

# CFO Insights | Japan

2016 Q1



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## Japan: Uneasy is the Economic Tide

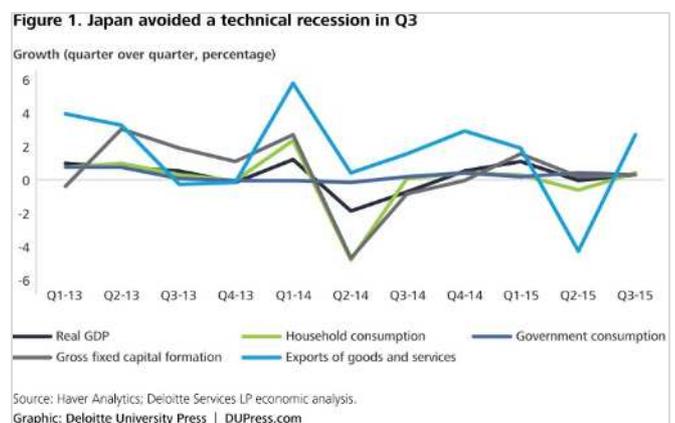
**While initial estimates had pointed to a Q3 recession, revised estimates of national accounts data in December indicated economic expansion instead. With external demand likely to be weighed down by a slowing China, policymakers will have to rely more on domestic sources of growth.**

Policymakers in Japan can likely breathe a little easier. In December 2015, revised estimates of national accounts data showed that the economy did not enter a technical recession in Q3. Earlier, initial estimates had pointed to GDP declining for the second straight quarter in Q3. The revised data show that GDP actually grew in Q3, although growth in key components such as household consumption and investment is still far from impressive.

With external demand likely to be weighed down by a slowing China, Japanese policymakers will have to rely more on domestic sources of growth, especially investments, but that is where trends have been disappointing this year. Despite healthy profits, Japanese corporations have been loath to increase capital expenditure—possibly due to factors such as uncertainty in the global economy and subdued domestic demand.

## Saved by a data revision

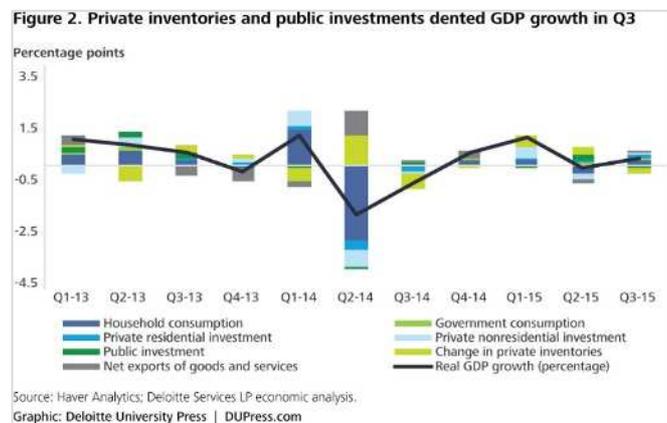
The economy expanded 0.3 percent quarter over quarter in Q3, according to revised official figures. Initial estimates had pointed to a 0.2 percent decline, indicating that the economy would enter a technical recession for the fifth time since 2008; GDP had contracted 0.1 percent in Q2 (figure 1). Thankfully, that was not the case.



**The flip-flop on GDP growth figures, though, casts some doubts on the reliability of**

## national accounts data, a complication Japan could do without at this stage.<sup>1</sup>

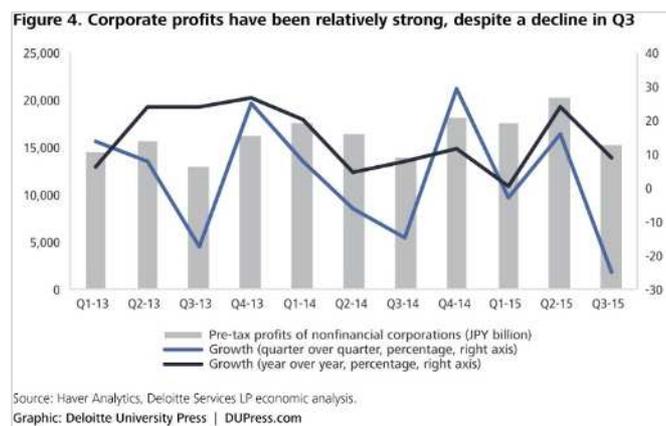
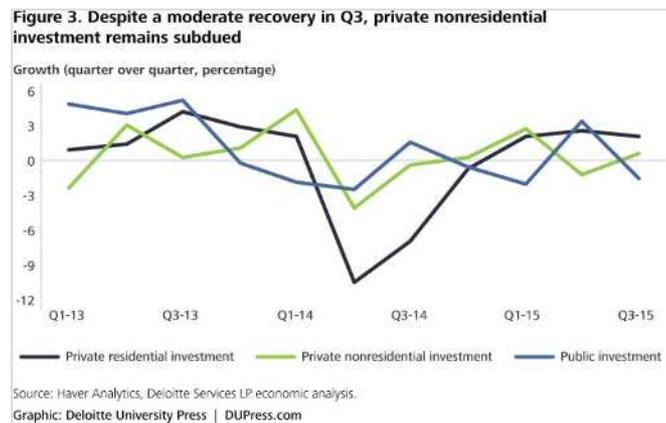
Household consumption was a key growth driver in Q3, expanding 0.4 percent, in contrast to a 0.6 percent contraction in Q2. The economy also received support from investments, with gross fixed capital formation growing 0.3 percent. However, the figure is less than required for Japan’s economy to move into a trajectory of stable growth without strong monetary and fiscal support. There was good news on the exports front in Q3. Exports grew 2.7 percent, reversing from a 4.3 percent decline in Q2. With imports growth also strong, the contribution of net exports to GDP growth was a mere 0.1 percentage point. Inventories were the other factor that weighed on growth in Q3, cutting 0.2 percentage points off GDP growth (figure 2).



## What’s with investments these days?

The moderate recovery in gross fixed capital formation in Q3 must have come as a welcome relief to policymakers. Nevertheless, within the expansion there lie some worries. Private nonresidential investment, which accounts for two-thirds of total gross fixed capital formation, has been subdued despite two years of strong monetary and fiscal support to the economy (figure 3). Moreover, a weak Japanese yen (due to

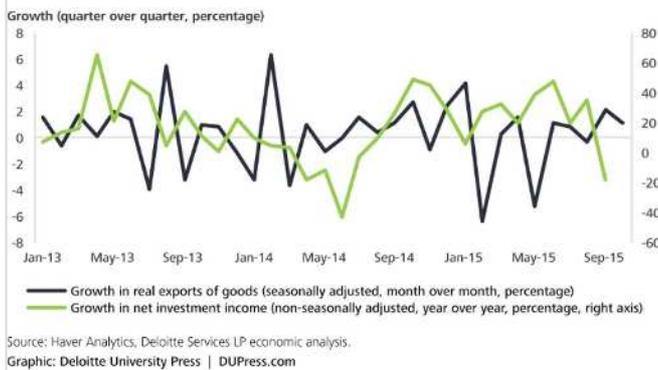
quantitative easing) has aided exports, thereby pushing up corporate profits (figure 4).



Yen earnings from investment income also have been healthy (figure 5). There are likely a number of reasons weighing on Japanese companies’ capital expenditure. First, exporters are wary of slowing external demand due to weak growth in China. Second, as the yen relatively stabilizes, Japanese exports do not have the same benefits of a weak yen as they did when quantitative easing started (figure 5). Third, exporters are likely to evaluate the impact of any rate hike by the US Federal Reserve (Fed) on global currency markets before deciding to expand capacity. Finally, Japanese companies might also be concerned about domestic demand, which has barely grown in the last two quarters (0.1 percent in each quarter).

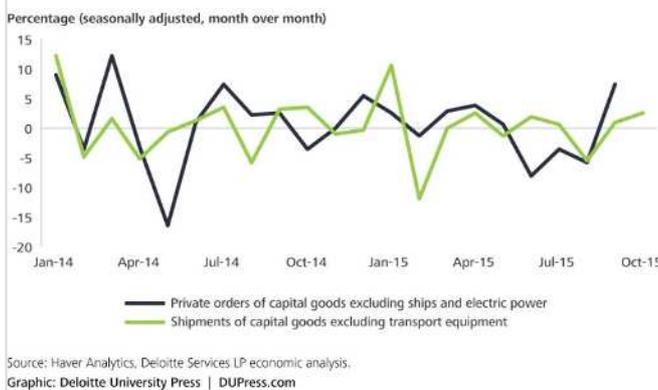
<sup>11</sup> Robin Harding, “Japan GDP revised from recession to growth in Q3,” Financial Times, December 8, 2015, <http://www.ft.com/cms/s/0/8aebcf66-9d41-11e5-8ce1-f6219b685d74.html#axzz3tjeNMkRf>.

**Figure 5. Exports have slowed down, while net investment income growth is relatively positive**



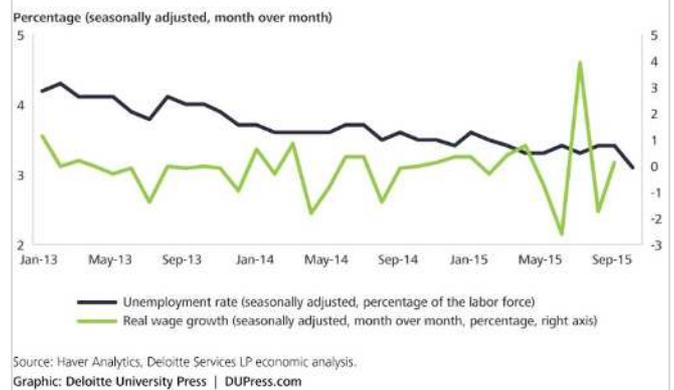
On a positive note, recent data suggest that Japanese corporations might just be scaling up investment activity. For example, private sector orders of core capital goods went up 7.5 percent month over month (seasonally adjusted) in September (figure 6). This is, however, not likely to be the start of a secular upward movement in investment, given the current bout of uncertainty in the global economy.

**Figure 6. Orders of private core capital goods grew in September**



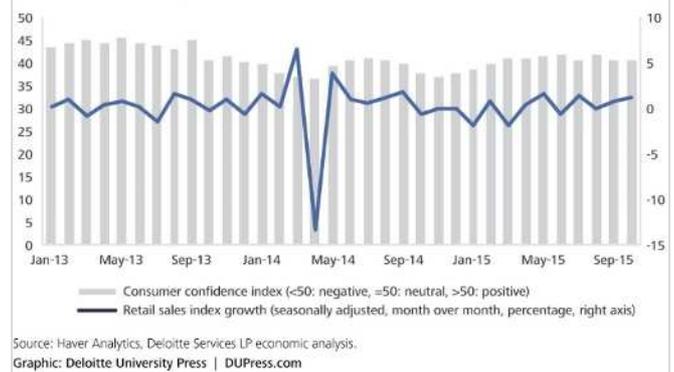
Consumers remain wary in the absence of real wage growth. Household consumption recovered in Q3 but, at 0.4 percent, can at best be described as modest. A key factor that is weighing on consumer spending is earnings. Real earnings have been sluggish (figure 7) and are not set to strengthen this year unless year-end bonuses surprise on the upside. Surprisingly, earnings growth is slow despite a strong labor market. In October, unemployment fell to 3.1 percent from 3.4 percent in September; October's figure was the lowest in about 20 years.

**Figure 7. Real earnings growth has been sluggish despite a strong labor market**



Prices are yet another concern for consumers, with Japan not yet out of the woods regarding deflation. It's no wonder, then, that consumer confidence continues to be in negative territory, although a slight recovery in seasonally adjusted retail sales volumes will give policymakers some degree of relief in the short term (figure 8). The strong impact of the consumption tax hike in April 2014 has forced the government to postpone the second phase of the tax hike to April 2017 from October 2015. This will soothe immediate consumer concerns. By that time, the economy is likely to be in much better shape to handle the impact of the tax hike.

**Figure 8. Consumer confidence continues to be negative; retail sales moderately recover**

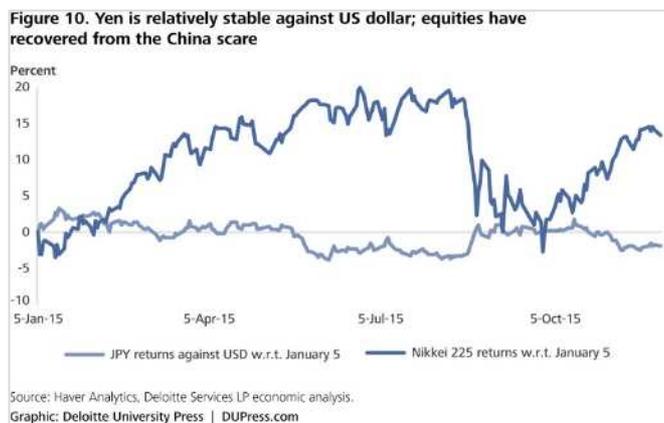
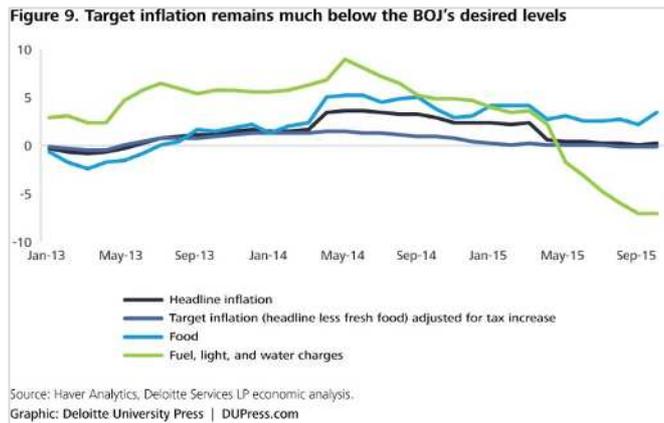


## BOJ holds onto monetary stance

In November, the Bank of Japan (BOJ) kept its pace of quantitative easing unchanged (at about \$648 billion a year), citing improving economic fundamentals and positive trends in

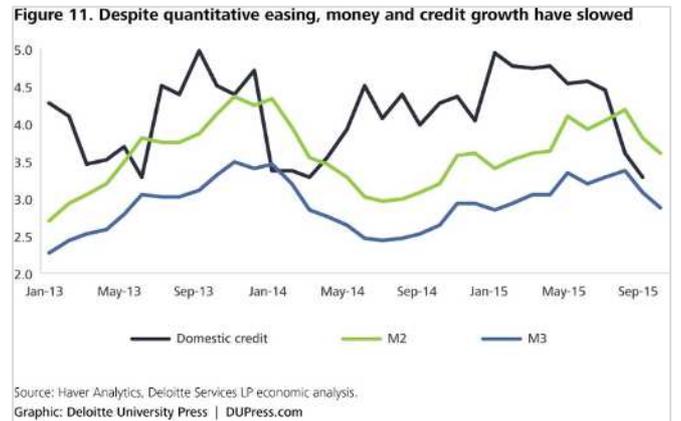
long-term inflation expectations.<sup>2</sup> In particular, the BOJ expects investments to go up (due to strong corporate profits) in the next few quarters, thereby benefitting the economy. All eyes will now be on key investment indicators such as orders and shipments of core capital goods in the next quarter or two.

The BOJ, however, expects to take more time (until March 2017) to bring inflation up to its target of 2 percent. Target inflation (excluding fresh food) was at -0.1 percent for the third straight month in October (figure 9), with low oil prices continuing to play spoilsport. On a positive note, core inflation (excluding food and energy) has been edging up and was 1.2 percent in October. This could have been an important factor behind the BOJ's decision not to expand quantitative easing in October.



The yen will be less of a concern for the BOJ (figure 10), given that any rate hike by the Fed will widen the interest rate differential with the United States. In such a scenario, the BOJ

is not likely to change its policy stance in the next two to three quarters. The central bank will, however, be concerned that a long bout of quantitative easing has not pushed up credit and broad money growth (figure 11).



<sup>2</sup> Toru Fujioka and Masahiro Hidaka, "BOJ keeps policy unchanged after recession, weak inflation," Bloomberg, November 19, 2015, <http://www.bloomberg.com/news/articles/2015-11-19/boj-keeps-policy-unchanged-even-after-recession-weak-inflation>.

## Time for the third arrow

The twin arrows in Abenomics—fiscal stimulus and monetary easing—have had some success. But much also depends on the third arrow: structural reforms. Prime Minister Shinzo Abe will continue to face strong opposition to reforms in key sectors such as agriculture, health care, and retail. He also has not made much headway (despite promises) in reforming corporate governance and the labor market.

The scenario is also clouded by the lack of detail in recent promises. For example, Abe has not given a time frame within

which he intends to increase nominal GDP by 22 percent, as he promised in September.<sup>3</sup> Without clear strategies and a roadmap to address key issues, confidence in the Japanese economy will remain subdued. Now, more than ever, Abe needs to reduce the gap between expectations and reality. Maybe the recent agreement on the Trans-Pacific Partnership—a free-trade deal between the

United States, Japan, and 10 other Pacific Rim countries—could just be the impetus Abe needs.



## Accounting News

### IFRSs

#### IFRS 16 – Leases

The International Accounting Standards Board (IASB) has published a new standard, IFRS 16 **Leases**, which supersedes **IAS 17 Leases** and related interpretations. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained.

The project was undertaken as a joint project with the US Financial Accounting Standards Board (FASB), with both

standard-setters looking to develop an approach requiring lessees to recognise assets and liabilities for the rights and obligations arising under leases. The IASB has now issued a final standard with a single lessee accounting model, whereas the FASB has decided to have a dual lessee accounting model in their forthcoming standard – both however require assets and liabilities to be recognized (with limited exceptions).

The new standard conveys that a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Control is conveyed where the customer has both the right to direct the identified asset's use and to obtain substantially all the economic benefits from that use.

<sup>3</sup>Abenomics: Less of the same," Economist, September 26, 2015, <http://www.economist.com/news/asia/21668283-japans-new-three-little-arrows-shinzo-abe-tweaks-his-economic-programme-japan>.

Under IFRS 16 a lessee recognizes a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly and the liability accrues interest. This will typically produce a front-loaded expense profile (whereas operating leases under IAS 17 would typically have had straight-line expenses) as an assumed linear depreciation of the right-of-use asset and the decreasing interest on the liability will lead to an overall decrease of expense over the reporting period.

The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate.

As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease.

For finance leases a lessor recognizes finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognizes operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

Notwithstanding requirements of IFRS 16 described above, a lessee may elect to account for lease payments as an expense on a straight-line basis over the lease term or another systematic basis for the following two types of leases:

Leases with a lease term of 12 months or less and containing no purchase options – this election is made by class of underlying asset; and, leases where the underlying asset has a low value when new (such as personal computers or small items of office furniture) – this election can be made on a lease-by-lease basis.

IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted if IFRS 15 **Revenue from Contracts with Customers** has also been applied.

No other new standards or interpretations were issued by the IASB during this Quarter. However, the IASB finalized several limited amendments to existing standards:

## Amendments to IAS 12

The amendments to IFRS 12 **Income Taxes** consisted on some clarifying paragraphs and an illustrating example to provide guidance for recognition of deferred tax assets for unrealized losses. The amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted.

## Amendments to IFRS 10 and IAS 28

The IASB published final amendments to IFRS 10 **Consolidated Financial Statements** and IAS 28 **Investments in Associates and Joint Ventures**. The amendments defer the effective date of the September 2014 amendments to these standards indefinitely until the research project on the equity method has been concluded. Early application of the September 2014 amendments continues to be permitted.

## Amendments to IAS 7

The IASB published final amendments to IAS 7 **Statement of Cash Flows**. The amendments require an entity to provide disclosures changes in financing liabilities arising from cash flows and non-cash changes. The amendments are effective for annual period beginning on or after 1 January 2017, with early application permitted.

The IASB also published exposure documents to solicit public comments on following subjects:

## Amendments to IFRS 4 and IFRS 9

The IASB published an Exposure Draft (ED) of proposed amendments to IFRS 4 **Insurance Contracts** and IFRS 9 **Financial Instruments**. The proposed amendments aim to address concerns about the different effective dates of IFRS 9 and the forthcoming new insurance standards by introducing a temporary option and exemption from straight application of IFRS 9 by certain entities that issue insurance contracts within the scope of IFRS4.

## Annual improvements to IFRSs 2014-2016 Cycle

The Exposure Draft (ED) of proposed amendments affect the following standards:

IFRS 1: To delete some short term exemptions

FRS 12: These amendments clarify that the disclosure requirements in the standard apply to an entity's interests that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5.

IAS 28: To clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

## Amendments to IAS 40

The IASB published an Exposure Draft (ED) of proposed amendments to IAS 40 **Investment Property** to clarify that transfers into, or out of, investment property in IAS 40 should only be made when there has been a change in use of the property.

## Practice Statement on Materiality

The International Accounting Standards Board (IASB) has published an Exposure Draft (ED) of a proposed IFRS Practice Statement (PS) **Application of Materiality to Financial Statements**. The PS aims at explaining and illustrating the concept of materiality and at helping preparers of financial statements in applying the concept.

The guidance proposed is intended to provide explanations and examples to help management apply the definition of materiality and it covers three main areas: (1) characteristics of materiality; (2) presentation and disclosure in the financial statements; and (3) Omissions and misstatements.

## New Revenue Standards

Please see IFRS & U.S.GAAP – New Revenue Standards below.

## Deloitte Releases Latest Edition of its iGAAP Series, “iGAAP 2016”

Deloitte has released the latest edition of its iGAAP series, “iGAAP 2016,” which provides comprehensive guidance for entities reporting under IFRSs. The new edition (1) focuses on the practical issues faced by reporting entities; (2) clearly explains the requirements of IFRSs; (3) adds interpretation and commentary on topics about which IFRSs are silent, ambiguous, or unclear; and (4) contains many illustrative examples. Do download an electronic copy, please point your browser to: <https://www.cch.co.uk/content/deloitte-international-ifs-pack-2016>.



## U.S. GAAP

The FASB has issued several Accounting Standards Updates, including:

### ASU No. 2015-17

**Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes** currently requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. Deferred tax liabilities and assets are classified as current or noncurrent based on the classification of the related asset or liability for financial reporting. Deferred tax liabilities and assets that are not related to an asset or liability for

financial reporting are classified according to the expected reversal date of the temporary difference.

To simplify the presentation of deferred income taxes, the amendments in FASB ASU No. 2015-17 require that deferred income tax liabilities and assets be classified as noncurrent in a classified statement of financial position.

For public business entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period.

The amendments in this Update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. If an entity applies the guidance prospectively, the entity should disclose in the first interim and first annual period of change, the nature of and reason for the change in accounting principle and a statement that prior periods were not retrospectively adjusted. If an entity applies the guidance retrospectively, the entity should disclose in the first interim and first annual period of change the nature of and reason for the change in accounting principle and quantitative information about the effects of the accounting change on prior periods.

## ASU No. 2016-01

FASB ASU No. 2016-01 amends FASB ASC Subtopic 825-10 **Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities through targeted improvements that enhance the reporting model for financial instruments**, as follows:

Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price

changes in orderly transactions for the identical or a similar investment of the same issuer.

Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.

Eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities.

Eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

Require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.

Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in this Update earlier as of the fiscal

years beginning after December 15, 2017, including interim periods within those fiscal years.

Early application of the following amendments in this Update are permitted for all entities as of the beginning of the fiscal year of adoption:

1. An entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.

Entities that are not public business entities are not required to apply the fair value of financial instruments disclosure guidance in the General Subsection of Section 825-10-50.

Except for the early application guidance discussed above, early adoption of the amendments in this Update is not permitted.

In addition to these finalized updates, the FASB is in the process of obtaining public feedback on several matters including:

## Proposed ASU Clarifying the Definition of a Business

In November 2015, the FASB issued a proposed ASU which is intended to provide entities with a more robust framework for evaluating whether to account for transactions as acquisitions (or disposals) of assets or as businesses.

## IFRS & U.S. GAAP – New Revenue Standards

IASB and FASB have been jointly trying to address implementation issues identified since the issuance of new converged revenue standards in 2014. However, the direction of their travel has showed difficulty to get to the identical solution for issues identified.

## Clarifying Amendments

The IASB published an Exposure Draft (ED/2015/6) with proposed clarifications of IFRS 15 **Revenue from Contracts with Customers**.

The proposed amendments address three of the five topics identified and aim at transition relief for modified contracts and completed contracts. In all its decisions, the IASB considered the need to balance helping entities with implementing IFRS 15 and not disrupting the implementation process. The topics included in the proposed clarifications are as follow:

Identifying performance obligations,  
Principal versus agent considerations,  
Licensing,  
Transition relief; and  
Other topics.

To date, the FASB has exposed the following three exposure drafts to clarify new revenue standards:

Issued in:	Title
12 May 2015	Proposed Accounting Standards Update, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.
31 August 2015	Proposed Accounting Standards Update, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)
30 September 2015	Proposed Accounting Standards Update, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedient

The proposal issued by the FASB in September is to amend the guidance related to collectability, non - cash consideration,

and completed contracts at transition, and the addition of new practical expedients.

Since these clarifying proposals from both Boards are not identical, a careful analysis is needed in understand similarities and differences.

## The joint Transition Resource Group (TRG) activities

The joint TRG is responsible for soliciting, analyzing, and discussing issues arising from implementation of the new revenue standards in order to assist the IASB and the FASB to determine what, if any, action will be needed to address those issues. Clarifying amendments discussed above reflect past discussions by the joint TRG.

The TRG held its sixth meeting in November 2015 and discussed matters including:

Customer options for additional goods and services.

Pre-production activities.

Licenses - Specific application issues related to restrictions and renewals.

Whether fixed-odds wagering contracts are inside or outside the scope of ASC 606.

In January 2016, the IASB announced that the TRG is not scheduled to meet again. On the other hand, the FASB has scheduled three TRG meetings in 2016.

## Japanese GAAP

### Accounting Standards Board of Japan (ASBJ) seeks feedback on developing a comprehensive standard for revenue recognition

On February 4, 2016, the ASBJ published a **Request for Information as an early step in considering the development of a comprehensive accounting standard for revenue recognition**. The ASBJ has begun to consider the development of the new accounting standard for revenue recognition based on IFRS15 'Revenue from Contracts with Customers' with the objective of enhancing a quality of generally accepted accounting principle in Japan and

comparability. The aim of the Request for Information is to identify a range of potential implementation issues that may arise by applying the new standard for revenue recognition and seeks views from constituents on how the issues would be addressed adequately. The Request for Information is open for comments until May 31, 2016.

## ASBJ issues Implementation Guidance on Recoverability of Deferred Tax Assets

On December 28, 2015, the ASBJ issued the **Guidance No.26 'Implementation Guidance on Recoverability of Deferred Tax Assets' (the 'Implementation Guidance')**. The Implementation Guidance essentially carries forward the existing requirements as set out in the Auditing Guidance No.66 **Auditing Treatment for Judgment of Recoverability of Deferred Tax Assets** with some amendments. The amendments include those made to the criteria that define the ceiling amount of recoverable deferred tax assets for respective categories into which an entity would fall.

An entity is required to apply the Implementation Guidance for annual years beginning on and after April 1, 2016. Earlier application is permitted for the annual years ending on or after March 31, 2016.

## ASBJ releases the Exposure Draft of Guidance on tax rates used in applying tax effect accounting

On December 28, 2015, the ASBJ released for public comments the Exposure Draft of **Guidance on tax rates used in applying tax effect accounting**. The ASBJ proposes that deferred tax assets and liabilities are calculated by reference to the tax rates of which the Diet passes the legislation process as of the end of financial year. The existing standard requires using the tax rates that are announced by the government by the end of financial year.

The comment is due on February 10, 2016.

For more information, please visit: IASPlus.com (IFRS) or USGAAPPlus.com (U.S. GAAP) or speak to our Deloitte experts Shinya IWASAKI, Partner (shinya.iwasaki@tohmatu.co.jp) or ALEJANDRO Saenz, Senior Manager (alejandro.saenzmartinezgejejo@tohmatu.co.jp).

## Tax News

### Overview of Base Erosion and Profit Shifting initiative and Adoption by Japan

**The Japanese government is supportive of the OECD's Base Erosion and Profit Shifting ("BEPS") initiative and may be considered as a "first mover" in adopting BEPS-related changes in the region.**

In our 2015 Q4 publication, we presented a series of BEPS-related changes which were expected to be introduced in Japan. Since that time, the Japanese Cabinet approved the 2016 tax reform proposal, which includes new transfer pricing documentation rules in response to BEPS action 13. Draft legislation is currently before The National Diet, and is expected to be approved before April 1, 2016. As expected, the new documentation rules follow the three-tier documentation approach described in the OECD report. We provide below a summary of the proposed new rules.

#### Country-by-country report

Japanese companies that are the ultimate parents of multinational groups and meet the filing threshold of ¥100 billion (€780 million) of previous year group revenue must file a report.<sup>4</sup> The report must contain the information listed in Annex III of the OECD's Action 13 Final Report. The requirement applies for tax years beginning on or after April 1, 2016 and the report must be filed electronically in English within one year after the end of the group's fiscal year.

A Japanese subsidiary of a multinational group or a Japanese permanent establishment of a non-Japanese group company in which the ultimate parent is not a Japanese company is

required to file the country-by-country report if the report has not been received from the applicable government.

#### Master file

Japanese companies or permanent establishments that are members of a multinational group that meets the filing threshold of ¥100 billion (€780 million) of previous year group revenue must file a master file. The master file must be filed electronically with the Japanese tax authorities for tax years beginning after April 1, 2016 and is due within one year after the year end of the company or permanent establishment required to file the master file. The master file must contain the information specified in Annex I of the "Transfer Pricing Documentation and Country by Country Reporting Final Report." and may be prepared in Japanese or English.

#### Local file

Japanese companies and permanent establishments that meet the filing threshold must prepare a local file. Further guidance on the timing of preparation of the report is expected. The filing threshold is ¥5 billion of related-party transactions or ¥300 million of related-party intangible property transactions in the previous year (the current year if no previous year). Local files must first be prepared under the new rules for taxable years beginning after April 1, 2017, one year later than the first year for the master file and country-by-country report.

The requirements for the local file includes both the current documentation requirements and those contained in Annex II of the "Transfer Pricing Documentation and Country by Country Reporting Final Report." As a practical matter, there is substantial overlap between the current requirements and Annex II. Information not required by both includes: key

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<sup>4</sup> The ultimate parent company is the company required to file consolidated financial statements for the multinational group that is not included in the consolidated financial statements of any other group. A Japanese company required to file the country-by-country report may appoint another company to file the report on behalf of the group. The reporting entity must provide its name and location and similar information for other Japanese constituent entities.

competitors, segmented related-party profit and loss statements, and bilateral and unilateral advance pricing agreements (APAs) that impact the transactions.

The local file must be provided to the Japanese tax authorities upon request. Failure to do so may lead to the authorities applying a presumed transfer pricing method, which could

include the use of secret comparables. Companies that do not meet the prescribed thresholds for filing the local file are nonetheless required to provide support for their transfer prices to the Japanese tax authorities within 60 days, or be possibly be subject to the same presumed transfer pricing methods. Additional guidance on the exact timing is expected to be issued.



## Penalties

It is expected that penalties will be applied for non-compliance. Based on the current draft legislation, a ¥300,000 penalty may be imposed against a company for failure to disclose the country-by-country report or the master file. A company's officer or employee may also be subject to a similar penalty for failure to disclose the country-by-country report, the master file or the local file. Further guidance on penalties may be issued.

## Conclusion

The new Japanese transfer pricing rules adopting the OECD three-tier approach are significantly more prescriptive than the prior rules with respect to both the specific information to be provided and the timing for when that information must be provided. Given this, it will be important to coordinate the data to be included in all three reports.

For more information, please speak to our Deloitte experts Timothy O'BRIEN, Partner (timothy.obrien@tohatsu.co.jp), or Gary THOMAS, Partner (gary.thomas@tohatsu.co.jp).

## Rethinking the CFO's Role as Strategist

**CEOs and boards increasingly want CFOs to not only deliver a finance organization that gets the numbers right, but also partner with them in shaping the company's strategy. Given the lack of consensus as to how this might look, how should CFOs orient themselves to supporting strategy?**

The strategy process frames answers to strategy questions and executes on them to deliver returns to shareholders. The challenge for CFOs is to choose effective ways to engage in the process in the context of their company's business, leadership and directors. Based on practice observations, discussions with numerous CFOs and knowledge gained from more than 700 Deloitte CFO Transition Lab™ sessions, Deloitte has framed the four orientations of a strategist CFO model to help guide better alignment between CFOs' actions and CEO and board expectations. Beyond the well-established four faces of the CFO as operator, steward, catalyst and strategist, the orientations bring greater clarity to the strategist role and the capacity of an organization to reorient and execute a new strategy.



### Engaging in the Strategy Process

There are four distinct ways CFOs can orient themselves to engage in the strategy process—as responder, challenger, architect or transformer:

#### Responder

As a responder, the CFO and the finance organization support the company's strategy development by helping key business leaders quantitatively analyze the financial implications of different strategy choices. This type of CFO orientation is especially evident in highly decentralized businesses where the CEO chooses to drive accountability for strategy and performance to business-unit leaders. Occasionally, this orientation is also prevalent when the CEO chooses to limit the role of the CFO or finance in the strategy process to quantitative and analytic support. To be an effective responder, the CFO and finance organization should consider having a central financial planning and analysis (FP&A) capability that delivers the relevant analyses and data to the businesses, whose leaders have primary responsibility for generating strategy alternatives.

#### Challenger

As a challenger, the CFO and finance organization act as stewards of future value in the strategy process by critically examining the risks to, and expected returns on, different strategy alternatives. Being a challenger is sometimes equated with being a “Dr. No,” as the CFO and finance organization seek to minimize risk or ensure adequate returns to future capital allocations and investments.

Being an effective challenger may require the CFO and finance organization to have FP&A capabilities similar to those required of a responder, as well as access to requisite information from the business units on key strategy assumptions and models. Importantly, the CFO requires the permission of the CEO to challenge business-unit leaders and their strategies. When given that permission, the CFO as challenger is especially critical to the review of major strategy investment decisions.

## Architect

In the architect orientation, the CFO, finance department and business leaders jointly work through shaping strategy choices and applying finance strategies to complement and maximize the value of particular strategies. Architects go beyond the challenger orientation to enable the financing of innovative initiatives through varied finance strategies and finance arrangements with suppliers, customers, or delivery channels. Architects thus work to find “a path to yes” on key business investments.

To effectively deliver the architect orientation, the CFO, finance organization and businesses might need to establish mutual trust and work together at the outset of setting the strategy. In addition, the CFO often needs a strong finance team inside the businesses to proactively partner with business leaders throughout the strategy process.

## Transformer

As a transformer, the CFO becomes a lead partner to the CEO in shaping and executing future strategy. The CFO is key to execution of “real operational and financial options” for shifting the product market mix, delivering value and creating distinctive capabilities. For example, consider a multidivisional company with common accounting and financial systems where the original synergies driving the existing product market mix no longer exist. By upgrading the systems, but doing so in a way that allows the efficient spinout of a division in the future, the CFO operationally creates the capacity for shifting a core strategy choice - the product market mix.

## Choosing to Be an Effective Strategist

For CFOs, choosing to be an effective strategist demands earning a seat at the strategy table, having an effective finance team, and selecting the strategy orientation that is appropriate to the context of the company and level of permission granted by the CEO. This is obviously not simple, and effective CFO strategists continually need to reorient themselves to changing organization situations and contexts.

One way to generate valuable strategy opportunities is to ask critical questions about the dominant growth constraints, uncertainties and risks, and to scale assumptions confronting the company. A strong finance team is also key to earning a seat at the table, for three reasons. First, by getting the basics right, the team presents the finance organization as credible. Second, a strong finance team frees up the CFO to attend to strategic matters. Third, it can provide the quantitative analysis and support capabilities vital to shaping strategy. The choice of strategist orientation depends extensively on the context of the company and the level of permission from the CEO.

## No Single Approach

There is no one single approach to being an effective strategist CFO. The four CFO orientations should help CFOs, CEOs, boards and business-unit leaders better establish mutual expectations on how the CFO will engage in the strategy process and address key strategy questions within the company. These orientations are not static, and the appropriate orientation will vary with the changing context and performance of the organization.

## Driving Individual Innovation: Interview with Mark Buthman, CFO of Kimberly-Clark

**Mark Buthman, SVP and CFO of Kimberly-Clark Corporation since 2003, is known for establishing the “Power of a CFO,” a mindset to motivate his finance organization of 1,600 people to offer ideas and challenge the status quo.**

In addition to overseeing a global finance organization spanning 54 countries, he is responsible for Kimberly-Clark’s real estate, investor relations, information technology (IT) and procurement teams.

Mr. Buthman, who has announced he will be retiring at the end of the year, discusses why it’s important to push not only his finance team but also IT, sales, marketing and others, to bring more value—to themselves as well as to the company.



### How does the “Power of a CFO” work in practice in a finance organization that is so large and dispersed across different geographies?

“The Power of a CFO” is more about a mindset, behaviors and thinking like a CFO rather than specific skills. I often say that in finance our job is to bring an independent, economic mindset to difficult business problems. So in keeping with “The Power of a CFO,” this is a mindset that I want the 1,600 people in my finance organization to take. The three ideas at the core of the “Power of a CFO” are: inspire, drive and transform. The

simple construct of inspire, drive and transform is based on my own personal objectives. All the results I’m responsible for, whether it’s interest expense, cash flow, business unit performance, that’s under what I can drive, and that cascades to my finance deputies. I’m very much a believer that if you can get your top 100 leaders modeling desired behavior, others will look to them and emulate them.

I expect everyone on my team to inspire the people around them to drive business results, to improve their performance and transform their capabilities every day. Every single person in my organization has those three categories of objectives, although they’re not strictly prescribed. I want all of our employees to come to work every day trying to do things just a little bit better and to never be satisfied with the status quo. In a sense, it’s about individual innovation.

To put the program into action, we encourage everyone in the finance organization to send us their ideas for improvement. My leadership team provides feedback, and we communicate the ideas out through various channels, including videos, blogs and face-to-face meetings. We also have an awards program to recognize achievement, with an award given for each of the behaviors we’re trying to drive. For example, a new employee based in Costa Rica attended a kick-off meeting on the “Power of a CFO” and followed up with an idea that later would save the company millions of dollars. The program comes down to sharing great ideas, especially across functional boundaries and geographies, to make things better.

### You also train your finance staff in risk-taking skills. Why and how are you doing that?

I think you need to articulate what your expectations are. That’s the real value of the three categories of inspire, drive and transform—to make it easier for others to understand my priorities. Setting clear expectations with your team and your customers is important, and often that can involve changing the mindset of teams and recalibrating what’s expected within

the business. You also have to provide tools and development programs to reach everybody, especially in a large organization, such as an online university with hundreds of resources.

We provide a lot of in-person training, including problem-solving. For example, with our top talent we do a simulation in which a CFO and a CEO come into the room and pressure test their conclusions. We also offer rotations to provide people experiences within different parts of the organization. When possible, we provide our finance team experience outside of finance, which can really stretch their leadership capabilities.

### **Is “The Power of a CFO” and your other talent development programs used outside of finance?**

Yes, in part, as the concepts apply universally. I have talked with our sales, marketing analytics and digital teams, as well as our IT and procurement organizations. To me this can apply to anyone. It's about thinking like an aspirational leader and unlocking the potential of each person in the organization to deliver their best in a way that they can figure out. Of course, not everyone wants to take this approach, so that is the challenge. My response is, “It's not just to make your life easier; it's to have a bigger impact.” A big part of the challenge

is figuring out how to bring changes to the wider organization, so others can understand and strive for something they never had before.

### **Since the IT function reports to you, how do you see finance benefiting from a closer alignment to IT?**

There's a wealth of information out there, and it is a big, untapped opportunity for us. The connection linking IT, finance and marketing is going to get closer and closer. Our challenge is how to connect data from across the company in a way that drives insights. So it's about figuring out how to use the data and apply individual logic to it. We have a project called “True North,” which uses statistical methods to understand correlations which translate into predictive analytics, and to help predict actions for business decisions that are being made. For example, “If I do this trade promotion, what will the result be? Or If I run this marketing campaign, what will the result be?” My dream is to have the right information to make the right decisions on the desktop of every decision-maker around the world right at the time they need to make the decision. It's very possible, but it's also a very complicated problem to solve. There's no information we need to make a decision that can't be delivered to the desktop. It's all available to us.



## Talent Dilemmas: What Should You Do?

**Among the hardest decisions CFOs face are those pertaining to people. Time and again, new executives tell us that their biggest regret in their first year on the job was moving too slowly on talent issues. And longer-term finance chiefs know that not having the right people in the right seats may compromise the execution of their vision.**

While there are no simple answers to talent dilemmas, identifying and understanding critical trade-offs and having processes to address them may lead to better resolutions. In this issue of CFO Insights, we will discuss three talent situations that can disrupt your team and offer approaches to consider.

### Pass over or pass on?

As CFO, you often have to decide which of your team members will be promoted—and which will not. And sometimes you may even have to deal with a passed-over rival on your team.

While Machiavelli suggests executing prior princes and rivals, today we can usually avail ourselves of more civilized, win-win strategies. It is probably best to begin by having a direct conversation, acknowledging the passed-over individual's loss, re-recruiting him or her to the team, and framing mutually beneficial expectations and ways of working together. Ultimately, it is in the interest of you, the newly promoted executive, and the passed-over colleague to work together to achieve success.

Consider this hypothetical case: You name the head of FP&A to be a divisional CFO, passing over the controller. Part of your decision is a lack of confidence in the controller's ability around treasury issues. One way to help is to offer the individual a new responsibility overseeing treasury. Ideally, such a restructuring enhances the controller's experience while potentially developing a future successor candidate.

While this may be a good strategy, it is not easy to pull off. Implementing the suggested strategy could block other high-

potential talent in your organization, for instance. Where a role expansion is not feasible, collaborating with the individual to identify projects that build the relevant experiences can also be helpful. When the passed-over individual does not have a clear development role or does not want to develop the skills needed, the next best strategy is probably coming up with a retention or exit plan, as the person will likely want to leave.

**Having a retention plan is important when the passed-over individual has valuable, tacit knowledge and you cannot easily identify a replacement, nor a development role.**

A retention bonus can be structured to foster an orderly exit, permitting your team to build the capabilities to fulfill the role vacated. For example, some plans are structured so that a half or a third of the bonus is available in the first two months, with the remainder provided at the end of the first six months or the year. With proper focus, that should be sufficient time to develop interim leadership or recruit a replacement.



While it is generally in the interest of the parties involved to create an orderly transition, sometimes it just doesn't work out. The chemistry between the passed-over individual and the promoted employee simply may not be there. It is especially problematic if the one who was passed over undermines the values you seek to promulgate. In such a case, the best course may be to follow Machiavelli's advice to "take the pain over suffering" and exit the individual as quickly as possible.

**Takeaway:** The key to dealing with a passed-over individual is to have clarity on possible solutions. Those solutions should be mutually advantageous (that is, you get to develop a more

effective team member and the passed-over candidate has an opportunity for career growth). When this isn't feasible, you may want to undertake a strategy for an orderly knowledge transfer.

## Rescue me... or not

CFOs sometimes fall victim to the "rescue fantasy," where a lot of time is spent trying to save certain staff members, only to find it was better to replace them. There are two common variations. The first involves a very congenial, well-liked individual who is not performing at the level required. Conversely, the second variation occurs when there is a talented individual who is good at his or her specialty or execution, but does so in a manner inconsistent with the culture, teaming, and other norms you want to instill.

**As rescue efforts do not always succeed and can be costly in terms of time and effort, you have to carefully assess the likelihood of success and trade off such efforts against recruiting staff with the requisite skills and temperament to succeed.**

For illustrative purposes, let us name the two problematic individuals Carol and David.

Carol is your congenial, well-liked tax director, but you have concerns about her ability to devise effective tax plans. David is leading your main finance transformation project, but you have heard noises from internal customers and observed some disrespectful behaviors toward his peers. Carol's gap appears to be skill-related, and to test this, you assign her a 45-day task to frame a tax plan. David's issues seem behavioral, so in addition to observing him, you conduct a 360 performance review and informally get feedback from those involved in the project.

As a former tax director, you are disappointed with the plan Carol provides, and you ask her to come back with a revised overall tax plan, limiting the timeline to another 60 days. On David, you get troubling feedback of how he is intimidating his

staff and is not an effective listener. But David is also smart and execution-oriented, and you cannot easily replace him in the midst of the transformation project. You provide David with candid feedback and assign him to a coach for the next 90 days.

At the end of that period, you remain disappointed in Carol's abilities, and it is now clear she will not gain the expertise to effectively drive the tax plan. David's case is more troubling. The coach initially notes that David is improving, but another 360 review reveals that he continues to behave in a manner inconsistent with the values you are trying to instill. While in each case you have made an effort to rescue a key member of your team, based on your observations, you decide to replace both employees. Still, in this rescue effort, you minimized your time in the process, leveraging other resources to help these individuals develop critical skills and modify behaviors as needed.

**Takeaway:** A critical role of every executive is to develop his or her team. But watch out for the rescue fantasy. A rescue effort with a direct report should generally maintain an established timeline that helps resolve the situation. In addition, using third-party resources such as external coaches, training programs, and external networks to help individuals develop the skills they lack can give you leverage in rescue efforts.



## Let it go, let it go

Given the ever-increasing demands on finance and market trends regarding talent, there are times when you need to shake up your team to either fill a gap or meet new responsibilities. But making internal changes, particularly

promotions, comes with a downside: internally promoted executives often make choices that can constrain their time and compromise their credibility. How? They continue to do their old job for so long that it gets in the way of addressing the new job.

Part of the problem is that promotions (especially to C-level roles) are not always well planned. Despite organizational succession plans, unexpected turnover or the need to fill a gap does not give the new executive much time to prepare for the role—let alone prepare the person who will assume his or her current responsibilities. Thus, whether it is the unavailability of a successor or the unexpected nature of a promotion, the new executive may suddenly be doing two jobs. And while this may be sustainable for a month or two, it can significantly lessen the executive's ability to do the new job. Thus, a strategy is needed to help him or her end the old job and move forward.

The best case is to have a successor ready to assume responsibility for the vacated role. In some cases, a few one-to-two-hour briefings may be sufficient to inform the successor of the key issues and projects he or she will be taking over. One suggestion for organizing the discussion is to focus on the essential tenets of transitions:

- **Time** Address current priorities and projects.
- **Talent** Assess the strengths and weaknesses of the current team.
- **Relationships** Articulate issues pertaining to key relationships, including stakeholders who are supportive and those who are not.

**In a case where there is no successor, however, the situation is more challenging. You have to fill the gap between recruiting an external candidate to take the old job or accelerate the preparation of an internal candidate. Either route can take time.** Two strategies we've seen work

are delegating as much of the old job as possible to previous and current direct reports, and recruiting interim help until a permanent replacement can be found. Fortunately, in many markets, it is now possible to get senior executives for a wide variety of roles on an interim basis. While there is some risk—for example, an underperforming outsourced executive—it is an important strategy to consider when trying to protect the newly promoted executive's time. In addition, such a strategy may help that executive gain the runway he or she needs to perform effectively in the new role.

**Takeaway:** Beware of the newly promoted executive continuing to do his or her old job in addition to the new one. Allowing the executive to effectively move forward in a new role may require extensive delegation of the prior role across your team, the use of interim staff, and an honest assessment of the inherited team's ability to deliver on the future agenda.

## Turning Disruptive Trends into Opportunity

**Disruption is edging many companies out of dominant positions at an increasing pace, but they can leverage certain consistent patterns of disruption to anticipate threats and adapt more effectively. “These patterns of disruption, when discovered early and monitored, represent a significant opportunity for organizations to establish new and more effective businesses,” noted Donna Epps, a Deloitte Advisory partner at Deloitte Financial Advisory Services LLP, during a Deloitte webcast.**

Disruption occurs when leading incumbents are displaced by a new approach. “Companies are squeezed by more powerful customers from one side, and more powerful knowledge workers on the other, resulting in mounting performance pressure,” said John Hagel III, co-chairman of Deloitte’s Center for the Edge, during the webcast. “In addition, a fundamental change is occurring in value creation in the global economy, which we call the Big Shift. It requires new ways of doing business, affecting all companies regardless of market or industry,” he added.

According to Mr. Hagel, the Big Shift is driven by two long-term forces: digital technology infrastructures that are improving at exponential rates and a long-term shift in public policy on a global scale toward freer movement of products, money, people and ideas across geographic and industry boundaries. “When those two forces come together, you get much more intense competition, and consumers are reaping the benefit of that, and so are the knowledge workers,” he noted.

### Categories of Disruption

Deloitte’s Center for the Edge research has identified three broad groupings of disruption.

One focuses on the supply side in terms of fragmenting the vendors and producers that customers deal with; where scale was once the key driver of success, increasingly there are diseconomies of scale in certain areas.

The second category concerns strengthening the power of the customer, helping customers to choose and co-create the best options for themselves. “One of the implications of the increasing power of customers is that they are no longer willing to settle for the mass-market item produced for everybody. Instead, they want something tailored to their specific need and context—and, in many cases, a relationship with the provider of that product or service,” said Mr. Hagel. “This can be seen as an example of a pattern of disruption that creates an opportunity.”

The third group of disruption is often triggered by inflated profit pools, and takes shape in the form of approaches to pricing and ways of designing and configuring products. The marketplace is increasingly driven by powerful customers, and they want the best product at the lowest price feasible. “Anytime a profit pool is accumulating in a market or industry that isn’t providing direct value to the customer, it sits vulnerable to attack,” observed Mr. Hagel.

### Strategies for Confronting Disruption

“When leading companies stumble and fall out of long-held positions of leadership, two responses typically dominate: paralysis and denial,” said Andrew Blau, a Deloitte Advisory director at Deloitte & Touche LLP, and managing director, Strategic Risk Solutions. Both tend to keep the organization from adapting to a changing world. “In reality, the organization’s first step should be to define its strategic risks,” Mr. Blau added. “Strategic risks are a subset of the many risks that an organization will be called on to identify and manage over time, and they get to the very basis for a strategy, the competitive advantage that a company hopes to achieve,” Mr. Blau added.

The inability to manage those risks is a contributor to the increasing tople rate. At the same time, “these patterns of

disruption actually create opportunity: They are going to be someone's business. Organizations are leveraging these opportunities and using them as building blocks for new and more effective businesses," said Mr. Blau.

The following steps can help organizations identify and address disruptive trends:

### Accelerate discovery

Understanding patterns of disruption can help accelerate the pace at which organizations discover sources of surprise. An organization that merely responds to events will have difficulty surviving into the long-term; rather, organizations need to learn faster, look more broadly and then prepare for surprises. "Companies can decide what to track by looking outside current business intelligence efforts, enhanced by big data and data analytics," said Mr. Blau. In addition, simulations can help an organization to accelerate learning and avoid getting stuck in an all-or-nothing situation once disruption hits.

### Scan continuously

The patterns of disruption provide a cross-sector, outside-in perspective that can inform organizations about changes outside their field of vision. In a changing world, one snapshot is inadequate: The organization requires a moving picture that can track change over time. Big data, data analytics and potentially even newer capabilities such as cognitive computing, as well as traditional business intelligence resources, can be employed for scanning. "Those tools allow us to expand the horizon that we are scanning and to do that more effectively. Even without them, organizations can scan the environment in a systematic way once they know where to look," Mr. Blau added.

### Prepare for surprises

Understanding patterns of disruption can help organizations rehearse readiness to respond quickly in ambiguous situations, and develop capabilities that translate disruption into opportunity. "Preparation can take many forms," said Mr. Blau.

"Perhaps you are spotting and tracking something and that gives you time to identify hedges. You could also run simulations to prepare for the effects. Many companies learn a lot by running simulations to prepare for how they would adapt in a challenging environment or where they might invest to pursue their corporate strategy," he added.

### Confront biases

It's natural to view the world through one's individual, respective biases. Being highly aware of one's own biases is critical to addressing disruption well. If executives know they have a tendency to search for what they already are looking for (the confirmation bias), or overestimate the likelihood of things that they heard about recently rather than take a more objective view (the availability bias), they can start to understand the biases that might prevent them from seeing and addressing disruptive trends.



"What we know today becomes obsolete at a faster and faster rate. The companies that are more likely to succeed are those that participate in a broader and more diverse range of knowledge flows, learn faster by tapping into these knowledge flows and, as a result, refresh their knowledge stocks," said Mr. Hagel. "An executive who became successful in the old paradigm can count on facing a very difficult transition, because this new disruptive model challenges some of industry's most basic beliefs," Mr. Hagel noted.

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The CFO Program in Japan hosts regular events for executives of international companies to provide insights and networking opportunities.

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