

Mandatory annual disclosures for listed companies during crises in Japan:
COVID-19 and the Great East Japan Earthquake

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List of Abbreviations

ASBJ	Accounting Standards Board of Japan
FSA	Financial Services Agency (a component of Japanese government)
GC	going concern (see description in page 10)
GEJE	the Great East Japan Earthquake
JICPA	Japanese Institute of Certified Public Accountants
METI	Ministry of Economy, Trade and Industry (a component of Japanese government)
MOJ	Ministry of Justice
TEPCO	The Tokyo Electric Power Company, Inc.
TOPIX	Tokyo Stock Price Index that is calculated based on all the domestic common stocks listed on the TSE First Section
TSE	Tokyo Stock Exchange
Yu-Ho	Yukashoken-Hokokusho (mandatory annual securities report to be submitted to FSA)

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Introduction

Given the information asymmetry between a company's management team and its various stakeholders, investors and other stakeholders are usually imperfectly informed about a company's business performance and financial condition. If management manipulates the nature, timing or extent of material information it is misleading and runs counter to the notion of fairness in stock pricing and credit analysis, causing investors to mistrust and potentially turn away from the capital markets system. This is the reason laws and regulations require ongoing disclosures for listed companies.

However, when emergencies arise it can be challenging to enforce the legal requirements for the listed company disclosures. Company management and employees who operate the business and prepare the disclosures may be personally affected by an emergency situation, which may cause difficulties in providing correct and timely information to investors and other stakeholders. Given such circumstances, it is important to figure out how companies can meet the legal requirements for disclosures, so that investors can make informed decisions about an economy that is attempting to recover from an emergency. Businesses often rely on public support (government assistance) to survive in difficult times, but they should work toward weaning themselves from that type of assistance; otherwise, a true economic recovery is not sustainable.

Japan has experienced two significant emergency situations within the past decade. On March 11, 2011, the Great East Japan Earthquake (hereinafter "GEJE") struck. Nine years later, on March 11, 2020, the World Health Organization determined that COVID-19 was a global pandemic. The former triggered a sudden change in energy policy, and the latter triggered major changes in how and where individuals work and interact, a situation that persists as this analysis is being written.

Among the various types of company disclosures required in Japan, this study focuses on the mandatory annual securities report (in Japanese "Yukashoken-Hokokusho"; hereinafter "Yu-Ho") required of listed companies in Japan. The goal is to compare what happened to the nature and timing of Yu-Ho during challenging times with the times before or after presenting the report, and to provide some findings and suggestions. Section 1 provides a general description of the events and compares their impact on the stock market and in certain other areas. Section 2 compares measures taken by the government regarding Yu-Ho in light of these emergencies. Section 3 shows the impact on representative companies within key industries. Lastly, the key findings are summarized and suggestions are offered.

I. Background

The GEJE occurred suddenly on March 11, 2011. The disaster was a combination of a massive earthquake and aftershocks, a tsunami and a nuclear power plant accident. A majority of the victims were killed by the tsunami; however, as many buildings were heavily damaged by the primary earthquake, the subsequent aftershocks caused additional significant damage to those buildings. The combined events severely damaged the economy in east Japan.

COVID-19 began to spread around the world in early 2020. In Japan, the number of people who had been infected was growing notably by the end of February. At that time, the magnitude and duration of the event was unknown. Although the COVID-19 state of emergency in Japan was terminated in late May 2020, it was not known if or when an effective vaccine would be available.

Although these two emergencies look quite different, there are some similarities. Both events directly affected many people's lives, and people not only suffered at a specific point in time but were also worried about secondary disasters. To a significant degree, the impact of both emergencies (radioactivity versus virus) was not physically visible, so people tended to rely on social media to obtain related information. Moreover, even when the primary wave of the disaster had passed, it was possible that another similar and serious disaster would soon follow, and such an occurrence would not be easy to prevent or control. Behavioral economics theory teaches that investors will hesitate to invest in stocks when the condition of many companies is unclear, as was the case under these uncertain circumstances.

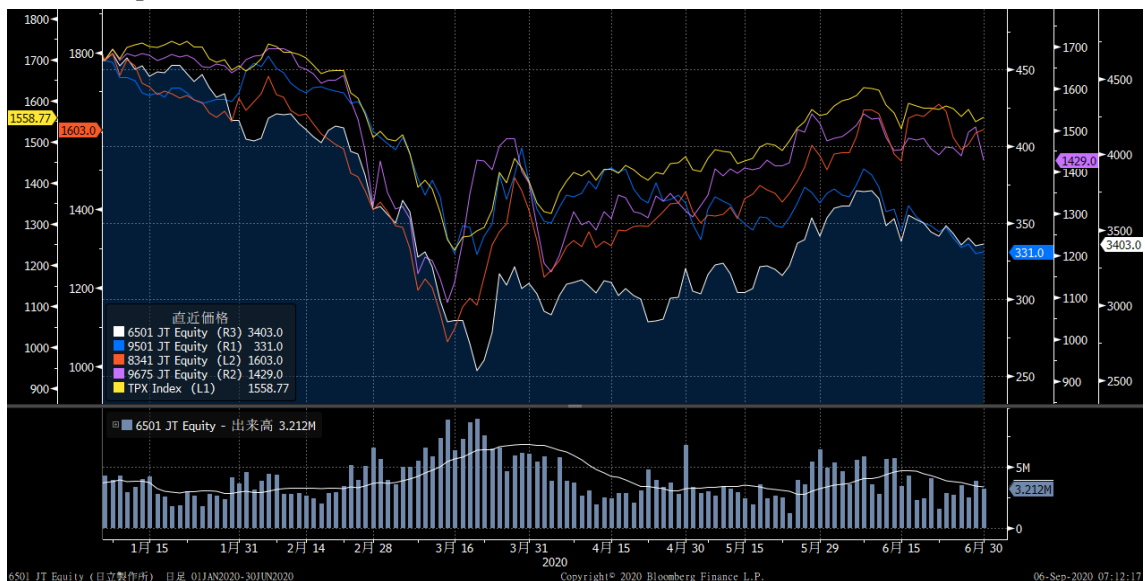
Chart 1 shows stock price fluctuations during these emergencies. Although the patterns are somewhat different, in both cases prices fell sharply within a short period.

Chart 1: Comparison of selected stock prices

(1) Stock price fluctuations, first half of 2011 (GEJE)



(2) Stock price fluctuations, first half of 2020 (COVID-19)



Percentage decline of each stock

	First half of March 2011	First half of March 2020
Joban Kosan Co., Ltd (purple)	-54%	-18%
TEPCO (blue)	-42%	-17%
The 77 Bank, Ltd. (red)	-28%	-24%
Hitachi, Ltd. (white)	-27%	-21%
stock price index: TOPIX (yellow)	-19%	-16%

Source: Bloomberg

The GEJE disaster destroyed industrial supply chains, and the damage caused by the tsunami had a strong negative emotional impact on the public. Moreover, reputational damage arising from concerns about radioactive contamination from the heavily damaged Fukushima nuclear power plant operated by TEPCO affected many export businesses, and the resulting power outage affected production. On the other hand, not all results are negative. Various forms of support were effective in reducing the economic impact. For example, companies located in western Japan supported the suffering economy in eastern Japan. Although shutdowns of some operational facilities caused unemployment, relocating jobs from east to west mitigated those job losses and public subsidy programs were well utilized. Establishing business continuity plans or refreshing crisis management techniques became popular, especially among larger companies. While their employees remained at home, some companies encouraged volunteer activities. Power outages triggered some companies to reconsider working hours, which improved the balance between employees' work and personal lives [The Japan Institute for Labour Policy and Training, 2013].

In the case of the COVID-19 pandemic, although buildings were not destroyed, industrial supply chains have suffered significantly. Table 2 compares a few aspects of these two events.

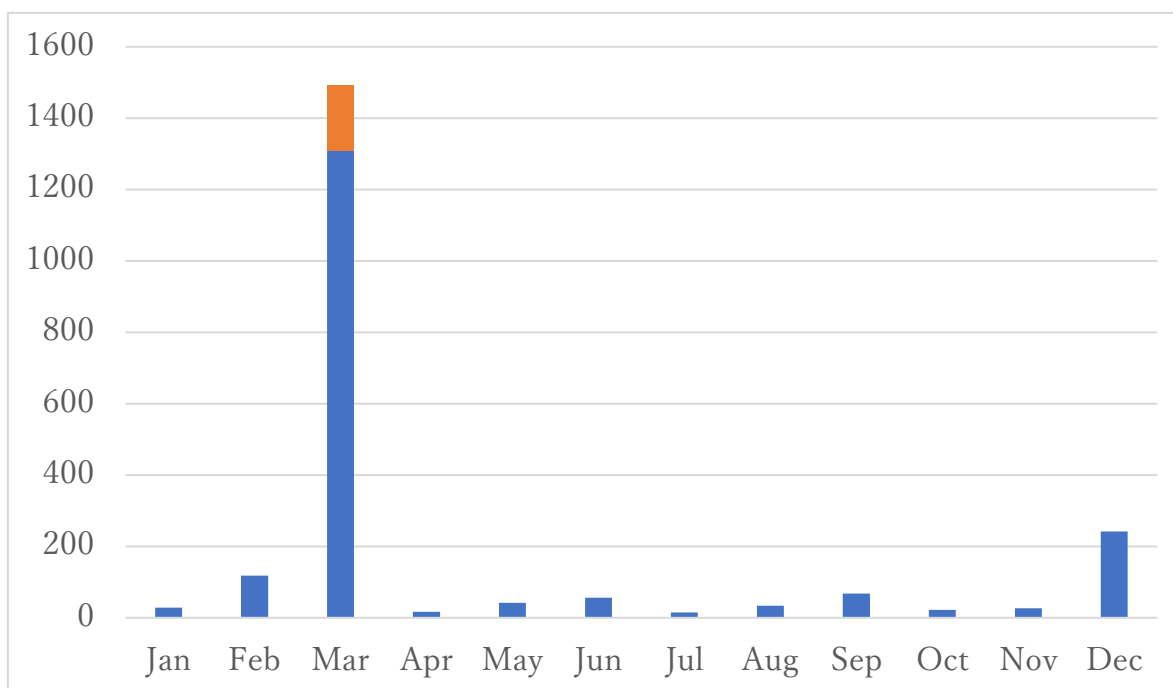
Table 2: Comparison of events overview

	Great East Japan Earthquake (2011)	COVID-19 (2020)
Affected area	East Japan (Especially Japan's Pacific coast and area surrounding the Fukushima nuclear power plant)	Almost all of Japan, especially in large cities Many other countries are more seriously affected.
Time period of the government declaration of the state of emergency	March 11 (for the nuclear power)	April 7 – May 25
Most affected sectors	Operations in the Tohoku area; Electric power; Tourism and entertainment; and Financial institutions	Multinational business; Tourism, pubs, restaurants and entertainment; and Financial institutions

Source: Prepared by author based on general information

Coincidentally, both events began in the month of March. In Japan, most companies have adopted financial year-end closing in March, partly because the government accounting and education systems begin their new year in April. Chart 2 shows the monthly distribution of fiscal year-ends of the TOPIX constituent stocks.

Chart 2: Fiscal year-end of Japanese listed companies



Source: Based on data from Bloomberg

Note: the orange bar included in March represents companies whose financial results had not been announced as of May 23, 2020.

II. Significant measures taken

This section compares two measures taken for mandatory annual corporate reporting: postponement of reporting deadlines and guiding the contents of disclosures (see Table 2).

For both events, the quickest measure taken was to postpone the deadline for Yu-Ho submissions. Normally, a listed company that missed the filing deadline would be subject to civil and criminal sanctions. However, in an emergency it is understood that saving people’s lives is more important than meeting a filing deadline. In 2020, the first announcement regarding a delayed filing deadline was published in February, which seems relatively early compared to steps taken elsewhere in the world. The reason may be that Japan had a similar experience nine years earlier, with the GEJE.

On the other hand, with regard to guidance on sufficient disclosures the government’s actions seemed not only later, in terms of timing, but also softer in tone (i.e., “notice” rather than “order”). Communication regarding guidance on sufficient disclosures was clearer in 2020 than in 2011, which may be due not only to the GEJE experience in 2011, but also that the Japanese government may have taken into account actions of related international organizations.

Table 2: Comparison of measures taken for mandatory annual corporate reporting

	2011	2020
Postponement of Yu-Ho submission deadline by the FSA	Urgent measure: March 13 Revision of regulation: June 22	Announcement of basic policy: February 10 Revision of regulation: April 17
Guidance regarding disclosure	Auditing considerations released on March 30 by JICPA	Accounting guidance released on April 9 and May 11 by the ASBJ; Auditing considerations continuously released by the JICPA; and Notice of sufficient disclosure released on May 21 by the FSA

Source: Edited based on government announcements

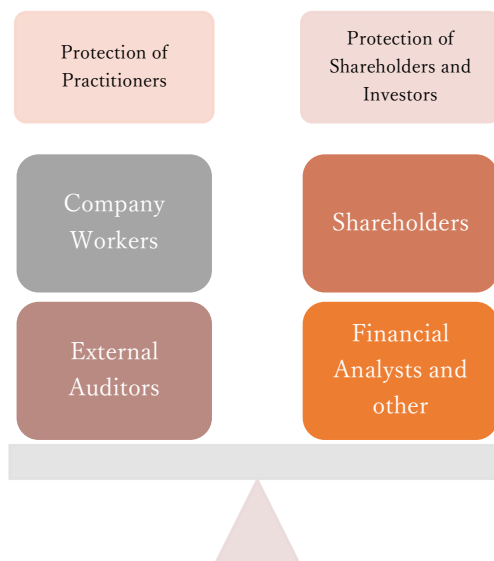
Priorities and balancing of protection

Addressing the issues faced by companies that have their fiscal year-end in March required a trade-off between protecting the employees that prepare the company's financial statements, and protecting shareholders and investors.

According to a 2020 survey by the Japan CFO Association, the greatest concern was the delay in publishing financial statements. It pointed out that the larger the company, or the higher its ratio of overseas sales, the more serious the concern.

Concerns regarding the difficulty in holding a general shareholders' meeting was relatively low.

According to a 2020 survey by the Japan Securities Analysts Association, 38% "Evaluated Positively" measures that allowed financial statements filings to be postponed, while as many as 61% said it was "unavoidable". One respondent noted that the announcement of financial results and its assumptions are important, but they are only one of the inputs necessary for making investment decisions [The Securities Analysts Association of Japan, April 24, 2020].



Anticipated difficulties with timely preparation of financial results

The reasons companies needed more time to prepare their annual financial reporting compared to normal conditions are as follows. First, verification of physical inventory, confirmation of the balance of receivables and payables, and collection of supporting documents to prepare financial statements could not be carried out as usual. In particular, in 2020, communication with overseas offices where lockdowns had been implemented were significantly more challenging than in a typical year. Furthermore, there was a need to re-evaluate internal controls on financial reporting [JICPA, March 18, 2020].

Second, accounting decisions had to be made about the impact of the disaster on business performance. For example, accounting professionals had to determine whether certain events belonged to fiscal year 2019 or fiscal year 2020, and had to make key accounting estimates under highly uncertain circumstances (doubtful accounts, impairments, etc.) [JICPA, revised May 12, 2020]. Judgments had to be made as to whether fixed costs incurred during the lockdown period should be classified as operating costs or extraordinary losses [JICPA, April 22, 2020], and so on.

Third, management and auditors had to assess the company's ability to continue as a going concern (hereinafter "GC"). If an event or situation creates significant doubts about a company's ability to operate as a GC, and if significant uncertainties remain even after the company take mitigating steps, the company is required to disclose certain matters regarding its GC status in its financial statements. Due to the significant uncertainty created by these disaster situations, even if an affected company takes steps to address the problem, it would be expected to describe this in the annual report. Also, the independent auditor would have to consider management's assessment and response, and would determine whether the GC uncertainty had to be recognized.

Fourth, there were considerations regarding the wording of the audit report [JICPA, May 15, 2020]. For example, if an auditor determines that there is a possibility of material misstatement in the financial statements because sufficient audits could not be carried out, an unmodified opinion cannot be granted in the audit report.

Sufficient disclosure

In April 2020, the Accounting Standards Board of Japan conducted deliberations regarding the impact of COVID-19 on various accounting estimates, such as impairment of fixed assets and the recoverability of deferred tax assets, for companies preparing their financial statements. A summary of the discussions pointed out that the spread of COVID-19 has had a broad impact on the economy and on individual business activities, and that it was difficult to predict the future of the virus' spread and when the pandemic would end. It also pointed out the necessity to specifically disclose information that would enable users of financial statements to understand whether or not an accounting estimate has been made, and what assumptions had been used. The following month, it added that even if the impact of the accounting estimates on the current year's financial statements was fairly minor, if there is a risk of a more significant impact on the next fiscal year's financial statements, the disclosure of information regarding key assumptions, such as the future spread of COVID-19 and the timing of its convergence (e.g., discovering an effective vaccine), will provide useful information to users of financial statements [ASBJ, May 11, 2020].

FSA made stronger statements regarding its expectations for more concrete disclosures of the assumptions used in accounting estimates with regard to highly uncertain events such as the COVID-19 pandemic. With regard to non-financial information, it strongly encouraged the management discussion and analysis section to thoroughly address the impact of, and response to COVID-19 in terms of business risks, performance and cash flow [FSA, May 21, 2020]. It also published guidance regarding good disclosure practices in a Q&A format [FSA, May 29, 2020].

III. Case study

This section selects representative companies that were seriously affected by these two disasters. This is solely for purpose of illustration, as evaluating individual companies or their disclosures is not the key objective of this report.

Tourism

Joban Kosan Co., Ltd. owns and operates Hawaiian-style resort hotels and entertainment facilities located in Fukushima Prefecture, one of the areas most heavily affected by GEJE.

Table 3: Comparison of key annual reporting dates for Joban Kosan Co., Ltd.

	2011	2020
Preliminary Earnings Release	May 30	May 22
Annual Shareholders Meeting	June 29	June 26
Submission of Yu-Ho to FSA	June 30	June 26

Source: Bloomberg

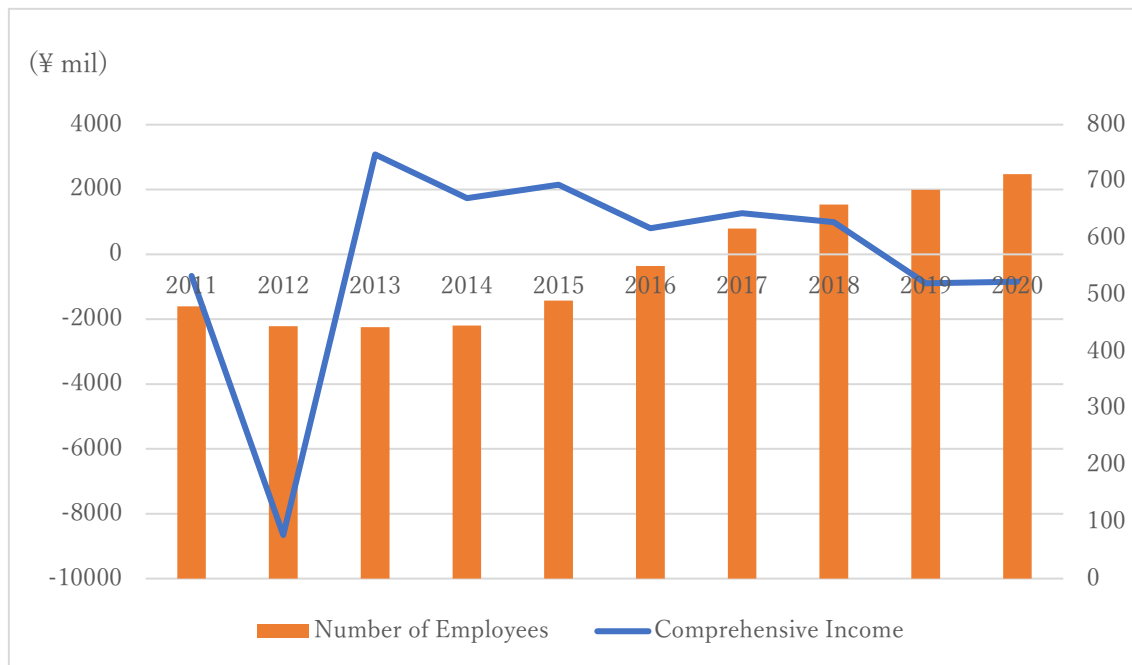
Although the company's Preliminary Earnings Release in 2011 was somewhat late compared to a normal schedule (i.e., within 45 days after the fiscal year-end, as requested by the TSE), the difference between the 2011 and 2020 reporting dates was minor.

According to its 2011 Yu-Ho, although the initial damage to its facilities on March 11 was not too serious, the subsequent damage caused by another earthquake on April 11 was significant and triggered a suspension of operations.

In contrast, in its 2020 Yu-Ho, the company stated that because of the COVID-19 emergency, it would have to suspend operations for several months, which would cause material extraordinary losses. The company's 2020 Yu-Ho states that in management's judgment there was no material uncertainty with regard to its GC status, based on its re-opening schedule and commitments from financial lending institutions (see page 11). With regard to the assumption of accounting estimate, page 50 of the Yu-Ho refers that there are many factors regarding COVID-19 effect, which may materially affect 2021 financial conditions, and the effect would continue until fiscal year 2021. However, it may be difficult to read how much magnitude set in the assumption.

Its income and employment trends for the ten-year period 2011 - 2020 are as follows.

Chart 3: Trends for Joban Kosan Co., Ltd., 2011 – 2020



Source: Edited based on Bloomberg

The financial performance in 2012 was likely worse than in 2011 because it was not possible to estimate the entire loss caused by the disaster in time for the 2011 fiscal year end. It took more than three years for the company to recover in terms of its number of employees.

Electric power supply

TEPCO had nuclear power plants at Fukushima, and suffered serious damage in 2011.

Table 4: Comparison of key annual reporting dates for TEPCO

	2011	2020
Preliminary Earnings Release	May 20	May 15
Annual Shareholders Meeting	June 28	June 25
Submission of Yu-Ho to FSA	June 29	June 26

Source: Bloomberg

Nonetheless, it was able to submit its Yu-Ho on time during both emergencies. According to its 2011 Yu-Ho, the company was facing the most serious crisis in its history, due to the accident at its Fukushima nuclear power plants. It referred to the risk that the company could not control the resolution of the accident. With regard to its GC status, it disclosed that in management’s judgment there was material uncertainty. With regard to its contingent liabilities, it notes the allowance for damage compensation was not recorded because the amount could not be reasonably estimated at that time.

In contrast, according to its 2020 Yu-Ho, although it refers the risk of infection (COVID-19) in the business risk section, the MD&A describes the effect of COVID-19 as minor during the fiscal year (page 31). With regard to the assumption of significant accounting estimate, although it explains the way to estimate the costs related to the Fukushima cleanup effort (which also refers that some amounts still could not be estimated because of ongoing discussions with the government) and the assumption of reserve for retirement allowance, the effect of COVID-19 was not mentioned (page 32-34).

The trends of TEPCO’s income and employment for the period 2011-2020 are as follows.

Chart 4: Trends for TEPCO, 2011 – 2020



Source: Edited based on Bloomberg

The company faced a longer period of crisis than the tourism business after 2011, recording substantial losses for three years after the disaster. Although it was finally able to record a profit with government support, it has had to decrease its employment ever since. This could have been triggered by the disaster, although it is possible that the company has fundamentally changed its employment practices.

Financial institution

The 77 Bank, Ltd. is one of the largest regional banks in the area significantly affected by GEJE.

Table 5: Comparison of key annual reporting dates for the 77 Bank, Ltd.

	2011	2020
Preliminary Earnings Release	May 26	May 15
Annual Shareholders Meeting	June 29	June 26
Submission of Yu-Ho to FSA	June 29	June 26

Source: Bloomberg

The bank's 2011 Yu-Ho refers to natural disaster risk. It recorded a net loss due primarily to extraordinary credit losses caused by the earthquake, and its group capital ratio slipped from 13.25% to 11.69%. In its earnings release, it did not include a forecast for the following year because it could not reasonably estimate the direct and indirect effects of the disaster.

In contrast, despite the challenges of the pandemic, the bank included a performance forecast for the following year in its 2020 earnings release. Its group capital ratio was reported at 10.31%. Its 2020 Yu-Ho refers to the risk of the pandemic. With regard to the accounting policy of reserving for bad debts, although the MD&A (page 34 of the Yu-Ho) refers that it has assumed that a recession would persist for some time due to COVID-19, it may be difficult to read how it set the assumption of duration and magnitude of COVID-19 effect for the accounting estimate. With regard to the uncertainty regarding COVID-19 effect, it refers that the impairment of supply chain may affect production activities people consumption may be cooled down.

Chart 5 shows trends for the 77 Bank, Ltd.'s income and employment for the period 2011 – 2020.

Chart 5: Trends for the 77 Bank, Ltd., 2011 – 2020



Source: Edited based on Bloomberg

The bank recorded a profit in 2012. As a regional bank, it played an important role in the economic recovery after the GEJE disaster. On the other hand, the continuous decline in its number of employees could be interpreted as a sign of a challenging situation. Not only this bank but many regional financial institutions in Japan face difficult business circumstances due to the negative interest monetary policy imposed by the central bank of Japan.

Multinational enterprise

Hitachi, Ltd., one of the most popular multinational enterprise headquartered in Japan, has a number of major facilities in the area significantly affected by the GEJE.

Table 6: Comparison of key annual reporting dates for Hitachi, Ltd.

	2011	2020
Preliminary Earnings Release	May 31	May 29
Annual Shareholders Meeting	June 24	July 30
Submission of Yu-Ho to FSA	June 24	August 31

Source: Bloomberg

In Hitachi’s case, there was no delay in its Yu-Ho submission in 2011, despite serious damage to some of its facilities. However, in 2020, it utilized the deadline extension and submitted its Yu-Ho at the end of August, explaining that the delay was caused by lockdown measures in overseas regions where its subsidiaries operate [Hitachi, Ltd., May 13, 2020]. The Hitachi Ltd. Annual General Meeting of Shareholders was held on July 30. As of the company's cut-off date (May 28, 2020), 248,522 shareholders had voting rights, while only 143 shareholders physically attended the meeting [Hitachi, Ltd., October 16, 2020]. With regard to the assumption of accounting estimate, page 88 of the Yu-Ho refers that although the effect of COVID-19 would occur mainly in the first half of fiscal year 2020, there would be no material effect in the long run. With regard to the uncertainty regarding COVID-19 effect, it refers that although it is the best estimate at the moment, if the effect be prolonged or expanded, it may bring effect on the accounting estimate.

The company’s income and employment trends for the period 2011 – 2020 are shown in Chart 6.

Chart 6: Trends for Hitachi, Ltd., 2011 – 2020



Source: Edited based on Bloomberg

Hitachi recorded a profit even in 2011, but reported a loss in 2016. According to its 2016 Yu-Ho, the loss was mainly due to a decline in the value of overseas assets caused by the appreciation of the Japanese Yen, and by a decline in net asset values caused by losses in the stock market and to interest rates. Even if its operating performance was strong, the company could suffer a net loss depending on its investments in other assets. The company appeared to handle the 2011 disaster reasonably well but has been affected by overseas market conditions.

Closing remarks

One of the fastest policy responses to the disasters discussed in this analysis was postponing financial reporting deadlines, although relatively few companies took advantage of that extension. In 2011, almost all listed companies submitted their Yu-Ho within 90 days, even after the GEJE disaster [Nakano, 2020]. In 2020, as of the end of July, of the 2,336 companies that had closed in the fiscal year ended in March, only 44 companies had not yet submitted their Yu-Ho, including Hitachi, Ltd. [Japan Exchange Group, as of Aug 3, 2020]. This may raise the question of whether the 90-day deadline is an appropriate mandatory regulation.

A difficulty for investors is that they have little information about how the seriousness of those losses is measured. For instance, with regard to the impairment of fixed assets, there is no detailed quantitative discussion of the estimate in the Yu-Ho. This raises the question of whether regulators provide sufficient guidance regarding disclosures of what is “certain” and what is “uncertain”. Further, not only providing explanation of uncertainty in the Yu-Ho, but also providing clearer information about the assumption of significant accounting estimate would be helpful for readers to understand the financial condition.

A disaster has various effects on many companies, and the type, magnitude and duration of these effects vary. Even essential businesses could be so heavily damaged as to require government support to sustain them through the crisis. The total amount of support needed is difficult to reasonably estimate within a short period of time. Stakeholders should understand the need to sustain essential businesses and make a timely decision about supporting them. Thus, providing high quality information from management is so important in times of crisis. In other words, cooperation between management and other stakeholders is key to surviving through hard times.

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