Deloitte CFO Signals Report

2021Q3

December 2021

Contents

About Deloitte CFO Signals

Deloitte CFO Signals is a quarterly global survey for investigating the thinking and actions of leading Chief Financial Officers (CFOs). We share the highlights of survey results with analysis from Deloitte Tohmatsu and publish them as the CFO Signals report.

The survey consists of two sections: the "Survey on the Economic Environment," which is assessed globally in every edition, and the "Survey on Hot Topics," which varies for each country.

In Japan, it was conducted for the first time in August 2015, making this the 26th edition. In the "Survey on the Economic Environment," we analyse chronological changes in CFOs' thinking as well as the latest forecast at the time of the survey. In addition to recurring questions, we also inquire about how the CFO and the Finance & Accounting Department are tackling tax management.

Surveys for this edition were conducted in November 2021, and we were able to receive responses from 45 CFOs and finance and accounting executives.

Thank you for your cooperation.

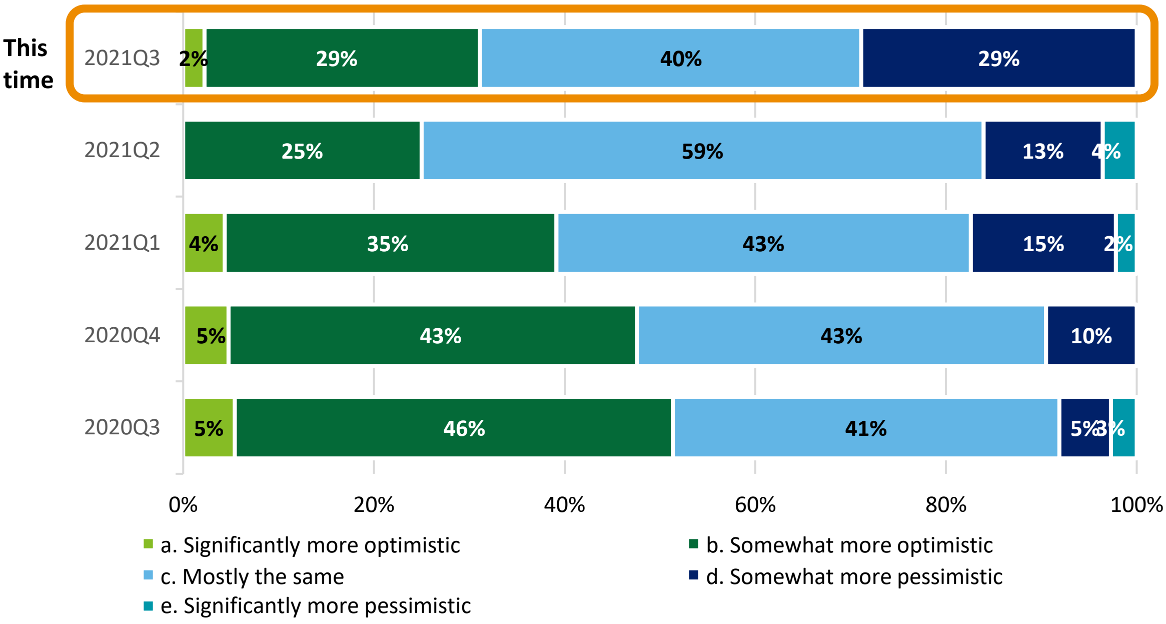
Deloitte Tohmatsu Group
The CFO program
December 2021

Survey on the Economic Environment

Financial environment prospects

Financial environment prospects polarized between optimistic and pessimistic.

Graph 1
Compared with three months ago, how do you feel about the financial prospects for your company? Choose the most appropriate answer.

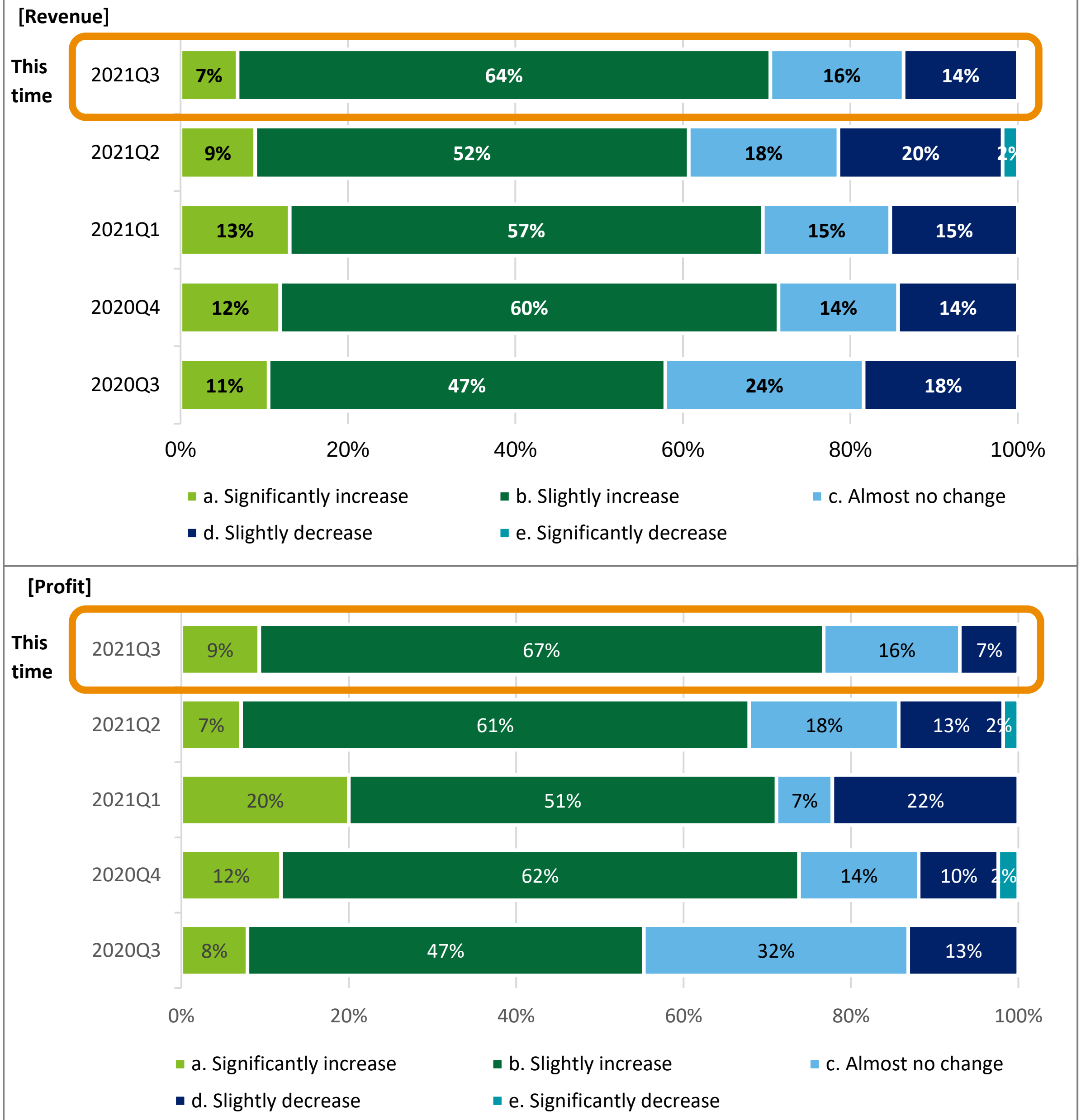


Graph 1 shows how the financial prospects of the respondents' businesses have changed over the last three months. During the period of this 2021Q3 survey, economic activities gradually resumed after the full lifting of the state of emergency against COVID-19 in Japan on October 1, although financial markets deteriorated significantly later due to the spread of a new variant (Omicron) in South Africa on November 26. Moreover, it was also the time of growing concerns about global inflation, with crude oil futures temporarily exceeding $80 per barrel in October. In the questionnaire asking for their financial prospects this time, 31% of respondents in total were "Significantly more optimistic" or "Somewhat more optimistic," while 29% in total were "Somewhat more pessimistic" or "Significantly more pessimistic," both of which exceeded those in the previous survey, showing the polarizing trend of CFOs' business confidence. Accordingly, responses of "Mostly the same" decreased significantly to 40% from 59% in the previous survey. The underlying factors to the diversification of the financial prospects into optimism and pessimism cannot be read directly from these survey results. However, it can be assumed that a positive factor seems to be the expectation of an economic recovery due to the global settling down of the COVID-19 pandemic, and negative factors seem to be the rise in production costs due to inflation and the continuation of supply constraints, while their impacts may differ from industry to industry. As we shall see in later sections, the CFOs' focus is shifting from COVID-19 to inflation. The polarization of financial prospects may continue for the time being.

Business performance outlook

Business performance outlook continues to improve, but with inflation a possible cause for concern.

Graph 2
How do you expect your key operating metrics to change over the next 12 months? Choose the most appropriate answer.

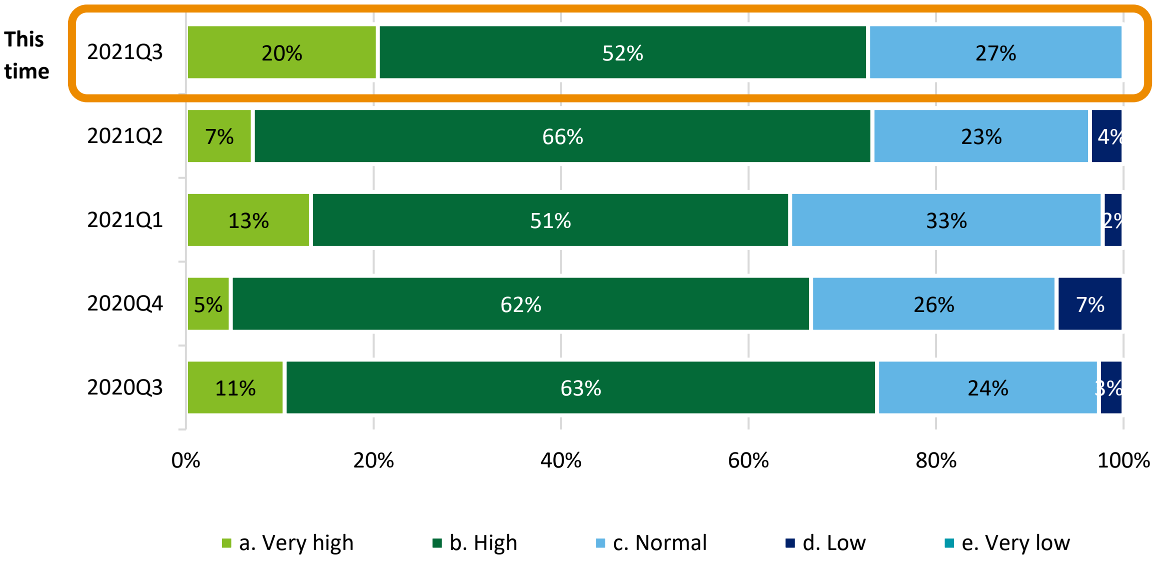


Graph 2 shows the CFOs' prospects for their company's financial performance (revenue and profit) over the coming year. Overall, the business performance outlook improved from the previous survey. The total of "Significantly increase" and "Slightly increase" was 71% for revenue and 76% for profit, both of which exceeded those in the previous survey, remaining at high levels. It suggests a steady upturn to the CFOs' business performance outlook due to the end of the COVID-19 pandemic. The business performance outlook does not show the polarization seen in the above financial prospects. In addition to the economic upturn associated with the end of the COVID-19 pandemic, companies may have restructured their business models in response to co-existence with COVID-19. However, higher inflation may hamper profits in the form of higher production costs. Moreover, the pass-through of costs to prices has not progressed in Japan as much as overseas. Given this situation, it is difficult to say that the CFOs' business performance outlook will always stay at this level going forward.

Uncertainty

Uncertainty remains high

Graph 3
How would you rate the level of financial and economic uncertainty faced by your business? Choose the most appropriate answer.

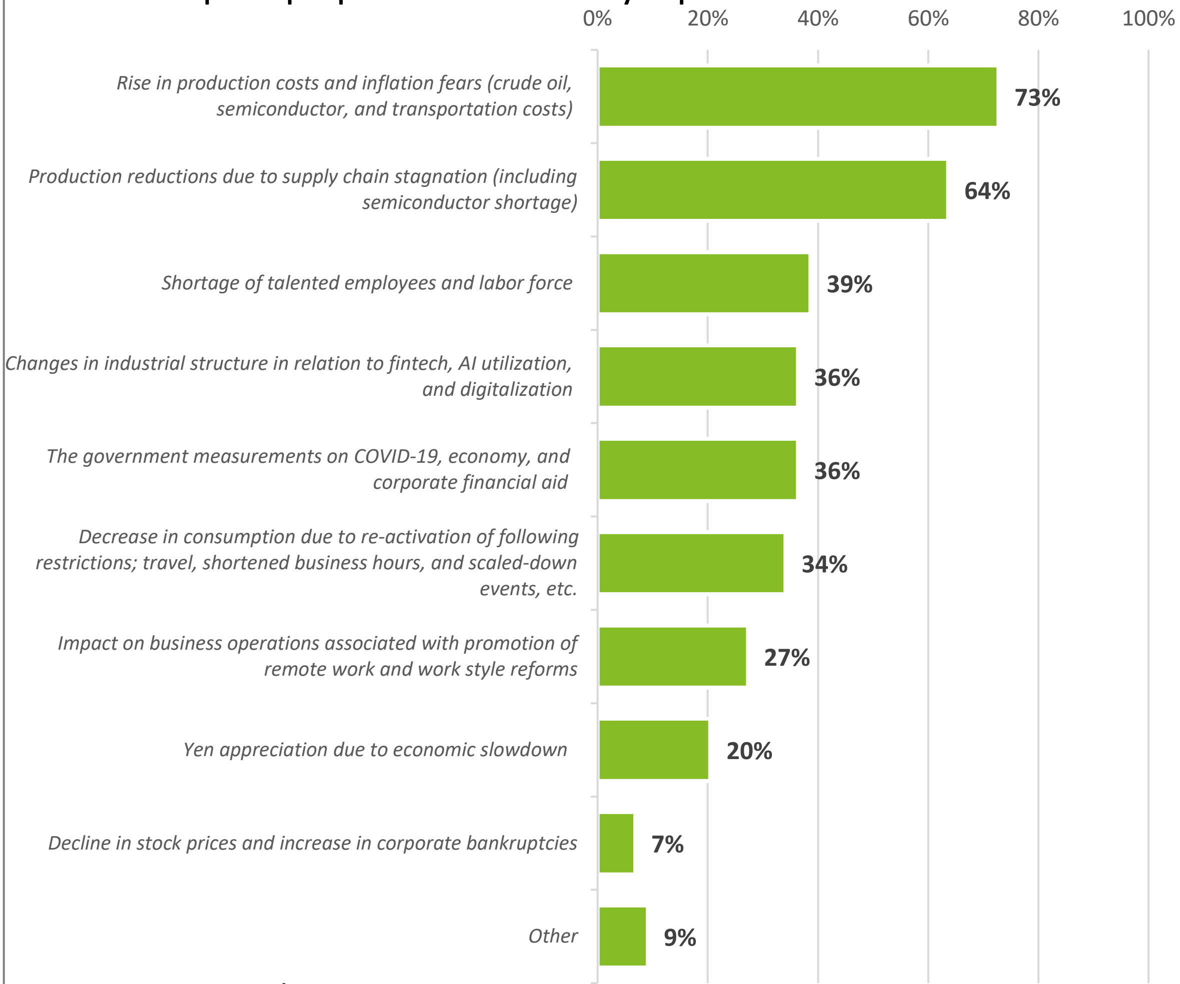


Graph 3 shows CFOs' perceptions of financial and economic uncertainty. In this survey, the total of "Very high" and "High" uncertainty was the same as in the previous survey at 72%, while for their breakdown, 20% said "very high," up 7% from the previous. Financial and economic uncertainty as seen by CFOs remains high. Factors for uncertainty include the intensified U.S.–China conflict and geopolitical risks around the world, in addition to a new COVID-19 variant, inflation and supply constraints. Others of uncertainty are the slowdown and the growing default risk of the real estate business in the Chinese economy that have become evident recently. With all of these, it is difficult to predict their future outcome. COVID-19 is a natural phenomenon, while inter-state conflict is a political factor. Inflation, supply constraints, and the Chinese economy are economic factors, but political factors such as political conflicts between countries and the government's domestic policy are also involved, making the situation impossible to assess from pure supply-demand forecasts. Uncertainty is also likely to remain high for the time being.

Key change factors in the Japanese economy

Significant shift of key change factors from COVID-19 to inflation and supply constraints

Graph 4
For the items below, please choose up to four possible changes affecting the Japanese economy that you believe need particular attention based on their likelihood and expected impact on business development prospects over the next one-year period.



Other comments to add/describe the reasons for the choices

・Central bank actions: FED, ECB, BOJ

・Declines in private capital investment due to economic slowdown

・Consumer sentiment and wage alignment with inflation

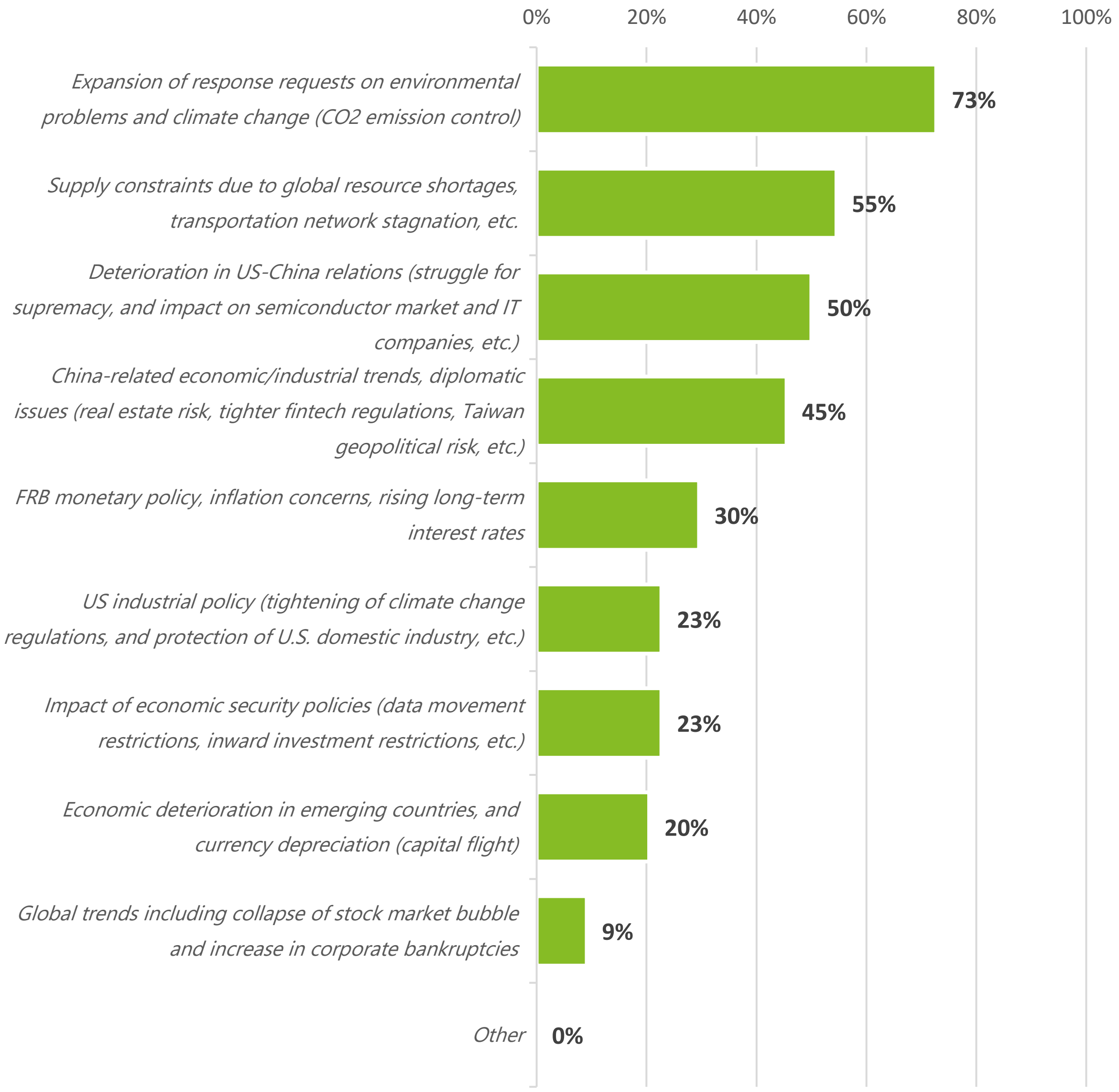
・Obstacles to the global economy's recovery from COVID-19 due to the intensifying U.S.-China conflict structure

Graph 4 shows the key factors in the Japanese economy that CFOs will most closely watch when preparing business plans over the next year. This time, there was a big change in the CFOs' attention. "Production costs and inflation fears" rose to first from third last time, followed by "Supply chain stagnation" in second place as in the previous survey, and third "Shortage of talented employees and labor force" (new item). "Government measures on COVID-19 and the economy" fell considerably to fifth place from the previous first place. The CFOs' attention has shifted significantly from COVID-19 to inflation and supply constraints. In the United States, the consumer price index rose to +6.8% year-on-year in October, the highest level in about 40 years, and crude oil prices temporarily rose to above $80 per barrel. The semiconductor supply shortage continued, forcing the automobile industry to continue reducing production. The ratio of active job openings to applicants in Japan was high at 1.15 in October. In addition, there are reports that even after the business restrictions were lifted, restaurants and other establishments still faced difficulties in operating due to a shortage of workers. High costs and labor shortages have become new risks for companies restarting business after the end of the COVID-19 pandemic. These risk factors are likely to continue for the foreseeable future, as inflation and labor shortages appear to be due to structural changes following the COVID-19 pandemic.

Key change factors in the global economy

Environmental problems and supply constraints are key change factors of CFOs’ concerns.

Graph 5
Please select up to four of the following risk events related to the international economy that you feel are noteworthy in terms of probability and impact on business development over the next one-year period.



Graph 5 shows what trends in the global economy CFOs will most closely watch when preparing their business plans over the next year. “R esponses to environmental problems and climate change” was again ranked first, remaining the biggest key change factor as in the previous survey. A new item " Supply constraints due to global resource shortages" came in second place, while "Deterioration in U.S.–China relations” was in third place, down from the previous second place. Responding to environmental problems and climate change has come to the point where it is necessary to formulate and implement concrete plans. Ahead of the

Tokyo Stock Exchange's reclassification of market segments in April next year, companies wishing to be listed on the prime market are required to disclose their climate change risks. In order to achieve net-zero greenhouse gas emissions by 2050, companies must make more specific reduction plans and implement them, while disclosing quantitative and qualitative information for reduction. Furthermore, supply chain management related to human rights is an urgent issue in some industries. Resource shortages and supply constraints in second place is also a major key change factor overseas as well as in Japan. The U.S.–China conflict has further intensified economically, politically, and militarily. These issues are likely to be long term for years to come and will remain key change factors for CFOs in the foreseeable future.

Survey on Tax Management

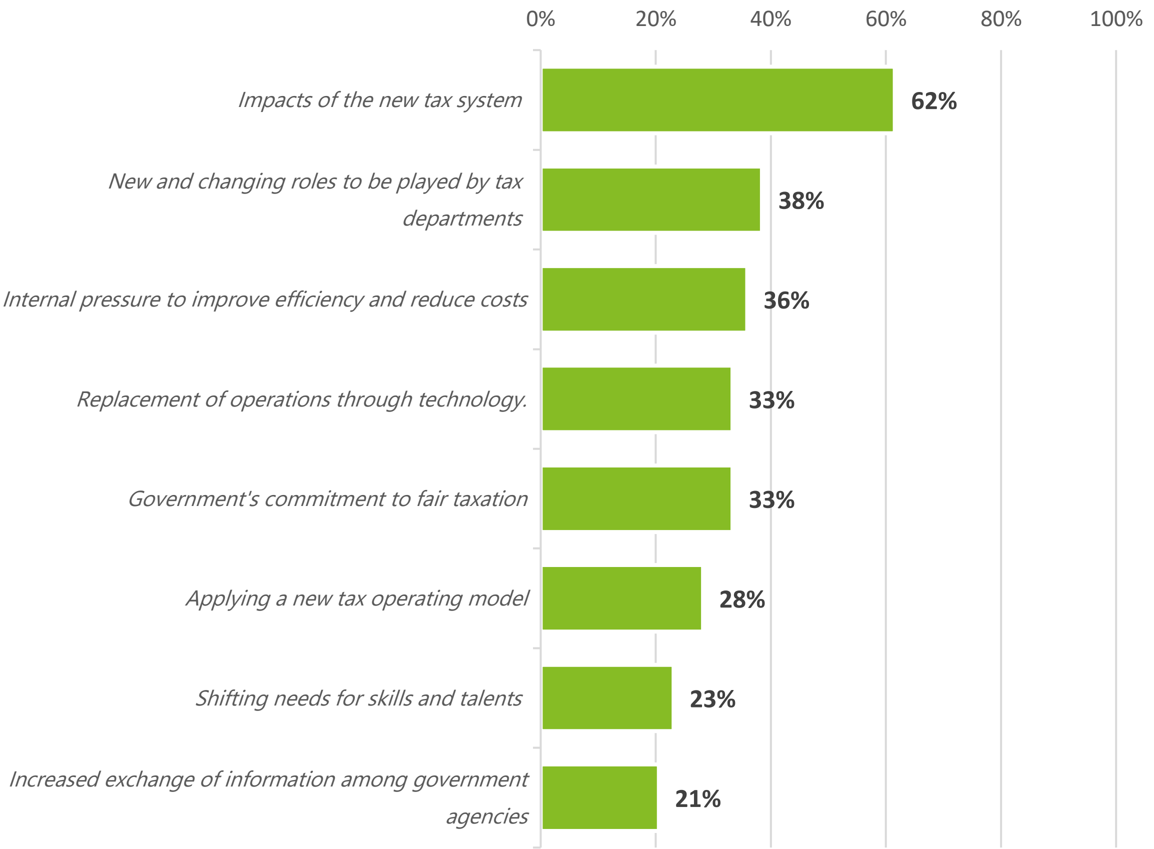
The later section asked how do they address tax management as the CFO and Finance and accounting department.

Items of interest and/or to be addressed in tax management controls

The result shows a lot of interest in the international agreement on a minimum tax rate of 15% and the new tax code to achieve it, which were reported in the media recently.

Graph 6

Please select the top three items that you are interested in and think should be addressed in your company's tax management controls.



It is about to come to a conclusion with the framework of taxation on the digital economy in response to the BEPS (Base Erosion and Profits Shifting) initiative that has been led by the G20 and the OECD since around 2013. This will address the issues of reducing tax costs through tax planning, which has been pursued mainly by some multinational companies in the United States and Europe, and competition among some countries or regions to reduce corporate tax rates to encourage such trends. Many countries, including Japan and the United States, have agreed to a minimum corporate tax rate of 15% as an international framework, requiring emerging economies, which have promoted investment through preferential tax treatment, to change their paradigm. In addition, the environment surrounding taxes has been changing time and time again, including the introduction of new taxation such as the carbon tax, which has emerged due to environmental issues. There has also been a strengthening of tax enforcement to supplement public finances damaged by the COVID-19 pandemic, besides the shift from direct taxes such as corporate tax to indirect taxes such as value-added tax (VAT) and consumption tax.

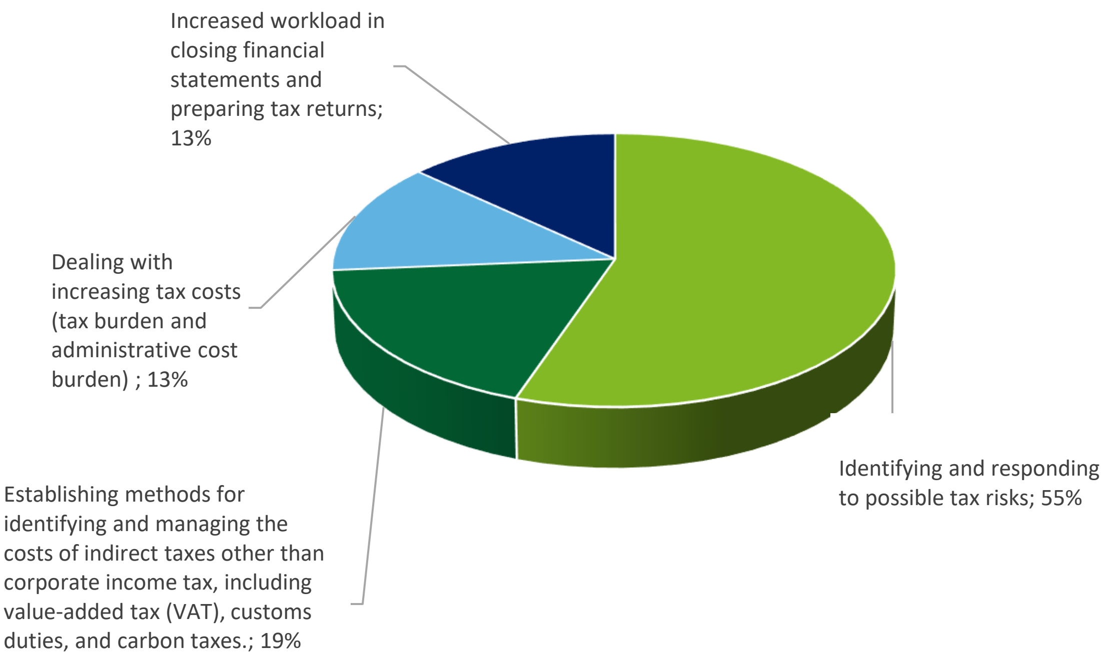
The first question on tax management (Graph 6) was asked to identify the challenges companies are facing in dealing with them, including how to strengthen their ability to respond to such trends in taxation and what kind of systems they should have. The "Impacts of the new tax system," which garnered the largest number of responses, has shown the attention to the international framework agreement on a minimum tax rate of 15%, as reported in the media in October of this year. It appears to be an interest in how the complex tax system to be implemented will affect the company's tax payments, information disclosure, financial statements, and operations for settling accounts and preparing returns, in order to achieve a consensus internationally. In addition, as the following three items for tax management, there appears to be high interest in the changing roles to be played by tax departments, efficiency and introduction of technology within the tax departments.

Necessary measures in response to the new tax system

There is more interest in addressing tax risks than managing tax costs. Emphasis is placed on corporate taxes (transfer pricing and M&A) rather than on indirect tax areas.

Graph 7

Please select the items that you think need to be addressed as a response to both Pillar 1 and Pillar 2* of the new tax regulations to achieve fair taxation.



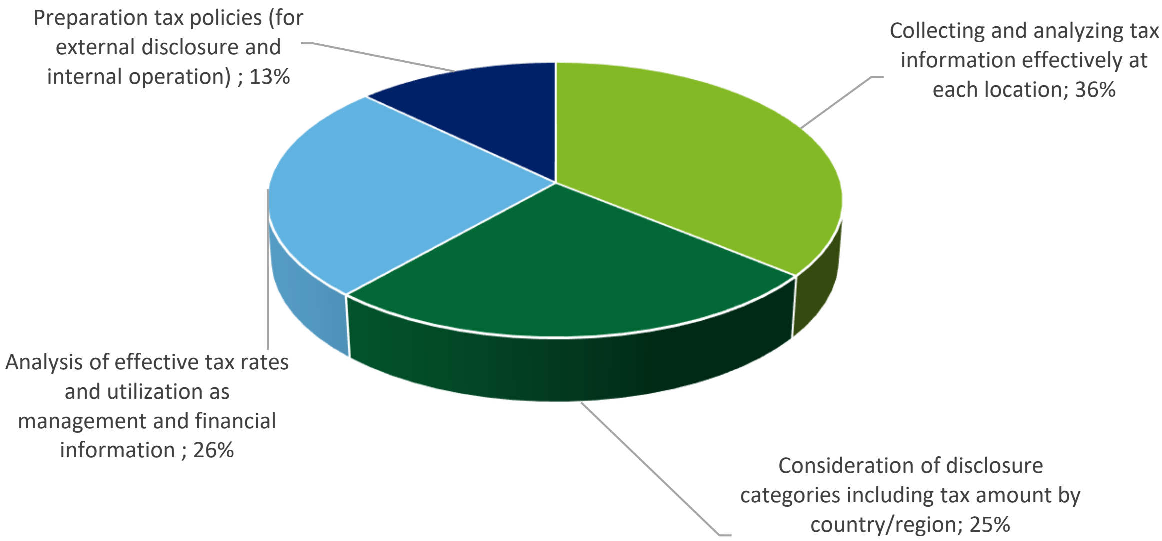
**Key agreements on Pillar 1 and Pillar 2 of the new tax code.*
The outline of the agreement for Pillar 1: Select about 200 companies worldwide based on size and profitability (about 6 Japanese companies), and introduce a framework to allocate 25% of the portion exceeding a certain level of profit to the market countries where consumers and customers exist.
The outline of the agreement for Pillar 2: The minimum corporate tax rate should be set at 15%. In order to ensure the implementation of Pillar 2, for companies with a consolidated revenue of 750 million Euros or more, a new scheme will be introduced in which companies will be taxed at the parent company if there is a country with a tax rate lower than 15%.

As initiatives to be addressed as a response to the new tax regulations to achieve fair taxation, the majority of responses were “Identifying and responding to possible tax risks.” As the impact of the introduction of Pillar 1 and Pillar 2 of the new tax system of taxation on the digital economy, it is easy to expect operational burdens to be increased, but there are still many unknowns in terms of tax costs and risks. As the minimum tax rate will be set at 15% internationally, tax costs are certain to increase. For example, under Pillar 2, tax costs are expected to increase by several hundred million yen to several billion yen, although the impact will vary depending on the size of the company and the previous overseas tax rates. On the other hand, in terms of tax risks, emerging economies are also likely to increase their tax collection to cover their fiscal spending in the midst of the COVID-19 pandemic, with corporate taxes, which have been lowered to attract corporate investment, expected to be subject to such trend as well.

Measures that are deemed to require consideration with regard to tax governance

The most important priority is placed on the consideration of effectively collecting and analyzing tax information required for disclosure at each country location.

Graph 8
With regard to tax governance, please select the measures that you think need to be considered, given that disclosure of tax information is also required as part of ESG.

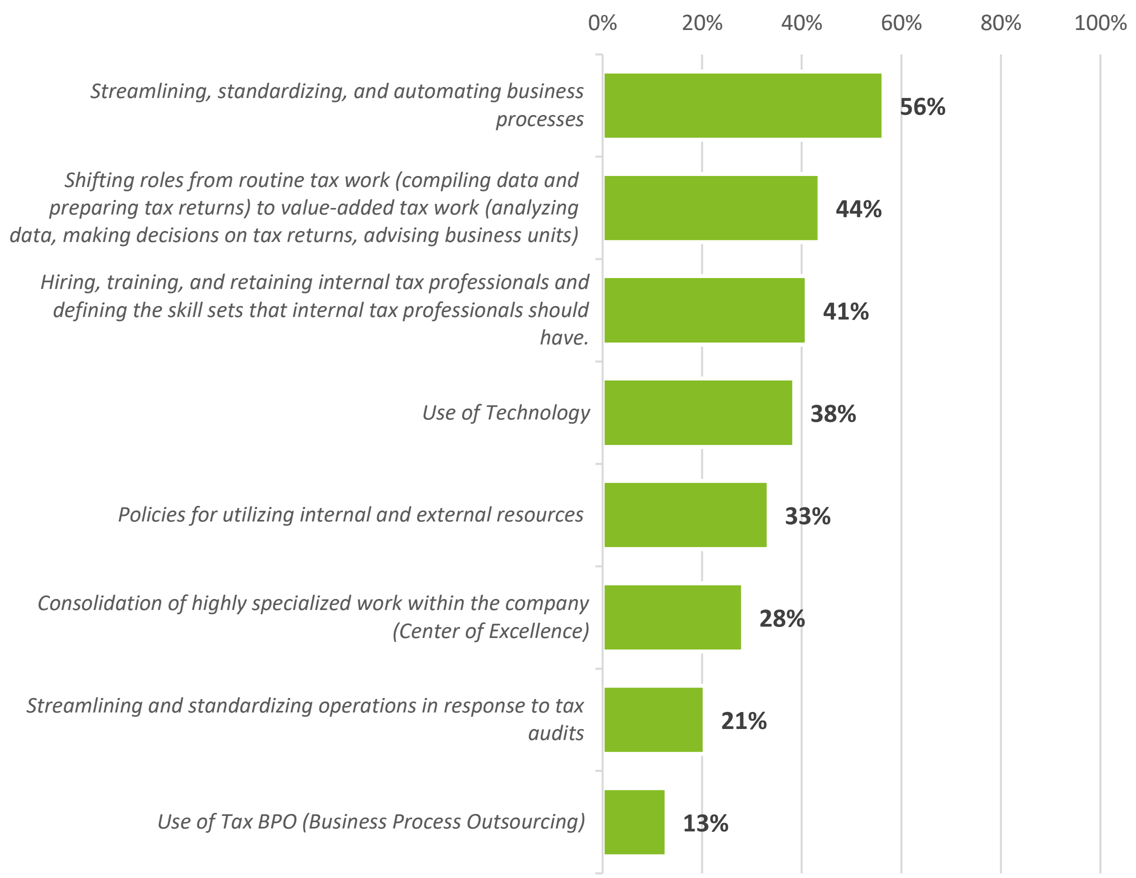


In dealing with tax governance, which is of growing interest to stakeholders such as shareholders, employees, consumers, business partners, and tax authorities, key issues include the disclosure of tax information by country, in addition to the existence/non-existence of initiatives for tax strategies, tax risk management and organizational structure, accountability to stakeholders, and disclosure of their details. Graph 8 shows that as initiatives by companies, it is necessary to first verify how to efficiently collect internal information and whether such information is good enough for disclosure by analyzing it. The result shows that this is followed by “Consideration of disclosure categories including tax amount by country/region” and “Analysis of effective tax rates and utilization as management and financial information.” While all four items listed as options this time are necessary for tax governance, the result indicates the priorities companies have in mind.

Items that are of interest or deemed to require consideration regarding the restructuring of the tax business model

In the area of taxation, as in other accounting operations, the highest interest is shown in streamlining, standardizing, and automating business processes. It is worth noting the high interest in the following shift to value-added tax work and closely related utilization of internal tax professionals.

Graph 9
Please select the top three items below that you are interested in or should consider regarding the restructuring of the tax business model to cope with the increasing complexity of the tax system and



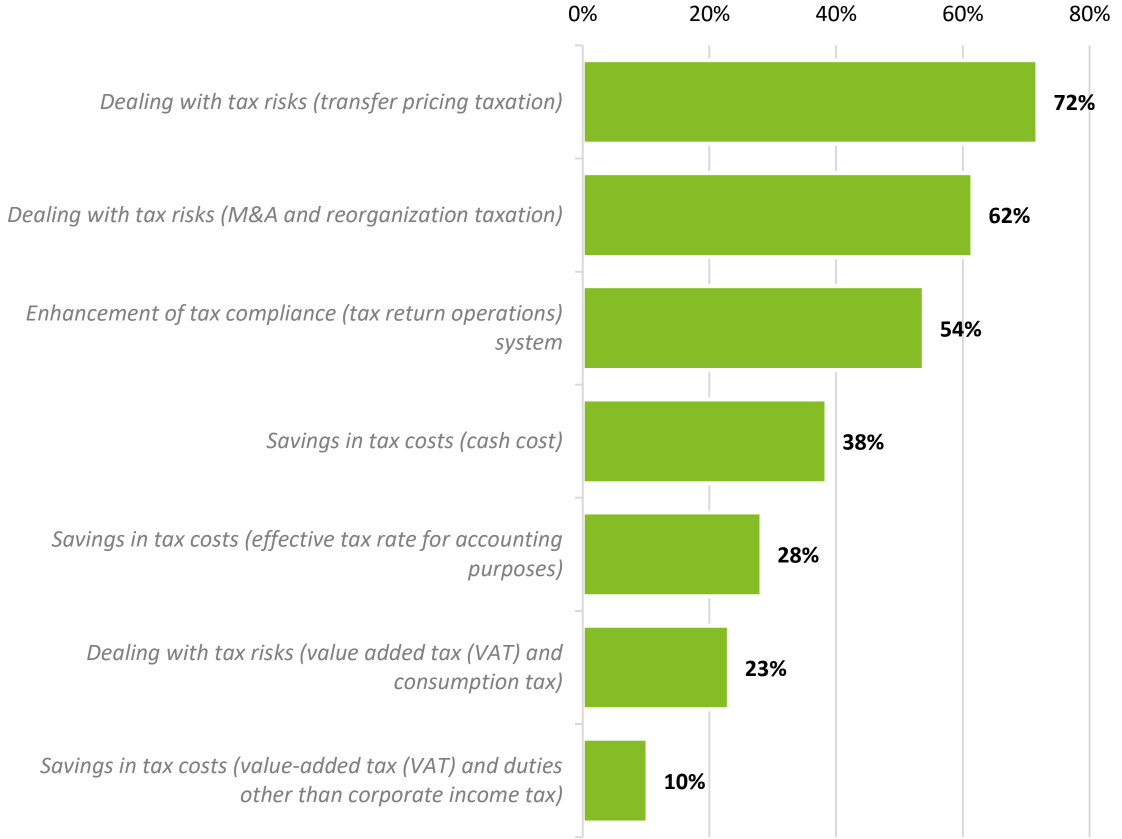
With the introduction of a new international tax system, responses to stronger enforcement by tax authorities, and disclosure of tax information to stakeholders, it is expected to increase the complexity of the tax system and the burden on operations for risk management and governance. On the other hand, in many cases it is difficult to acquire and develop tax personnel resources, and moreover, there are time constraints imposed by the recent workstyle reforms. Hence, we understand that an issue is now how to deal with tax return operations which have a seasonal aspect. As shown by Graph 9, the most important issue for corporate management in such circumstances was "Streamlining, standardizing, and automating business processes," followed by "Shifting from routine tax work to value-added tax work" and "Hiring, training, and retaining internal tax professionals and redefining the skill sets that internal tax professionals should have," intended for making tax work more sophisticated. It can be seen from this that companies are very interested in how to streamline, standardize, and automate routine operations, and how to shift resources generated from there to value-added work while promoting workstyle reforms. An increasing number of companies are trying to prevent tax risks by shifting the tax department to the front line, in other words, by focusing on their support for its sales forces and investment activities. To this end, some large companies are boldly outsourcing seasonal operations such as tax returns to improve the skills of their in-house resources.

Important items in terms of tax optimization

It is characterized by an emphasis on dealing with tax risks and compliance.

Graph 10

When considering the various stakeholders surrounding your company, such as shareholders, employees, business partners, and tax agencies, please select the three most important items for your company in terms of tax optimization.



Dealing with tax risks is clearly deemed to be more important than managing tax costs. With regard to tax risk management, the most important issue is deemed to be dealing with transfer pricing taxation related to international income distribution. This is still recognized as an important issue for companies involved in a tug-of-war on taxation between countries, including as an ideal form for appropriate income distribution and specific practices to realize such form. It appears that the following item of dealing with M&A and reorganization taxation is also ranked high because it requires a good level of expertise. Attention should also be paid to the high level of interest in enhancing tax compliance (tax return operations). Recognition of the need to enhance the system to ensure correct tax returns is seen as a manifestation of the challenge of grasping and managing how to pay taxes appropriately, not too much nor too little, including at overseas bases. On the other hand, there is still little interest in the indirect tax area in terms of both risk management and cost management, although in light of some recent cases where additional taxes related to value-added tax were imposed overseas, there seems to be a need to reassess risks in particular.

Conclusion

This time, we asked CFOs about matters that need to be addressed and are of high interest in tax management. Attention was paid to the new international system of taxation on the digital economy partly due to recent media reports. Moreover, the majority expressed the opinion of wishing to understand the impact in terms of tax risks more than anything as its impact. Furthermore, the requirement to disclose tax information led to the recognition that the greatest need was for efficient collection and analysis of tax information. In the background, it appears that companies disclose the minimum tax information required and present the minimum information to tax authorities at the moment. However, it takes time to collect such information and they are unable to consider the impact of disclosing and providing such information, particularly in terms of risks.

In the global trend toward tax optimization, the result shows that many companies are focusing on reducing tax risks, particularly in transfer pricing taxation, M&A and re-organization. Given the difficulty of securing excellent tax professionals under the workstyle reform situation, it appears that finding a way to allocate limited resources so as to strengthen tax risk management is now a challenge for companies.

Based on the results of this later questionnaire survey, we believe that it is time to reconsider tax operations, taking into account the increasing complexity of the tax system and resource constraints. Emphasis should be placed first on dealing with tax risks and shifting tax operations to the front line to prevent such risks. With those as keywords, it is necessary to take initiatives regarding the issues of how to make time by improving the efficiency of routine work and to improve the skills of in-house resources.

What is the CFO Program?

The Deloitte Tohmatsu Group's CFO Program is a comprehensive program to revitalize the Japanese economy by supporting the CFOs of companies that it rests on and contributing to improving the capabilities of CFO organizations. As a Trusted Advisor, we bring together professionals from all walks of life to help CFOs solve challenges. In addition, we aim to improve the competitiveness of Japanese companies by providing the latest information, including global trends, and CFO-networking beyond corporate and industry boundaries.

Deloitte Tohmatsu Group
The CFO Program
Marunouchi Nijubashi Building, 3-2-3 Marunouchi Chiyoda-ku, Tokyo, 100-0005