

Q&A

*on the Disclosure of Narrative
Information Regarding the Impact of
COVID-19 Infection*

*– Key Points for Better
Disclosure for Investors –*

Contents

- Amid the spread of COVID-19 infection, the FSA compiled the concept of disclosure of information regarding the impact of the infection as part of narrative information in securities reports and publicized the key points for better disclosure for investors in the form of a Q&A.
- In line with the "Principles Regarding the Disclosure of Narrative Information" (publicized on March 19, 2019), this Q&A was compiled with the aim of encouraging companies to make efforts to enhance their information disclosure regarding the impact of COVID-19 infection, which should be more than just a formal response to the rules, and is not intended to add new disclosure items.

- CONTENTS -

1. Outline of the "Principles Regarding the Disclosure of Narrative Information"	P.1
2. Key points of the General Remarks of the "Principles Regarding the Disclosure of Narrative Information"	P.2
3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection	
Q1: Information on business policies and environment as well as issues to be addressed, etc.	P.3
Q2: Information on business risks	P.4
Q3: Information on countermeasures against business risks	P.5
Q4: Information on analysis by the management of financial conditions, operating results and cash flow status (MD&A)	P.6
Q5: Information on analysis of the cash flow status	P.7
Q6: Information on accounting estimates	P.8
Q7: Information on the status of activities of company auditors, etc.	P.9
Q8: Information on executive compensation	P.10
Q9: Information on cross-shareholdings	P.11
Q10: Concept of disclosure regarding ex-post changes in the circumstances included in future information	P.12

1. Outline of the "Principles Regarding the Disclosure of Narrative Information"

Based on the report prepared by the Disclosure Working Group of the Financial System Council in June 2018, the FSA formulated **a principle-base guidance** concerning narrative information (publicized on March 19, 2019).

Objective

- By compiling the concept of disclosure of narrative information in securities reports, with a focus on business policies and strategies, analysis of operating results as well as risk information, the Principles **aim to promote corporate efforts to enhance disclosure that is more than just a formal response to the rules.**

Composition

- I. General Remarks:** Indicate the concept common for the disclosure of narrative information in general and efforts for better disclosure
- II. Itemized Details:** Indicate the concept of disclosure and efforts for better disclosure regarding business policies and strategies, etc., which are among narrative information items that enable investors to make appropriate investment decisions and lead to constructive dialogues between investors and companies.

I. General Remarks

II. Itemized Details

1. Business policies and environment as well as issues to be addressed, etc.

- 1-1. Business policies and strategies
- 1-2. Operational and financial issues to be primarily addressed
- 1-3. Key Performance Indicators (KPIs)

2. Business risks

3. Analysis by the management of financial conditions, operating results and the cash flow status (Management Discussion and Analysis, or MD&A)

- 3-1. Items in common within the MD&A
- 3-2. Analysis and examination of the cash flow status as well as information on sources of funds and capital liquidity
- 3-3. Important accounting estimates and the assumptions to which they are applied

Positioning

- The Principles **do not add new disclosure items** but companies are **expected to make efforts to enhance their information disclosure** in line with them.
- The FSA intends to make efforts to **widely disseminate best practices** in line with the Principles by publicizing them, and also **reflect accumulated best practices into the Principles** as necessary.

2. Key points of the General Remarks of the "Principles Regarding the Disclosure of Narrative Information" (publicized on March 19, 2019)

Appropriate reflection of discussions from the perspective of the management

- Discussions at the board of directors and the Executive Committee regarding business policies, performance evaluation, and management risks should be reflected appropriately in disclosure.
- The management should present basic policies regarding disclosure.

(Note) In companies where multiple departments are involved, the executive in charge should oversee each department so as to ensure consistent disclosures based on the discussions of the board of directors and the Executive Committee in each department, and a system should be established in which the cooperation of the related departments is appropriately obtained.

Materiality

- Judgements on the materiality of narrative information should take into account the degree of the impact that the matter will have on business performance and the likelihood of occurrence of the matter. The evaluation of the materiality of narrative information should be reflected appropriately in disclosure.

Reflection of discussions on capital costs, etc.

- Discussions at the board of directors and the Executive Committee regarding growth investments, cash reserves and shareholder returns, as well as capital costs, and future directions of management based thereon should be reflected appropriately in disclosure.

Segment information

- As it is required to discuss a preferable business portfolio, in-depth segment information based on the perspective of the management should be disclosed.

Clear disclosure

- In order to promote the understanding of narrative information, supplementary visuals like charts, graphs, and images should be actively utilized.

(Note) In cases where explanatory materials of financial results and annual reports are prepared, companies may consider using the charts, graphs, and images therein in legal disclosure documents. In doing so, it is necessary to ensure that material information is sufficiently disclosed.

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q1: Information on business policies and environment as well as issues to be addressed, etc.

Amid the spread of the impact of COVID-19 infection:

- Do we need to describe the impact of COVID-19 infection on the business environment?
- What points should we take into account when reviewing business policies and strategies in light of the current business environment?
- When we do not need to review business policies and strategies, don't we need to provide an additional explanation?

(Explanation)

- When disclosing business policies and strategies in securities reports, companies are required to also provide an explanation of the management's view on the business environment behind such policies and strategies.
- Companies are expected to describe the management's view on the business environment, not only on the corporate structure, the condition of the market in which they operate, and competitive advantages over competing companies, but on their weaknesses and challenges, and expected chances and risks in consideration of possible changes in the business environment, and disclose business policies and strategies based thereon. It is preferable to include an explanation of the management's view on the business environment unique to each segment so that investors can properly understand the business policies and strategies of respective segments.
- The spread of COVID-19 infection has been exerting a significant impact on the business environment as a whole, but the degree of the impact may vary by business type. Therefore, companies are expected to describe the impact of COVID-19 on their business environment specifically for each segment, in light of their own weaknesses and challenges, as well as chances and risks, which were newly recognized by the management.
- Additionally, it is preferable to also include the management's view on possible changes in the business environment that may be caused by the impact of COVID-19 infection.
- When reviewing and altering business policies and strategies in light of the current changes in the business environment, a description should be made to clarify altered points. If KPIs also need to be altered, companies are expected to not only indicate new KPIs but also specifically explain the grounds for the alteration.
- Even if it has been judged unnecessary to review business policies and strategies, companies are expected to specifically describe the developments of discussions leading to such judgment, in consideration of the fact that people are requested to change their lifestyles due to the spread of COVID-19 infection.

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q2: Information on business risks

With regard to the impact of COVID-19 infection:

- Do we need to describe the impact as business risks in securities reports?
- When we describe the impact in the section of "Business risks," how should we describe the amounts of the impact on our operating results?

(Explanation)

- When the management considers that COVID-19 infection may exert a significant impact on their businesses as a result of examinations, such impact needs to be described as business risks in securities reports.
- When describing the impact of COVID-19 infection, companies are expected to specifically describe the details of their current status and the impact on their operating results, such as by including the content of discussions at the board of directors and the Executive Committee concerning the impact on workers' working styles and supply chains or on other business activities (the management's recognition and analysis of the situation and countermeasures (alteration of business strategies, etc.)). Additionally, quantitative information should also be incorporated to the extent possible.
- Quantitative information may include the amounts of the possible impact on operating results as discussed at the board of directors and the Executive Committee. Those amounts may be indicated as rough estimates or in certain ranges of amounts. It is also important to describe the assumptions and scenarios for calculating the amounts of the impact.
- When it is impossible to reasonably estimate the amounts of the impact on operating results as of the time of submitting securities reports, companies are recommended to describe to that effect in securities reports and disclose the amounts, when a reasonable estimation becomes possible, in quarterly securities reports or extraordinary reports or on a timely basis.
- When describing the impact of COVID-19 infection in connection with business policies and strategies is considered to be helpful for investors, companies may incorporate a description on the impact under a title regarding risks in the section of "Business policies and strategies," and merely state, in the section of "Business risks," something like "Refer to the description in the business policies and strategies section."

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q3: Information on countermeasures against business risks

If we recognize COVID-19 infection as one of our major risks but do not have specific countermeasures, can we omit them?

(Explanation)

- When countermeasures have been discussed at the board of directors and the Executive Committee, companies should specifically describe the details of the discussions. However, when any countermeasures have yet to be decided, companies are recommended to describe to that effect in securities reports and disclose the information, when countermeasures are decided, in quarterly securities reports or extraordinary reports or on a timely basis.
- When describing countermeasures, it is preferable to describe not only countermeasures pertaining to operating results but also those for business activities specifically, such as the adoption of remote work or other measures for preventing the infection.
- When companies have put in place a special council or control system as measures against risks caused by COVID-19 infection, it is commendable to describe the details thereof, such as the decision maker, members, authority, and positioning of the council, content of the discussions and status of activities.

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q4: Information on analysis by the management of financial conditions, operating results and cash flow status (MD&A)

If it becomes difficult to achieve KPIs due to the impact of COVID-19 infection, what do we need to disclose? Do we need to analyze the impact of the infection?

(Explanation)

- In the section of "Analysis by the management of financial conditions, operating results and cash flow status (MD&A)," companies are expected to explain how the management looked back on the operating results of the term (confirmation of the achievement level of KPIs) and analyzed and reviewed factors having caused increases or decreases in the operating results.
- When describing the achievement level of KPIs under the current circumstances where COVID-19 infection has been exerting a significant impact on operating results, companies are required to distinguish the impact of COVID-19 infection and the impact of other factors and describe the details separately, instead of merely stating "Impact of COVID-19 infection" as a factor having caused increases or decreases in the operating results for the current term.
- With regard to the impact of COVID-19 infection, companies are expected to specifically describe the details of the management's analysis, including the following points:
 - (i) Where (which business segments or regional segments, or which of the processes of procurement of materials and components in the supply chain, production, distribution, sale, etc.) and how the impact has appeared
 - (ii) Whether the management takes the relevant impact as being temporary or as having a possibility to be prolonged due to changes in people's lifestyles

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q5: Information on analysis of the cash flow status

Do we need to describe our cash management in light of the impact of COVID-19 infection in the section of "Analysis by the management of financial conditions, operating results and cash flow status (MD&A)"?

(Explanation)

- Information to be entered in the section of "Analysis by the management of financial conditions, operating results and cash flow status (MD&A)" includes a description concerning sources of funds and capital liquidity.
- With regard to cash management in light of the impact of COVID-19 infection, it is important to describe the management's consideration and actions specifically as information on sources of funds and capital liquidity.
- For example, important information includes the levels of cash and deposits currently held (separately for those held by domestic companies and those held by overseas subsidiaries), the status of established commitment lines, scheduled cash outflow, need for new funding in the short and long term, and measures for avoiding risks of falling foul of financial covenants. It is considered to be helpful to describe unavoidable short-term expenditures as scheduled cash outflow.
- It is also recommendable to describe the management's view regarding allocation of funds for growth investments, cash reserves and shareholder returns in light of the impact of COVID-19 infection. When altering any existing policy, it is necessary to specifically describe the grounds for the alteration and the concept of the new policy.
- When it is considered to be helpful for investors, companies may incorporate a description concerning risks of falling foul of financial covenants in the section of "Business risks," for example (and merely state, in the section of "MD&A," something like "Refer to the description in the business risks section"). In this manner, companies are allowed to flexibly decide where to provide explanations to a certain degree.

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q6: Information on accounting estimates

When we have included a description on the impact of COVID-19 infection as additional information, in line with the Summary of the Discussions publicized by the Accounting Standards Board of Japan, "Incorporating the Effects of the Novel Coronavirus Pandemic when Making Accounting Estimates under Japanese GAAP" (publicized on April 10 and supplemented on May 11, 2020), can we omit a description on accounting estimates in the section of "MD&A"?

(Explanation)

- With regard to what assumptions companies had made in relation to the impact of COVID-19 infection when making the accounting estimates, it is strongly expected that companies specifically disclose the relevant information as additional information in financial statements, as recommended in the Summary of the Discussions publicized by the Accounting Standards Board of Japan and a request issued by the FSA (on May 21, 2020).
- When all or part of the matters that should be entered in the column of accounting estimates in the section of "MD&A" ((32)a(g) of Points of Attention Concerning Preparation of Form 2 of the Cabinet Office Order on Disclosure of Corporate Affairs) has been described as additional information or other notes, it is permissible to omit those matters already described as additional information only by stating that fact in the column of accounting estimates in the section of "MD&A."
- However, if all information cannot be specifically described as additional information or other notes, a supplementary explanation should be provided in the column of accounting estimates in the section of "MD&A."
- In the column of accounting estimates in the section of "MD&A," companies are expected to describe not only assumptions used for making accounting estimates but also the background for adopting the relevant assumptions and possible impact on operating results that may be caused by changes in the assumptions. (See the Part, "Important accounting estimates," of the "Best Practices for the Disclosure of Narrative Information.")
- With regard to the possible impact on operating results, quantitative descriptions are preferable, but when it is difficult to measure such impact quantitatively, companies should describe supposed scenarios, etc. qualitatively in an easy-to-understand manner.
- The approach shown in the Summary of Discussions (Supplement) that "in such cases as where, as a result of making accounting estimates for this business year, it is found that the impact of the infection on the amounts for this year's financial statements is marginal but there remains a risk of a significant impact on the following year's financial statements, disclosing additional information on assumptions, including assumed future spread of the infection and timing of resumption of a normal situation, would be helpful for users of financial statements" will also be applicable to descriptions concerning accounting estimates in the section of "MD&A."

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q7: Information on the status of activities of company auditors, etc.

- If activities of company auditors, etc. are restricted due to the spread of COVID-19 infection, how should we describe them?
- Do we need to describe our measures for ensuring proper audit work under the impact of COVID-19 infection?

(Explanation)

- In the section of "Status of auditing," activities of company auditors, etc. throughout a business year need to be described. Companies are expected to describe activities already carried out by company auditors, etc. first, and if there are any scheduled activities that have become difficult due to the impact of COVID-19 infection, such as becoming unable to follow ordinary procedures in auditing financial statements and business reports, companies should describe the details thereof and measures taken alternatively.
- If it is also difficult to take alternative measures, companies are expected to specifically describe the relevant grounds and risks that may be caused by the absence of such activities of company auditors, etc. When companies have decided not to take alternative measures, that decision and the grounds therefor should be specifically described.
- Companies are also expected to disclose what efforts they have been making with financial auditors in order to ensure proper audit. For example, it is recommendable to specifically describe what kind of discussions company auditors, etc. have had with financial auditors and what measures they have taken for ensuring proper audit under the current circumstances where the spread of COVID-19 infection has been making it difficult for financial auditors to perform audit work as usual.
- Additionally, it is preferable to describe future measures for ensuring proper audit in the event of an abnormal incident that may hinder audit work, based on the current experience (such as measures for reducing risks of a delay in audit work).

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q8: Information on executive compensation

- If we alter calculation methods for executive compensation due to the impact of COVID-19 infection, to what points should we pay attention in disclosing executive compensation?

(Explanation)

- In the section of "Executive compensation," companies are required to describe methods of deciding and paying compensation and underlining ideas, such as calculation methods of the performance-linked compensation, and when the methods are linked with KPIs or other indicators, such indicators and the grounds for selecting them, as well as target values and achievements. Furthermore, in order to secure objectivity and transparency in the process of deciding executive compensation, concrete activities of the board of directors and the compensation committee regarding decisions of compensation should be described in detail.
- When altering calculation methods for executive compensation (including the alteration of KPIs), it is necessary to describe the background and grounds leading to the alteration, such as the content of discussions at the board of directors and the compensation committee. Differences between the new calculation methods and the former calculation methods should also be described specifically in an easy-to-understand manner.
- Even in the case of newly adding indicators for maintaining employment and securing workers' health and safety (non-financial indicators) to KPIs, relevant target values and achievements need to be described.
- Even in the case of altering calculation methods for executive compensation with the aim of reducing the amount temporarily, it is important to describe the background and ideas regarding the alteration and the content of discussions at the board of directors and the compensation committee.

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q9: Information on cross-shareholdings

If there is any valuation loss due to the stagnant state of share prices, do we need to provide an additional explanation on the effect of cross-shareholdings?

(Explanation)

- It is not that the effect of cross-shareholdings is evaluated by share prices, but when any risks have surfaced, such as significant fluctuations in fair value caused by rapid changes in share prices, further detailed descriptions will be required regarding how such risks are examined in verifying the effect of cross-shareholdings.
- When companies concluded that the significance of cross-shareholdings has decreased and decided to sell those shares by altering their policies, they should describe such decisions and approaches for selling them, including the timing.
- On the contrary, when companies have increased cross-shareholdings, it is preferable to describe what benefits will be brought about by the additional purchase and the effect of cross-shareholdings in a more detailed manner. It should be noted that it is not enough to merely enter acquisition processes, like "Acquisition through dividend reinvestment" or "Acquisition through client stock ownership," or merely state "Strengthening of business relations."

3. Q&A on the Disclosure of Narrative Information Regarding the Impact of COVID-19 Infection

Q10: Policy for the disclosure regarding ex-post changes in the circumstances included in future information

If actual results turn out to be different from descriptions in securities reports regarding the impact of COVID-19 infection, which is highly uncertain, could such fact be considered to constitute a false statement?

(Explanation)

Summary of Public Comments and the FSA's View on Comments (publicized on January 31, 2019) [Extract]

No.	Summary of Comments	The FSA's View
16	<p>Is it correct that when actual results turn out to be different from any of the descriptions made based on an issuer's awareness as of the time of submitting a securities report, the relevant description does not fall under a false, incomplete, or misleading statement? If any of the following cases may be considered to fall under a case involving a false, incomplete, or misleading statement, an issuer may have to make conservative and abstract descriptions to some extent.</p> <ol style="list-style-type: none"> (1) A case where the issuer stated that the relevant risks would be unlikely to arise, but they have actually surfaced; (2) A case where the relevant risks actually surfaced at a different time from the supposed timing entered in a securities report; (3) A case where the actual impact of the relevant risks was different from the supposed impact entered in a securities report 	<p>When disclosing business risks, companies are expected to provide investors with an easy-to-understand explanation as to how the board of directors, etc. considers the materiality of each risk depending on the degree of the impact that the risk would have on their future operating results and the likelihood thereof. The same view is also indicated in the "Principles Regarding the Disclosure of Narrative Information," which the FSA publicized on March 19, 2019.</p> <p>In this manner, companies are not required to provide accurate predictions on all uncertain future incidents in the section of "Business risks," but are expected to specifically explain major risks that the management considered as being highly likely to exert a material impact on their operating results as of the time of submitting securities reports.</p> <p>Whether any description in the section of "Business risks" constitutes a false statement should be judged on a case-by-case basis. <u>When a company provided a concrete explanation within a scope generally considered reasonable with regard to major risks that the management considered as being highly likely to exert a material impact on their operating results as of the time of submitting a securities report, the company will not be held liable for a false statement only due to changes in the circumstances after the submission of the report. On the contrary, if a company purposefully failed to describe major risks that the management considered as being highly likely to exert a material impact on their operating results as of the time of submitting a securities report, such case may fall under a case involving a false statement.</u></p>

