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Council of Experts Concerning the Corporate Governance Code
Opinions on Agenda Items Leading up to the Fourth Council

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As I discussed at the first meeting, I believe that it will be necessary to draft the Corporate Governance Code in such a way that the Japanese market can gain recognition as the safest, most secure and most reliable in the global capital market.

I have compiled my opinions on the issues brought up at the four previous meetings, including supplementary notes, as follows.

1. Basic matters concerning the Corporate Governance Code
(Material 3, Second Council)

➤ Corporate Governance Codes of other countries typically explain basic points concerning the Codes in their Preambles or the like.
Upon drafting the Code in Japan, what should we keep in mind?

- The Code should, for example, provide detailed explanations concerning the unique Japanese *kansayaku* system, the newly established Company with Audit and Supervisory Committee system, the role of accounting auditors and other matters, with the aim of identifying the organizations responsible for execution, oversight (including outside directors) and auditing, and especially the functions and roles of those who conduct audits (not the same as those of oversight). I also believe it will be necessary to stress the importance of the disclosure of information as a core principle.

2. Rights of Shareholders and Equal Treatment of Shareholders (Material 1C (page 2), Third Council)

➤ What kind of considerations should be taken into account in order to establish an environment which allows for shareholders to exercise their voting rights effectively?

(In response to a suggestion to further promote spreading out the dates on which general shareholders' meetings are held)

- At present, the dates of general shareholders' meetings are concentrated toward the last week of June, and I believe this to be unsuited to allowing shareholder participation. This is due to a majority of companies having set the date for the confirmation of shareholder rights at the end of March. I believe such companies will have to consider the need to facilitate shareholder attendance at general shareholders' meetings by changing these dates, which in turn would be possible by changing their articles of incorporation.

(Dispatching convocation notices early on)

- With regard to the information received by investors before they exercise their voting rights, I believe the following points are important to establish an environment which allows them to exercise their voting rights effectively: ① the nature and scope of information; ② its reliability; and ③ whether there is sufficient time to consider how to exercise voting rights.
- With regard to the period mentioned in point ③, some have suggested that we may want to encourage companies to dispatch convocation notices at earlier dates. However, given the great responsibility borne by companies in disclosing information, I believe that a certain period would still be necessary to enable companies to disclose a sufficient amount of information in a responsible fashion.
- Also, with regard to point ②, the reliability of information must be ensured through audits by accounting auditors and by *kansayaku*; undergoing such audits is a prerequisite for the responsible disclosure of information. In view of this and of current business practices, I believe that sending out convocation notices even earlier would be rather problematic. For shareholders to make effective use of their voting rights, they must be given sufficient time to analyze information after they receive it. In turn, this is linked to the issue of general shareholders' meetings concentrating in the same period. For example, it may be beneficial to consider postponing the general shareholders' meeting even by one week only to secure time for the shareholders to study their information.
- Assuming, then, that there are limits to how early convocation notices can be

dispatched, I believe that submitting securities reports before general shareholders' meetings would prove useful from the standpoint of the nature and scope of information (point ①). Under the current system, securities reports contain more information than financial statements. Making the information contained in securities reports available during the review period before shareholders exercise their voting rights, as is done in foreign countries, will make the exercise of voting rights more effective.

3. Disclosure and Transparency (Page 1, Material 1, Fourth Council)

➤ From the viewpoint of improving the effectiveness of corporate governance, what should we keep in mind in order to ensure that companies make timely and accurate disclosure?

- Accurate disclosure requires reliable information, and preparing reliable information requires setting aside a certain amount of time leading up to disclosure. When disclosing information, companies bear great responsibility, and the reliability of disclosed information must be ensured through audits by accounting auditors and by *kansayaku*.
- In other words, I believe it is important to remember that sending out convocation notices at earlier dates is meaningless unless an appropriate amount of time is set aside to make sure that information is reliable. Convocation notices are already being dispatched as early as possible. It would be preferable to avoid unnecessary compression of the period during which the information to be disclosed is prepared in an attempt to dispatch convocation notices even earlier.

(The following concerns pages 2 and 3 of Material 1C, Fourth Council)

➤ Matters to be studied in order to “ensure external accounting auditors properly fulfill their roles”

- I believe it is important to clearly define the role of accounting auditors firstly, and then consider each point at issue in relation to this role.
- I believe that accounting auditors should serve as professional specialists, and audit information to be disclosed by the company as accurate and timely from an independent, third-party perspective, giving credibility to its financial information. In this way, they are responsible for guaranteeing the reliability of the information that the company discloses.

➤ Establishing standards or policies for proper appointment and evaluation of external auditors (①)

➤ Confirming the independence, expertise, etc. of external auditors (②)

- Companies should clarify the approach they adopt in the appointment/reappointment of accounting auditors, and the Code must clearly state this.
- Also, I would like to stress that, when actually appointing an accounting auditor, it is necessary to go through a process of evaluation of his/her audits based on quality considerations, instead of simply looking at the extent of

his/her remuneration in addition to his/her independence and expertise.

- Also, in relation to the "roles and responsibilities of *kansayaku* ", at least one of the *kansayaku* with the authority to pass resolutions on the appointment and dismissal of accounting auditors will be required to be thoroughly familiar with accounting auditors' audits, and possess the necessary knowledge and skills to appropriately evaluate these. This will allow for better results.

- Securing sufficient time for audit (③)
- Companies' responses to the cases where an external auditors find any fraud, etc. and ask the company to make appropriate response, or point out any inadequacies or problems (④)

- For companies aiming to disclose information in a timely and accurate fashion, the reliability of information is important; companies are responsible for ensuring this, which entails, among other tasks, compliance with Standard to Address Risks of Fraud in an Audit.
- Sufficient time for auditing must also be secured in order to ensure that accounting auditors can maintain audit quality and appropriately fulfill their roles. Even taking it for granted that audit procedures will be carried out effectively and efficiently, sufficient time must be set aside for audits, including compliance with Standard to Address Risks of Fraud in an Audit.
- In view of the above, either the Code's main text or its notes should state that management will require accounting auditors to set aside sufficient time for audit and ensure the reliability of disclosed information.
- Obviously, I believe that, in order to ensure the disclosure of accurate information, the Code should state the duty of companies to seriously address any remarks by accounting auditors, including compliance with Standard to Address Risks of Fraud in an Audit.

- Securing external auditors' access to CEO and CFO (interviews, etc.) (⑤)
- Ensuring sufficient coordination between external auditors and corporate auditors/internal audit department (⑥)

- Accounting auditors are subject to rules on the necessity of communication with management, *kansayaku* and internal audit department. However, I believe that such communication should be carried out at the initiative of both the company and the accounting auditors. Therefore, I believe that the Code should stipulate for companies to secure access for their accounting auditors.

While some of the above matters, while not clearly stipulated by law, may nevertheless be inferred from the existence of auditing standards, I believe they should be codified in order to indicate our companies' stance. Accordingly, I believe that the six items listed as points of consideration (① to ⑥) should all be included in the Code's main text or in its notes.

Also, I believe that the following two items should likewise be included in the Code's main text or in its notes.

- ⑦ Matters relating to attendance at the *kansayaku* board meetings as necessary for accounting auditors to fulfill their role more effectively
- ⑧ Matters relating to two-way communication between outside directors monitoring the board and accounting auditors

(About items in page 3, Material 1D, Fourth Council)

➤ What should we think about describing a basic concept that external auditors, who are appointed by shareholders, have responsibilities for the shareholders (although an audit contract itself is concluded with the management) in the Code?

- I agree that this should be incorporated into the code.
- Under the current system, the responsibility of accounting auditors toward shareholders is fulfilled through audit reports and the duty to state opinions at general shareholders' meetings as stipulated in Article 398, paragraph 2 of the Companies Act. I believe that this matter should not be determined solely by regulatory authorities, persons preparing financial statements and accounting auditors; rather, it should be determined with an eye to promoting understanding on part of all users of financial statements, including shareholders.
- Let us look, for example, at audit reports. In foreign countries, the audit reports of listed companies are required to list key audit matters in addition to audit opinions. Companies can thus promote the users' understanding of key areas included in financial statements. This is being studied as a possible basis for more in-depth dialogue between companies and users. In the UK, a system requiring audit reports to indicate key audit matters has already been introduced.

4. Responsibilities of the Board (focusing on the fulfillment of their roles/functions, etc.)

(Roles and responsibilities of *kansayaku* from page 12, Material 1, Fourth Council)

- What should we think about professional knowledge and experience required of *kansayaku*?
- It is pointed out that *kansayaku* (and/or the *kansayaku* board) should include person(s) with knowledge of finance/accounting. What should we think about it?

- I believe that knowledge on audits by accounting auditors and specialized knowledge in financial and accounting matters will be necessary in the process of appointing and evaluating accounting auditors, and while supervising audit implementation. In particular, as corporate accounting and auditing standards become more specialized and complex, the appointment of *kansayaku* having sufficient knowledge of the professional duties of accounting auditors will ensure that *kansayaku* can fulfill their roles more effectively. Also, *kansayaku* are in a position to determine the appropriateness of the audit results produced by accounting auditors. Therefore, I believe that at least one of them should be thoroughly familiar with audits carried out by accounting auditors, and possess knowledge and skills relating to financial and accounting matters.
- Likewise, I believe that such specialized knowledge is necessary not only for *kansayaku*, but also for outside directors and the Audit and Supervisory Committee, which are expected to serve a monitoring function at the board.

- Determining proposals to the general shareholders' meeting concerning appointment/dismissal of external auditors, exercising their consent rights to remunerations for external auditors, etc.

- In discussing corporate governance codes, I will assume that current laws apply, and that they do not need to be amended in order to establish the code.
- The role of accounting auditors is that of ensuring the reliability of information disclosed by companies as accurate and timely. For this role to be fulfilled, ensuring the quality of audits conducted by accounting auditors will be imperative. When appointing or dismissing an accounting auditor, his/her audits must be evaluated. For practical purposes, this will also require a decision on audit remuneration.
- Also, I believe that audit quality cannot be maintained unless a suitable remuneration is provided for the audit period required by the accounting auditor who is appointed.

- As discussed above, I believe that decisions on an accounting auditor's appointment/dismissal and audit remuneration should be taken by a single institution in order to ensure the process's effectiveness. If we assume the application of the current Companies Act, I believe the Code should stipulate for the *kansayaku* to first take the act's terms into account in proposing audit remuneration to the board, which, in turn, will on this basis submit a proposal at the general shareholders' meeting.

➤ The structure necessary for *kansayaku* (and/or *kansayaku* board) to effectively fulfill their responsibilities (securing personnel/budgets for supporting *kansayaku*; cooperation and information sharing with the management, internal audit department, outside directors, external auditors, etc.)

- I believe that developing an appropriate organization will prove essential to enable *kansayaku* to fulfill their role more effectively. To this end, I believe that it would be beneficial for the Code to include the aims of “securing personnel/budgets for supporting *kansayaku*; cooperation and information sharing with the management, internal audit department, outside directors, external auditors, etc.

5. Dialogue with shareholders

- I believe that, in order to ensure constructive dialogue between the company and shareholders, it would be beneficial to disclose not only financial information, but also prospective information. To this end, I would recommend considering the disclosure of information in the form of integrated reports covering a good amount of non-financial information (management policies, business strategies, CSR/green initiatives, corporate governance system, performance, future outlook, business model, etc.).