

## **Proposals concerning non-financial CSR disclosures, with particular reference to KPIs relating to corporate value.(Summary)**

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Japanese Institute of Certified Public Accountants

### **I. Purpose**

This is a report of a study into future CSR reporting taking into consideration current and possible future mandatory requirements on CSR reporting.

Our study focused on KPIs (key performance indicators) for non-financial CSR reporting and related qualitative information.

In this document, KPIs for CSR reporting are understood as defined in the UK's statement of best practice on the OFR (ASB, Reporting Statement: Operating and Financial Review, 2006), which states " KPIs are factors by reference to which the development, performance or position of the business of the entity can be measured effectively. They are quantified measurements that reflect the critical success factors of an entity and disclose progress towards achieving a particular objective or objectives."

We assumed that the stakeholders to whom CSR reports will be disclosed will include investors who will use non-financial information for their decision making in some way.

### **II. Outline of the study**

#### **1. Scope of the study**

Mandatory requirements considered were: (1) annual securities reports, (2) draft standards on the evaluation and audit of internal control over financial reporting, and (3) KPI reporting schemes in some European countries. Guidelines considered were (4) G3 version for invitation of public opinions of GRI Draft Sustainability Reporting Guidelines<sup>1</sup>,

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<sup>1</sup> The final version of G3 has now been issued.

(5) Environment Reporting Guidelines (Ministry of the Environment, 2003), (6) Reporting Guidelines on Intellectual Assets Management (Ministry of the Economy, Trade and Industry, 2005).

## **2. CSR information classification for the study**

The base classifications of CSR information are the economy, society and the environment, which form a triple bottom line, and six detailed classifications, (1) corporate governance, (2) employees, (3) customers, (4) interaction with wider society, (5) environment and (6) other. They are based on the assumption that the parties to whom the information is disclosed include investors.

## **3. Major characteristics of KPIs and related qualitative information.**

The major characteristics for selection of KPIs and related qualitative information which should be disclosed as CSR information are objectivity, understandability and financial significance.

Refer to Annex 1: Study Process Outline

## **III. Results of the study**

### **1. Annual securities reports**

A study of CSR reporting in annual securities reports<sup>2</sup> was reviewed.

Four narrative reporting sections, in which CSR information is particularly likely to be disclosed, were examined; risks relating to the business; the state of corporate governance; current challenges ; and R&D activities. Information subject to the study was determined by referring to environmental and social performance indexes set in the year 2002 version of the GRI Guidelines and considering the matters actually stated.

The study revealed that CSR information: is disclosed more than expected in annual securities reports which are core media for mandatory information in Japan; typically does

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<sup>2</sup> Yoshinao Kozuma, "Preliminary Study of CSR Reporting in Annual Securities Reports", *JICPA Journal*, July 2006 (no. 612).

not comply with GRI Guidelines; and significantly differs by company.

## **2. Draft standards on the evaluation and audit of internal control over financial reporting.**

Draft standards on the evaluation and audit of internal control over financial reporting (referred to as the “Draft Standards” below) were announced in a report called “Requirements for standards on the evaluation and audit of internal control over financial reporting” (the Business Accounting Deliberation Council, December 8, 2005). The Draft Standards require company executives to test and evaluate the effectiveness of internal control over financial reporting of their own company and to publicize the results.

Utilizing KPIs for CSR reporting is effective for testing and evaluating control design or operating effectiveness of company-level internal control. Cases in the US, where an audit of internal control over financial reporting is advanced, were studied to identify relevant KPIs because the Draft Standards do not include examples. During our study of Auditing Standard No.2 of Public Company Accounting Oversight Board<sup>3</sup>, we found such factors as integrity and ethical values, commitment to competence, and participation of the board of directors or the audit committee, to be significant considerations when identifying KPIs.

## **3. KPI reporting schemes in some European countries.**

KPI reporting schemes are guidelines with companies deciding for themselves whether or not to make such reporting, although there are some mandatory requirements in countries including France, the UK, the Netherlands and Germany.

Classifications are based on the triple bottom line, but detailed items vary.

The following three points should be referred to concerning mandatory requirements and the reporting media of CSR information. One point is that CSR information items are specified in the Netherlands’ Annual Report Guideline 400. The second point is that there are three choices of reporting media, namely, (1) only in annual reports, (2) only in CSR reports and (3) in both annual reports and CSR reports, based on the view that such

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<sup>3</sup> Auditing Standard No.2- An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements, PCAOB, March 9 2004

information should be disclosed in annual reports but that disclosure also in CSR reports is permitted. The final point is that in the case of (2) or (3), it is recommended to note in an annual report that a separate CSR report is prepared.

#### **4. Guidelines**

Reflecting possible differences in the purposes of guidelines, there exist differences among them regarding what should be included in the CSR report. However, it is significant that a relatively large number of items pertaining to employees and the environment are specified as being desirable for disclosure.

The names and content of similar items vary by guidelines.

#### **5. Annexed table of study results**

Taking into consideration the study results described above, the annexed table, “Examples of qualitative information for KPIs pertaining to CSR Disclosures”, based on a policy of (1) provision of illustrative examples, (2) uniformity of naming and (3) provision of examples of qualitative information, was prepared.

Refer to Annex 2: Major areas, by classification, for identifying KPIs for non-financial CSR disclosures.

Refer to Annex 3: Outline of an annexed table “Examples of qualitative information for KPIs pertaining to CSR disclosures”

### **IV. Proposals**

It is no exaggeration to say that CSR reporting is taking root, considering that CSR information is being reported in annual securities reports to a greater extent than expected and is provided under systematized internal control.

Therefore, it is understood that the importance of non-financial CSR information is increasing for investors because such information is very useful for them in making decisions.

On the other hand, annual securities reports include many descriptions which are not required

by GRI Guidelines and mention only major items. Descriptions of more detailed items and levels of descriptions vary between companies. Therefore, there are problems concerning which CSR information to disclose and in how much detail, from the viewpoint of international standardization.

Under these circumstances, the following are problems that companies (the information providers) and stakeholders (the information users) are facing, or will be facing in the near future.

Companies — the information providers.

It is considered that a significant difference in reporting levels is generated because of duplication of work for similar information. The fact that different sections take responsibility for complying with each of the mandatory requirements and guidelines causes inefficiency and increased costs and problems concerning reporting standardization. Confusion may increase because there are likely to be more mandatory requirements and guidelines in the future.

Stakeholders — the information users.

Stakeholders have difficulty in comparing companies and in making decisions concerning companies, for reasons such as inconsistent indexes and differences in similar information disclosed by the same company.

In the light of the above, mandatory requirements and comprehensive guidelines concerning classifications, KPI examples and related qualitative information for non-financial CSR disclosures, are desirable in Japan. Reference should be made to the Netherlands' Annual Report Guideline 400, mentioned above, considering the present circumstances of the annual securities reports stated earlier. It is important that we provide cooperation and support as assurance providers to ensure the effectiveness of CSR reporting from the viewpoint of securing the reliability of CSR information.

Refer to Annex 4: Problems and directions to take.