

# **FUTURE OF INTEGRATED THINKING AND REPORTING**

## **IN JAPAN AND GLOBALLY**

Speech by Takashi Nagaoka, Deputy Commissioner for International Affairs, the Financial Services Agency, Japan, at the “IFRS Integrated Thinking & Reporting Conference” on June 12, 2023

### **1. Introduction**

Good morning, ladies and gentlemen, distinguished guests. First of all, allow me to express my gratitude to the IFRS Foundation for organizing this great conference today. I would like to also thank Goethe University for letting us get together at your beautiful campus. It is my great pleasure and honor to have the opportunity to speak in front of you all, who are taking the lead in the area of integrated reporting and sustainability disclosure.

To begin my speech, I would like to share with you that the year 2023, although it is still only half way through, is a key milestone to sustainability disclosure, most notably with the ISSB’s inaugural standards to be issued later this month. To me personally, this year is also special, as I was appointed Chair of the Monitoring Board of the IFRS Foundation this March. As many of you may know, the Monitoring Board was created in 2009 by a group of capital markets authorities, with the aim of overseeing the IFRS Foundation, whose remit now extends to the development of high-quality international accounting and sustainability disclosure standards. The Monitoring Board member authorities are strongly committed to supporting the IFRS Foundation’s work of standard-setting.

Further in April, I was also appointed Chair of International Forum of Independent Audit Regulators (or IFIAR). IFIAR is a group of independent audit regulators from all over the world, working together to serve the public interest, including investors, by enhancing audit oversight globally. In this context, we pay close attention to and have strong interest in developments in sustainability assurance.

A few months have passed since I began to wear these two hats. The experiences so far make me pause and think that tackling sustainability disclosure is really something that

requires the way of “integrated thinking”, defined by IIRC (International Integrated Reporting Council)’s Integrated Reporting Framework as, quote, “the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects.” As capital markets regulators, we are encountered by multi-faceted issues such as rules for disclosure, assurance, market data and transactions. On top of them, capacity building for preparers, assurance providers and users of sustainability information is also a quite important issue. The regulators are expected to do the work so that everything is functioning properly in the capital market ecosystem, both nationally and internationally, and integrated thinking, I believe, should help us in meeting such expectations.

### **<2023 G7 Japan Presidency Outcome>**

At this important juncture, it is an honor that Japan takes on the G7 Presidency this year, succeeding the German Presidency. Last month, G7 Finance Ministers and Central Bank Governors met in Niigata and the G7 Leaders in Hiroshima. The communiqués from the two meetings highlighted the ISSB’s progress. Both statements support the ISSB’s finalizing the standards for general reporting on sustainability and for climate-related disclosures, and also look forward to the ISSB’s future work on disclosure on biodiversity and human capital, in line with its work plan consultation. Finance Ministers and Central Bank Governors further noted that these future work could enhance investors’ ability to assess companies’ value creation from activities related to biodiversity and human capital such as investment in their workforce, as well as diversity, equity and inclusion.

With that, I would like to speak about the value of integrated reporting in the context of growing attention to sustainability disclosure.

## **2. JFSA’s initiative in corporate governance and work towards sustainability disclosure**

Now, let me take a little time to share with you our initiative in enhancing corporate governance and work towards sustainability disclosure in Japan.

Japan FSA has been working for more than a decade to help enhance medium- to long-term corporate value through the mechanism of investment chain. We established the Japanese Stewardship Code in 2014 and Corporate Governance Code in 2015, and implemented a series of corporate governance reforms.

The most important element in increasing medium- to long-term corporate value is to have a continuous and constructive dialogue between investors and investee companies. Without doubt, corporate disclosure has a tremendously important role in facilitating a constructive dialogue.

Institutional investors have been paying more attention to non-financial information over the past decades. In order to evaluate sustainability of the company's business, investors seek more information on "Environmental", "Social" and "Governance" factors that the company relies on. In other words, investors actually do look at a company's strategies and responses over various sustainability topics for making an investment decision.

In Japan, sustainability disclosure in the statutory annual securities report has just started this year, from the financial year ending March. More than 4,000 entities, including both listed companies and large non-listed companies, are subject to this legal requirement.

### **3. Sustainability disclosure and integrated reporting**

Requirement for sustainability disclosure is now becoming part of securities regulation not only in Japan but also in other parts of the world. However, we should recall that corporate disclosure of sustainability information has evolved over years on a voluntary basis, supported by numerous reporting frameworks with different scopes and different requirements, which led to a diverse situation often called "alphabet soup". Among such a variety of frameworks, one of the most prevalent is indeed the International Integrated Reporting Framework established by the IIRC.

Speaking of Japan, a lot of companies issue their integrated reports in line with the IIRC's framework to bring together financial and non-financial information to convey an organization's strategy, governance, performance and prospects in a way that reflects

the commercial, social and environmental context where they operate.

In fact, we see a continuous increase in the number of entities issuing an “integrated report” in Japan. The number first exceeded 100 in 2014, and over the past few years, since 2020, we have been witnessing more than 100 additional organizations every year starting their integrated reporting. In total, over 800 organizations issue an integrated report as of the end of 2022. Arguably, Japan could be one of the top countries with entities engaging in integrated reporting. According to a PwC survey, among Nikkei 225 companies, about 70 percent use IIRC’s Integrated Reporting Framework.

Global institutional investors, on the other side of the equation, also seem to pay close attention to integrated reporting. In 2021, the world-leading 24 investors published their support, emphasizing the value of integrated reporting and its importance in their capital allocation decisions. JFSA, as a securities regulator, recognizes the value of such reporting as a means of providing useful information for investment decision.

#### **4. What drives integrated reporting in Japan**

Now, what is the driver for so many Japanese companies to work on integrated reporting? I would like to point to three elements.

First, it presents a company’s value creation story to investors and other stakeholders. It explains the prospect of the company’s sustainable growth based on the recognition of and responses to future business opportunities and risks to which the company will be exposed. The Integrated Reporting Framework proposed by the IIRC is a model that clearly shows the process by which an organization creates value. It closely relates to the past, present, and future performance by the organization. It clarifies how the six types of financial and non-financial “capital” are used in the organization, and how its business activities affect the “capital.” A lot of Japanese companies are trying to differentiate themselves by telling their value creation stories through the Framework.

Second, the Integrated Reporting Framework works as a common language, facilitating dialogue and engagement with investors both domestic and international. In order to

increase corporate value over medium- to long-term, it is important for companies to draw up management strategies under sound corporate governance that extend to medium- to long-term. At the same time, it is important to attract institutional investors who are willing to make medium- to long-term investments by means of high-quality corporate reporting. In particular, for those Japanese companies with global operations, attracting investments from overseas are essential. To that end, approximately 80 percent of Japanese companies which publish integrated reports also disclose them in English.

Third, an element that looks more into the future, *i.e.*, the momentum towards enhancing disclosure on investment for human capital. The Japanese society has been experiencing structural issues such as low rate of birth, aging population and long period of subdued economic growth. To address these, the Japanese government is promoting “Investment in people,” and corporate disclosure on human capital is one of the important components of that policy package.

### **<Sustainability disclosure and disclosure on human capital in Japan>**

Here, I would like to elaborate a bit more on the enhancement of disclosure of sustainability-related information, *inter alia*, disclosure on human capital in Japan.

As mentioned earlier, very recently, a new section has been created in the Annual Securities Reports to provide sustainability-related information such as climate change and human capital in an integrated manner. In particular, with regard to human capital and diversity, which are becoming increasingly important for investors, JFSA has taken a determined step to address the issue by requiring a number of actions: *i.e.*,

- companies shall disclose “Human resource development policies” and “Policies on improving workplace environment,”
- companies shall set measurable metrics consistent with these policies, and disclose their targets and progress, and
- companies shall disclose “Ratio of women in managerial positions”, “Ratio of male workers taking childcare leave”, and “Gender pay gap” as items necessary to determine corporate value over medium- to long-term.

We regard this as a first step, and although we have not yet specified any disclosure standards, we expect that companies' sustainability initiatives will nonetheless be widely disclosed. We hear that some Japanese companies have taken this opportunity to start considering seriously their human capital strategies.

Now, I have been focusing on what is happening in Japan, but this issue of human capital is not necessarily Japan-specific. Investment in human capital and subsequent growth in productivity should be an essential part of a company's strategy for sustainable growth over the medium- to long-term regardless of where it is located or operates.

Indeed, human capital is one of the six capitals defined by the IIRC's Integrated Reporting Framework, and other sustainability disclosure frameworks also identify human capital as one of the key subtopics. In the traditional accounting, investment in people is recognized as costs, and thus cannot capture the whole impact of human capital in the corporate value creation. Therefore there is a strong reason why human capital should be looked at in the context of sustainability disclosure. It coincides with the fact that institutional investors around the world increasingly seek information on human capital management in making investment decisions. However, although reporting on human capital is increasing, investors say they do not have information that is sufficiently decision-useful and comparable to evaluate. As ISSB is publicly consulting on its agenda priorities at this moment, I would hope that the investors and other stakeholders pay close attention to this important topic of human capital and share their views through their responses.

## **5. ISSB and integrated reporting**

In the earlier part of the speech today, I mentioned that many Japanese companies have built up their experience with sustainability disclosure through producing integrated reports.

It may be noteworthy that the first set of ISSB's sustainability disclosure standards, to be published later this month, has been developed with reference to the IIRC's Integrated Reporting Framework which have been observed by many companies.

The ISSB Standards require an entity to disclose metrics and targets to enable users to understand performance on sustainability-related risks and opportunities, including (but not limited to) how an entity measures, monitors and manages such risks and opportunities. This is likely to increase the quality of sustainability reporting for many companies, including with regard to the progress towards the targets they have set forth.

Following the finalization of S1 and S2 standards, the ISSB will focus on providing guidance and capacity-building for the implementation of its standards. In addition, various jurisdictions across the globe including Europe, the United Kingdom, the United States and Japan are considering rules and standards for sustainability disclosure within their jurisdictions.

Looking at the situation in Japan, in January 2023, the Sustainability Standards Board of Japan (or SSBJ), the standard-setting body for sustainability disclosure in Japan, decided to undertake projects to develop Japanese sustainability disclosure standards.

In its standard development plan announced in February 2023, the SSBJ stated that they:

- develop internationally consistent Japanese standards to increase comparability of sustainability-related financial information and to ensure reliability of the Japanese sustainability disclosure standards; and
- ensure that Japanese standards are consistent with the ISSB's standards, which will be regarded as a comprehensive global baseline.

According to the plan, exposure drafts of the SSBJ standards will be published by March 2024 and final standards by March 2025, assuming that the first two ISSB standards are published by the end of this month.

Companies and investors are becoming increasingly interested in sustainability disclosure, facing the development of a legal and regulatory regime around sustainability disclosure in each jurisdiction. From the experience in financial reporting, one of the big potential concerns is that compliance becomes the ultimate goal and consequently the content of disclosure simply a boilerplate. In order to prevent such situations, it is critical

that substantial dialogues take place between the companies and investors facilitated by providing companies with good practices, while disseminating basic concepts like integrated thinking and integrated reporting framework, and further improving engagement by investors.

## **6. Conclusion**

Let me conclude my speech with a few words.

In a world that is continuing to change rapidly, I believe high quality frameworks and standards are increasingly needed along with integrated thinking practice. They would help orient the conversations between companies and investors, explain the economic implications, and improve visibility of the drivers of long-term value creation for investors—in short, unlocking the opportunity for better decision-making driven by better information.

I would like to stop here.

Thank you so much for you kind attention.