Survey of Integrated Reports in Japan 2015

Integrated Reporting Advisory Group
KPMG in Japan

April 2016

kpmg.com/jp

Contents

Introduction

In modern societies, the company is the most significant entity producing economic value. That means, at the same time, the company has the potential to transform society and actively fulfill its responsibilities to the future.

In a capitalist society that is based on a monetary economy, KPMG's raison d'être is to build trust. Through its efforts to maintain and increase that trust, KPMG is keenly aware of the responsibility involved in social value creation. As long as companies are social entities, they cannot deviate from social systems and rules and cannot exist in isolation. It is essential that they exist together in the present age and co-create and collaborate with numerous entities. To that end, companies must recognize their reason for existence, distinctive characteristics, and role, as well as explain and disseminate information. They must continue to properly communicate their identity while making decisions from a medium- to long-term view.

It has been said that 2015 was the beginning in earnest of corporate governance in Japan. The context of Japan's corporate governance differs from that of other countries. Companies have been encouraged to maintain autonomy and objectivity and to conduct external disclosure in this context using a comprehensive system.

Through our survey of integrated reporting of 205 companies—prepared in Japan in 2015—KPMG sensed major changes were taking place in corporate communications. Specifically, we saw that a single report can have a major impact when it demonstrates that management was deeply involved in communication with stakeholders and leveraged that communication to better manage the company. But, at the same time, we reconfirmed that issues, such as reports with superficial content, are on the increase.

"Inspire Confidence, Empower Change" is the goal of KPMG Japan. I hope that you too will seek to empower change and contribute to raising the medium- to long-term value of your organization. Your opinions and comments are always welcome.

We hope that this survey will assist you in your work.

Chairman, KPMG in Japan
Tsutomu Takahashi

Background and purpose of this survey

As pointed out in the "The Japan Revitalization Strategy" revised in 2015, the enhancement of integrated disclosure to promote growth-oriented corporate governance contributes to value generation by facilitating a company's constructive dialogue with investors.

In 2014, the KPMG Japan Integrated Reporting Advisory Group conducted the first survey on "Self-Declared Integrated Reports" issued in Japan. In order for companies' autonomous efforts at integrated reporting, which does not rely on laws or system frameworks, to continue to spur their integrated thinking, raise their competitiveness, and lead to national wealth, KPMG believes it is important that companies recognize their current condition and clearly present their achievements and challenges. Therefore, this year as well, KPMG decided to conduct this survey targeting the 205 companies which published the "Self-Declared Integrated Report."

Some survey items have been added or partially revised in view of the content integrated reports are expected to include and their significance to investors, who are assumed to be the primary users.

Survey methodology

A broadly agreed-upon definition of the integrated report does not yet exist. With the cooperation of the Corporate Value Reporting Lab, KPMG chose to survey and analyze the 205 companies in the List of Japanese Companies Issuing Self-Declared Integrated Reports in 2015.

Furthermore, in the survey of pharmaceutical companies, KPMG obtained the cooperation of students in the Healthcare Industrial Research (Practicum) supervised by Professor Tetsuo Kitagawa of the Graduate School of International Management, Aoyama Gakuin University.

The survey established criteria for selected disclosure items and was carried out by several team members on the general principle that a single person in charge would verify the details for each disclosure item across all companies' reports. For items that required a decision by survey members, criteria were adjusted and leveled as appropriate.

List of Japanese Companies Issuing Integrated Reports in 2015

AEON Financial Service Co., Ltd.
Ahresty Corporation
Aisin Seiki Co., Ltd.
Akebono Brake Industry Co., Ltd.
ALPS ELECTRIC CO., LTD.
AMITA HOLDINGS CO., LTD.
ANA HOLDINGS INC.
ANRITSU CORPORATION
ASAHI GLASS CO., LTD.
Asahi Group Holdings, Ltd.
Asahi Industries Co., Ltd.
Asahi Kasei Corp.
ASKA Pharmaceutical. Co., Ltd.
Astellas Pharma Inc.
Azbil Corporation
BROTHER INDUSTRIES, LTD.
CAPCOM CO., LTD.
Chiome Bioscience Inc.
Chubu Electric Power Co., Inc.
Chugai Pharmaceutical Co., Ltd.
DAI-DAN Co., Ltd.
Daiichi Sankyo Co., Ltd.
DAIKYO INCORPORATED
Daito Trust Construction Co., Ltd.
Daiwa Securities Group Inc.
Denka Company Limited
Development Bank of Japan Inc.
Don Quijote Holdings Co., Ltd.
EBARA CORPORATION
Echo Electronics Industry Co., Ltd.
Eisai Co., Ltd.
EY Japan
FamilyMart Co., Ltd.
FANCL CORPORATION
Freund Corporation

FUJI ELECTRIC CO., LTD.
Fuji Heavy Industries Ltd.
Fujikura Ltd.
Fujitsu Limited
Furukawa Electric Co., Ltd.
Hitachi Capital Corporation
Hitachi Chemical Co., Ltd.
Hitachi Construction Machinery Co., Ltd.
Hitachi High-Technologies Corporation
Hitachi Maxell, Ltd.
Hokuetsu Kishu Paper Co., Ltd.
HORIBA, Ltd.
Hulic Co., Ltd.
Idemitsu Kosan Co., Ltd.
IHI Corporation
IINO KAIUN KAISHA, LTD.
INPEX CORPORATION
ITO EN, LTD
ITOCHU Corporation
ITOCHU ENEX CO., LTD.
ITOCHU Techno-Solutions Corporation
Japan Airlines Co., Ltd.
Japan Exchange Group, Inc.
JFE Holdings, Inc.
JGC CORPORATION
J-OIL MILLS, Inc.
JVC KENWOOD Corporation
JX Holdings, Inc.
Kajima Corporation
Kansai Paint Co., Ltd.
Kawasaki Heavy Industries, Ltd.
Kawasaki Kisen Kaisha, Ltd.
KDDI CORPORATION
Kirin Holdings Co., Ltd.
Komatsu Ltd.

KPMG Japan
Kubota Corporation
Kurimoto, Ltd.
KYORIN Holdings, Inc.
KYOWA EXEO CORPORATION
Kyowa Hakko Kirin Co., Ltd.
Lawson, Inc.
Leopalace21 Corporation
LINTEC Corporation
LIXIL Group Corporation
Marubeni Corporation
MARUI GROUP CO., LTD.
MEC CO., LTD.
MEIDENSHA CORPORATION
Meiji Holdings Co., Ltd.
Meiji Yasuda Life Insurance Company
Mitsubishi Chemical Holdings Corporation
Mitsubishi Corporation
Mitsubishi Heavy Industries, Ltd.
Mitsubishi Paper Mills Limited
Mitsubishi Research Institute, Inc.
Mitsubishi Tanabe Pharma Corporation
Mitsubishi UFJ Financial Group, Inc.
Mitsubishi UFJ Lease & Finance Company Limited
MITSUI & CO., LTD.
Mitsui Chemicals, Inc.
Mitsui Engineering & Shipbuilding Co., Ltd.
Mitsui Fudosan Co., Ltd.
Mitsui O.S.K. Lines, Ltd.
Mizuho Financial Group, Inc.
Monex Group, Inc.
Morinaga Milk Industry Co., Ltd.
MS&AD Insurance Group Holdings, Inc.

Nabtesco Corporation
NAGASE & CO., LTD.
NEC Capital Solutions Limited
NEC Corporation
NHK SPRING CO., LTD.
NICHICON CORPORATION
Nihon Unisys, Ltd.
NIKON CORPORATION
NIPPON KOEI CO., LTD.
Nippon Shinyaku Co., Ltd.
Nippon Signal Co., Ltd.
NIPPON TELEGRAPH AND TELEPHONE CORPORATION
Nippon Yusen Kabushiki Kaisha
Nissha Printing Co., Ltd.
Nisshinbo Holdings Inc.
NISSIN FOODS HOLDINGS CO., LTD.
Nitto Denko Corporation
NOMURA Co., Ltd.
Nomura Holdings, Inc.
Nomura Real Estate Holdings, Inc.
Nomura Research Institute, Ltd.
Noritz Corporation
NS United Kaiun Kaisha, Ltd.
NTN Corporation
NTT Urban Development Corporation
Obayashi Corporation
OHARA INC.
Oji Holdings Corporation
Olympus Corporation
OMRON Corporation
ONO PHARMACEUTICAL CO., LTD.
OSAKA SODA CO., LTD.
PACIFIC INDUSTRIAL CO., LTD.
Panasonic Corporation

PARCO CO., LTD
PENTA-OCEAN CONSTRUCTION CO., LTD.
POLA ORBIS HOLDINGS INC.
PricewaterhouseCoopers Aarata
Ricoh Co., Ltd.
ROHM Co., Ltd.
S.T. CORPORATION
SANGETSU Co., Ltd.
SANKI ENGINEERING CO., LTD.
SATO HOLDINGS CORPORATION
Sawai Pharmaceutical Co., Ltd.
SCREEN Holdings Co., Ltd.
SCSK Corporation
SEGA SAMMY HOLDINGS INC.
Sekisui House, Ltd.
Senshukai Co., Ltd.
Shikoku Electric Power Co., Inc.
Shionogi & Co., Ltd.
Shiseido Co., Ltd.
SHOWA SHELL SEKIYU K. K.
SKYLARK CO., LTD
SOHGO SECURITY SERVICES CO., LTD.
Sojitz Corporation
Solaseed Air Inc.
Sompo Japan Nipponkoa Holdings, Inc.
Sumitomo Chemical Co., Ltd.
SUMITOMO CORPORATION
Sumitomo Dainippon Pharma Co., Ltd.
SUMITOMO LIFE INSURANCE COMPANY
Sumitomo Mitsui Construction Co., Ltd.
Sumitomo Riko Co., Ltd.
Sun Messe Co., Ltd.
SYSMEX CORPORATION

Taisei Corporation
Taisho Pharmaceutical Holdings Co., Ltd.
Takeda Pharmaceutical Company Limited
Takenaka Corporation
TEIJIN LIMITED
Terumo Corporation
The Dai-ichi Life Insurance Co., Ltd.
The Kansai Electric Power Company, Inc.
TODA CORPORATION
Tokio Marine Holdings, Inc.
TOKYO DOME CORPORATION
TOPPAN FORMS CO., LTD.
TOPPAN PRINTING CO., LTD.
Topy Industries, Ltd.
TOTO LTD.
TOYO CONSTRUCTION CO., LTD.
Toyo Denki Seizo K.K.
Toyo Engineering Corporation
Toyoda Gosei Co., Ltd.
TOYOTA BOSHOKU CORPORATION
Toyota Industries Corporation
Toyota Tsusho Corporation
TS TECH CO., LTD.
Tsubakimoto Chain Co.
UACJ Corporation
ULVAC, Inc.
Unicharm Corporation
UNITED ARROWS LTD.
Wacoal Holdings Corp.
Yamaha Motor Co., Ltd.
YAMATO HOLDINGS CO., LTD.
YASKAWA Electric Corporation
Yokogawa Electric Corporation
YOSHINOYA HOLDINGS CO., LTD.
Zeon Corporation

Resource: Website of Corporate Value Reporting Lab

Executive Summary

The number of companies issued integrated report in 2015:

205 companies

(Increase of 65 companies from 2014)

Issuing of integrated reports

The number of companies that issued integrated reports in 2015 was 205, an increase of 65 companies over the previous year. Of these, 191 were listed on the First Section of the Tokyo Stock Exchange (TSE), representing 10% of all 1,901 companies listed on the First Section of the TSE (Source: Japan Company Handbook Autumn 2015).

This year, there was a gradual increase in companies where departments relatively close to management, such as Corporate Planning or the President's Office, played the leading role in integrated reports.

More than half the surveyed companies issued reports 60 pages or shorter. These companies focused on being concise in their integrated reports.

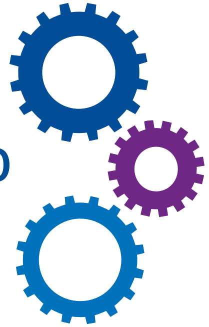
Of the total, 182 companies issued integrated reports in both Japanese and English. Of those, 69 companies issued the two versions simultaneously.

The number of companies that issue integrated reports is steadily increasing year after year. Realizing the importance of dialogue between companies and investors with the introduction of Japan's Corporate Governance Code, the number of companies that issue integrated reports as a communication tool is expected to increase even further.

* The previous survey covered the 142 companies that issued integrated reports as of December 31, 2014. Comparative information contained herein is based on the results of the previous survey. However, according to the most recent survey by the Corporate Value Reporting Lab, the number of companies that issued reports in 2014 has changed and is now 140; accordingly, this year's report refers to the most recent survey results.

Companies that disclosed business models:

44%



Value creation

After considering the optimal allocation of resources based on the nature of diversifying capital, the efficient and effective utilization of management resources is important for sustainable growth.

Reports that disclose the capitals, the basic concept behind integrated reporting, remained at 28%. Moreover, although 44% of companies disclosed their business models, which represent the framework for capital utilization, this was largely unchanged compared with the previous survey. Explaining the positioning of social and relationship capital and natural capital in business activities, their relationship with value creation, and the direction of business model changes to suit the management environment are important future challenges.

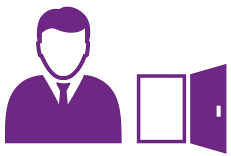
(See pages 13-16 for details)

Companies that disclosed the skills, career, and reasons for appointment of external directors:

55%

Companies that disclosed the skills, career, and reasons for appointment of internal directors:

31%



Corporate governance

Announced by the International Integrated Reporting Council (hereafter "IIRC") in 2013, the International Integrated Reporting Framework (hereafter "IIRC Framework") requires that an integrated report describe how an organization's governance structure supports the short-, medium- and long-term value creation capability of the organization. The reason for appointing board of director members is important in order to assess the quality of governance. Further, in order to understand and address the legitimate needs of various stakeholders, diversity is called for even in managers responsible for governance and board members. On this point, while 55% of companies disclosed the skills and reasons for appointing external directors, only 31% of companies disclosed the skills and experience of internal directors. Expanding the disclosure of information needed to judge governance quality, such as the approach behind governance and specific operational conditions, is important.

(See pages 17-22 for details)

Companies that disclosed materiality results:

15%

Materiality

Materiality assessment forms the basis of critical decision-making on topics such as optimal resource allocation, and the review of risks and opportunities. Disclosure of materiality information in an integrated report helps to improve the quality of dialogue between the company and its information users, especially with investors, the information's primary users. The publication of the recognition of "key stakeholders and materiality" by the board of directors is considered the foundation of the report. Even including the disclosure of materiality assessment results in view of what has been seen in conventional CSR reports, disclosure remained at 15%. Along with the recognition of effectiveness, KPMG believes there is a substantial need for efforts to raise the level of discussion. In order to decide what to disclose in the integrated report and be thought-provoking, the process of determining materiality needs to be improved while mutual understanding with key stakeholders is promoted through disclosure. (See pages 23-25 for details)

Companies that disclosed risk information by providing it in a separate section:

52%

Risk

Risk information shows the recognition of the company of matters substantially related to the value creation process. Content that is meaningful for investors who conduct company assessments from a medium- to long-term perspective will lead to deeper trust and the building of better relations. However, companies that disclosed by providing a section on risk remained at 52%. On the other hand, some of the companies that received excellent assessments in their disclosure proactively communicated about their management of the internal and external risks they are facing. Risk management that oversees the business process manages the impact of potential risk and will lead to gaining a competitive advantage and creating further business opportunities by contributing to the adaptability and resilience of the business model. (See pages 26-29 for details)

The percentage of KPIs provided that were non-financial:

27%

Performance

Performance represents a report of business results and strategic target achievement; 97% of companies summarized Key Financial Indicators (KPIs) as highlight information. As a result of correlating disclosed KPIs with the six capitals (financial, manufactured, intellectual, human, social and relationship, and natural) by referencing the classification of the capitals in the IIRC Framework, financial KPIs accounted for 73% of the total, while disclosure of non-financial KPIs was only 27%. The importance of non-financial elements, such as human and intellectual capital, in value creation is growing more than ever. There is significant room for improvement in both the quality and quantity of disclosed KPIs in performance reports. (See pages 30-32 for details)

Conclusion

There has been significant growth in the number of companies preparing integrated reports in the past several years. In particular, 43% of large companies with sales of JPY 1 trillion or more listed on the First Section of the TSE have taken up integrated reporting. KPMG believes this reflects the realization that, as globalization accelerates and management challenges grow increasingly diverse and complex, the company's commitment to financial results, explanations and proactive dialogue with outside stakeholders will influence both financial value and social value, and are requisite for delivering medium- to long-term value growth.

For this survey, we increased the number of survey items on the three key points of integrated reports, based on integrated thinking. The first concerns the business model for sustainable value creation through the disclosure of the various capitals and optimal allocation of management resources. The second concerns the disclosure of corporate governance, a system that supports underlying business activities. Third comes determination of materiality and the process used to determine it, seeking to contribute to strategic decision-making which integrates business processes with the improvement of financial and social value.

An integrated report not only reports past results, but conveys a holistic picture of a company's sustainable value creation within a timeline that includes past, present and future, and also shows the company's vision of the ideal. There are still few reports where a comprehensive image of the company with a consistent message and mutually aligned content emerges. However, compared to the 2014 survey, we saw a trend toward an attempt to achieve the true character of the strategic integrated report which integrates nearly all elements.

The results of each element indicate the views of KPMG. I hope you will take advantage of this opportunity to promote and discuss integrated reporting by reading through the report.

Head of Integrated Reporting Advisory Group
KPMG in Japan
Masayuki Sawada

Issuance of integrated reports

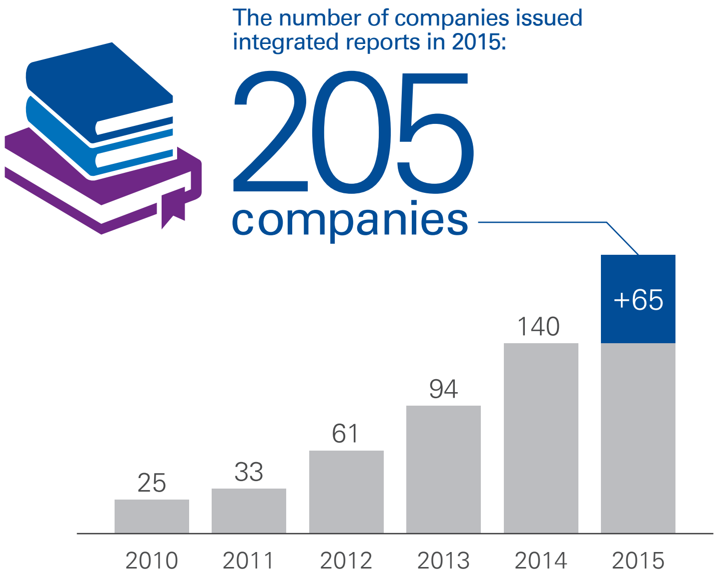


Figure 1: Number of Japanese companies issuing Self-Declared Integrated Reports

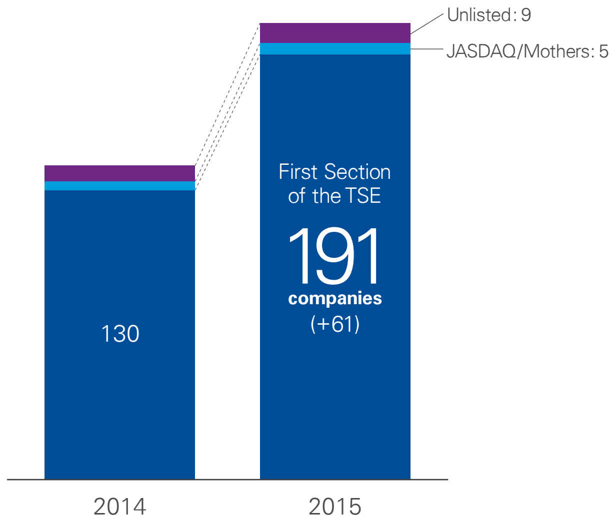


Figure 2: Listing market of issuer companies

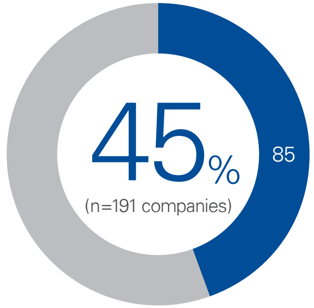


Figure 3: Nikkei 225 component percentage

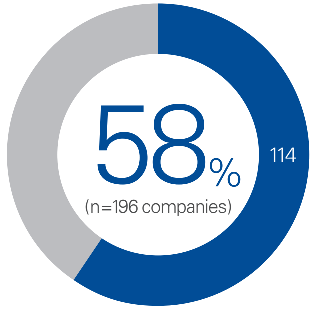


Figure 4: JPX-Nikkei 400 component percentage

Number of issuing companies and their key characteristics

1. Changes in issuing companies

The number of companies that issued integrated reports in 2015 was 205, an increase of 65 companies over the previous year (Figure 1). With the revitalization of capital markets and the introduction of Japan's Corporate Governance Code, it is predicted that the number of companies issuing integrated reports will continue to grow in 2016 and beyond with increasing recognition of the importance of dialogue between companies and investors in capital markets, a factor that is thought to be pushing the growth of integrated reports.

2. Listing market of issuing companies

Among issuing companies, 191 (93%) were listed on the First Section of the TSE (Figure 2), an increase of 61 companies over the previous year. On the other hand, in emerging markets such as JASDAQ and Mothers, there were no significant changes in the number of issuing companies, so thus far integrated reporting does not seem to be spreading to those levels.

3. Index attributes of issuing companies

Among the 191 companies listed on the First Section of the TSE that issuing integrated reports, 85 of them (45%) were components of the Nikkei 225 (Figure 3). Moreover, among the 196 listed companies, 114 of them (58%) were components of the JPX-Nikkei 400 (as of September 15, 2015) (Figure 4).

Roughly half of the companies that issued integrated reports were components of these indexes, demonstrating that many of Japan's leading companies emphasize accurate information disclosure and investor dialogue, and thus issue integrated reports.

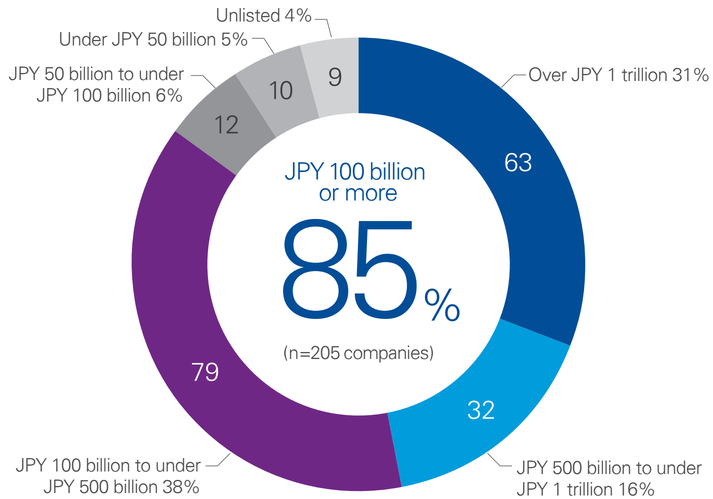


Figure 5: Revenue of issuing companies

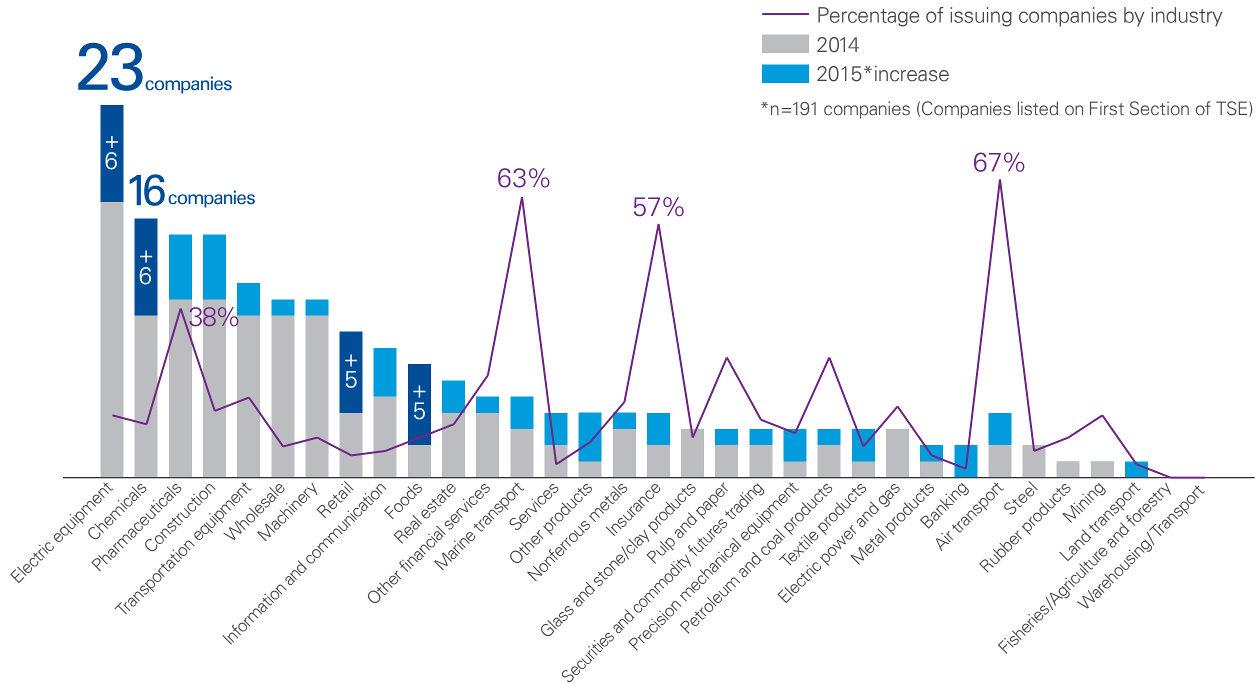


Figure 6: Industries of issuing companies and ratio within the industry

4. Size of issuing companies

Looking at distribution by revenue of the issuing company shows that 85% of the companies had more than JPY 100 billion in annual revenue and that the issuing of integrated reports is progressing at relatively large companies (Figure 5). Among companies listed on the First Section of the TSE, 148 large companies had revenue of more than JPY 100 billion (Source: Japan Company Handbook Autumn 2015), of which 63 (43%) have issued integrated reports.

5. Industries of issuing company

Among all 33 industries (Source: Japan Company Handbook Autumn 2015), companies in 31 industries have taken up integrated reporting (Figure 6). The electric equipment industry had 23 companies issuing integrated reports, like last year, the most of any industry.

Certain industries saw particular brisk reporting activity. In air transport, 67% of companies issued reports, in marine transport, 63%, in insurance, 57%, and in pharmaceuticals, 38%. Other than the percentage for marine transport, which increased slightly over the previous year, the trend remained unchanged year on year.

Breaking down this year's 61 company increase, the electric equipment and chemical industries each saw an increase of six companies, the largest of any industry, and the retail and foods industries each saw a five company increase. Further, this year featured more B-to-C companies reporting than the previous year. An analysis shows that the move to issue integrated reports has gained momentum at companies where stakeholders are diversifying due to the globalization of business and at companies where the globalization of capital, such as the presence of foreign shareholders, is advancing.

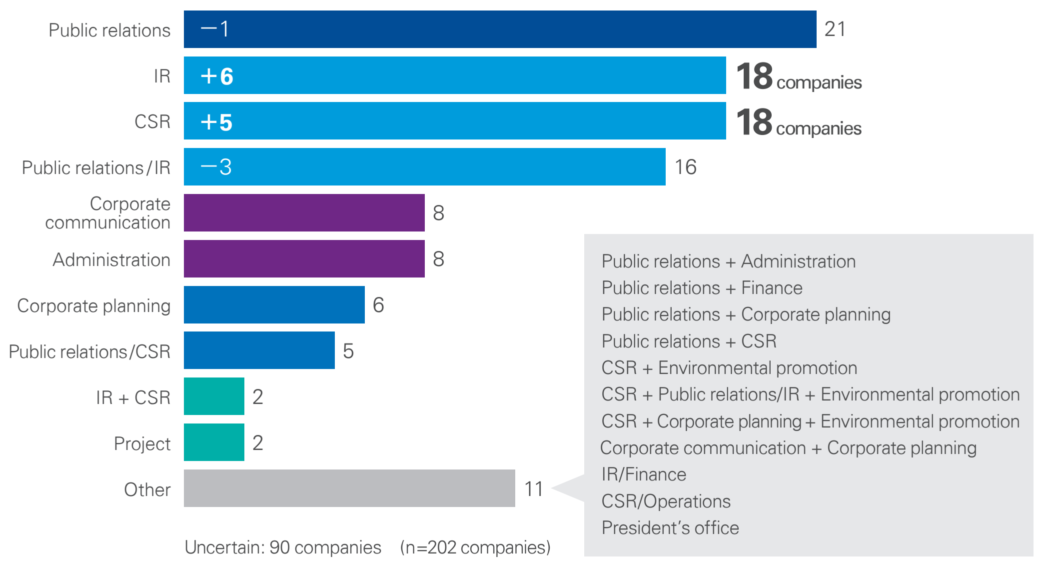


Figure 7: Departments issuing integrated reports

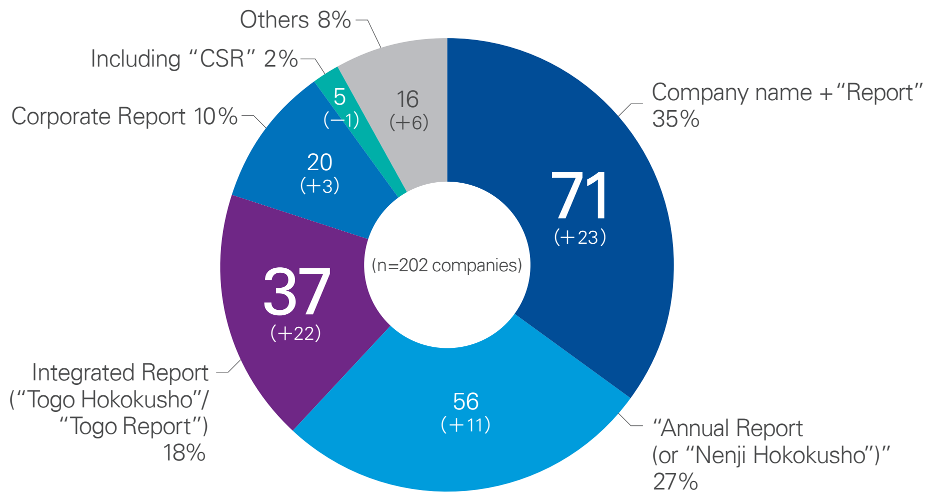


Figure 8: Title of reports

6. Departments issuing integrated reports

As for departments issuing integrated reports, although there are differences in department names, public relations, IR, and CSR were the three departments most often in charge (Figure 7). On the other hand, there was a gradual increase in companies where departments that are relatively close to management, such as Corporate Planning or the President' s Office, played the leading role.

The question of which department should oversee integrated reporting efforts is frequently debated. In the first place, it is assumed that companies organize functional lines for the purpose of creating corporate value as a whole. In addition, the integrated report is a companywide effort and cannot be implemented single-handedly by any one organization. Therefore, it is important to improve the quality of overall business management and the report and raise corporate value through cross-departmental coordination. Everyone involved within the company needs to understand this point, regardless of what department actually issues the report.

Overview of reports

1. Title of integrated reports

A unique feature this year is that the number of companies that titled their reports using the word "Integrated" ("Togo" in Japanese) increased by 22 from 15 companies last year, reaching 37 companies (Figure 8). Not only were there companies that began preparing reports this year; there were also cases where companies that had issued reports since before the previous year changed their titles.

In titles that included the word "integrated," it is assumed that companies strongly intended to directly convey to readers that the content and messages included were based on integrated reporting.

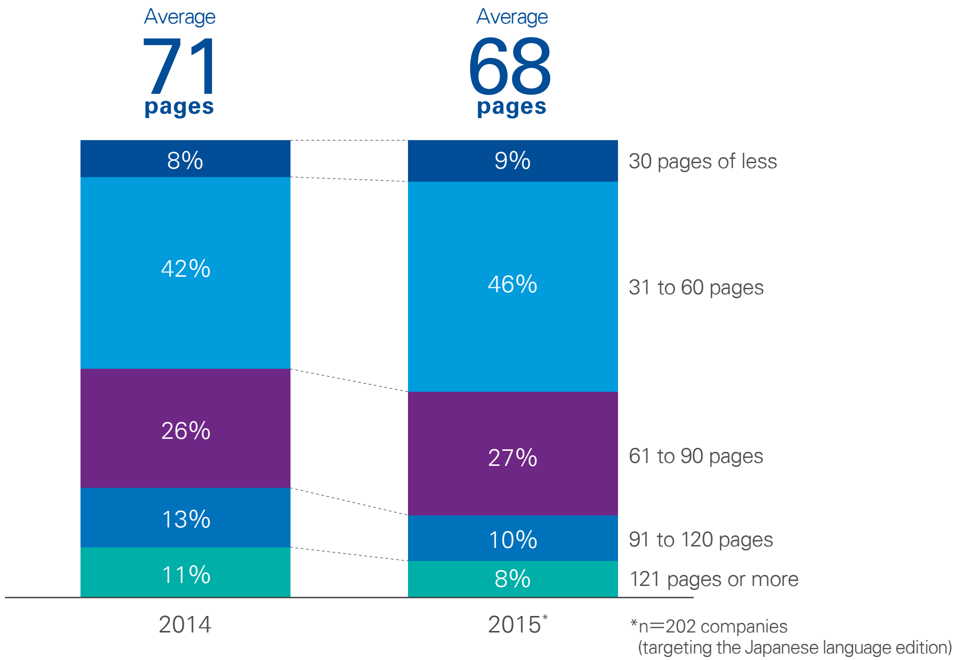


Figure 9: Number of pages of integrated reports

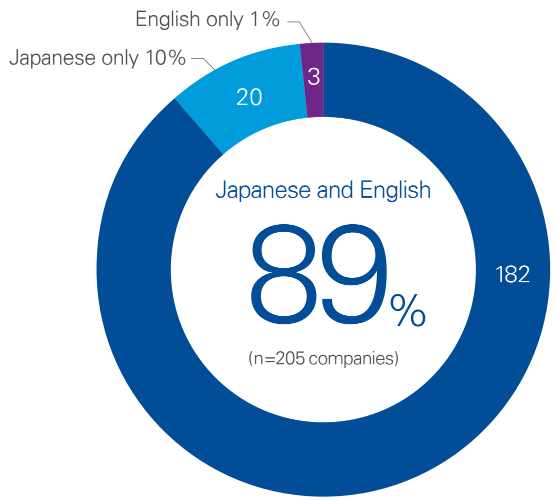


Figure 10: Issuance of English integrated reports

2. Volume of integrated reports

The overall average volume of integrated reports was 68 pages, a decrease of about three pages from the previous year. More than half of the companies created reports of less than 60 pages, while 93 companies (46%), the most, kept reports to within 31 to 60 pages (Figure 9).

On the other hand, there were 35 companies (18%) with reports exceeding 90 pages. The reports of these companies, in most cases, included financial statements, footnotes, performance analysis, or detailed information in the areas of CSR and environmental reporting.

The level of information detail is influenced by awareness of reader expectations, but it is essential to clarify the message to be conveyed and to convey it clearly and concisely. For example, the idea of contextual reporting* may also be helpful with respect to detailed and relevant information

* By presenting the context through integrated reporting, the readers of integrated reports are able to quickly access necessary detailed information, and users with access to such information will be able to track whatever meaning it has based on the context.

3. Language of integrated reports

Nearly 90% of companies issued integrated reports in both Japanese and English, an increase compared to 85% in the previous year (Figure 10). With requests that information be sent to investors both in Japan and abroad, the integrated report is being seen as a means to more effectively communicate a company's value creation efforts. In addition, although some companies issued their reports in languages such as Chinese and Korean, an analysis reveals that the companies saw not only their shareholders and investors, but also their employees and business partners, as intended readers and chose the languages of reports based on global business conditions.

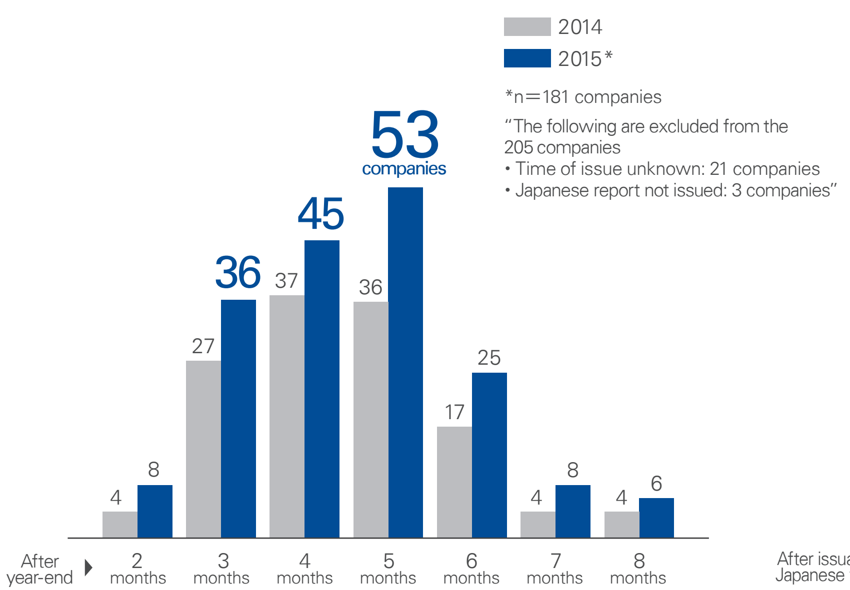


Figure 11: Timing of issuance of integrated reports (report in Japanese)

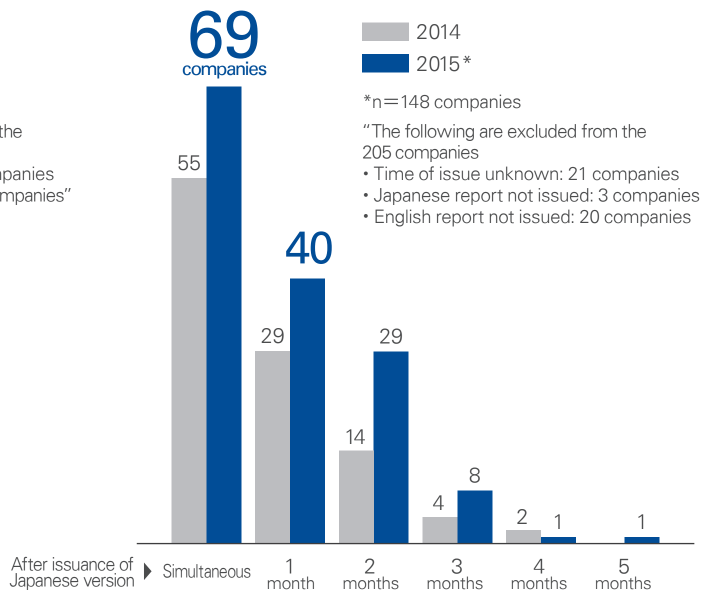


Figure 12: Timing of issuance of integrated reports (English version)

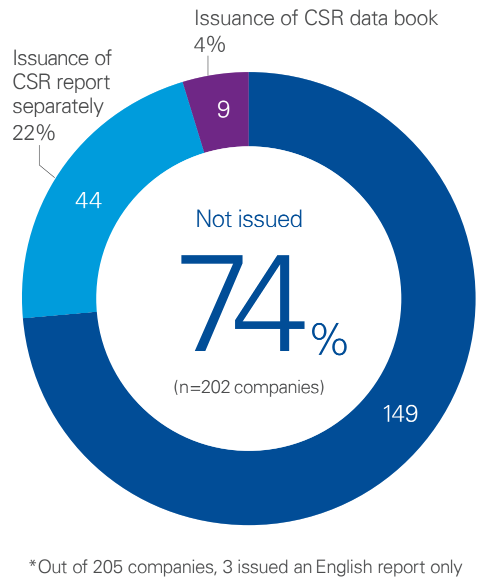


Figure 13: Issuance of CSR reports

4. Timing of issuance of integrated reports

Reports in Japanese were mainly issued three to five months after the fiscal-year end (Figure 11). Despite a slight tendency to delay issuance compared with the previous year, just under 80% of companies issued their reports one to two months after the annual general meeting of shareholders. Integrated reports that focus on the medium to long term are not necessarily required to be issued in the same timeframe as documents related to financial reports. But since they include financial results that summarize the fiscal year, many companies strive to issue integrated reports as quickly as possible. The content of integrated reports and the timing of their issuance is likely to vary depending on a review of the overall design of corporate communications, that is, consideration about what kind of information about company activities and what aspect of their results should be disclosed, and when, in order to communicate with stakeholders.

On the other hand, more than 70% of companies issued reports in English at the same time the Japanese reports were issued or within one month of the Japanese report (Figure 12). This is because many companies strive for simultaneous issuance in an effort to eliminate the information gap between domestic and overseas shareholders.

5. Integrated reports followed by CSR reports

Companies that did not issue CSR reports after their integrated reports were 149, or 75% of the total (Figure 13). With companies undertaking integrated reports, analysis shows that many have unified their disclosure medium, as also seen in the previous year. It is important not to simply connect the reports, but to improve their connectivity to deepen discussion about the relationship between challenges and results in CSR, strategy and financial results.

There were 53 companies separately issued a CSR report, data book or other documents, a substantial increase over the 35 companies in the previous year. This shows that a reporting system which complements integrated reporting is starting to be established.

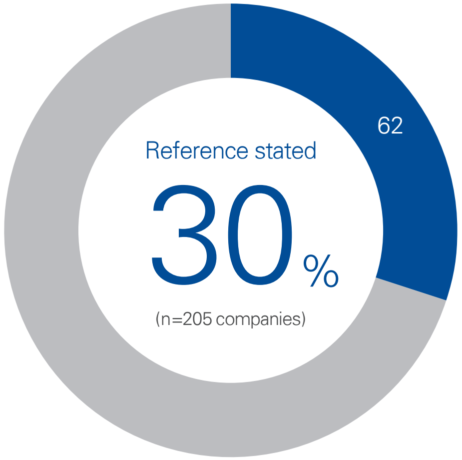


Figure 14: Presence or absence of reference to IIRC Integrated Reporting Framework

6. Integrated reporting framework

The number of companies that referred to the IIRC Integrated Reporting Framework, which was released in December 2013, in their integrated report was 62 (30%), an increase of 37 companies (26%) over the previous year (Figure 14). Further, the number of companies that stated their "compliance" with the IIRC Framework was two, an increase of one company over the previous year.

While there is no restriction to a company stating that they had "referred to" the Framework, companies should note that they must fulfill the requirements of the Framework in order to state "compliance" with it.

KPMG's view

The results of this survey show that, among companies listed on the First Section of the TSE, those with a relatively large business scale are playing a central role in promoting integrated reporting. This is likely a sign, in the form of revitalized capital markets and support for the Corporate Governance Code, of the growing awareness of the importance of dialogue with investors.

In order to obtain a proper assessment and understanding from investors, it is important that a company voluntarily explain to them the true status of business activities, which cannot be understood from financial information only. It must also present a holistic picture of value creation that includes the distinctive features of the business model along with the company's strategic scenario.

On the other hand, rather than investors also analyzing and assessing information disclosed by the company, it is important to deepen dialogue with companies regarding information previously not disclosed but considered essential for assessing the medium- to long-term ability of the company to create value, in exchange for not demanding information that was available but unimportant. Especially, based on the fact that non-financial and future information differ substantially in nature from past financial information, market players need to work together to deepen the debate about the proper way to disclose information in the future.

Today, with all economic activity being irreversibly linked and complexity growing across the globe, building a system of information disclosure that supports long-term optimal decision-making is an important challenge that also affects the sustainability of society. One of the reasons that IIRC developed this globally acceptable integrated reporting framework was to deal with this problem, and until it is overcome, testing and verification of the integrated report should continue, especially with companies and investors.

Integrated reports are spreading steadily, but among these reports are some that merely combine the financial report and CSR report. This suggests that there is a large gap between the creation of an integrated report and sufficiently drawing out the integrated report's potential. Confusing the means with the purpose, making completion of the integrated report itself the purpose, and not practicing "integrated thinking" are likely the reasons for this.

Of course, the practice of integrated thinking, a prerequisite for integrated reporting, is fraught with difficulties. The size of a company increases as the business diversifies, and the number of key stakeholders and challenges increases and cooperation between departments grows more complex. However, what gives the integrated report innovative potential are the results of integrated thinking. If the practice of integrated thinking is abandoned, the opportunity to raise corporate value will be missed.

The environment surrounding a company is wide-ranging and constantly changing. With no precedent, people are asked to make many decisions in situations where there are no clear right answers. Exposed to rapid and significant change, there are companies which struggle to survive and companies that see those struggles as opportunities and leverage them as a springboard to a growth trajectory, even if it is not a smooth one. KPMG believes that integrated thinking through integrated reports could be the management foundation that turns change into a growth opportunity.

Value creation

An integrated report is a concise yet comprehensive communication about value creation by an organization. Therefore, it is important to show that value creation can effectively drive sustainable growth, without favoring specific capitals, focusing on a variety of assets regardless of whether they are internal or external to the organization, while striving for optimal allocation. The previous survey investigated disclosure of business models, which is a mechanism for value creation. However, to understand the holistic picture of value creation, this survey also investigates the six capitals, since it is important to understand the relationship of these capitals to business models. This survey was then compiled into this section on value creation.

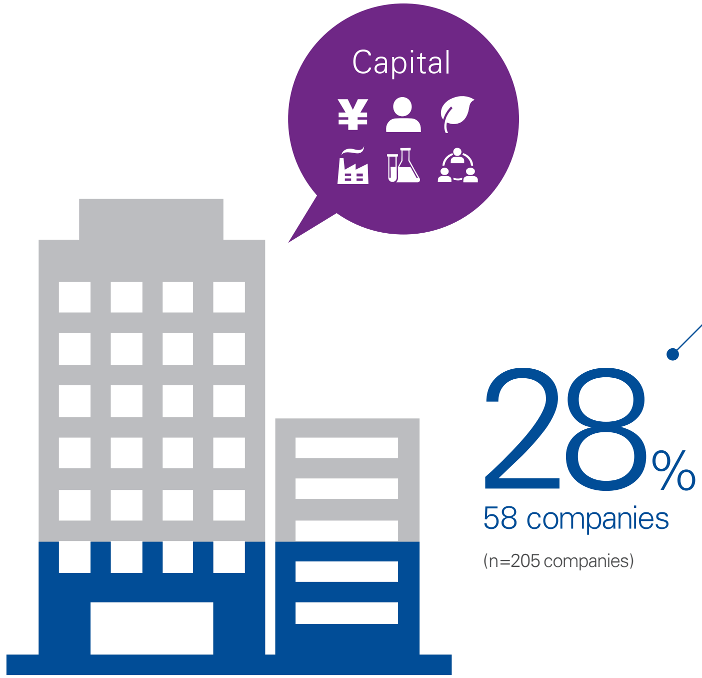


Figure 15: Companies that disclose capital

Disclosure of capitals

1. Companies that disclose capitals

The IIRC Framework explains that "The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organizations." In other words, capital is a representation of value, and the description of the value creation process conveys the mechanism by which various capitals increase or decrease. However, in an integrated report, which should be a report on value creation, companies that disclose capitals which they considered important numbered only 58 (28%) (Figure 15). Further, the primary reasons for including the capitals in this Framework are to serve: (1) as a part of the theoretical underpinning for the concept of value creation, and (2) as a guideline for ensuring organizations consider all the forms of capital they use or affect.

In most cases, as a partial description of the value creation concept, capitals are disclosed in the first half of the report with a description of the value creation process or business model. This shows a holistic picture of the company's value creation, and aids the readers' understanding. There are also many instances in which capital is not described in concrete terms. In particular, concepts that have been less familiar, such as natural capital and social and relationship capital, need further reinforcement of background information and explanation to impart a proper understanding.

Figure 16: Capitals and KPI

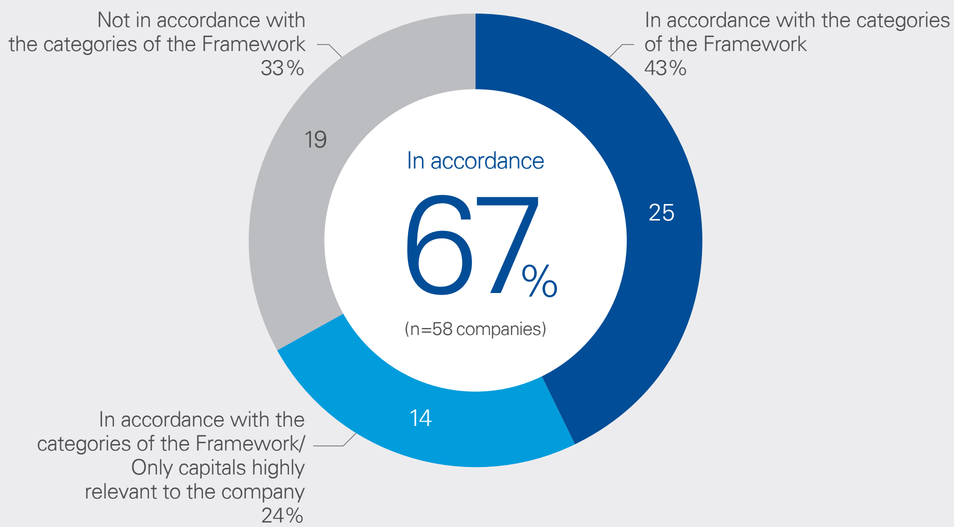


Figure 17: Categories of capitals

2. Relation between the capitals and KPI

In addition to a detailed description of capitals, examples of disclosure of the quantitative results pertaining to each capital illustrate the qualitative and quantitative aspects and are thought to be helpful in evaluating company strength and size. Moreover, seven companies (12%) associated KPI and the capitals in their financial highlights (Figure 16).

3. Categories of capitals

As for the categorization of disclosed capitals, 39 companies (67%) were in accordance with the categories of the Framework, and 19 companies (33%) were not (Figure 17). Companies not in accordance included those that directly described specific contents in the form of "technology" and "knowhow," but conceptually these could have been categorized into the six capitals.

In addition, the Framework states that when the interactions between the organization and the capitals are relatively minor or very indirect, they are not sufficiently important to include in an integrated report. In fact, among the aforementioned companies that are in accordance with the categories of the Framework, 14 companies (24%) disclosed only those among the six capitals that are highly relevant to the company. Selective disclosure of capitals includes a message about which capitals are more or less important to the company, and can be considered significant information. Even in the case where companies selectively disclosed capitals, they also disclosed financial capital and human capital; on the other hand, most companies did not disclose natural capital.

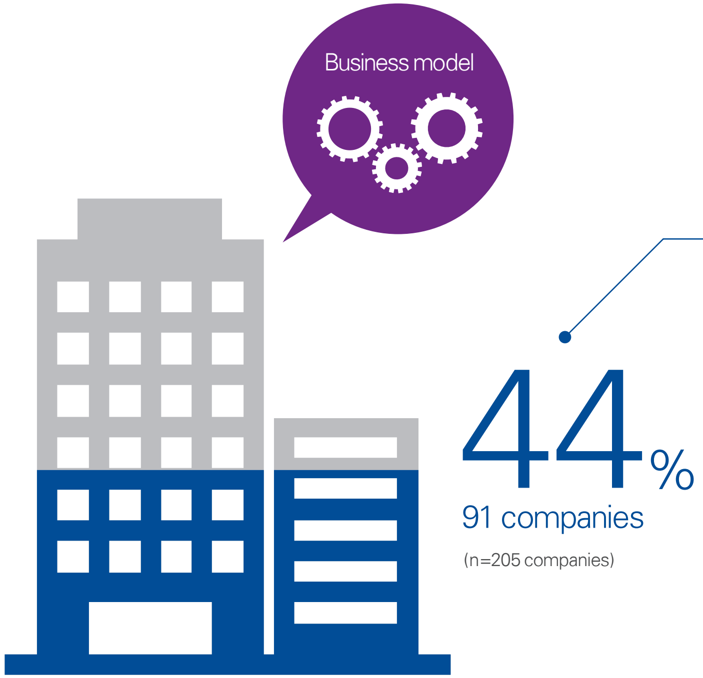


Figure 18: Companies that disclose their business model

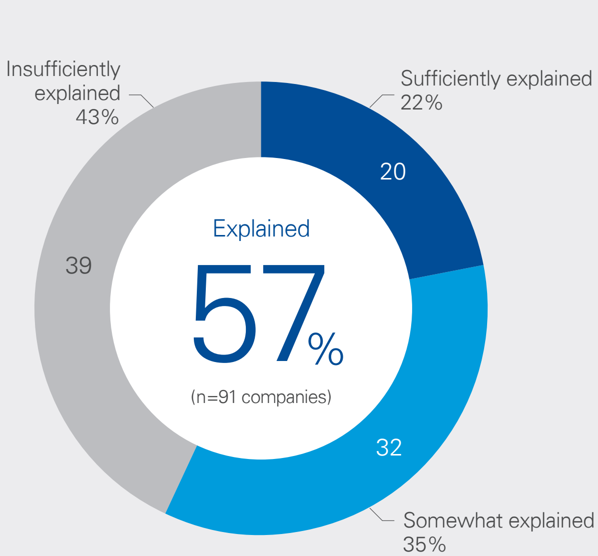


Figure 19: Business models and the capitals

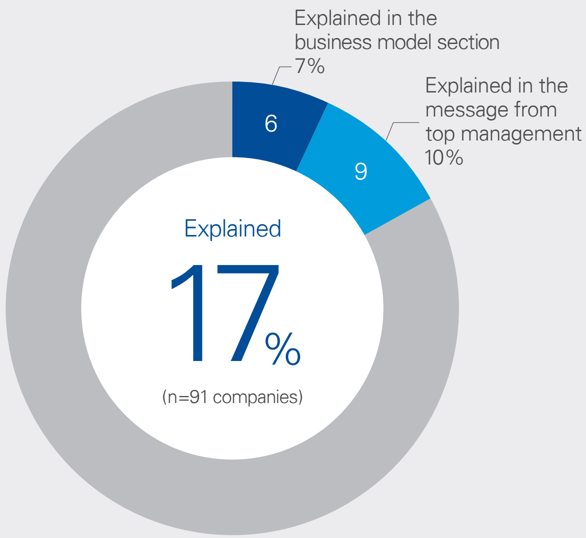


Figure 20: Long-term view of the business model

Disclosure of business model

1. Companies that disclose their business model

Of the 205 companies surveyed, 91 (44%) described their business model (Figure 18). This was largely unchanged compared with the 59 companies (42%) last year. Many companies make an effort to describe the model using diagrams. Starting with the business model, several cases were seen that applied the connectivity principle by referencing detailed information, such as the capitals and business activities, to aid understanding of the context.

Among companies that disclosed their business model, 52 (57%) described their relationship to the capitals (Figure 19). Last year, of the 59 companies that disclosed their business model, 24 (41%) described their relationship to the capitals. More companies now understand the function of the business model in the integrated report and describe the capitals, the source of their competitive advantage. It should be noted that, among companies that do not describe their relationship to the capitals, there are many cases where the company "describes their business model" through their review of operations and business description.

A total of 15 companies (17%) disclosed the long-term view of their business model (Figure 20). 'Even in sections other than the "business model" section, information about companies' long term view could not be found very often.

KPMG's view

Along with the growing complexity of society, factors that had been little considered in the past now have a major impact on business decisions and their results. Because of their social presence, companies need to conduct business while bearing in mind their impact on socially shared components, such as social and relationship capital and natural capital. Social value created by companies helps to generate social and relationship capital, natural capital, and manufactured capital and has a deep relationship to long-term value formation. On the other hand, economic value has a major influence on short-term aspects and the business cycle of individual companies. In integrated reports, considering the various capitals and disclosing them from a value creation perspective leads to a discussion on the state and effective use of management resources related to the creation of short- and long-term economic and social value. This contributes to the decision-making not only of the company, but of the users of the report.

A business model illustrates how the company creates value using the capitals and is central to interrelating the content elements of the integrated report. It forms the core element of the company' s sustainable value creation and can be used to show in a structured manner the elements that have an impact, while supporting a comprehensive and simple description by management about strategy and its implementation, thus gaining understanding and support from stakeholders. Please note that the description of the business model is not only used to describe past and present business, but to show how flexibly and quickly adaptable the organization is in an environment of mounting uncertainty. Managers, while describing their vision for the future of their companies over longer timelines, use business models to explain their efforts to improve value sustainably over the medium- to long-term and convey the economic and social value of their companies, as a process, which leads to promising outcomes based on the use of various capitals. In doing so, they can obtain investor support and win understanding from various stakeholders.

Corporate governance

An explanation of how an organization's governance structure supports its ability to create value is required in the integrated report. On the other hand, Japan's Corporate Governance Code has the goals of sustainable growth and improving medium- to long-term value creation by helping companies to achieve "growth-oriented governance." "Ensuring appropriate information disclosure and transparency," a basic principle of the code, calls for proactively dealing with the disclosure of non-financial information by listed companies. In this manner, the integrated report and the Corporate Governance Code are compatible in purpose and are complementary to each other in practice. This is why the items in this survey are determined based on the respective requirements of the IIRC Framework and the Corporate Governance Code.

In the survey on corporate governance disclosure, of the 205 companies targeted, 198 were actually surveyed, omitting three audit firms and four companies that do not disclose information on corporate governance.

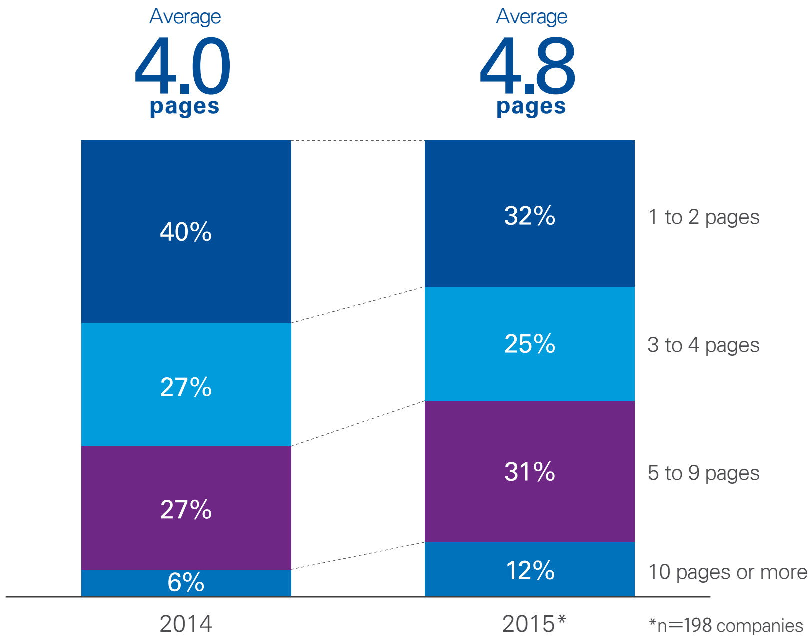


Figure 21: Number of pages in the corporate governance section

Disclosure of corporate governance information

1. Size of disclosure of corporate governance information

The length of the corporate governance information of 114 companies (57%) was four pages or less. Although this represents, as a percentage, a decline compared to the 88 companies (67%) in the previous year, more than half of the companies still perform only simple disclosures of four pages or less. On the other hand, the number of companies that devote 10 pages or more increased to 23 (12%), double that of the previous year (Figure 21).

The average number of pages of the 198 companies surveyed on corporate governance disclosure was 4.8, an increase over the 4.0 page average in the previous year. If we compare the average number of pages by organizational form of corporate governance, the average for a company with company auditors and a company with audit and supervisory committee was 3.5 pages and 4.3 pages, respectively. In contrast, among companies with company auditors, the average for companies that adopt a so-called "hybrid-type" with a compensation committee or nominating committee, or both committees as optional advisory bodies to the board of directors, was 6.9 pages, and the average for companies with three committees was 6.3 pages. The latter companies were proactive in both addressing corporate governance and disseminating information (Figure 22).

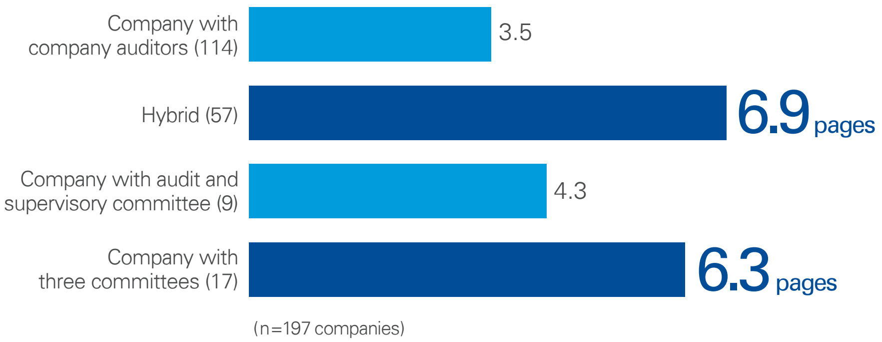


Figure 22: Average number of pages by form of governance

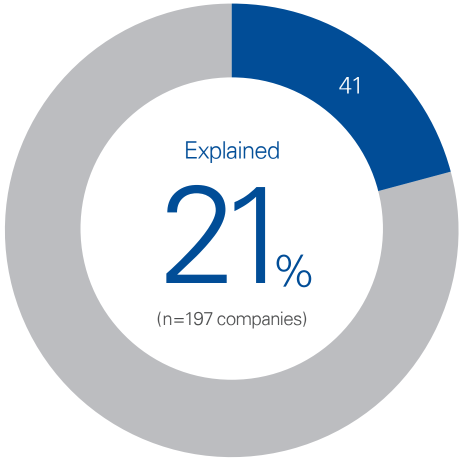


Figure 23: Reason for selection of the particular form of governance

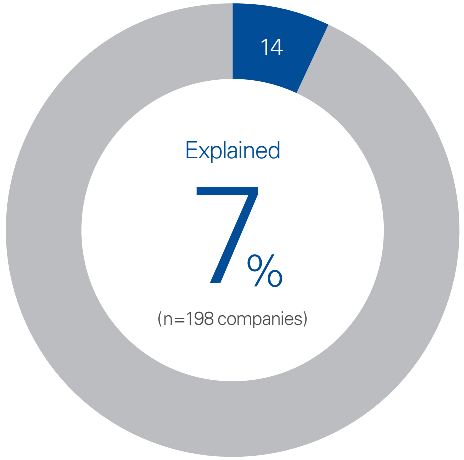


Figure 24: Approach to board of directors' size and diversity

2. Reason for selection of the particular form of governance

Out of 197 companies, excluding one company that has not adopted a form of governance stipulated in the Companies Act because it is a mutual company, 41 (21%) explained the reason and basis for the selection of their particular form of governance (Figure 23). For companies that shifted to a "company with audit and supervisory committee," a new selection enabled by a revision in the Companies Act, there were several cases the reason for selecting this form was given, but many did not explain how they decided that their particular form of governance would be best suited to the company's sustainable creation of value.

3. Approach to size and diversity of board of directors

The number of companies that described the effective size and diversity of the board of directors needed to ensure its effectiveness was 14 (7%) (Figure 24). Although a limited number of companies provided a concrete description, there were also companies that offered this sort of description: "Because most of the users of our products are women, women's values are emphasized in board of directors' decision-making; therefore several women have been appointed directors."

In order to execute the strategy and achieve sustainable value growth, the following two points are emphasized as one element of the value creation story in integrated reports: (1) review the size and diversity of the board of directors in conformity with the company's value creation scenario; and (2) explain how to shape the board of directors' function in such a way that its actual state approaches the ideal and each director's contribution is high.

Figure 25: Disclosure of external directors' experience, skills, and reasons appointed

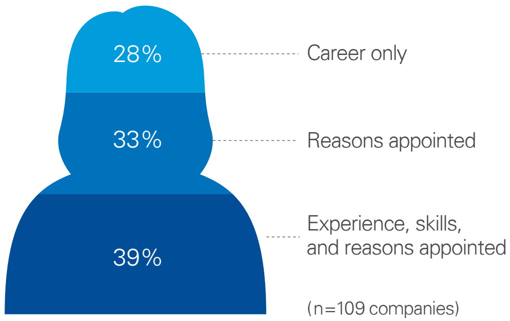


Figure 26: Disclosure of external directors' experience, skills, and reasons appointed (breakdown)

Figure 27: Disclosure of internal directors' experience, skills, and reasons appointed

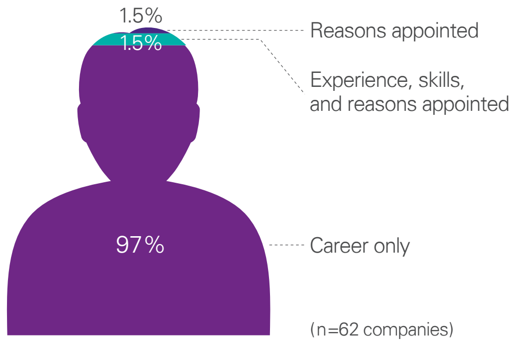


Figure 28: Disclosure of internal directors' experience, skills, and reasons appointed (breakdown)

4. Directors' experience, skills, and reasons appointed

The number of companies that disclosed any of the external directors' experience, skills, and reasons appointed was 109 (55%), an increase of 42 (37%) over the previous year (Figure 25). Out of the 109 companies, 43 (39%) disclosed experience, skills, and reasons appointed, 36 (33%) disclosed only the reasons appointed, and 30 (28%) disclosed only their career (Figure 26). The appointment of external directors is thought to be one attempt to strengthen governance which many companies embarked upon due to the revision of the Companies Act and the enactment of the Corporate Governance Code. Because its inclusion is also sought in corporate governance reports, many companies have disclosed "reasons appointed" for external directors in the integrated report.

On the other hand, the number of companies that disclosed any of the internal directors' experience, skills, and reasons appointed was 62 (31%), a relatively low percentage (Figure 27). Of those 62 companies, 60 limited inclusion to main career histories in its list of directors. There were only two companies that disclosed skills and reasons appointed (Figure 28).

5. Evaluation of the board of directors' effectiveness

In order to evaluate whether the board of directors is fulfilling its role and function of contributing to raising corporate value over the medium to long term, it is important to describe in the integrated report how board evaluation is practiced. However, of the 198 companies surveyed, only eight (4%) described evaluation of the board of directors' effectiveness (Figure 29). With the inclusion of this process in Principle 4 of the Corporate Governance Code, many companies are just starting to create a new structure for evaluation of the board of directors' effectiveness.

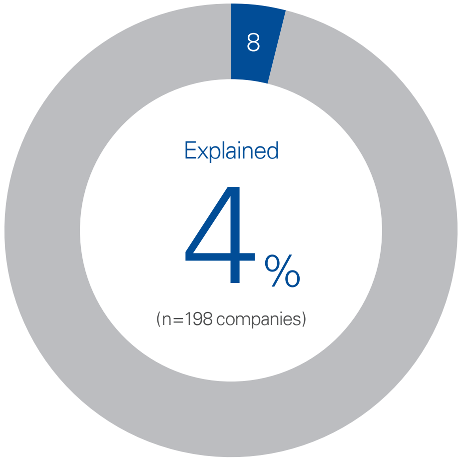


Figure 29: Explanation of evaluation of board of directors' effectiveness

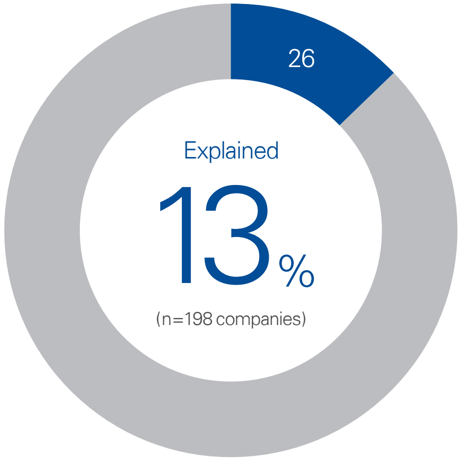


Figure 30: Disclosure of policy on dialogue with shareholders and investors

Figure 31: Disclosure of directors' compensation

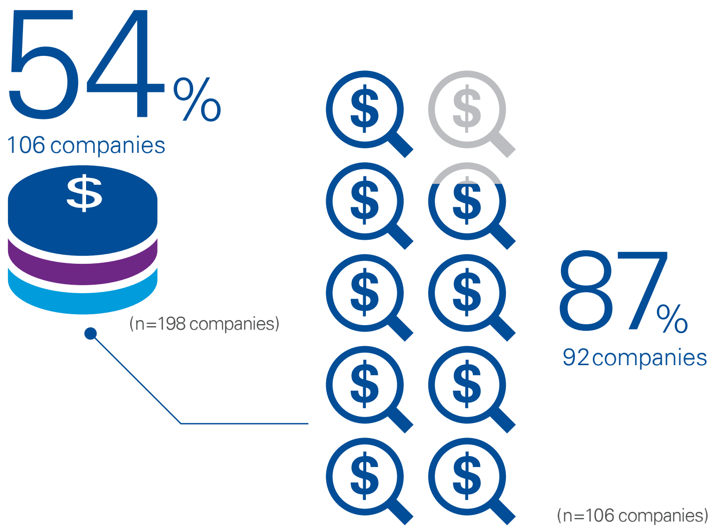


Figure 32: Disclosure of method for determining directors' compensation

In this survey, based on the fact that the Corporate Governance Code is in the introductory phase, companies who explained their engagement with evaluation of the board of directors' effectiveness in any way, even when not giving full evaluation results, but merely evaluation implementation plans or information on the progress of consideration, have been counted. As one important element in measuring a company' s ability to create value over the medium to long term, it is hoped that the effective management of the board of directors will be sufficiently explained in integrated reports in the future.

6. Policy on dialogue with shareholders and investors

To strengthen their governance function, it is important for companies to carry out two-way dialogue with shareholders and investors, and reflect their useful comments and suggestions in management. Of the 198 companies surveyed, 26 (13%) described their policy on dialogue with shareholders and investors (Figure 30). If the description of the policy of communication with shareholders and investors used the keyword "dialogue," or included a description of a policy on interactive dialogue, KPMG considered this a description of their communication with shareholders and investors.

7. Executive compensation

The number of companies that disclosed executive compensation was 106 (54%), virtually unchanged from the previous year' s 53% (Figure 31).

Of the 106 companies that disclosed executive compensation, 92 (87%) disclosed their method for determining that compensation, almost the same as the 84% of the previous year (Figure 32). However, most of the descriptions for determining compensation covered the presence or absence of variable parts, and the body that determines compensation. Almost none of the companies explicitly described the relevance of their remuneration policy to medium- to long-term value creation.

Figure 33: Inclusion of a message from those charged with governance

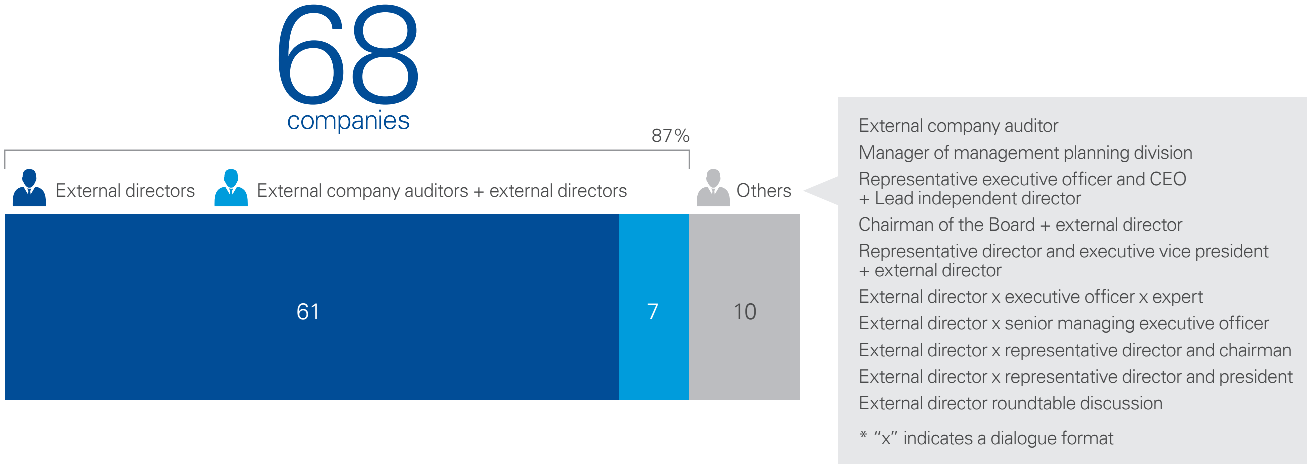


Figure 34: Breakdown of messages from those charged with governance

8. Message from those charged with governance in the governance section

In the corporate governance section, 78 companies (39%) included a message from those charged with governance, such as the chairman of the board, president, or an external director (Figure 33).

While the form of the message varied, such as a Q&A format, a dialogue format among multiple people, or a special message from those charged with governance, out of the 78 companies that included a message from those charged with governance, 68 (87%) adopted a format of the external director (or external director and external company auditor) describing their expectations for the company and their aspirations as an external director (Figure 34).

Amid the trend toward including a message from external directors, in one case, at the beginning of the governance section, the chairman of the board, seeking to describe how the board serves the management oversight function, reviewed the CEO's performance in the area of executive management and described his own recognition of the business environment. He further explained his thinking about the best form of governance for the company and the role of the board of directors.

KPMG’s view

The Corporate Governance Code was adopted in the listing regulations of the Tokyo Stock Exchange in June 2015. Therefore, at the time of integrated report issuing this year, it is assumed that most companies were still in the process of accommodating this code, so the results of this survey saw no major changes compared with the previous one. In the next report, KPMG expects many companies will be disclosing the results of their governance reforms.

Disclosure of governance in the integrated report explains how the system and mechanism that support value creation over the short, medium and long term are structured and whether they are being managed effectively. Therefore, as evidence of effective implementation, it is important to explain the actual operational status, not only of the results that comply, but why it can be said they comply.

Diversity of the board of directors is vital from the standpoint of satisfying stakeholder concerns. To achieve harmonious governance with consideration for a wide range of stakeholders, those charged with governance must understand the legitimate needs of key stakeholders and discuss them from the standpoint of representing their interests.

As for directors’ experience, skills, and reasons appointed, in many cases the disclosure of information about external directors were seen, but disclosure of information about internal directors was hardly seen. In order to evaluate the quality of governance, the experience and skills of internal directors who play a key role in management execution are also considered important.

Further, in the disclosure of executive compensation, the compensation system should not overemphasize short-term performance; rather, it is important to explain the system’s association with medium- and long-term value creation.

Integrated reporting is a helpful tool in assisting those charged with corporate governance to understand the organization’s value creation and sort out management issues. For sustainable value creation, how should resources be allocated? In order to respond to changes in the business environment, how should one change the strategic business model? How should one think about important opportunities and risks and management issue priorities for value creation? Both are central themes related to long-term value creation that are handled by the integrated report. It is hoped that those charged with governance, whose role is to oversee the strategic direction of the organization, the accountability of the organization, and to practice stewardship, will proactively work on these themes.

Materiality

The IIRC Framework applies materiality in its Guiding Principles and asks that information about matters affecting the organization's ability to create value be disclosed. When creating and presenting integrated reports, the process of materiality assessment is fundamental and is even applied to risks and opportunities, future outlook, and other areas. Priorities are reviewed based on the materiality, and the information to be disclosed is decided. Furthermore, materiality is assessed by taking into account the size and probability of impact of a matter from the standpoint of its "impact on the organization's ability to create value."

On the other hand, in the disclosure of CSR reports, in order to identify topics to be included in the report, the materiality assessment is carried out from the standpoint of the "impact on the economy, the environment, and society" and the "impact on stakeholder assessment and decision-making" based on the G4 Sustainability Reporting Guidelines from GRI. In recent years, there have been changes to the assessment of "importance to the business" and "importance to society or stakeholders."

Because integrated reports and CSR reports have different objectives, the materiality assessment objective and process also differ. However, they are the same in that materiality is a criterion for dividing information into that which is important and not important. They are also the same with respect to regular engagement with key stakeholders, who are users of the reports, in order to verify and ensure that the criterion is reasonable.

From the standpoint of sustainable value creation that takes into account various capitals, materiality assessment can be used as a tool to assist in the formulation of sustainable strategies by organizing thoughts about management issues and taking advantage of dialogue with shareholders.

Figure 35: Disclosure of materiality assessment results

Disclosure of materiality assessment results

1. Disclosure of materiality assessment results

A total of 31 companies (15%) disclosed materiality assessment results (Figure 35). The low absolute number of companies disclosing indicates that awareness of materiality assessment is also low, which suggests that the discourse on this topic is still relatively immature. The diagrams contained in this section are the summary and analysis results of 31 companies (the population) that have disclosed materiality assessment results.

2. Materiality assessment targets

Of companies that disclosed materiality assessment results, 27 (87%) assessed only the CSR items (Figure 36). Materiality assessment in integrated reports targets all matters that impact the company's ability to create value. Companies that had until now conducted materiality assessments with the purpose of preparing CSR reports can use this as an opportunity to shift to the integrated report and create even better materiality assessments by focusing on value creation.

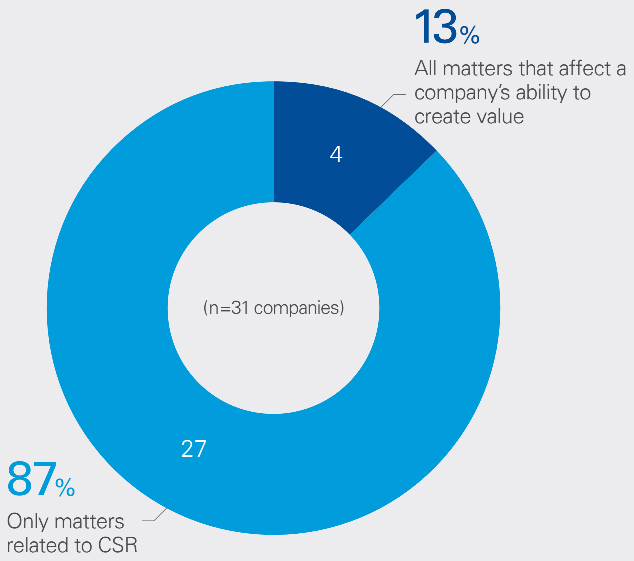


Figure 36: Materiality assessment targets

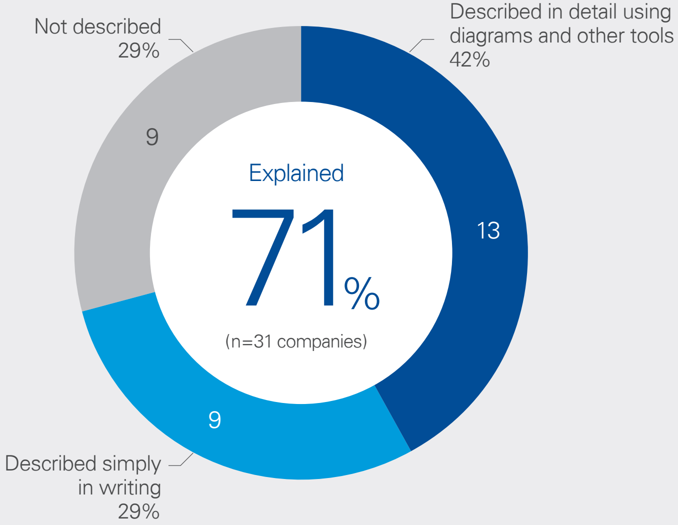


Figure 37: Description of materiality assessment process

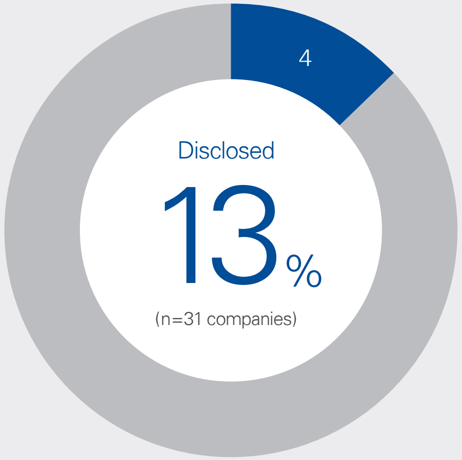


Figure 38: Disclosure of the involvement of those charged with governance in materiality assessment

3. Description of materiality assessment process

Among companies that disclosed materiality assessment results, 22 (71%) described the assessment process, of which 13 (42%) provided concrete descriptions using diagrams (Figure 37). Further, 2 of those 13 disclosed their website address in their reports and described in detail the assessment process on the linked website. The IIRC Framework mentions the method of giving a link to provide an "entry point" to more detailed information. Through the use of web technology and maintaining a concise integrated report, users of the report can readily access required detailed information.

4. Involvement of those charged with governance

Among companies that disclosed materiality assessment results, four companies (13%) disclosed information indicating the involvement of those charged with governance (Figure 38).

In te first place, involvement of those charged with governance and the extent of that involvement is unknown in most cases. However, based on the fact that there are few companies that disclose materiality assessments and there are companies that have assessed only CSR items, it is assumed that the involvement of those charged with governance in materiality assessments is limited.

When there is explicit or assumed involvement of directors and company auditors, such involvement is counted as the involvement of those in charge of governance. Out of four companies, three explicitly discussed and approved this at management meetings.

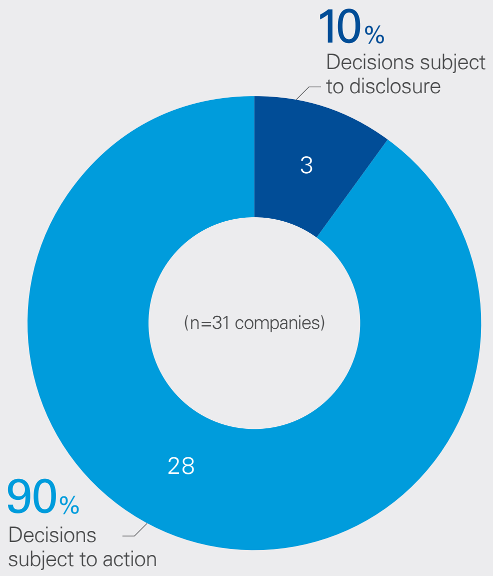


Figure 39: Purpose of materiality assessment

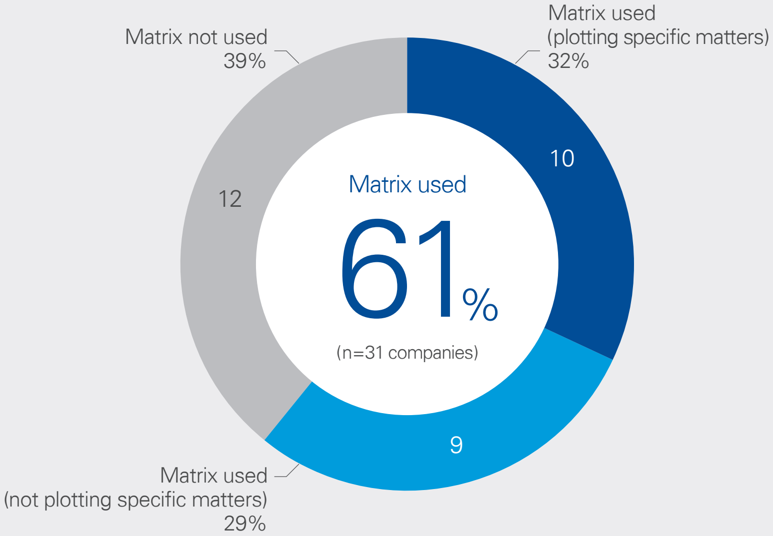


Figure 40: Description by materiality matrix

5. Purpose of materiality assessment

Among the companies that disclosed materiality assessment results, only three (10%) had the objective of determining disclosure in the integrated report with the purpose of materiality assessment. For the other 28 companies (90%), the objective of disclosure was explicitly to select activity targets, or it can be assumed that it was to select activity targets (Figure 39). The fact that multiple patterns are present in the materiality assessment objective itself suggests that the discourse on materiality evaluation is still relatively immature.

6. Description by materiality matrix

Among companies that disclosed materiality assessment results, 19 (61%) disclosed a materiality matrix. Of these, 10 (32%) showed specific matters that were assessed in the materiality matrix (Figure 40).

* When an organization conducts a materiality assessment based on two assessment axes, a materiality matrix displays those results in the form of a matrix diagram.

KPMG's view

One of the reasons that information disclosure about materiality is scarce is the difficulty of transposing it into appropriate Japanese. Because each of the various organizations (e.g., IIRC, GRI, and SASB) have their own distinct initiatives, activity perspectives, objectives, positions, and types of information targeted (e.g., general business, ESG, financial, quantitative, and qualitative), it is difficult to forge a common understanding. Thus, the discourse on these topics and recognition of them is still relatively immature in companies and among report users. Since it is an element that forms the basis of a company's strength and competitive advantage, "what is material" varies by company. Therefore, the first step is for management to take the lead, exhaustively debate the matter at a board of directors meeting, and express "views on materiality for significant audience."

In integrated reporting, materiality assessment is viewed as an effort that leads to strategic decision-making that comprehensively understands management issues, and that is effective in achieving the connectivity of each element in the value creation process of a company. On the other hand, materiality assessment for CSR reporting purposes has been viewed as able to clarify risks and opportunities. If these two processes can be integrated, the materiality assessment results will be seen to have addressed both the business strategy and CSR strategy, thus helping to carry out optimum resource allocation that leads to value creation which makes the best use of the nature of diversifying capital.

Disclosure of the materiality assessment process gives report users an opportunity to assess its suitability. In addition, information users can verify any difference in perspective from their own corporate assessment process, and companies can provide thought-provoking explanations.

Materiality assessment is built into management's decision-making process and that part of it is necessary. Consistency with the management resource utilization process for the strategy and its realization can be achieved by involving those charged with the governance of the entire company. To also deal with changes in timelines and the management environment, companies not only dialogue with key stakeholders, but with a wide range of other stakeholders, and also pursue an approach that strives to confirm the validity of the assessment.

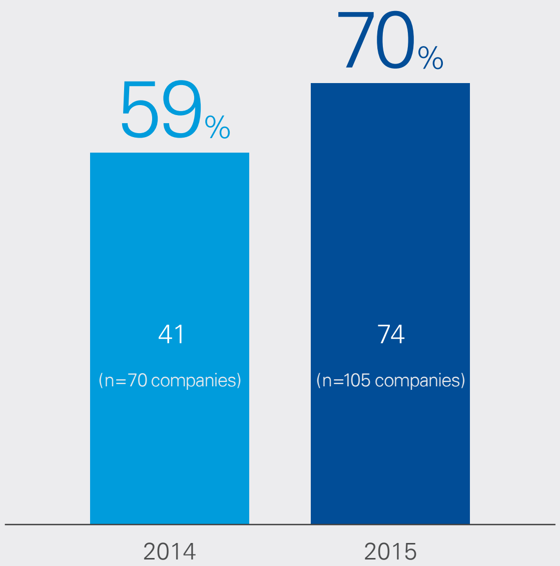


Figure 42: Risks specific to the organization

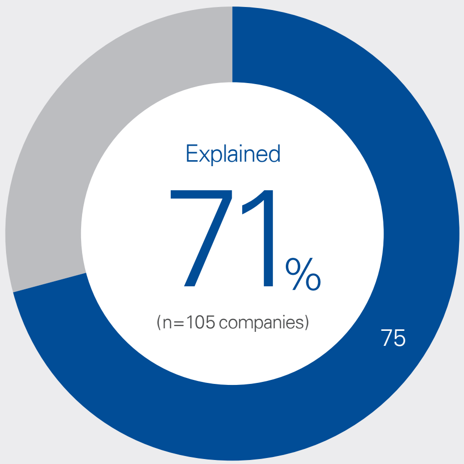


Figure 43: Explanations on relevance to shareholder value

2. Risks specific to the organization

Out of 105 companies, 74 (70%) described risks specific to the organization, more than 10 percentage points higher than in the previous year (Figure 42). However, all specific risks were not individually described in concrete terms, and general descriptions were also intermingled. The remaining 31 companies (30%), although they disclosed the risk itself, gave little description of it or only gave a general description that could be applied to any company.

Reflecting the characteristics of the business, there were also industries that recognized common risks. For instance, in the financial industry, this is recognized by common classifications such as credit risk, market risk, liquidity risk and operational risk. In the pharmaceutical industry, common risks included risk related to new product R&D, risk related to intellectual property, and risk related to reform of the medical-care system.

3. Explanation of relevance to shareholder value

Out of 105 companies, 75 (71%) described risks relevant to shareholder value (Figure 43). Compared to the previous year's 48 companies (69%), there was no significant change. The remaining 30 companies (29%) disclosed many risks in which the relevance to shareholders appeared somewhat obscure. As the principle of conciseness in the IIRC Framework indicates, it is vital to consider the utility value of information provided to readers, recognizing that disclosing the maximum amount of information may actually make the integrated report more difficult to understand.

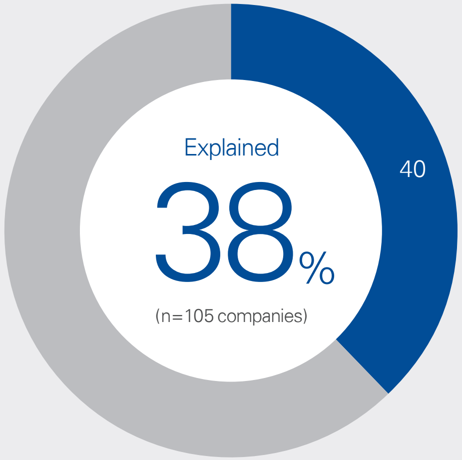


Figure 44: Disclosure of potential impact of risks

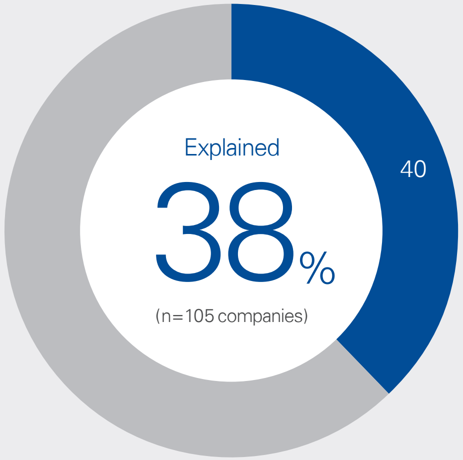


Figure 45: Risk management policy and its achievement

4. Disclosure of potential impact of risks

Out of 105 companies, 40 (38%) described the potential impact of risks. This was a slight increase over the 23 companies (33%) of last year (Figure 44).

When areas impacted by one or more risks have been specifically indicated, and it could also be determined that their positive or negative impact was described in the report, the company was counted as having described the potential impact. However, companies that described the potential impact of risks did not describe all risks, and they included numerous formulaic expressions such as "may have an effect on performance and financial information." The disclosure of sensitivity analysis has already been put into practice at some companies, and such disclosure by management can be considered useful. In corporate valuation, future cash flow projections that assess the company's ability to generate cash flows are commonly performed. Risk is one extremely important piece of information that has an impact on future cash flow. Therefore, if risk is quantified based on future cash-generation prospects, and the impact on company performance is shown, the difference between the company's awareness and outside awareness of risk becomes clear. Moreover, readers are able to correct their own cash flow projections while also assessing the quality of the company's risk awareness.

5. Addressing risks

There were 40 companies (38%) that explained their risk management policies and specific actions taken based on such policies. Just as last year, detailed explanations were only provided for some risks and the explanations were usually general. Thus, assessment of how the company responded to risks was unclear for several of the risks (Figure 45). The remaining 65 companies (62%) gave no indication of their management policies or provided only an overview of their risk management policies. With regard to the appropriate handling of material risks, it is hoped that companies will disclose specific information that could serve as a reference for assessing their risk responsiveness.

KPMG's view

Companies seem to have various concerns about the disclosure of risk information. While disclosure content has improved compared to last year, these concerns could explain why the number of companies disclosing risk information in integrated reports remains at about half.

Providers of financial capital, who are the primary users of integrated reports, are keenly interested not only in risks that substantially impact value creation, but also in opportunities. To support their decisions, they not only describe risk items; they need to provide information about the relevance of the risk to the generation of future cash flow, its impact on targeted business domains, and countermeasures for projected risks derived from these factors, as well as the current status of those efforts. A convincing explanation will lead to deeper trust with users and help to build good relationships.

Efforts to effectively disclose risk information provide an opportunity to reexamine decisions and responses about the risks facing the company. Deep insight into risk as a social problem and specific business risk can be used as a strategic opportunity that leads to a competitive advantage. Moreover, if a company's efforts to disclose specifically lead to an external assessment that "the organization has the strength to face risk," this will, in turn, probably promote even higher quality disclosure of risk information.

The introduction of risk management that oversees the business process supports sustainable growth. Management needs to take action by demonstrating leadership and to maintain a mechanism that monitors progress through proper governance. The formulation and explanation of policy is another important message.

It is assumed that sincere efforts and discussions on risk management are already taking place in many companies. Risk awareness, which forms the foundation, and disclosure are essential to these efforts and will continue to be used as significant information in the decision-making of report users.

Performance

Numerical information for performance reporting is disclosed in various sections of the integrated report, such as the president's message, review of operations, and special feature pages. KPMG surveyed and analyzed the quantitative information given in the highlight section, wherein are summarized the company's important KPIs.

Since how companies allocate resources and how they seek to improve performance is of vital concern, KPMG conducted its analysis from the standpoint of the six capitals (financial, manufactured, intellectual, human, social and relationship, and natural).

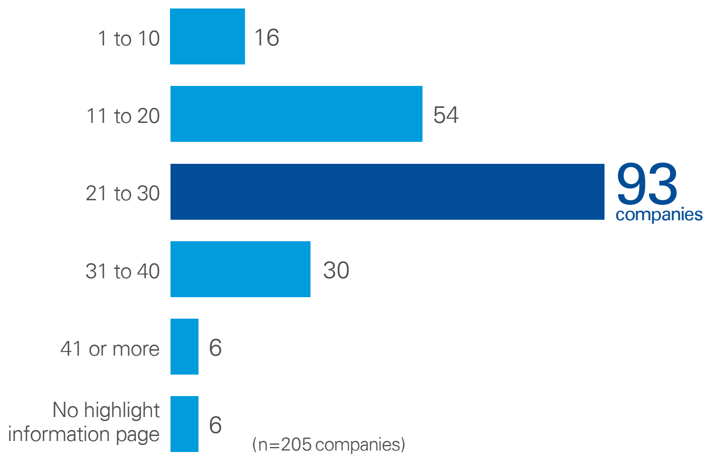


Figure 46: Number of disclosed KPIs by capital

Figure 47: Disclosure of plans, targets, and forecasts

Disclosure of highlight information

1. Disclosed KPIs

Of the 205 companies surveyed, 199 (97%) disclosed highlight information. As in last year's survey, most companies disclosed from 21 to 30 KPIs (Figure 46).

Further, many companies only disclosed past performance in their highlight information, and almost none of the companies disclosed their plans, targets, and forecasts (Figure 47).

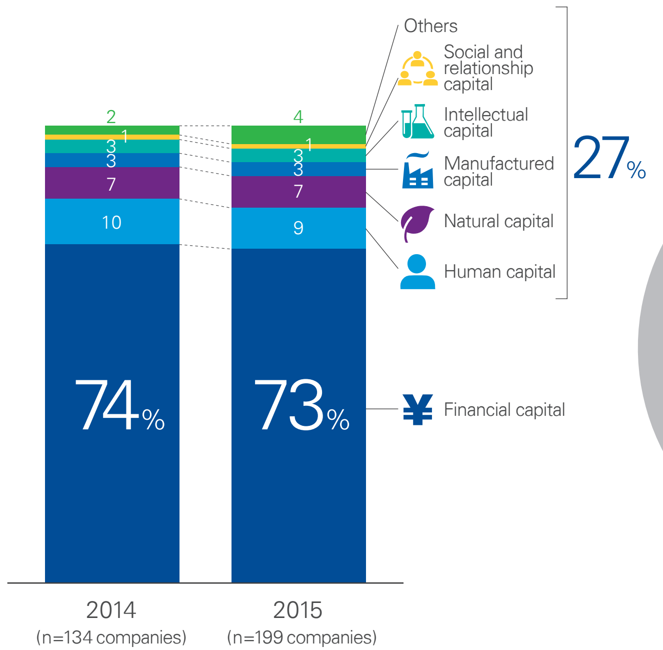


Figure 48: Disclosed KPIs by capital

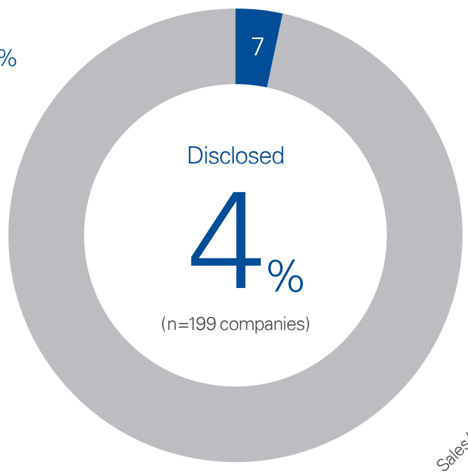


Figure 49: Capitals disclosed

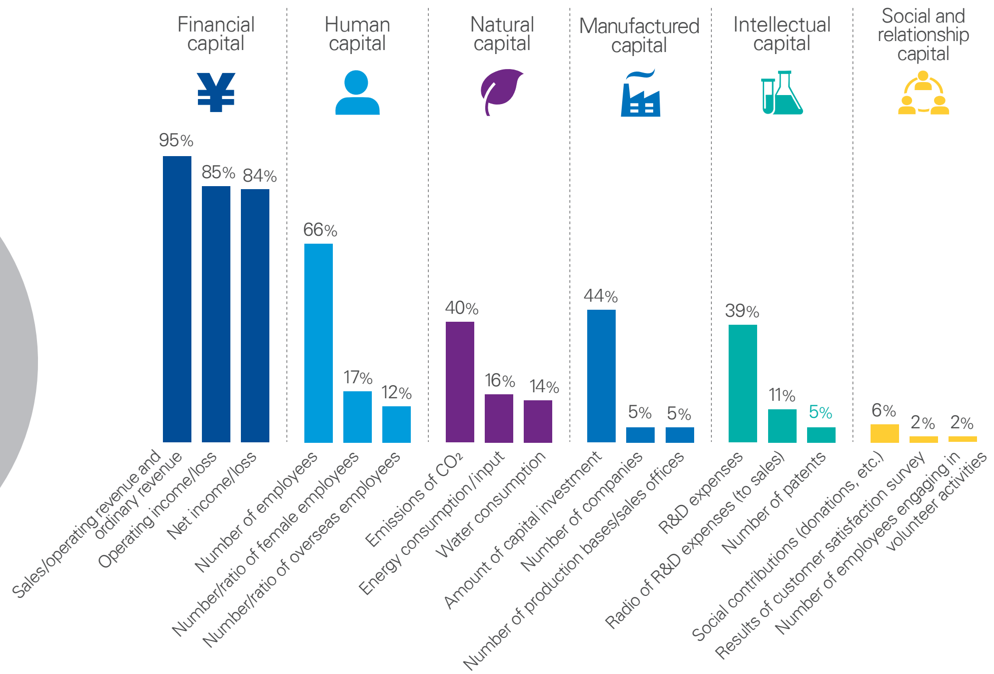


Figure 50: Top three disclosed KPI by capital

2. Disclosed KPIs by capital

We classified the disclosed KPIs into the six capitals based on the classification of capitals in the IIRC Framework (financial, manufactured, intellectual, human, social and relationship, and natural) (Figure 48).

Disclosed KPIs by capital were virtually unchanged from the previous year. Financial KPIs accounted for 75% of the total, and disclosure of non-financial KPIs was still low. Among non-financial KPIs, disclosure of KPIs related to human and natural capital was relatively extensive.

Companies that displayed KPIs by dividing them into financial and non-financial were relatively common, but only seven (4%) companies disclosed KPIs separately by capital (Figure 49).

The top three disclosed KPIs by capital are shown in Figure 50. Although there were changes in several positions, there were no major changes from the previous year.

Financial capital indicators that are often cited as target values, even in the medium-term management plan, such as sales, operating income, and net income, were ranked in the top three.

In addition, the disclosure rate of key indicators in investment decisions, such as return on equity (ROE), dividend per share, and net income per share, has increased.

With regard to human capital, more than half of companies disclose the number of employees, but explaining how this is linked to value creation is crucial in an integrated report. There were also many companies that disclosed information about the breakdown of female managers and overseas employees, but if there were an explanation that linked this detailed information with the company philosophy and strategy, that would be considered an even more valuable KPI.

The disclosure of quantitative indicators related to the allocation of manufactured and intellectual capital to capital investment and R&D expenses was conspicuous. However, since there is not always a positive correlation between investment and outcome, adding information related to output would be helpful when viewed from the perspective of performance reporting.

CO_2 emissions, energy consumption, and water consumption were the top-ranked natural capitals disclosed. CO_2 emissions in particular are recognized as important international challenges and KPIs in this area were disclosed by 80 (40%) companies. At the moment, KPIs related to company CO_2 emissions and energy consumption occupy the top position, but there were also cases where contributions to the environment via the companies' products and services were disclosed.

Social and relationship capital has so far been an unfamiliar concept, as few companies disclose it at all, and even when they do, the items disclosed vary from company to company. Broadly classified, there were cases where KPIs related to "social contribution," such as social contribution expenditures and number of employee volunteers, were disclosed, and cases where KPIs ascribed to "evaluations from customers," such as customer satisfaction and the number of inquiries from customers, were disclosed.

Others such as sales volume, production volume, market share, number of users, breakdown of user information, and rating information were also disclosed.

KPMG's view

Performance involves reporting on the achievement of strategic targets.

It is important that the KPIs disclosed when reporting performance be consistent with those used in decision-making within the organization. Rather than gathering new information for disclosure purposes, companies should disclose information which can be externally announced and is particularly important for value creation from among the KPIs already established to monitor strategy implementation in day-to-day business management. In doing so, the communication of internal information and the dissemination of information externally will be consistent. In addition, to demonstrate the achievement of strategic objectives in a more accessible way, disclosure of plans, targets and results in a comparative format is helpful. If the target is not achieved, presenting an analysis of the cause and describing next steps is also important.

Furthermore, when disclosing materiality assessment results, consistency between assessment results and KPIs is vital. Companies analyze material matters that affect value creation and identify in this process opportunities, risks, and management challenges, and then draw up strategies for addressing them. KPIs are established to monitor the achievement of strategic objectives.

In the current survey, it can be acknowledged that disclosure of financial KPI was substantial, but disclosure of non-financial KPI has much room for improvement in both quality and quantity. One of the reasons that integrated reporting is attracting attention is that the significance of non-financial elements such as human capital and intellectual capital to value creation is growing faster than ever. Another reason is the growing recognition that sustainable management is not feasible when ignoring social value, which is often represented in the natural and social and relationship capitals. With the increasing importance of non-financial elements, there are growing expectations for related information to be disclosed. By responding to those expectations, issuers of integrated reports can help stakeholders see new value, which will lead to a more accurate valuation of their company.

In disclosure, it is vital to ensure people understand value creation not just as an outcome, but also as a mechanism. This can be done by not only enumerating the KPIs for each capital, but by explaining the relationship of the interaction between capitals and the company's value creation process. It may be relatively easy to explain how manufactured, human, and financial capital are linked to value creation, but to explain how natural capital and social and relationship capital are linked to value creation is more challenging. Yet companies that have overcome this challenge can create integrated social and economic value and maintain a long-term strategic competitive advantage.

Conclusion

Fields for improvement

I am delighted at the publication of this year' s results of our survey on integrated reports.

In this report, which summarizes the survey' s results, the survey items have been summarized into five fields. Of these, the three fields of corporate governance, materiality, and value creation (in particular, descriptions concerning the business model for value creation and the six capitals, which is the model' s target) are considered crucial fields that hold the key to achieving medium- to long-term value creation.

The governance section of this survey report describes the corporate management systems that companies reported they are using to enhance corporate value. It focuses on the management systems companies have set up to pursue medium- to long-term value creation and how they describe them in their integrated reports. In this survey, it became clear that there was room to improve disclosure concerning the experiences, skills, and reasons for appointment of company directors who play a central role in management.

Disclosure of materiality assessment is a means for carrying out a dialogue by showing, for instance, what management issues the company considers important in pursuing medium- to long-term value creation, and then asking whether these issues are the same issues that stakeholders expect the company to address. In this survey, we determined that the disclosure of materiality assessment results was remarkably low (15%); clearly, there is room for improvement.

Disclosure about value creation demands an explanation of how much value creation occurred not only with respect to financial capital, but also with respect to manufactured, intellectual, human, social and relationship, and natural capital, and about what a business model for that purpose looks like. The business model was disclosed by 43% of companies and capitals were disclosed by 28%. The survey made it clear that there is room for improvement in this field.
I believe the survey findings are therefore highly suggestive. KPMG Japan conveys these facts and wishes to forge ahead to improve the quality of integrated reports through demonstrating thought leadrship.

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Research Department
Tatsumi Yamada

Survey Team

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Among the companies targeted in this survey, the survey of pharmaceutical companies benefitted from the participation of students in the Healthcare Industrial Research (Practicum) supervised by Professor Tetsuo Kitagawa of the Graduate School of International Management, Aoyama Gakuin University.

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KPMG Japan Integrated Reporting Advisory Group

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