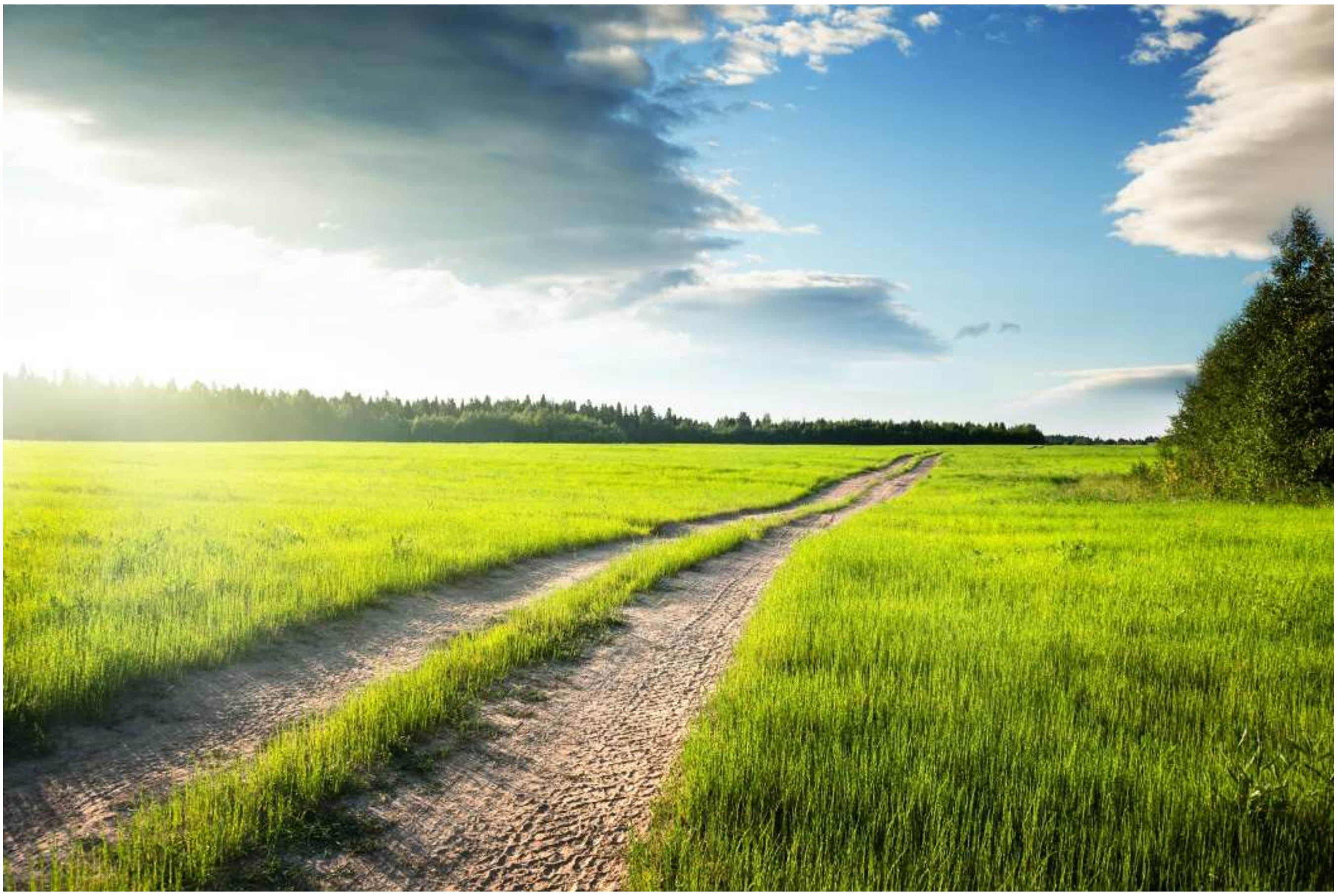
CFO Insights | Japan

2018 Q1



The CFO Program

Contents

Japan Economic Outlook: Mixed Signals

Japan's economy has seen a significant rebound in growth in the past year, largely fueled by an acceleration in exports, which in turn was helped by the lagged effect of a weak yen and an increase in global growth. Moreover, the improvement in export performance is helping to boost business investment.

Introduction

Japanese exports were up 12.2 percent in January from a year earlier, signaling the 14th consecutive month of rising exports.[1] There was especially strong growth in the exports of machinery, chemicals, and non-ferrous metals. Exports were up 30.8 percent to China, 1.2 percent to the United States, 21 percent to Germany, 35 percent to the United Kingdom, 7.6 percent to South Korea, 9.8 percent to Taiwan, 21.9 percent to Vietnam, and 23.5 percent to Indonesia. Japanese companies have substantial regional value chains; thus, it is likely that components made in Japan are shipped to neighboring countries for reprocessing and assembly before final products are then sent to other countries, such as the United States. The recent strength of exports appears to reflect the lagged impact of a weak yen - something that has lately changed - as well as the rebound in the global economy.

Meanwhile, many Japanese exporters are now concerned about the potential impact of the recent rise in the value of the yen. Indeed, the well-known Reuters Tankan survey of manufacturing executives found a sharp deterioration in business confidence in

[1] Trading Economics, "Japan exports," accessed March 7, 2018.

February.[2] In addition, Markit's flash purchasing manager's index for manufacturing showed deceleration in February, driven in part by a weakening of export orders.[3] Weak business confidence could have a negative impact on business investment. Further, despite the sharp 15 percent rise in the value of the yen in the past year, Japan's Finance Minister Taro Aso says that currency market intervention is not needed and that, because the yen is not moving "abruptly" in either direction, government intervention is not warranted.[4] One possibility is that his comments might encourage investors to push the yen even higher.

However, there are other positive signs for Japan. Industrial production increased 2.7 percent in January versus a year earlier, a moderate rate of growth roughly in line with the experience of the past year.[5] Prior to that, industrial production had been declining since mid-2014. Thus, things have clearly improved, in large part due to the weakness of the yen, which has helped boost demand for Japanese manufactured exports.

Meanwhile, despite a tight labor market, wages remain relatively stagnant, thereby leading to weakness in consumer spending. In December, household spending fell 2.5 percent from the previous month and was down 0.1 percent from a year earlier.[6] The unemployment rate increased slightly, from 2.7 percent in November to 2.8 percent in December. The jobs-to-applicants ratio, which had been falling for some time, increased slightly in December. In addition, housing starts fell in December and new construction orders fell as well. On the other hand, retail sales did exceptionally well in December, despite a decline in overall household spending. Retail sales were up 3.6 percent from a year earlier, the best seen since 2012 if one excludes the volatile behavior of retail sales prior to and after the last sales tax increase. Thus, the picture one takes away of the Japanese economy is rather mixed.

A twist in the growth story?

It is possible that Japan is at a turning point. Inflation is starting to accelerate, driven in part by a still modest upsurge in wages. Japanese consumer prices were up 1.0 percent in December versus a year earlier, the fastest rate of inflation since March 2015.[7] Moreover, the increase in 2015 was entirely due to the imposition of a higher national sales tax. In the current case, the increase in inflation represents a true acceleration in the rise of prices, reflecting a strong economy and labor market. In addition, core inflation, which excludes the impact of volatile food and energy prices, was 0.9

[2] Tetsushi Kajimoto and Izumi Nakagawa, "Japan manufacturers' mood worsens as yen rises: Reuters Tankan," Reuters, February 19, 2018.

[3] IHS Markit, "Nikkei Flash Japan Manufacturing PMI," February 21, 2018.

[4] Robin Harding, "No need for yen intervention, says Japan's finance minister," *Financial Times*, February 15, 2018.

[5] Trading Economics, "Japan industrial production," accessed March 7, 2018.

[6] Ministry of Internal Affairs and Communication, Statistics Bureau, accessed March 7, 2018.

[7] Ibid.

percent in December versus a year earlier, also the highest since the impact of the sales tax increase in 2015.[8] However, despite the evident acceleration in inflation, it remains well below the Bank of Japan's (BoJ's) target of 2.0 percent. Thus, it remains reasonable to expect the BoJ to retain a highly aggressive monetary policy of low-interest rates and continued purchases of assets (quantitative easing).

Trade and taxes

On the trade front, Japan is working with other Pacific Rim nations to revive the Trans-Pacific Partnership (TPP), the free trade agreement from which the United States withdrew a year ago. Japan was keen on the original TPP not only because of the trade liberalization that it entailed, but because it was likely to provide the government with the political cover needed to impose controversial structural reforms. In addition, the TPP is often seen as a counterweight to China's plans for a regional free trade agreement. The new plan is for a smaller TPP involving the original 11 nations other than the United States.

Longer term, one of the biggest issues facing Japan is whether to go ahead with the planned increase in the national sales tax in 2019. The last time the tax was increased, it caused a modest recession. Raising the tax again could have the same impact. Still, the government is determined to eventually do this in order to reduce the long-term deficit faced by the country's pension system. That deficit is being driven by onerous demographics. Japan's population is declining and the working-age population is declining even faster.[9] Absent increased taxes, many officials are concerned that the budget deficit could increase dramatically, thus adding to an already high level of government debt.

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[8] Ibid.

[9] Ibid.

Accounting News

IFRSs

2015-2017 Annual Improvement Cycle

The IASB issued in December 2017 **Annual Improvements to IFRS Standards 2015–2017 Cycle**. The pronouncement contains amendments to four International Financial Reporting Standards (IFRSs) as a result of the IASB's annual improvements project.

Annual Improvements to IFRS Standards 2015–2017 Cycle makes amendments to IFRS 3 **Business Combinations** and IFRS 11 **Joint Arrangements as well as** IAS 12 **Income Taxes** and IAS 23 **Borrowing Costs**.

The amendments are effective for periods beginning on or after 1 January 2019. Earlier application is permitted.

For additional information, see our related IAS Plus project page as well as the IASB press release and our IAS Plus project page on IFRS 3/IFRS 11 on the amendments.

Amendments to IAS 19

In February 2017 the IASB released **Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)** thus finalising one of two issues relating to IAS 19 submitted to the IFRS Interpretations Committee and exposed together in June 2015.

Based on the Amendments to IAS 19 if a plan amendment, curtailment or settlement occurs, it is now mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement.

The amendments are effective for periods beginning on or after 1 January 2019. Earlier application is permitted but must be disclosed.

For additional information, see our related IAS Plus project page as well as the IASB press release.

U.S. Tax Reform Bill Signed into Law

Please see IFRS & U.S.GAAP – European Securities and Markets Authority (ESMA) Public Statement on accounting for Income tax consequences of the US Tax reform under IFRS section below.

No other new standards, amendments or interpretations were issued by the IASB during this Quarter. However, the IASB also published in January 2017 a one-page summary of the accounting model in IFRS 17 **Insurance Contracts** as part of its initiative to help constituents understand the requirements of IFRS 17. The summary explains different elements of the accounting model and how they will be displayed in certain financial statements.

For additional information, see the IASB press release and the One-page summary of IFRS 17.

U.S. GAAP

The FASB has issued several Accounting Standards Updates, including:

Accounting Standards Update No. ("ASU") 2017-14 - Income Statement - Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605) and Revenue from Contracts with Customers (Topic 606) (SEC Update)

This ASU incorporates amendments made to SEC guidance that is included within the accounting standards codification. For more information, see this ASU as included on the FASB's website.

ASU 2017-15 - Codification Improvements to Topic 995, U.S. Steamship Entities: Elimination of Topic 995

This ASU supersedes obsolete guidance in Topic 995 and affects steamship entities that have unrecognized deferred taxes related to statutory reserve deposits that were made on or before December 15, 1992. This ASU requires entities to recognize such deferred income taxes in accordance with Topic 740.

The amendments in this ASU are effective for all entities for fiscal years beginning after December 15, 2018 (and interim periods therein). Early adoption is permitted for all entities, including adoption in an interim period. For more information, see this ASU as included on the FASB's website.

ASU 2018-01 — Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842

This ASU allows entities an option to use a transitional practical expedient for land easements that existed or expired prior to an entity's adoption of Topic 842 as long as those land easements were not previously accounted for under Topic 840. Once the entity has adopted Topic 842, it should prospectively apply the guidance to any new or modified land easements.

The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in ASU 2016-02. For more information, see this ASU as included on the FASB's website.

ASU 2018-02 — Income Statement— Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

This ASU allows entities to reclassify stranded tax effects resulting from the Act from accumulated other comprehensive income to retained earnings. Entities will also be required to include certain disclosures about the stranded tax effects that were reclassified.

The amendments in this ASU are effective for all business entities for fiscal years beginning after December 15, 2018 (and interim periods therein). Early adoption is permitted for all entities, including adoption in an interim period. For more information, see this ASU as included on the FASB's website.

ASU 2018-03 - Technical Corrections and Improvements to Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

This ASU makes minor changes to the Board's previously issued January 2016 ASU 2016-01 Recognition and Measurement of Financial Assets and Financial Liabilities.

For more information, see this ASU as included on the FASB's website.

IFRS & U.S. GAAP

Tax Reform Bill Signed into Law

On December 22, 2017, President Trump signed into law the tax legislation commonly known as the Tax Cuts and Jobs Act (the "Act"). Under ASC 740, the effects of new legislation are recognized upon enactment, which requires recognition of the tax effects of the Act in the interim and annual periods that include December 22, 2017. The SEC staff issued Staff Accounting Bulletin No. 118, which provides guidance on accounting for the Act's impact.

Some of the significant changes that resulted from the Act include the following:

- Change in the corporate tax rate (lowered from a maximum of 35% to 21%)
- Eliminates, with certain exceptions, the Net operating loss (NOL) carryback period and permits an indefinite carryforward period
- There is a deemed repatriation of foreign earnings subject to tax

All income statement impacts resulting from the tax law should be reflected in income from continuing operations (see also ASU 18-02 above).

In January 2018, the FASB staff issued four Staff Q&A documents that address various financial accounting and reporting implementation issues related to the Act.,

For more information, see our Financial Reporting Alerts 18-1, 18-2 and 18-3, the Staff Accounting Bulletin No. 118 and the FASB Staff Q&As.

European Securities and Markets Authority (ESMA) Public Statement on accounting for Income tax consequences of the US Tax reform under IFRS

From an IFRS perspective, accounting for the effects of the Act under IAS 12 Income Taxes will present significant challenges for some entities. These could arise in determining how an aspect of the Act applies to the entity's specific facts and circumstances, in gathering data to quantify that application or a combination of the two.

Hence, in order to avoid the risk of inconsistent application of IFRS in the European Union, ESMA decided to publish a Public Statement to provide clarifications on accounting for the income tax consequences of the Act under IFRS.

For additional information, see our related IFRS in Focus as well as the Public Statement on the ESMA website.

Japanese GAAP and other local developments

The ASBJ issues Partial Amendments to Accounting Standards for Tax Effect Accounting, etc.

In February 2018, the ASBJ issued the Accounting Standard and its related Guidance to partially amend the tax effect accounting. The partial amendments include accounting for deductible temporary differences, on separate financial statements, in relation to investments to subsidiaries and associate companies as well as some issues on presentation and disclosures. The amendments are effective for accounting periods beginning on or after 1 April 2018, with some exceptions.

The ASBJ updates its "Work Plan for Accounting Standards under Development"

In February 2018, the ASBJ released its updated work plan for accounting standards that are under development. The major accounting standards and interpretations under development include Accounting Standard for Revenue Recognition and its Guidance, the Exposure Drafts of which were issued for public comment. The ASBJ is currently analysing the comments received from constituents and targeting March 2018 to publish the final standard and guidance.

The ASBJ meets the FASB in a series of Biannual Meetings.

At the end of January and the beginning of February 2018, the ASBJ met the FASB in Tokyo. In addition to giving updates on their respective standard-setting activities, the two boards exchanged views on technical topics in which they both have an interest, including the conceptual framework, financial statement presentation and disclosures, impairment of financial assets, and leases. The next meeting between the two boards is expected to be held in August 2018 in Norwalk. For more information, see the press release on the ASBJ's website.

The FSA proposes additional IFRSs designated for Voluntary Use by Japanese Companies

In January 2018, the FSA proposed the update to the list of "designated" IFRSs that are issued by the IASB by 31 December 2017. The "designated" IFRSs are for use by companies that voluntarily apply IFRSs in Japan. **Prepayment Features with Negative Compensation (Amendments to IFRS9), Long-term Interests in Associates and Joint Ventures (Amendments to IAS28) and Annual Improvements to IFRS Standards （2015-2017 Cycle）** were proposed to be newly reflected on the list. The comment period was closed on 1 March, 2018.

The ASBJ issues Practical Solution on Transactions Granting Employees and Other Stock Acquisition Rights, which Involve Considerations, with Vesting Conditions, etc.

In January 2018, the ASBJ issued PITF No. 36 **Practical Solution on Transactions Granting Employees and Other Stock Acquisition Rights, which Involve Considerations, with Vesting Conditions** and ASBJ Guidance No.17 (revised 2018) **Guidance on Accounting for Compound Financial Instruments with an Option to Increase Paid-in Capital** in order to clarify the accounting treatment for the transactions granting employees and other stock acquisition rights, which involve considerations, with vesting conditions. The PITF No.36 and ASBJ Guidance No.17 (revised 2018) made it clear that those transactions are within the scope of and accounted for under ASBJ Statement No. 8 **Accounting Standard for Share-based Payment** and its Implementation Guidance – **ASBJ Guidance No. 11 Guidance on Accounting Standard for Share-based Payment**.

The ASBJ issues the Exposure Draft on the Tentative Practical Solution Regarding the Effective Periods of PITF No.34 (Exposure Draft of PITF No.54).

In December 2017, the ASBJ issued the Exposure Draft of PITF No.54 to modify and extend the effective period of PITF No.34, which permits an accounting policy choice regarding the discount rate to be used in accounting for the post-retirement benefits under the current market, where negative interest rates can be observed. The comment period was closed on 7 February 2018.

The ASBJ issues the Exposure Draft on the Tentative Practical Solution on the Accounting for Virtual Currencies under the Payment Service Act.

In December 2017, the ASBJ issued the Exposure Draft to develop guidance for the accounting for virtual currencies, so that the audits of the financial statements of registered virtual currency dealers can be implemented smoothly. After its deliberation, the ASBJ decided to address only limited issues, considering that the virtual currency business was at a very young stage and its future was unpredictable, and that there was uncertainty regarding the legal status of virtual currencies under Japanese private law. The main proposal by the ASBJ includes accounting for virtual currencies held by an entity on its own, virtual currencies held by a virtual currency dealer on behalf of its customers as well as presentation and disclosures. The comment period was closed on 6 February 2018. A summary paper on the Exposure Draft is available in English on the ASBJ's website.

The ASBJ meets the standard-setters from China and the Republic of Korea.

In November 2017, representatives from China, Japan, the Republic of Kore, the IASB, together with guests from Hong Kong and Macao met and discussed applications of IFRSs and the developments of local accounting standards in the respective jurisdictions. Participants also had in-depth discussions on the major projects of the IASB. For more information, see the Meeting Communiqué in English on the ASBJ's website.

For more information, please visit: IASPlus.com (IFRS) or USGAAPPlus.com (U.S. GAAP) or speak to our Deloitte experts Takafumi OSEKO, Partner (takafumi.oseko@tohmatsu.co.jp) or ALEJANDRO Saenz, Senior Manager (alejandro.saenzmartinezgeijo@tohmatsu.co.jp).

Tax News

Allying with OECD, Tax Credits

With the proposed 2018 tax reforms ("Reforms"), Japan continues its commitment to align with OECD principles on international tax, while at the same time seeking to invigorate the domestic economy through tax incentives designed to encourage growth. Included in the Reforms are updates to the definitions of permanent establishment ("PE") and real estate rich corporations, both of which reflect guidance issued by the OECD as part of its Base Erosion and Profit Shifting ("BEPS") project. With respect to growing the local economy in Japan, the government is forcing the hand of corporations through the Reforms by offering expanded tax credits to companies that are increasing wages and investing in capital, while at the same time removing other tax benefits for companies that are not. Finally, the Reforms also include amendments that are certain to impact foreign nationals, the most significant being relief from inheritance and gift taxes on foreign assets of long-term residents who have left Japan. While the tax reforms in recent years have introduced Japan's direction going forward with respect to international tax and domestic growth, the 2018 proposal shows that the government is steadfast in continuing down this same path.

Reform in PE definition

As noted above, Japan plans to amend its domestic law definition of a PE to include provisions aimed at preventing artificial circumvention of the rules, which is a significant step forward in aligning with BEPS Action 7. For example, certain previously exempted activities which are not of a preparatory or auxiliary character would now create a fixed place of business PE under domestic law. This would also be the case for fragmented business operations of certain related enterprises which (in isolation) might have been exempted as preparatory or auxiliary, but which under the new rules would now be viewed in aggregate. Similarly, related construction projects that have been segmented over time, and considered separately, would now be viewed as a whole in determining whether the duration of activity is sufficiently long to constitute a construction PE. Furthermore, a dependent agent that plays a principal role leading to the conclusion of contracts would now generally create an agency PE, broadening the scope of a contract-concluding agent PE. It should be noted, however, that the impact of such changes would likely be limited for eligible enterprises which reside in jurisdictions with less stringent treaty definitions of a PE than under Japanese domestic law, as the treaty definition would still apply in such case.

The Reforms also include amended criteria for classifying a real estate rich corporation for Japanese tax purposes (i.e. a corporation deriving more than 50% of its value from Japan real property), gains on the sale of shares of which would generally be taxable in Japan. This is a proposal which follows recommendations included in BEPS Action 6 on the prevention of tax avoidance. In addition to the current criteria, a look-back period of 365 days is to be introduced, so that a company classified as real estate rich at any point in the prior year would maintain that status for tax purposes, even if it does not derive more than 50% of its value from real property at the time its shares are sold.

Incentivizing wage increase

On the domestic side, Japan continues to promote growth and spending in the local economy by incentivizing companies to increase wages through a system of tax credits. In particular, the Reforms offer an increase in the percentage credit to eligible companies that are raising wages, however this year's reform proposal has raised the bar for qualification in that an accompanying capital investment is required in order to obtain the credit, and a subsequent increase in training costs is required to obtain an additional credit. The accompanying requirements are less stringent for Small or Medium Sized Enterprises (i.e. typically a company with JPY100M or less in stated capital that meets certain other requirements), but the additional credit still requires an increase in training costs or proof of a certified business enhancement plan as a supplement to the increase in wages. To even further encourage wage growth and investment in assets, the Reforms would also disallow currently available R&D credits, as well as certain other tax incentives, for companies that do not raise wages and invest in capital. While tax credits for increasing wages are not new, the additional investment requirements and the removal of other tax breaks for companies not taking part are evidence of the effort by the government to jumpstart the economy.

Inheritance and gift tax

Aside from corporate tax, this year's proposals also include certain amendments to inheritance and gift tax which remedy some adverse consequences created by the 2017 reforms. Most notable for foreign executives stationed in Japan is the removal of the widely publicized liability for these taxes on assets located outside of Japan which are inherited or gifted from long-term residents of Japan up to five years after they have left the country. However, it should be noted that this favorable treatment will not be applicable for gift tax purposes in cases where a donor of such assets returns to Japan within two years after originally losing domicile.

Year 2018: Japan's commitment to OECD BEPS project

To summarize, the proposed 2018 tax reforms should be a reminder for foreign businesses that Japan is seriously committed to the underlying principles of the OECD BEPS project with respect to international tax. While applicable tax treaties may still offer some respite for the time being, companies should be aware that the tax authorities will now be guided by stricter definitions in domestic law, particularly with respect to PEs and real estate holding companies. However, for businesses that are committed to Japan for the long-term, there are expanded opportunities for tax savings available as a result of the Reforms, particularly for companies willing to raise wages and invest in capital assets. Furthermore, narrowing the scope of inheritance and gift tax regulations on foreign nationals is a significant improvement in promoting Japan as a destination for global business.

For more information, please speak to our Deloitte experts Kazumasa YUKI, Tax Partner (kazumasa.yuki@tohmatsu. co.jp), or David BICKLE, Tax Partner (david.bickle@tohmatsu. co.jp).

The 2018 Boardroom Agenda:

Confronting Challenges Old and New

Developments in 2017 demonstrated the range and depth of the challenges faced by boards. Perennial challenges include strategy, risk, compensation, shareholder engagement and regulatory uncertainty; evolving challenges include board composition, social responsibility, technology risk, culture risk and the combination of innovation and disruption.

This list below is not all inclusive; there will be considerations and challenges - possibly many - in 2018 other than those shown above. However, it is likely that some, if not all, of these items could be on the board's agenda in 2018.

Emerging Issues

— **Board Composition, Refreshment and Diversity**: Boards have been focused on their composition for years, but the related intensity evolved considerably in 2017, with proxy advisers recommending votes against companies lacking board diversity, mainstream investors casting negative votes at those companies and other institutional investors launching campaigns to promote diversity, such as the New York City Comptroller's Boardroom Accountability Project Campaign 2.0. Boards are frequently being pressured not only to become more diverse, but also to expand the definition of diversity to include gender, race, ethnicity, age and thought.

We may see the needle of diversity move significantly in 2018 - and in the right direction - in the boardroom. Diversity in the boardroom demonstrably enhances discussions, contributing to stronger oversight and performance.

—**Innovation and Disruption:** The last few years have seen unprecedented levels of disruption arising from technological innovation across all industry sectors. The board often has a significant role to play in this new "disrupt or be disrupted" environment, regardless of whether directors are well versed in technology and innovation. The board can support management's innovative strategies and can execute traditional board responsibilities in a way that supports those strategies, such as considering director candidates with specific skill sets that support innovation; the board can also act as an instigator, challenging management to be more innovative.

—**Social impact:** There has been a paradigm shift in recent years in which the fundamental purpose of corporations, to enhance shareholder value, has expanded to add the impact a company has on other constituencies, such as customers, investors, vendors, employees and the communities in which the company operates - including the global community. One aspect of this change is a new emphasis on sustainability; this encompasses a broad range of issues from environmental concerns to a focus on human capital intended to assure that a company has the workforce necessary to succeed in the future. Boards often have significant responsibilities in overseeing whether and to what extent their companies pivot from the traditional corporate role to a newer, more socially responsible role.

Companies are increasingly aware that what is socially good for brand is good for business, and conversely, that what is socially bad for brand is bad for business. Boards need to consider their company's social impact strategy, to help determine if and/or when to launch or enhance socially responsible activities.

—**Technology Risk**: Board members continue to confirm that technology risk will be on every company's boardroom agenda in 2018. Companies cannot shun the use of technology, as it has become a major driver of performance, growth and disruption across industries. However, the number and nature of technology related risks sometimes seem limitless - ranging from hacking incidents to reports that algorithms using artificial intelligence have resulted in the posting of false reports on social media platforms. The nexus of technology and board composition is often a topic among boards, with some suggesting boards should add technology expertise to properly address technology risks, while others recommend adding board members who may better understand technology.

—**Corporate culture:** In recent months, the media often has focused on scandals involving corporate culture, and the spotlight often hones in on the question: "Where was the board?" For many years, boards have been reminded of their role in setting the tone at the top, and numerous judicial opinions have noted the board's oversight role for corporate compliance. However, the current focus on culture is new in both kind and degree, and boards need to consider this all-important responsibility. Corporate culture failures have led to a number of adverse impacts, from the termination of senior leadership to the sale or break-up of the company or, at a minimum, reputational damage.

Perennial Items

—**Strategy**: Overseeing the development and implementation of strategy is one of the board's primary responsibilities - possibly its most important responsibility, along with CEO succession planning. Particularly in today's environment of exponential change, the role of the board in guiding the company's CEO and management team on the company's strategic path is critical and can be demanding. With the continued debate about short-term results vs. long-term growth and sustainability, companies need to be prepared with defined short-term strategic objectives that are aligned with the longer-term company vision.

–**Risk**: The board's oversight responsibility with respect to risk may be its broadest role. First, oversight of risk - including determining risk tolerance, and risk mitigation - permeate everything the board does; in fact, it can be argued that no board action should be taken without considering the risks involved. For these reasons, the use of enterprise risk management has been questioned because it suggests that risk is a separate issue rather than an integral one. A second factor suggesting that risk oversight may be the board's broadest role is the recognition that there are many types of risk. As a result, while the audit committee may nominally be tasked with risk oversight, it has become increasingly clear that some types of risk "belong" to other committees, and some should more properly reside with the full board.

–**Compensation**: Compensation is often a perennial item on the boardroom agenda; as a famous investor once said, "CEO compensation is the acid test for corporate governance reform." However, like other perennial agenda items, the compensation issues that most concern the board and/or the compensation committee often vary year to year. In 2018, the issue generating significant boardroom focus will likely be disclosure of the ratio of CEO total pay to that of a median employee. The CEO pay ratio rules adopted by the SEC under the Dodd-Frank Act become effective for the 2018 proxy season. While the SEC's rules and interpretive guidance implementing the Act significantly eased the compliance burdens, many corporations still view the requirement as burdensome without providing useful information to investors.

–**Shareholder Engagement**: In the recent past, only a handful of companies engaged with their shareholders; most companies that engaged were those that could afford to - generally because of size and resources or because they had great stories to tell. That has changed. Largely as a result of the requirement to conduct "say on pay" votes, many companies now routinely seek to talk to their investors to support their proxy solicitation efforts and to be comfortable that they have investor support. Some investors are concerned that they are running short on the time available for engagement.

Boards and management should consider the nature and extent of the board's role in shareholder engagement. Board members have the opportunity to educate shareholders and communicate strengths in governance and other areas along with management.

–**Regulatory Uncertainty:** Regulatory uncertainty often exists in most industries. And, to be technical, it's not only regulation; the uncertainty begins with existing laws and pending legislation that can effect significant changes in those laws, as well as in the regulations adopted under those laws. Moreover, it can take years to resolve statutory and regulatory uncertainties, and the alternatives posed in different versions of pending legislation or regulations call for widely divergent approaches. However, that may not offer much consolation to boards that are conscientiously trying to help their companies to grow in an era of extreme uncertainty.

Companies face a constant stream of challenges, and even those that have been resolved in the past can occasionally awaken and demand attention or action. Investors, regulators and other constituencies - and directors themselves - expect boards to rise to, and address these challenges. Thus, whenever a company is dealing with a challenge, it's not surprising to hear the question "where was the board?"

The Millennial Mix: What CFOs Should Know

Over the last two decades, as millennials have entered the workplace and evolved in their roles, many stereotypes have developed about the generation that reached adulthood around the turn of the 21st century. Commonly portrayed as idealistic and overzealous, millennials have often been unfairly characterized as valuing passion over performance and fulfillment over hard work - all while expecting the corner office.

Now that millennials are deeply entrenched in the workforce, do these stereotypes hold up? Are millennials really entitled, overenthusiastic and extroverted, or are they more reserved and practical? How can CFOs and other business leaders better understand the particular work style traits of this generation?

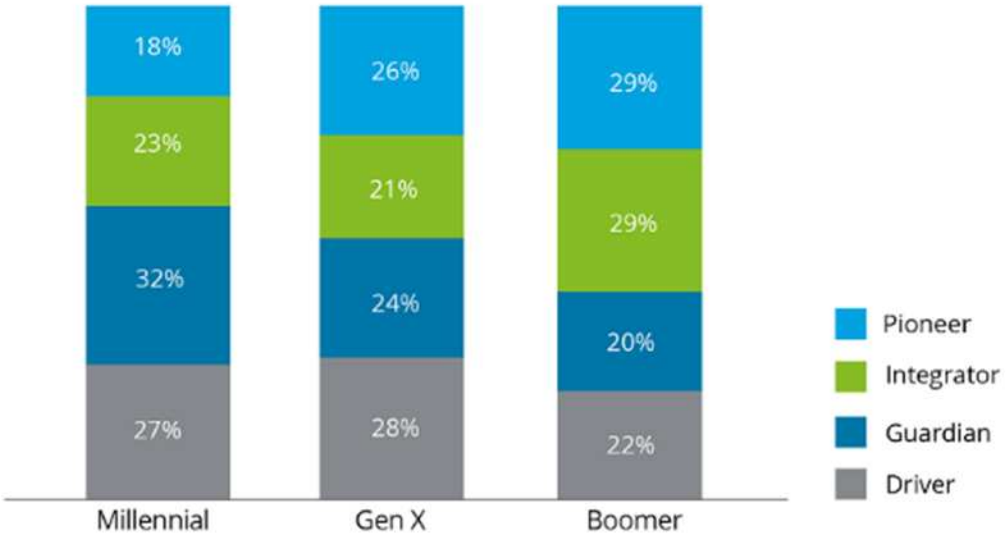
To find out, Deloitte conducted a generational study based on Business Chemistry®, a behavioral assessment framework that matches individuals to one - sometimes two - of four types: Drivers, who are experimental competitors; Guardians, who are detailed-oriented pragmatists; Integrators, who are empathic diplomats; and Pioneers, who are outgoing risk-takers.

By understanding millennials through the lens of Business Chemistry, CFOs can develop tactics that might help them engage members of this generation in the workplace.

Myth Meets Reality

While the research confirms some of the common stereotypes about millennials, it also reveals some surprising results. For example, millennials, sometimes referred to as Generation Me, are actually most likely to identify with methodical, risk-averse Guardians than with any other type (Figure 1). Given millennials' reputations for "thinking big" about their career aspirations and impact, this may seem counterintuitive. One possible explanation may be that, early in their careers, millennials were often relied upon - and rewarded for - their attention to detail and ability to follow a structured, methodical approach

Figure 1: Business Chemistry Types by Generation



Source: Deloitte Greenhouse Experience

Drivers, the second most prevalent type among millennials, are characterized by their focus on outcomes and goals, which suggests millennials' preferences for practicality and action over talk and theory. Notably, less than one-third of millennials surveyed are Integrators - the type known for its focus on people. The smallest proportion of millennials surveyed are Pioneers, who are known for blue-sky thinking, networking and spontaneity.

By contrast, according to the Deloitte study, baby boomers have a higher proportion of Pioneers and Integrators, both of which are the most nonlinear, ambiguity-tolerant and networked types. Baby boomers are more likely to be expansive thinkers with a transformational approach, traits associated with Pioneers. Adding to this picture are baby boomers' overall preferences for involvement and self-actualization, which align with Integrator leanings.

Finally, Gen Xers - those born between the baby boomer and millennial generations - represent a fairly even distribution of Business Chemistry types.

It is worth noting that stress levels also differ among generations. In analyzing those levels, Deloitte found that millennials experience the highest levels of stress overall, followed by Gen Xers and baby boomers. Across the Business Chemistry spectrum, millennial Integrators and Guardians - the types least likely to embrace risk - report the highest stress levels. Meanwhile, millennial Drivers and Pioneers - the most take-charge types - report less overall stress. They are also the types most likely to report being effective under moderate to high stress levels.

Millennials: A Closer Look

The 2017 Deloitte Millennial Survey, which polled nearly 8,000 millennials across 30 countries, reveals a number of trends and attitudes that senior leaders may want to take note of. Some of the specific results include:

–**Work commitmen**t: In 2016, the gap between those who saw themselves leaving their companies within two years versus those who anticipated staying beyond five years was 17%. In the 2017 survey, the gap declined to 7%. While these results signal better news for employers, the 38% of millennials who would leave their jobs within two years, if given the choice, is still high.

–**Full employment**: Nearly two-thirds of millennials prefer full-time employment versus freelance or contract work arrangements. The reasons most often given for preferring a permanent role are that it offers "job security" and "a fixed income."

–**Flexible work-style**: The proportion of respondents who say they are able, within certain limits, to start and finish work at times they choose is largely unchanged, rising to 69% from 67% between the 2016 and 2017 surveys. However, there is a significant expansion in the numbers able to work from locations other than their employer's primary site. The 2017 survey figure of 64% is up from 43% in 2016, reflecting how rapidly technology is facilitating mobile working, and how employers are becoming increasingly comfortable with such arrangements.

–**Performance and retention:** Flexible work arrangements are also strongly linked to improved performance and employee retention. For example, in highly flexible working environments, the difference between those who see themselves leaving within two years (35%) is just two points above those anticipating to stay beyond five years (33%) - among those in the least-flexible organizations, there is an 18-point gap (45% versus 27%).

–**Financial performance and flexible work-style:** Those in highly flexible workplaces are also two-and-a-half times more likely than those in more restrictive organizations to say that flexible working practices have a positive impact on financial performance.

–**Trust and flexible work:** Moreover, levels of trust are greatest in workplaces where flexible arrangements are most embedded, with only one in 10 suspicious of colleagues or believing that their line managers doubt them.

–**Automation and millennials:** Within "super-connected" millennials, only 15% believe automation will reduce the number of jobs available to people like them, while 64% think more jobs will be available. In contrast, those who make relatively little use of digital communication or social media are three times more likely to predict a reduction rather than an increase in jobs due to increasing automation (45% versus 15%).That said, 40% of all respondents see automation posing a threat to their jobs; 44% believe there will be less demand for their skills; a majority believe they will have to retrain (51%); and 53% see the workplace becoming more impersonal and less human.

Engaging Millennials in the Workplace

Understanding millennials' work-style types is one way that CFOs can engage millennial workers. In addition, CFOs and other business leaders can consider the following measures to help make the most of millennial talent:

—**Be a coach first, a manager second**: For many millennials, ongoing consultation is not a sign of weakness but rather a real-time feedback loop used to self-correct. Finance leaders may want to consider serving as regular sounding boards, continually providing younger colleagues with helpful perspectives. This is especially important because millennials are the least likely of all generations to use stress-coping strategies such as pausing to consider the bigger picture, thinking through alternatives and trying to look on the bright side, according to the Deloitte study. Managers who can coach their millennial workers toward these cognitive coping strategies are likely to benefit from less stressed and more productive team members.

—**Help create passion for the job:** Giving millennials dedicated time to customize part of their jobs can make them more than just employees; it can make them designers. Allowing them to craft their projects and titles can deliver some independence, enable them to convey their learning to others and foster a deeper sense of job satisfaction. This can be particularly important to millennials who, according to the Deloitte study, are the most likely of respondents to thrive when they have work they enjoy.

—**Rethink leadership development programs:** Many corporate leadership programs are built on the idea that everyone advances by leading. According to the Deloitte study, millennials are more likely than other generations to aspire to be top performers, experts or innovators, but not necessarily leaders. These aspirations may allow them more career mobility, so they can more easily transition from gig to gig. Finance leaders can consider shifting traditional leadership development programs toward a career-centered approach.

—**Communicate clearly:** One way to help engage millennial workers is through the use of clear, concise messages about company direction and progress. Finance leaders can aim to provide direct and transparent communications that dispel any ambiguity. With the millennial generation, no news is not necessarily better than bad news - and disingenuous or hypocritical communications will likely be noticed.

—**Loosen the tether:** More than any other generation surveyed, millennials are likely to cope with stress using strategies outside the office. Companies can benefit from allowing a more fluid, revolving-door approach to work and play. What may look like procrastination might actually be high-value time that refreshes millennials′ energy levels, enabling them to attack their work with gusto.

Managing the Mix

As the workplace evolves into one that is more transient, flat and virtual, creating a sense of affiliation among millennial employees will likely be a growing challenge for employers. By understanding their work-style types and employing strategies to engage them, CFOs and other business leaders can help foster commitment and empowerment among this generation of employees.

Bolstering Growth as a Business Partner: Diane Morefield, CFO, CyrusOne

When real estate veteran Diane Morefield was named executive vice president and CFO of CyrusOne Inc. in 2016, she recognized she was joining what some consider a non-traditional real estate investment trust (REIT), given the company's specialization in data centers. Soon after coming on board, she led a strategic effort to realign the debt structure, including raising significant capital to support the growth of the business. Ms. Morefield discusses capital raising in a high-growth environment and how her finance organization supports the company's overall strategy, as well as what it means to be a strategic CFO. Ms. Morefield also talks about her career journey and efforts to mentor aspiring executives.

Q: In your first year as CFO at CyrusOne, you were faced with a fast-growing business model in the data center space, which resulted in the need to raise approximately $2.5 billion in capital. What was the impetus for that?

Diane Morefield: Real estate is a capital-intensive business, and REITs, in particular, require third-party capital since they are required to distribute 95% of their taxable income in dividends. This restricts the amount of free cash flow that can be retained in the business to fund growth. More mature REITs typically provide a stable cash flow to shareholders, but grow relatively slowly, maybe two to four percent annually. However, data center REITs are high-growth companies and require much more significant levels of third-party capital to fund the development and acquisition pipeline, which was the impetus for the roughly $2.5 billion of capital markets activity that we executed at CyrusOne in 2017.

Being a strategic CFO: Partner, learner, and organizer

Q: What does it mean to you to be a strategic CFO?

Diane Morefield: The first priority is being a partner to the CEO since the CFO's role is to support the chief executive's vision and strategy. I spent considerable time with Gary Wojtaszek, our CEO, before joining CyrusOne. I came in with a very clear picture of his vision for the company over the next five years. When I started in my new role, I presented Gary with my 180-day plan, which outlined the financial goals and philosophies that I felt would meet the strategic vision for the company. This plan became my roadmap for my first six months, and beyond. I feel that being proactive in setting out a plan for the CFO and the entire finance organization to execute against helps define a strategic CFO's thoughtfulness for the business and its strategy, versus just reacting to what comes at you in your daily job. In addition, this plan provided me with milestones which I continue to use to measure my progress against and report out to the CEO and the Board of Directors.

Learning the business, particularly if you are in a new industry, is also critical to being a strategic CFO. For example, although I have been in the REIT industry for more than 20 years, data center REITS are a relatively new asset class and a very different type of real estate. They require understanding technology and the various demand drivers, as well as the traditional issues REITs face. So I work closely with my colleagues that run the various other functional areas such as technology, sales, and construction and design, in order to become educated in their areas and ensure that the finance organization is supporting their needs. In addition, staying on top of trends in the broader economy and your specific industry is critical to being a strategic CFO. You can never read too much.

As a strategic CFO, you are constantly thinking about the direction the organization is headed and how finance supports that vision. Developing that support structure requires having in place the right talent that can effectively lead six key areas of finance: accounting, tax, FP&A, investor relations, capital markets and procurement. If you have the right people leading those areas, you don't have to micromanage. If you hire well, the finance organization will naturally align to support the CEO's strategy and vision for the business, rather than spending time being reactive and putting out fires. Sometimes that means making tough decisions if people are not the right fit or underperforming. In order for me to be productive everyone on my team has to be great leaders and as productive as possible.

Q: You've talked in the past about informed risk-taking. How does that play out in practice?

Diane Morefield: In the REIT industry, the most material risk we face is capital allocation. Compared to some other REITs, CyrusOne's business model might be considered higher risk because most of our development involves new assets built from the ground up versus buying existing, stabilized assets. The company's investment committee, and ultimately the Board, approves our capital spend, but as CFO my team and I have to evaluate the risks associated with the underwriting process. The assessment requires a combination of strong analysis, asking intelligent questions of project sponsors, and not always saying yes. Also, an effective underwriting process should include modeling a base case along with upside and downside scenarios, and providing guardrails for project development. In that way, the organization can stress test inputs - such as bank covenants and liquidity needs - against, for example, an increase in leasing activity or a reduction in capex spend. Always maintaining adequate liquidity and staying in front of capital requirements is critical to mitigating financial risk and something we are laser focused on at CyrusOne.

Q: How does the finance function partner with the business at CyrusOne?

Diane Morefield: Finance is the center of the wheel that supports all other parts of the business. I inherited an organizational structure at CyrusOne that bolsters that support. Our FP&A group, which oversees the annual corporate model and five-year business plan, embeds senior financial analysts in operational areas, such as construction, operations, sales and investments. Analysts report to finance with a dotted line to the various business units. That allows information to flow between finance and the operational functions in an efficient manner.

Our capital markets and investor relations activities are also centralized in the CFO organization so we can structure our balance sheet and capital-raising activities in a cost-effective and strategic manner. Our accounting and reporting functions provides information to the various business units to track performance and assist in critical business decisions.

In the end, the overall finance organization is there to serve our customers, the functional business units and the overall business model, and we can never lose sight of our role.

Experience and career journey

Q: What experiences have influenced your career journey, and what are you doing to help others build their careers?

Diane Morefield: For me, having broad career experiences was the most important factor in reaching the CFO level. I started out in public accounting, then moved into banking, where I really learned about the capital markets. I also managed an investor relations (IR) function before being named to an operational position where I ran a 400-person region. I found the experience of communicating the corporate story to The Street and investors as an IR professional, and the P&L responsibility of running a region, as important stepping stones to becoming a CFO.

Strong role models have been important to my career as well. Given I have spent most of my career in the REIT/real estate industry, most of my role models have been men. I was lucky to have many male mentors who taught me the business and how to be a good manager and leader, and who gave me great stretch assignments and career advancement opportunities. I had a wonderful father and have two great older brothers - so I am very comfortable around men as mentors, colleagues and friends. (I also have two sons.) Moreover, I learned a great deal about executive management from a woman I consider one of my most important role models and mentors. She was a trailblazer as the first woman partner in a major international law firm and then one of only a handful of women executives in the real estate industry when she rose through the ranks. Her style is authentic, understated and resilient (and she is brilliant). I was fortunate to work with her early in my career, and today we are peers on a board of directors where I chair the audit committee, so I am still learning from her incredible wisdom and style.

Over my career, I've mentored highly talented men and women, but I'm partial to helping women advance their careers because they often lack role models. That's one reason why I accepted the chairmanship of NAREIT's (National Association of REITs) Dividends Through Diversity Initiative. This new initiative was created in 2017 to promote the recruitment, inclusion and advancement of women in REITs and the broader commercial real estate industry. Having said that, many men who have worked for me over the years have gone on to become CFOs of public companies and have assumed other executive positions, which I'm very proud of.

Q: What traits have been helpful in shaping your leadership style, and what advice would you offer others aspiring to a leadership position?

Diane Morefield: In terms of traits, I'm very direct - which I think is a productive way to conduct business, although that approach may not work in all instances. Two of my most important traits are integrity and authenticity. In practice, integrity is always being true to your word and being willing to take a stand when you need to. Authenticity is being yourself whether you are with the CEO, your peers or the support staff. Being authentic makes one more approachable, and that can lead to more open communication and accurate information. In my opinion, it's never just one trait or career role that propels someone to the C-suite; it's quite the opposite. Building upon varied skills and experiences, having a strong work ethic, creating strong and lasting relationships, not taking yourself too seriously, and developing a team that understands and supports the corporate vision is how a career journey leads to the C-suite.

Accelerating Performance One Workgroup at a Time

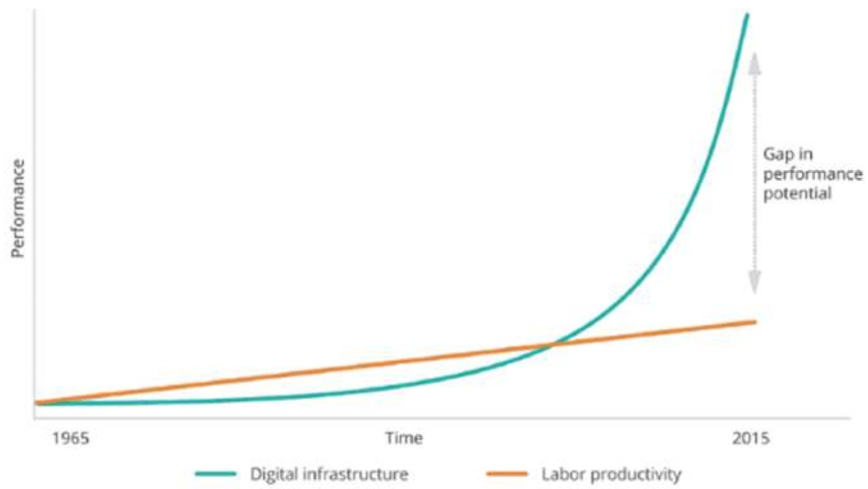
Improving performance. For many leaders, it's always top-of-mind. Yet, for all the attention it gets, a big opportunity may be being missed: There's a new approach that can not only improve performance, but accelerate it. This approach allows companies to break out of the trap of diminishing returns - in which a single-minded focus on cost-cutting finds less and less to cut - to a performance curve of increasing returns, where targeted efforts lead to better performance, which in turn fuel even better performance. Taking advantage of this opportunity, however, requires focusing on a part of the organization that is largely invisible today: the frontline workgroup. To unleash the potential for accelerating the performance improvement of workgroups, organizations need to both recognize the frontline workgroup as the key engine of future performance and move beyond the notion of "high-performing teams."

While accelerating performance improvement is a big, unrealized opportunity, it may also be an imperative. Organizations that don't get on an exponential trajectory may fall behind and become increasingly marginalized as the world advances at a faster rate.

Consider the gap between the rate of price-performance improvement in the digital infrastructure and the growth in labor productivity. Labor productivity has been increasing for decades, but this incremental linear increase is dwarfed by the exponential advances in the digital infrastructure (see Figure 1). Most companies are still capturing only a small fraction of the value that ought to be available through these new technologies.

How are companies reacting to these upheavals? Not well, judging by the performance of public companies as a whole over the 50 years since digital technology first began affecting business. A challenge for large companies - or companies that aspire to be large - is that scalable efficiency is often no longer effective. While that model yielded results in a relatively stable environment and may continue to improve productivity over time, it has created an environment that is often hostile to learning, where it is harder, and takes longer, to achieve higher levels of performance improvement.

Figure 1. Labor productivity is lagging behind technology



While labor productivity has more than doubled since 1965, digital infrastructures such as computing capacity have improved 8 million times over.

Source: 2016 Shift Index; Wikipedia

Understanding the Workgroup

What is a workgroup? Let's start with what it is not. It is not an entire department, a taskforce or committee focused on recommendations but not execution, a set of people whose work is determined by highly specified, tightly integrated tasks, or a standing unit whose composition remains stable over a long period. Rather, a workgroup pulls together three to 15 people working on an interdependent, collaborative effort to deliver a shared outcome that could not be achieved without all members of the group working on it together. The members spend the significant majority of their time interacting with each other, formally and informally, on tasks that cannot be highly specified or sequenced in advance.

Leaders and managers can address the potential of workgroups by cultivating a set of practices that are specifically designed to accelerate learning one workgroup at a time, starting with those that have the potential to disproportionately drive the organization's operating performance. Organizations that want to pursue this opportunity will need to focus their attention differently than where most are today.

Specifically, they will need to:

–**Focus on exception handling as a catalyst for performance improvement**. One consequence of the relentless, rapid changes of what is often called the Big Shift is that many employees in large companies are already spending more of their time on "exceptions" - those unexpected issues that fall outside the realm of existing standardized processes. These exceptions can be early signals of changing customer needs or shifting contexts that represent potential threats or significant new opportunities for growth. Organizations that focus on improving their ability to handle exceptions - not just to resolve or eliminate them but to glean learning and create value from them - will discover a valuable source of performance improvement, especially if exceptions increase.

—**Focus on frontline workgroups as the location of the work that is most relevant to organizational performance in a volatile environment**. Workers on the front lines of operations - whether a customer service unit or a supply chain management group, a cybersecurity response group or back-office IT department - will be the ones to first encounter the aforementioned exceptions. And it is at the front lines that new approaches to address these changing needs will likely first be crafted. These frontline workers are often best positioned to see change first, and they can learn from addressing the unexpected challenges and emerging opportunities. And yet, organizations often overlook and undervalue these workgroups. In an environment in which physical assets and intellectual property rapidly lose value, workers - humans - possess the boundless ability to adapt and continuously push the limits of performance improvement.

—**Focus on accelerating trajectories.** Success in this environment may require getting on a trajectory that mirrors the exponential rate of technology and technology-enabled change. The most relevant measures of performance and the appropriate rate of improvement will be a function of the context of each company and workgroup. In order to achieve an accelerating trajectory, it cannot be overemphasized that organizations and workgroups will have to adopt a relentless focus on that trajectory rather than getting tugged back into looking at snapshots in time, absolute numbers and comparisons with competitors.

—**Focus on value creation as the key driver of performance.** While costs can't be cut any lower than zero, the potential for value creation has no such bounds. Focusing on new value creation can be the key to getting on a trajectory of accelerating performance improvement. Given that technology is improving exponentially, the way to close the gap between business performance and technology performance is likely to involve looking for ways to create significantly more value than just being efficient or more flexible. At the same time, as noted earlier, customers' increasing power and expectations, as well as their own rapidly changing needs, offer an opportunity for organizations and workgroups to be more creative and imaginative in finding ways to constantly create new value. Doing so may require companies to learn faster about the changing needs and preferences of customers; the changing tools, potential partners, and resources available to serve customers; and how to leverage and develop capabilities into new approaches capable of creating significantly more value for everyone involved.

—**Focus on a different form of learning**: **learning through action.** When we talk about scalable learning, we aren't talking about what most people think of when they hear "learning" in a corporate context. We are talking not about learning for learning's sake, but about learning as a means to achieve ever-higher performance in a business environment characterized by mounting performance pressure. We aren't talking about knowledge management or sharing existing knowledge. This learning is about creating the new knowledge needed to solve new problems; it is the by-product of focusing on accelerating performance improvement. And we are not talking about skills acquisition through formal training programs, but, rather, the kind of learning that occurs day-to-day, on the job, where work practices are embodied in action.

Practice Makes Perfect

In this type of environment, creating new knowledge will be more important to performance than improving access to existing knowledge. The people and institutions that will likely have more success are those that learn faster by creating new knowledge through action - coming up with new ways of doing things that can increase impact.

Focus on the practices that will help accelerate performance improvement in the workgroup. The term "practice" is often used loosely, but at its most basic, practice is the way work actually gets done. To capture the opportunities available, we need to focus on developing a specific set of practices: those that can help accelerate performance improvement in the workgroup. The key seems to be that the practices have to catch up with the technology. And here it's important to recognize the connection between technology and practice. As new technology platforms and tools emerge, often so do new practices.

Practices tend to be context-specific, however. They emerge through action and are constantly evolving. Yet, there is also continuity. Specific instances of practices will share some similarities, such as intent and approach, which guide - rather than govern - our actions. So while you can describe a practice and what seems to be most important about it at a high level, the actual practice will develop in a way that is specific to the context. As a result, there is almost infinite variation in practice because of the infinite variation in context.

Provoke, Propel, Pull

Within the sphere of the many management, individual, and business practices that exist today, there are several that can accelerate performance improvement. These practices can be grouped into three categories:

1) Those that provoke the workgroup to think differently about the challenge and possible approaches and create better alternatives;

2) Those that propel the workgroup into action to gain additional insight into the next best move to make a greater impact;

3) Those that help the workgroup pull together to harness diversity and come up with ever-higher impact and outcomes.

While these practices aren't intended to be the comprehensive final word on accelerating performance improvement, they represent a robust tradecraft for getting better faster.

If taken seriously, these practices - and the new tools and technology that are available - have the potential to help create a business environment with an increasing returns curve, where the more of us that join together, the more value we can create together. And if we shift our focus toward creating new value, ultimately the value we can provide may be infinite.

Rather than approach this as a "big bang" initiative to redesign all of a company's workgroups, think in terms of small, smart moves to build momentum. Start by targeting the handful of workgroups that could potentially have the highest impact to your company - those that could be pivotal in addressing the biggest pain points or opportunities. Use these workgroups as a test bed for cultivating the practices that can accelerate performance improvement. By starting small, you don't need permission - just get started, track, and learn.

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