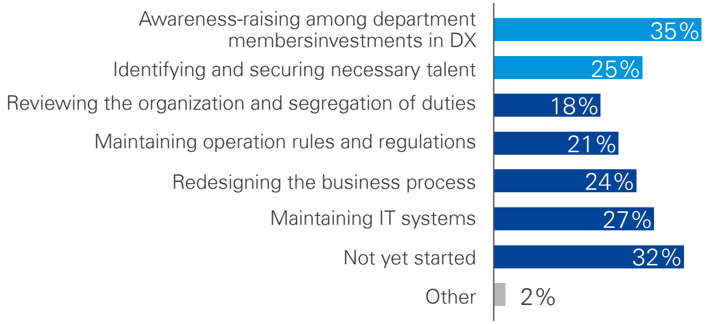
Areas of improvement that have been or are being addressed in the accounting and finance department for promoting SX



Future talent and skills required for the accounting and finance department (Multiple choice)

Fostering talent capable of thinking and acting from a management perspective

When we asked CFOs about improvement initiatives they implemented in their accounting and finance department, many had a focus on talent, citing "raising awareness among department members" and "identifying and securing necessary talent" as areas of improvement.

Raising awareness for the promotion of SX does not happen overnight—in addition to the disclosure of non-financial information, it involves transforming decision-making standards and rules themselves, for example, by introducing an internal carbon pricing system for formulating strategies, evaluating investments, and managing risk. Another major challenge will be fostering and recruiting talent capable of handling the expansive role of the accounting and finance department.

As the roles of the accounting and finance department change, so do the skills required of their talent. The accounting and finance department needs to understand the company's sustainability issues and provide relevant non-financial information to management in order to secure an active involvement in the mid- and long-term decision-making for SX.

Many CFOs were of the view that "a management perspective," "communication and conflict resolution skills" and "data analysis skills" are necessary in the future, all skills that apply universally to accounting and finance departments.

Our survey confirmed the importance of talent who are capable of analyzing and identifying issues for the company's sustainable growth from a long-term and strategic perspective, coming up with solutions together and persuading relevant parties in collaboration with other departments, and leading the implementation of solutions through collecting, evaluating, and providing information, including non-financial information. However, fostering talent with a management perspective is not easy to do based on the current training method, and companies should consider utilizing an intrapreneurship or hiring people with management experience from outside.

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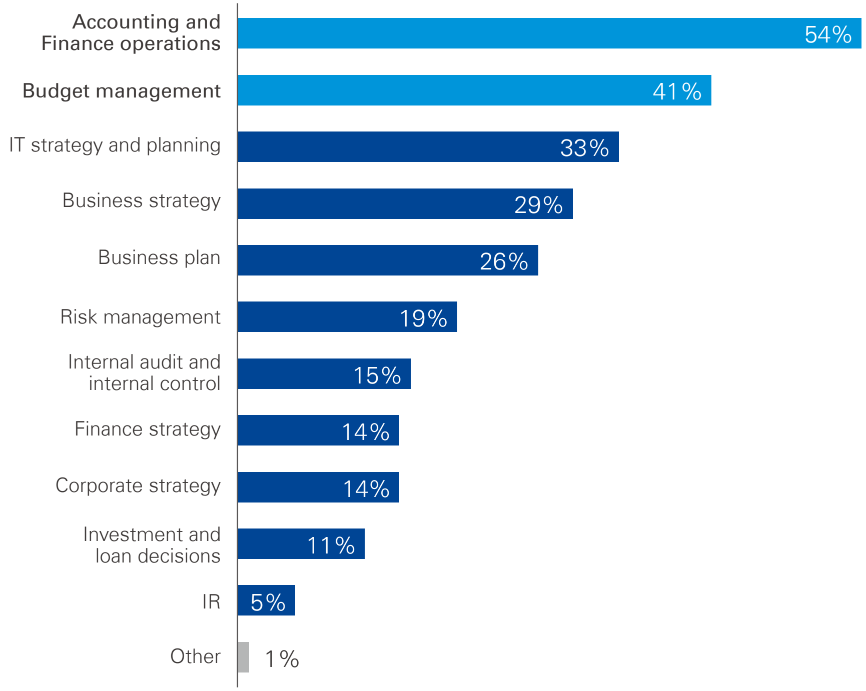
Accounting and Finance

Areas that require digitalization for the future SX promotion (Multiple choice)



Promoting DX to streamline existing operations and addressing expanding roles

In addition to SX, digital transformation (DX) is also important for sophisticating the management system and enhancing corporate value. Digital technologies are essential for promoting SX, which involves the collection, management and analysis of sustainability information. They may be applied, for example, to a wide range of operations including the collection of information on CO_2 emissions and ESG information within a supply chain, and KPI monitoring related to ESG.

Regarding areas requiring digital technologies for promoting SX, the top responses were "accounting and finance operations" and "budget management." These differ from the CFO roles that are considered to be of greater importance, which were "corporate strategy," "business plan" and "finance strategy."

CFOs now need to support the CEO's decision-making by providing an analysis of information relating to impacts on the environment and society based on a new level of awareness. In order to do this, CFOs should utilize digital solutions to make account closing and budget control—which involve an aggregation of past data—more efficient, and allocate resources to areas that will expand due to SX.

DX is also expected to be employed to advantage in areas related to mid- and long-term decision-making including "corporate strategy," "management plan" and "business strategy." While CFOs still appear cautious about using digital technologies in these areas, the ability to identify sustainability risk including climate change risk and supply chain risk and reflect them in strategic decision-making in a timely manner, will make it possible to achieve greater sustainability for their business.

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Sector Insights

Shoichi Yamamoto

Consumer & Retail Partner,
KPMG Japan

Using digital technologies to promote business transformation and support business strategy

As areas requiring digitalization more than ever before in order to achieve SX, 40 percent of CFOs in the consumer goods and retail industries cited "business strategy," a higher percentage than the overall 29 percent. In particular, food and beverage companies are more conscious of changes in customer needs and behaviors driven by digitalization. As a result, they are increasingly aware of the need to reduce food loss and develop biodegradable packaging and plant-based alternatives.

Digital technologies are already being applied. For example, there has been a move to make demand forecasting more sophisticated across the value chain by using digital solutions to minimize "mottainai," or wastefulness. This includes food wastage in stores, excess inventory at the manufacturing and distribution stages and excessive orders of raw materials associated with these factors. The new market environment has also facilitated the provision of information and two-way communication with customers via digital means. This has led to a growing demand for consumers to be able to make purchases through digital channels in line with the information made available to them. Companies in this industry need to develop their business strategies in response to such changes in the business environment.

Takeshi Kurata

Head of Transport, Logistics and Leisure
KPMG Japan

Companies need to shift from a wait-and-see mindset to getting ahead of the game with SX in order to stay competitive

The transport and logistics industry has suffered some of the biggest blows of COVID-19. Inbound demand that drove growth has evaporated, and with teleworking becoming the new norm, it is difficult to expect a recovery in demand. Many industries in this sector require large capital investments, and a finance strategy for business continuity is imperative. In the transport and logistics industry, CFOs responding that "corporate strategy" is a role for which they are currently responsible was 15 percent lower than the overall response, while "finance strategy" was 14 percent higher as a role which will become more important in the future.

Meanwhile, there is a stronger tendency to take a wait-and-see approach to the much-discussed topic of SX than in other industries, in terms of its positioning as a management issue, and the implementation of specific initiatives and tax measures. This may be because there is uncertainty about demand recovery, and therefore the immediate focus is on strengthening the financial aspect. In addition, this sector accounts for a smaller share of total CO_2 emissions in Japan compared to energy and manufacturing and is therefore associated more with energy use than CO_2 emission.

A rise in demand for clean energy and a surge in carbon taxes may make it difficult for supplies to be secured at expected prices in the future. Companies in this sector will need to come up with effective business strategies while monitoring the trends of leading companies in their industry in order to stay competitive.

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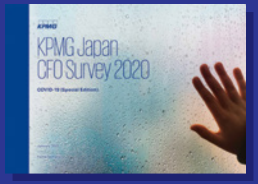
KPMG Japan
CFO Survey
2019

KPMG Japan CFO Survey 2019 (Japanese version only)

Dilemma of CFOs in Japan and Pressing challenges

https://assets.kpmg/content/dam/kpmg/jp/pdf/2019/jp-cfo-survey-2019.pdf



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KPMG Japan
CFO Survey 2020

COVID-19 (Special Edition)

KPMG Japan CFO Survey 2020

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https://assets.kpmg/content/dam/kpmg/jp/pdf/2021/jp-en-cfo-survey2021.pdf

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KPMG 2021
CEO Outlook

Plugged-in, people-first, purpose-led.

KPMG 2021CEO Outlook

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https://home.kpmg/xx/en/home/insights/2021/08/kpmg-2021-ceo-outlook.html

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