FINANCIAL SECTION

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FINANCIAL OVERVIEW

GENERAL

The following discussion and analysis provides information that management believes to be relevant to understanding Canon's consolidated financial condition and results of operations. References in this discussion to the "Company" are to Canon Inc. and, unless otherwise indicated, references to the financial condition or operating results of "Canon" refer to Canon Inc. and its consolidated subsidiaries.

OVERVIEW

Canon is one of the world's leading manufacturers of office multifunction devices ("MFDs"), plain paper copying machines, laser printers, cameras, inkjet printers, medical equipment, semiconductor lithography equipment and flat-panel-display ("FPD") lithography equipment. Canon earns revenues primarily from the manufacture and sale of these products domestically and internationally. Canon's basic management policy is to contribute to the prosperity and well-being of the world while endeavoring to become a truly excellent global corporate group targeting continued growth and development.

Canon divides its businesses into four segments: the Office Business Unit, the Imaging System Business Unit, the Medical System Business and the Industry and Others Business Unit.

Economic environment

Looking back at 2020, the global economy fell significantly with no signs of controlling the spread of infections, although the balanced measures to curb infections and expand economic activities were implemented around the world amid the global coronavirus ("COVID-19") pandemic. In the U.S., despite a record decline in consumption caused by movement restrictions implemented in the first half of the year, the economy gradually recovered in the second half of the year while repeating deregulation and tighter regulations of economic activities. In Europe, the consumption headed toward a recovery phase resulting from the easing of large-scale lockdowns and night curfews that were enacted in each country from March. The European economy, however, continued to slow down due to restrictions on economic activities being reinstated due to a resurgence of infections. In China, economic recovery has accelerated mainly through domestic demand and exports resulting from a rapid resumption of economic activities. Even in other emerging markets, despite restrictions on movement and economic activities in some countries, economies showed signs of recovery resulting from gradual resumption of economic activities amid the COVID-19 pandemic. In Japan, the recovery trend continued due to the resumption of economic activities and the easing of voluntary restrictions after the lifting of the State of Emergency, although infections began to rise again in November.

Market environment

Amid these conditions, the markets in which Canon operates were greatly affected by the spread of COVID-19. For office MFDs and laser printers, demand for both monochrome and color models declined due to insufficient recovery of corporate activities in the spread of COVID-19. For cameras, despite a significant decline in demand due to the impact of COVID-19, demand headed toward an improvement phase due to a recovery in consumption in the second half of the year. For inkjet printers, the pace of recovery gradually increased in some emerging countries in the second half of the year, in addition to developed countries and China, where demand for products were solid due to a rise in remote working and education. For medical equipment, although restrictions on sales activities to medical institutions in the first half of the year due to the impact of COVID-19 were eased in the second half of the year, sales activities were nonetheless affected by the prolonged impact of COVID-19. For industrial equipment, demand for both FPD lithography equipment and semiconductor lithography equipment remained solid.

The average value of the yen for the year was ¥106.68 against the U.S. dollar, a year-on-year appreciation of approximately ¥2, and ¥122.07 against the euro, the same level as the previous year.

Summary of operations

In 2020, sales of MFDs for the office and production printing market both decreased, although they showed signs of recovery since the second half of the year. Unit sales of laser printers, both monochrome and color models, were below those of the previous year. Sales of services and consumables also declined resulting from the moderate recovery in customers' print volumes after cancellation of office closures in response to the spread of COVID-19 and the resumption of corporate activities. For interchangeable-lens digital cameras, although unit sales were below those of the previous year, sales were better than expected in the second half of the year due to strong sales of the EOS R5 and EOS R6 full-frame mirrorless cameras. As for inkjet printers, unit sales, including refillable ink tank models, were significantly above those of the previous year due to the recovery in demand in some emerging countries on top of demand for remote working and education in developed countries and China. In medical equipment, amid the postponement of installation and restrictions on sales activities, sales were slightly below those of the previous year, as a result of capturing demand for equipment supplies to medical institutions supported by the government of each country in the second half of the year. For industrial equipment, despite solid demand for semiconductor lithography equipment for memory devices, and for organic LED ("OLED") panel manufacturing equipment, sales for FPD lithography equipment decreased compared with those of the previous year as a result of postponement of installation due to the impact of COVID-19. As for network cameras, which are being used in a growing range of applications and where the market is growing, sales increased slightly from those of the previous year due to a moderate recovery in sales activities. Under these conditions, net sales for the year decreased by 12.1% year-on-year to ¥3,160,243 million. Gross profit as a percentage of net sales decreased by 1.3 points to 43.5%. Gross profit for the year decreased by 14.5% year-on-year to ¥1,375,868 million. Operating expenses decreased by 11.9% year-on-year to ¥1,265,321 million, due to the further promotion of efficiency for expenses throughout the entire Group. As a result, although operating profit decreased by 36.6% year-on-year to ¥110,547 million, it exceeded the prediction which had been revised upward in the most recent forecast. Other income (deductions) decreased by ¥1,340 million to ¥19,733 million, mainly due to decrease of interest and dividend income, while income before income taxes decreased by 33.4% year on year to ¥130,280 million and net income attributable to Canon Inc. decreased by 33.3% year on year to ¥83,318 million.

Total assets decreased by ¥146,304 million to ¥4,625,614 million at December 31, 2020, compared with the end of previous year, mainly due to a decrease of fixed and intangible assets, and accounts receivables. Total liabilities decreased by ¥46,365 million to ¥1,841,573 million at December 31, 2020, compared with the end of previous year, mainly due to a decrease of accrued pension liabilities and accrued expenses. Total equity decreased by ¥99,939 million to ¥2,784,041 million at December 31, 2020, compared with the end of previous year, mainly due to the dividend payout, the repurchasing of treasury stock and an increase of accumulated other comprehensive loss resulting from the appreciation of the yen.

Key performance indicators

The following are the key performance indicators (“KPIs”) that Canon uses in managing its business. The changes from year to year in these KPIs are set forth in the table shown below.

Net sales and profit ratio

As Canon pursues the goal to become a truly excellent global corporation, one indicator upon which Canon’s management places strong emphasis is revenue. The following are some of the KPIs related to revenue that management considers to be important.

Net sales is one such KPI. Canon derives net sales primarily from the sale of products and, to a lesser extent, provision of services associated with its products. Sales vary depending on such factors as product demand, the number and size of transactions within the reporting period, market acceptance for new products, and changes in sales prices. Other factors involved are market share and market environment. In addition, management considers the evaluation of net sales by segment to be important for the purpose of assessing Canon’s sales performance in various segments, taking into account recent market trends.

Gross profit ratio (ratio of gross profit to net sales) is another KPI for Canon. Through its reforms of product development, Canon has been striving to shorten product development lead times in order to launch new, competitively priced products at a faster pace. Furthermore, Canon has further pursued cost reductions through enhancement of efficiency in its production. Canon believes that these approaches will improve Canon’s gross profit ratio, and so will continue pursuing the curtailment of product development lead times and reductions of production costs.

Operating profit ratio (ratio of operating profit to net sales), income before income taxes ratio (ratio of income before income taxes to net sales), and R&D expense to net sales ratio are considered to be KPIs by Canon. Canon is focusing on two areas for improvement. Canon is striving to control and reduce its selling, general and administrative expenses as its first key point. Secondly, Canon’s R&D policy is designed to maintain adequate spending in core technology to sustain Canon’s leading position in its current business areas and to exploit opportunities in other markets. Canon believes such investments will create the basis for future success in its business and operations.

Cash flow management

Canon also places significant emphasis on cash flow management. The following are the KPIs relating to cash flow management that Canon’s management believes to be important.

Inventory turnover measured in days is a KPI because it measures the efficiency of supply chain management. Inventories have inherent risks of becoming obsolete, physically damaged or otherwise decreasing significantly in value, which may adversely affect Canon’s operating results. To mitigate these risks, management believes that it is crucial to continue reducing work-in-process inventories by decreasing production lead times in order to promptly recover related product expenses, while balancing risks of supply chain disruptions by optimizing finished goods inventories in order to avoid losing potential sales opportunities.

The debt to total assets ratio is also one of the KPIs. For a manufacturing company like Canon, it generally takes considerable time to realize profit from a business due to lead times required for R&D, manufacturing and sales. Therefore, management believes that it is important to have sufficient financial strength. Canon will continue to reduce its dependency on external funds for capital investments in favor of generating the necessary funds from its own operations.

Canon Inc. shareholders’ equity to total assets ratio is another KPI for Canon. Canon believes that its shareholders’ equity to total assets ratio measures its long-term sustainability. Canon also believes that achieving a high or rising shareholders’ equity ratio indicates that Canon has maintained a strong financial position or further improved its ability to fund debt obligations and other unexpected expenses. In the long-term, Canon’s management believes a high shareholders’ equity ratio will enable Canon to maintain a high level of stable investments for its future operations and development. As Canon puts strong emphasis on its R&D activities, management believes that it is important to maintain a stable financial base and, accordingly, a high level of its shareholders’ equity to total assets ratio.

KEY PERFORMANCE INDICATORS

	2020	2019	2018	2017	2016
Net sales (Millions of yen)	**3,160,243**	3,593,299	3,951,937	4,080,015	3,401,487
Gross profit to net sales ratio	**43.5%**	44.8%	46.4%	48.8%	49.2%
R&D expense to net sales ratio	**8.6%**	8.3%	8.0%	8.2%	9.0%
Operating profit to net sales ratio	**3.5%**	4.9%	8.7%	7.9%	6.4%
Income before income taxes to net sales ratio	**4.1%**	5.4%	9.2%	8.7%	7.2%
Inventory turnover measured in days	**60 days**	59 days	56 days	49 days	59 days
Debt to total assets ratio	**10.9%**	10.8%	8.2%	10.2%	11.9%
Canon Inc. shareholders' equity to total assets ratio	**55.7%**	56.3%	57.5%	55.1%	54.0%

Notes: 1. Inventory turnover measured in days is determined by: Inventory divided by net sales for the previous six months, multiplied by 182.5.
2. The increase of the debt to total assets ratio in 2019 was primarily due to adopting new accounting standard ASU No. 2016-02, Leases (Topic 842) Section A. The company includes current operating lease liability and noncurrent operating lease liability as the debt since 2019. If this factor were excluded, the debt to total assets ratio in 2019 is 8.6%.
3. The decrease of the Canon Inc. shareholders' equity to total assets ratio in 2019 was primarily due to adopting new accounting standard ASU No. 2016-02, Leases (Topic 842) Section A. The company includes operating lease right-of-use assets in total assets since 2019. If this factor were excluded, Canon Inc. shareholders' equity to total assets ratio is 57.9%.
4. Canon adopted ASU No. 2017-07 from the quarter beginning January 1, 2018. The adoption of the new presentation requirement of the service cost component and the other components of net benefit cost resulted in reclassification from cost of sales, and selling, general and administrative expenses, and research and development expenses into other income (deductions) for the years ended December 31, 2017 and 2016 respectively.
5. Certain figures for the fiscal years ended December 31, 2019, 2018, 2017 and 2016 presented in the table above have been revised from the versions previously disclosed. The effect on the consolidated financial statements was immaterial, respectively. For further details regarding the circumstances of the revision, please refer to Note 1 (y) of the Notes to Consolidated Financial Statements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and based on the selection and application of significant accounting policies which require management to make significant estimates and assumptions. These estimates and assumptions include future market conditions, net sales growth rate, gross margin and discount rate. Though Canon believes that the estimates and assumptions are reasonable, actual future results may differ from these estimates and assumptions. In addition, new waves of COVID-19 infections are being seen in some regions, and it is still difficult to predict when COVID-19 will be brought under control. However, each country and region continues to pursue both the infection control and economic activities. Although the global economy is expected to recover in 2021, it is expected that some regions would continue to be affected by COVID-19. Canon believes that the following are the more critical judgment areas in the application of its accounting policies that currently affect its financial condition and results of operations.

Revenue recognition

Canon generates revenue principally through the sale of office, imaging system and medical system products, industrial equipment, supplies and related services under separate contractual arrangements. Revenue is recognized when, or as, control of promised goods or services transfers to customers in an amount that reflects the consideration to which Canon expects to be entitled in exchange for transferring these goods or services.

Revenue from sales of office products, such as office MFDs and laser printers, and imaging system products, such as digital cameras and inkjet printers, is recognized upon shipment or delivery, depending upon when the customer obtains controls of these products.

Revenue from sales of equipment that are sold with customer acceptance provisions related to their functionality including optical equipment such as semiconductor lithography equipment and FPD lithography equipment, and certain medical equipment such as CT systems and MRI systems, is recognized when the equipment is installed at the customer site and the agreed-upon specifications are objectively satisfied.

Most of Canon's service revenue is generated from maintenance service in the office and medical system products which is recognized over time. For the service contracts of office products, the customer typically pays a variable amount based on usage, a stated fixed fee or a stated base fee plus a variable amount which frequently include the provision of consumables as well as break fix activities. The majority portion of service revenue from the office products is recognized as billed since the invoiced amount directly correlates with the value to the customer of the underlying performance obligation to date. For the service contracts of medical system products, the customer typically pays a stated fixed fee for the stand ready maintenance service and revenue is recognized ratably over the contract period.

The majority of service arrangements for office products are executed in combination with related products. Transaction prices for products and services need to be allocated to each performance obligation on a relative standalone selling price basis where judgements are required. Canon estimates the standalone selling price using a range of prices that would meet the allocation objective based on all the information that is reasonably available including market conditions and other observable inputs. If transaction prices of the product or service contracts are not within the acceptable range then the revenue is subject to allocation based on the estimated standalone selling prices. Canon recognizes the incremental costs of obtaining a contract as an expense when related office products are sold.

Revenue from sales of certain industrial equipment which do not have alternative use and for which Canon has enforceable right to payment to the customers for the performance completed to date is recognized over time with progress towards completion measured using the cost based input method as the basis to recognize revenue and an estimated margin. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses become evident. Changes in job performance, job conditions, estimated margin and final contract settlements may result in revisions to projected costs and revenue and are recognized in the period in which the revisions to estimates are identified and the amounts can be reasonably estimated. Factors that may affect future project costs and margins include, production efficiencies, availability and costs of labor and materials. These factors can impact the accuracy of our estimates and materially impact future reported revenue and cost of sales.

The transaction prices that Canon is entitled to receive in exchange for transferring goods or services to the customer include certain forms of variable consideration, including product discounts, customer promotions and volume-based rebates mainly for imaging system products, which are sold predominantly through distributors and retailers. Canon includes estimated amounts in the transaction price only to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Variable considerations are estimated based upon historical trends and other known factors at the time of sale, and are subsequently adjusted in each period based on current information. In addition, Canon may provide a right of return on our products for a short time period after a sale. These rights are accounted for as variable consideration when determining the transaction price, and accordingly Canon recognizes revenue based on the estimated amount to which Canon expects to be entitled after considering expected returns.

Taxes collected from customers and remitted to governmental authorities are excluded from revenues in the consolidated statements of income.

Allowance for credit losses

Allowance for credit losses is determined using a combination of factors to ensure that Canon's trade and financing receivables are not overstated due to uncollectibility. These factors include the length of time receivables are past due, the credit quality of customers, macroeconomic conditions, historical experiences and future prospects based on a current expected credit loss model (Please refer to Note 1 (x) of the Notes to Consolidated Financial Statement). Also, Canon records specific reserves for individual accounts when Canon becomes aware of a customer's inability to meet its financial obligations to Canon, due for example to bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, estimates of the recoverability of receivables are further adjusted.

Valuation of inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined by the average method for domestic inventories and principally the first-in, first-out method for overseas inventories. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make a sale. Canon routinely reviews its inventories for their salability and for indications of obsolescence to determine if inventories should be written-down to market value. Judgments and estimates must be made and used in connection with establishing such allowances in any accounting period. In estimating the net realizable value of its inventories, Canon considers the age of the inventories and the likelihood of spoilage or changes in market demand for its inventories.

Impairment of long-lived assets

Long-lived assets, such as property, plant and equipment, and acquired intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Determining the fair value of the asset involves the use of estimates and assumptions.

Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation is calculated principally by the declining-balance method, except for certain assets which are depreciated by the straight-line method over the estimated useful lives of the assets.

Lease

As for lessor accounting, Canon provides leasing arrangement to its customers primarily for the sale of office products. Revenue from the sale of these products under sales-type leases is recognized at the inception of the lease. Interest income on sales-type leases and direct-financing leases is recognized over the life of each respective lease using the interest method. Leases not qualifying as sales-type leases or direct-financing leases are accounted for as operating leases and related revenue is recognized ratably over the lease term. When product leases are bundled with maintenance contracts, revenue is allocated based upon the estimated standalone selling prices of the lease and non-lease components. Lease components generally include product and financing while non-lease components generally consist of maintenance contracts and supplies. Some of the contracts include options to extend or to terminate the lease. Canon takes such options into account to determine the lease term when it is reasonably certain that it will exercise these options. The majority of Canon's lease contracts do not contain bargain purchase options for their customers.

As for lessee accounting, Canon has operating and finance leases for various assets including office buildings, warehouses, employees' accommodations, and vehicles. Canon determines if an arrangement is a lease at the inception of each contract. Some of the contracts include options to extend or to terminate the lease. Canon takes such options into accounts to determine the lease term when it is reasonably certain that it will exercise these options. Canon's lease arrangements do not contain material residual value guarantees or material restrictive covenants. As a rate implicit in most of Canon's leases cannot be determined, Canon uses incremental borrowing rate based on the information available at commencement to determine the present values of lease payments. Canon has lease contracts with lease and non-lease components, which are accounted for separately. Canon allocates the consideration in the lease contract to the lease and non-lease components based upon the estimated standalone prices. Costs associated with operating lease assets are recognized on a straight-line basis over the term of the lease.

Business combinations

Acquisitions are accounted for using the acquisition method of accounting. The acquisition method of accounting requires the identification and measurement of all acquired tangible and intangible assets and assumed liabilities at their respective fair values, as of the acquisition date. The determination of the fair value of net assets acquired involves significant judgment and estimates, such as future cash flow projections, appropriate discount and capitalization rates and other estimates based on available market information. Estimates of future cash flows are based on a number of factors including operating results, known and anticipated trends, as well as market and economic conditions.

Goodwill and other intangible assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon recognizes an impairment charge in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. Fair value of a reporting unit is determined primarily based on the discounted cash flow analysis which involves estimates of projected future cash flows and discount rates. Estimates of projected future cash flows are primarily based on Canon's forecast of future growth rates. Estimates of discount rates are determined based on the weighted average cost of capital, which considers primarily market and industry data as well as specific risk factors. Canon has completed its impairment test in the fourth quarter of 2020 and determined that there were no reporting units that were at risk of failing the impairment test as the fair value of each reporting unit substantially exceeded its respective carrying amount. However, with regard to goodwill attributed to the Medical System Business Unit, fair values in excess of reported carrying values as a percentage is lower than other reporting units. As a result, a future reduction in cash flows of the related business, could trigger an impairment. The goodwill related to this reporting unit as of December 31, 2020 is ¥506,513 million. Intangible assets with finite useful lives consist primarily of software, trademarks, patents and developed technology, license fees and customer relationships, which are amortized using the straight-line method. The estimated useful lives of software are from 3 years to 8 years, trademarks are 15 years, patents and developed technology are from 5 years to 18 years, license fees are 8 years, and customer relationships are 15 years, respectively.

Income tax uncertainties

Canon considers many factors when evaluating and estimating income tax uncertainties. These factors include an evaluation of the technical merits of the tax positions as well as the amounts and probabilities of the outcomes that could be realized upon settlement. The actual resolutions of those uncertainties will inevitably differ from those estimates, and such differences may be material to the financial statements.

Valuation of deferred tax assets

Canon currently has significant deferred tax assets, which are subject to periodic recoverability assessments. Realization of Canon's deferred tax assets is principally dependent upon its achievement of projected future taxable income. Canon's judgments regarding future profitability may change due to future market conditions, its ability to continue to successfully execute its operating activities and other factors. Any changes in these factors may require possible recognition of significant valuation allowances to reduce the net carrying value of these deferred tax asset balances. When Canon determines that certain deferred tax assets may not be recoverable, the amounts, which may not be realized, are charged to income tax expense and will adversely affect net income.

Employee retirement and severance benefit plans

Canon has significant employee retirement and severance benefit obligations that are recognized based on actuarial valuations. Inherent in these valuations are key assumptions, including discount rates and expected return on plan assets. Management must consider current market conditions, including changes in interest rates, in selecting these assumptions. Other assumptions include assumed rate of increase in compensation levels, mortality rate, and withdrawal rate. Changes in assumptions inherent in the valuation are reasonably likely to occur from period to period. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect future pension expenses. While management believes that the assumptions used are appropriate, the differences may affect employee retirement and severance benefit costs in the future.

In preparing its financial statements for 2020, Canon estimated a weighted-average discount rate used to determine benefit obligations of 0.5% for Japanese plans and 1.5% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.0% for Japanese plans and 4.8%

for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income government and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

Decreases in discount rates lead to increases in actuarial pension benefit obligations which, in turn, could lead to an increase in service cost and amortization cost through amortization of actuarial gain or loss, a decrease in interest cost, and vice versa. For 2020, a decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately ¥97,818 million. The net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, is deferred until subsequent periods.

Decreases in expected returns on plan assets may increase net periodic benefit cost by decreasing the expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For 2020, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥5,229 million in net periodic benefit cost. Canon multiplies management's expected long-term rate of return on plan assets by the value of its plan assets to arrive at the expected return on plan assets that is included in pension expense. Canon defers recognition of the difference between this expected return on plan assets and the actual return on plan assets. The net deferred amount affects future pension expense.

Canon recognizes the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans in its consolidated balance sheets, with a corresponding adjustment to an accumulated other comprehensive income (loss), net of tax.

Recently Issued Accounting Guidance

Please refer to Note 1 of the Notes to Consolidated Financial Statements.

CONSOLIDATED RESULTS OF OPERATIONS

SUMMARY OF OPERATIONS

	Millions of yen				
	2020	change	2019	change	2018
Net sales	**3,160,243**	**-12.1%**	3,593,299	-9.1%	3,951,937
Products and Equipment	**2,489,829**	**-12.2%**	2,835,428	-11.2%	3,194,724
Services	**670,414**	**-11.5%**	757,871	+0.1%	757,213
Operating profit	**110,547**	**-36.6%**	174,420	-49.1%	342,452
Income before income taxes	**130,280**	**-33.4%**	195,493	-46.1%	362,392
Net income attributable to Canon Inc.	**83,318**	**-33.3%**	124,964	-50.5%	252,441

Note: See note to KEY PERFORMANCE INDICATORS

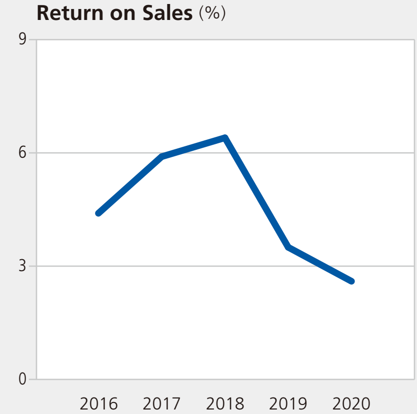
Sales

In the current business term, on a global basis, the economic slowdown continued. In such an environment, although each of Canon Group's businesses endeavored to expand sales particularly with respect to new products, Canon's consolidated net sales in 2020 totaled ¥3,160,243 million, a decrease of 12.1% from the previous year largely due to adverse effect of a shrinking market as well as unfavorable currency effects of foreign exchange rate fluctuation. Net sales of products and equipment totaled ¥2,489,829 million, a year-on-year decrease of 12.2%, while net sales of services totaled ¥670,414 million, a year-on-year decrease of 11.5%.

Overseas operations are significant to Canon's operating results and generated 74.5% of total net sales in 2020. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen relative to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen during the year was ¥106.68 against the U.S. dollar, a year-on-year appreciation of approximately ¥2, and ¥122.07 against the euro, the same level as the previous year. The effects of foreign exchange rate fluctuations

Return on Sales (%)



negatively affected net sales by approximately ¥27,159 million in 2020. This unfavorable impact consisted of approximately ¥22,416 million of unfavorable impact for the U.S. dollar denominated sales and favorable impact of ¥1,999 million for the euro denominated sales, and unfavorable impact of ¥6,742 million for other foreign currency denominated sales.

Cost of sales

Cost of sales principally reflects the cost of raw materials, parts and labor used by Canon in the manufacture of its products. A portion of the raw materials used by Canon is imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in foreign exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses, maintenance expenses, light and fuel expenses, and rent expenses. The ratios of cost of sales to net sales for 2020 and 2019 were 56.5% and 55.2%, respectively.

Gross profit

Canon's gross profit in 2020 decreased by 14.5% to ¥1,375,868 million from 2019. The gross profit ratio also dropped by 1.3 points to 43.5%. The decrease in the gross profit and gross profit ratio were mainly due to a decrease in sales, the effect of product mix and the negative effect of appreciation of the yen against other foreign currencies such as U.S. dollar.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Operating expenses decreased by 11.9% year on year to ¥1,265,321 million, thanks to the pursuit of cost efficiencies in Canon as well as positive effects of currency exchange fluctuation.

Operating profit

Operating profit in 2020 decreased by 36.6% from 2019 to a total of ¥110,547 million. The ratio of operating profit to net sales decreased by 1.4 points to 3.5% from 2019.

Other income (deductions)

Other income (deductions) for 2020 was ¥19,733 million, a decrease of ¥1,340 million from 2019 mainly due to a decrease in interest income.

Income before income taxes

Income before income taxes in 2020 was ¥130,280 million, a decrease of 33.4% from 2019, and constituted 4.1% of net sales.

Income taxes

Income taxes in 2020 decreased by ¥21,809 million from 2019. The effective tax rate for 2020 was 26.4%, which was lower than the statutory tax rate in Japan. This was mainly due to income of foreign subsidies taxed at lower than Japanese statutory tax rate.

Net income attributable to Canon Inc.

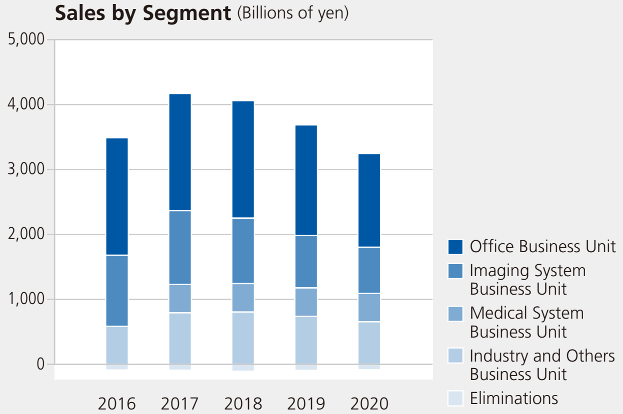
As a result, net income attributable to Canon Inc. in 2020 decreased by 33.3% to ¥83,318 million, which represents 2.6% of net sales.

Segment information

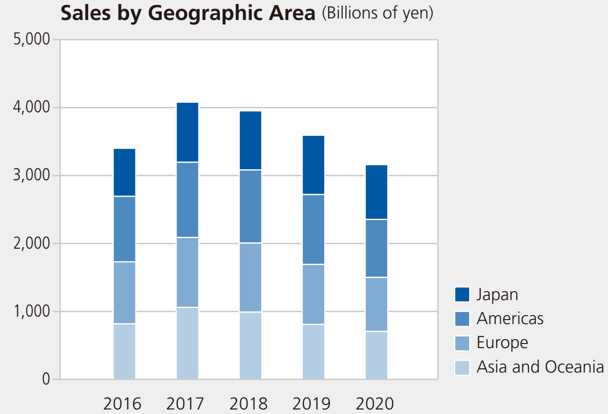
Canon operates four segments: the Office Business Unit, the Imaging System Business Unit, the Medical System Business Unit and the Industry and Others Business Unit.

- **The Office Business Unit** mainly includes Office MFDs / Laser MFPs / Laser printers / Digital continuous feed presses / Digital sheet-fed presses / Wide-format printers / Document solutions
- **The Imaging System Business Unit** mainly includes Interchangeable-lens digital cameras / Digital compact cameras / Interchangeable lenses / Compact photo printers / Inkjet printers / Large format inkjet printers / Commercial photo printers / Image scanners / Calculators
- **The Medical System Business Unit** mainly includes Digital radiography systems / Diagnostic X-ray systems / CT systems / MRI systems / Diagnostic ultrasound systems / Clinical chemistry analyzers / Ophthalmic equipment
- **The Industry and Others Business Unit** mainly includes Semiconductor lithography equipment / FPD (Flat panel display) lithography equipment / Vacuum thin-film deposition equipment / Organic LED (OLED) panel manufacturing equipment / Die bonders /

Sales by Segment (Billions of yen)



Sales by Geographic Area (Billions of yen)



Network cameras / Digital camcorders / Digital cinema cameras / Multimedia projectors / Broadcast equipment / Micromotors / Handy terminals / Document scanners

Sales by segment

Please refer to the table of sales by segment in Note 22 of the Notes to Consolidated Financial Statements.

Within the Office Business Unit, although sales of the new imageRUNNER ADVANCE DX series were strong, unit sales of MFDs for the office and the production printing market were below those of the previous year reflecting such factors as the moderate recovery in business negotiations following the resumption of in-office work. As for laser printers, unit sales of both monochrome and color models were below those of the previous year resulting from the continued economic slowdown caused by the COVID-19 pandemic. Sales of services and consumables also declined as a result of a moderate recovery in customers' print volumes after the resumption of corporate activities. These factors resulted in total sales for the business unit of ¥1,440,212 million, a year-on-year decrease of 17.8%, while income before income taxes decreased by 49.3% year-on-year to ¥86,483 million.

As for the Imaging System Business Unit, although unit sales of interchangeable-lens digital cameras were below those of the previous year as the market continued to shrink and, the decline of the demand caused by COVID-19, the shift to mirrorless models accelerated, particularly for full-frame mirrorless models, due to the introduction of the new EOS R5 and EOS R6. As for inkjet printers, sales of printers and consumables increased significantly from the previous year as a result of capturing the recovered demand in some emerging countries as well as the demand for remote working and education in developed countries and China. These factors resulted in total sales for the business unit of ¥712,238 million, a year-on-year decrease of 11.8%, while income before income taxes increased by 43.1% year-on-year to ¥71,070 million thanks to improvements in profitability due to the effect of new products.

Within the Medical System Business Unit, although COVID-19 caused delay of installation of the large equipment and business negotiation, the demand of CT systems for the diagnosis of pneumonia and Diagnostic X-ray systems was captured with the support to emergency medical system maintenance and financial support for medical institutions from governments of each country. These factors resulted in total sales for the business unit of ¥436,074 million, a year-on-year decrease of 0.6%, while income before income taxes decreased by 6.4% year-on-year to ¥25,544 million.

As for the Industry & Others Business Unit, regarding semiconductor lithography equipment, demand for memory devices remained solid. As a result, unit sales were significantly above those of the previous year. In OLED panel manufacturing equipment, sales increased due to the resumption of installation work after the easing of COVID-19 travel restrictions. In FPD lithography equipment, although the installation work after the gradual easing of travel restrictions were resumed, unit sales were below those of the previous year. Despite reflecting the negative impact of COVID-19, sales for network cameras slightly increased as a result of strengthened sales activities based on diversified applications made possible by video analysis for such purposes as remote monitoring and monitoring of crowded and confined, as well as conventional market needs including crime prevention and disaster monitoring tools. These factors resulted in total sales for the business unit of ¥654,813 million, a year-on-year decrease of 4.9%, while income before income taxes totaled ¥14,315million, a year-on-year decrease of 26.3%.

Intersegment sales of ¥83,094 million are eliminated from total sales for the four segments, and are described as "Eliminations".

SALES BY SEGMENT

	Millions of yen				
	2020	change	2019	change	2018
Office	**1,440,212**	**-17.8%**	1,752,107	-6.2%	1,868,355
Imaging System	**712,238**	**-11.8%**	807,414	-16.8%	970,435
Medical System	**436,074**	**-0.6%**	438,525	+0.2%	437,578
Industry and Others	**654,813**	**-4.9%**	688,433	-12.0%	781,887
Eliminations	**(83,094)**	**—**	(93,180)	—	(106,318)
Total	**3,160,243**	**-12.1%**	3,593,299	-9.1%	3,951,937

Note: From the beginning of the first quarter of 2020, Canon has reclassified certain businesses from Industry and Others Business Unit to Office Business Unit. Sales amounts for the years ended 2019 and 2018 also have been reclassified.

SALES BY GEOGRAPHIC AREA

	Millions of yen				
	2020	change	2019	change	2018
Japan	**806,305**	**-7.6%**	872,534	+0.3%	869,577
Americas	**852,451**	**-17.2%**	1,029,078	-4.4%	1,076,402
Europe	**795,616**	**-9.8%**	882,480	-13.1%	1,015,428
Asia and Oceania	**705,871**	**-12.8%**	809,207	-18.3%	990,530
Total	**3,160,243**	**-12.1%**	3,593,299	-9.1%	3,951,937

Note: This summary of net sales by geographic area is determined by the location where the product is shipped to the customers.

Sales by geographic area

Please refer to the table of sales by geographic area in Note 22 of the Notes to Consolidated Financial Statements.

In Japan, net sales decreased by 7.5% from the previous year mainly owing to a decline in sales of interchangeable-lens digital cameras and office MFDs mainly due to the decline of the demand caused by COVID-19 pandemic.

In the Americas, net sales decreased by 17.2% from the previous year mainly owing to a decline in sales of interchangeable-lens digital cameras and office MFDs mainly due to the decline of the demand caused by COVID-19 pandemic.

In Europe, net sales decreased by 9.8% from the previous year mainly owing to a decline in sales of interchangeable-lens digital cameras and office MFDs mainly due to the decline of the demand caused by COVID-19 pandemic.

In Asia and Oceania, net sales decreased by 12.8% from the previous year mainly owing to a decline in sales of interchangeable-lens digital cameras and office MFDs mainly due to the decline of the demand caused by COVID-19 pandemic.

Income before income taxes by segment

Please refer to the table of segment information in Note 22 of the Notes to Consolidated Financial Statements.

Income before income taxes for the Office Business Unit in 2020 decreased by 49.3% from the previous year to ¥86,483 million, mainly due to a decline in sales of office MFDs and laser printers and declines in sales of services and consumables.

Income before income taxes for the Imaging System Business Unit in 2020 increased by 43.1% from the previous year to ¥71,070 million, thanks to improvements in profitability due to the effect of new products.

Income before income taxes for the Medical System Business Unit in 2020 decreased by 6.4% from the previous year to ¥25,544 million, mainly due to COVID-19 caused delay of installation of the large equipment and business negotiation.

Income before income taxes for the Industry and Others Business Unit in 2020 decreased by 26.3% from the previous year to ¥14,315 million, mainly due to COVID-19 caused delay of installation of the FPD lithography equipment.

FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

Canon's marketing activities are performed by subsidiaries in various regions in local currencies, while the cost of sales is generally in yen. Given Canon's current operating structure, appreciation of the yen has a negative impact on net sales and the gross profit ratio. To reduce the financial risks from changes in foreign exchange rates, Canon utilizes derivative financial instruments, which consist principally of forward currency exchange contracts.

The operating profit on foreign operation sales is usually lower than that from domestic operations because foreign operations consist mainly of marketing activities. Marketing activities are generally less profitable than production activities, which are mainly conducted by the Company and its domestic subsidiaries. Please refer to the table of geographic information in Note 22 of the Notes to Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents decreased by ¥5,130 million to ¥407,684 million in fiscal 2020 compared to the previous year. Canon's cash and cash equivalents are primarily denominated in Japanese yen and in U.S. dollars, with the remainder denominated in other currencies.

Net cash provided by operating activities decreased by ¥24,656 million to ¥333,805 million in fiscal 2020 compared to the previous year due to a decrease in profit, despite improving working capital mainly through inventory reduction. The major component of Canon's cash inflow is cash received from customers, and the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, R&D expenses and income taxes.

For fiscal 2020, cash inflow from cash received from customers decreased due to sales deterioration. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials decreased due to a decrease of inventory compared with the inventory in fiscal 2019. Cash outflow for payments for income taxes decreased due to a decrease in taxable income in fiscal 2019.

Net cash used in investing activities decreased by ¥73,129 million to ¥155,439 million in fiscal 2020 mainly due to a decrease in payment for purchases of fixed assets.

Canon defines "free cash flow" as cash flows from operating activities less cash flows from investing activities. For fiscal 2020, free cash flow increased by ¥48,473 million to ¥178,366 million as compared with ¥129,893 million for fiscal 2019.

Note: "Free cash flow" is a non-GAAP measure. Refer to the "Non-GAAP Financial Measures" section for the explanation and the reconciliation to the reported GAAP measure.

Canon's management places importance on cash flow management and frequently monitors this indicator. Furthermore, Canon's management believes that this indicator is significant in understanding Canon's current liquidity and the alternatives of use in financing activities because it takes into consideration its operating and investing activities and believes that such indicator is beneficial to an investor's understanding. Canon refers to this indicator together with relevant U.S. GAAP financial measures shown in its consolidated statements of cash flows and consolidated balance sheets for cash availability analysis.

Net cash used in financing activities totaled ¥183,449 million in fiscal 2020, mainly resulting from the dividend payout of ¥126,938 million, the repurchases and reissuance of treasury stock of ¥50,008 million. The Company paid dividends in fiscal 2020 of ¥120.00 per share.

To the extent Canon relies on external funding for its liquidity and capital requirements, it generally has access to various funding sources, including the issuance of additional share capital, issuance of corporate bond or loans. While Canon has been able to obtain funding from its traditional financing sources and from the capital markets, and believes it will continue to be able to do so in the future, there can be no assurance that adverse economic or other conditions will not affect Canon's liquidity or long-term funding in the future.

Canon transferred 344,000 million yen which is loans with a repayment date of December, 2021, from long-term debt to the current portion of long term debt because the repayment date was within one year. As a result, short-term loans (including the current portion of long-term debt) increased by ¥350,201 million to ¥392,235 million at December 31, 2020 compared with ¥42,034 million at December 31, 2019. Long-term debt (excluding the current portion) decreased by ¥352,506 million to ¥4,834 million at December 31, 2020 compared with ¥357,340 million at December 31, 2019.

Canon's long-term debt mainly consists of bank borrowings and finance lease obligations.

In order to facilitate access to global capital markets, Canon obtains credit ratings from two rating agencies: Moody's Investors Services, Inc. ("Moody's") and Standard and Poor's Ratings Services ("S&P"). In addition, Canon maintains a rating from Rating and Investment Information, Inc. ("R&I"), a rating agency in Japan, for access to the Japanese capital market.

As of March 15, 2021, Canon's debt ratings are: Moody's: Baa1 (long-term); S&P: A (long-term), A-1 (short-term); and R&I: AA (long-term). Canon does not have any rating downgrade triggers that would accelerate the maturity of a material amount of its debt. A downgrade in Canon's credit ratings or outlook could, however, increase the cost of its borrowings.

Canon's management policy in recent periods to optimize inventory levels is intended to maintain an appropriate balance among relevant imperatives, including minimizing working capital, avoiding undue exposure to the risk of inventory obsolescence, and maintaining the ability to sustain sales despite the occurrence of unexpected disasters.

Canon's total inventory turnover measured in days were 60, 59, and 56 days at the end of the fiscal years 2020, 2019, and 2018, respectively. While sales declined significantly, inventory decreased by ¥21,949 million in fiscal 2020 compared to the previous year. As a result, inventory turnover measured in days was the same level as the previous year.

Increase in property, plant and equipment on an accrual basis in 2020 amounted to ¥132,302 million compared with ¥178,088 million in 2019 and ¥159,316 million in 2018. For 2021, Canon projects its increase in property, plant and equipment will be approximately ¥160,000 million.

Employer contributions to Canon's worldwide defined benefit pension plans were ¥26,965 million in 2020, ¥30,383 million in 2019 and ¥35,044 million in 2018. Employer contributions to Canon's worldwide defined contribution pension plans were ¥16,334 million in 2020, ¥17,414 million in 2019, and ¥19,570 million in 2018. In addition, employer contributions to the multiemployer pension plan of certain subsidiaries were ¥4,224 million in 2020, ¥4,321 million in 2019 and ¥4,452 million in 2018.

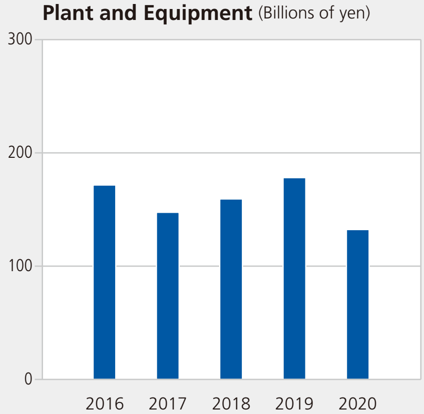
Working capital in 2020 decreased by ¥411,008 million to ¥462,954 million, compared with ¥873,962 million in 2019 and ¥1,009,269 million in 2018. Canon believes its working capital will be sufficient for its requirements for the foreseeable future. Canon's capital requirements are primarily dependent on management's business plans regarding the levels and timing of purchases of fixed assets and investments. The working capital ratio (ratio of current assets to current liabilities) for 2020 was 1.35 compared to 1.90 for 2019 and to 1.97 for 2018.

Return on assets (net income attributable to Canon Inc. divided by the average of total assets) was 1.8% in 2020, compared to 2.6% in 2019 and 5.0% in 2018.

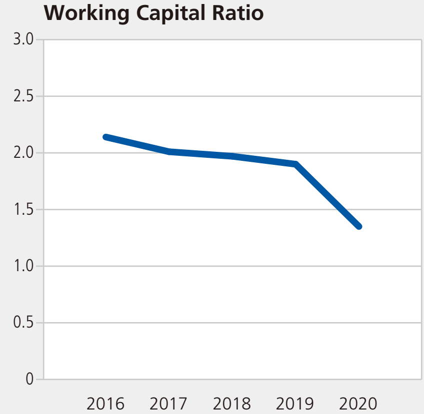
Return on Canon Inc. shareholders' equity (net income attributable to Canon Inc. divided by the average of total Canon Inc. shareholders' equity) was 3.2% in 2020 compared with 4.5% in 2019 and 8.9% in 2018.

The debt to total assets ratios were 10.9%, 10.8% and 8.2% as of December 31, 2020, 2019 and 2018, respectively. Canon had short-term loans, current operating lease liabilities, long-term debt, and noncurrent operating lease liabilities of ¥506,172 million as of December 31, 2020, ¥514,946 million as of December 31, 2019 and ¥400,489 million as of December 31, 2018.

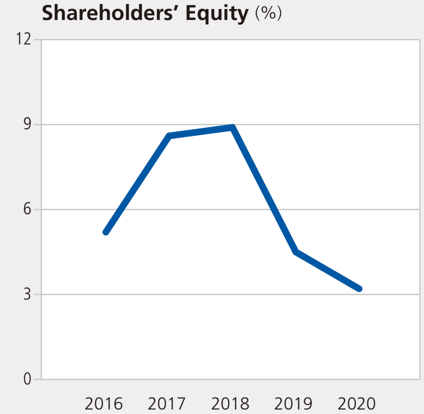
Increase in Property, Plant and Equipment (Billions of yen)



Working Capital Ratio



Return on Canon Inc. Shareholders' Equity (%)



Non-GAAP Financial Measures

We have reported our financial results in accordance with U.S. GAAP. In addition, we have discussed our results using the combination of two GAAP cash flow measures, Net cash provided by operating activities and Net cash used for investing activities, which we refer to as "Free Cash Flow" which is a non-GAAP measure. We believe this measure is beneficial to an investor's understanding of Canon's current liquidity and the alternatives of uses of financing activities because it takes into consideration its operating and investing activities.

A reconciliation of this non-GAAP financial measure and the most directly comparable measure calculated and presented in accordance with GAAP is set forth on the following table.

FREE CASH FLOW

	Millions of yen	
	2020	2019
Net cash provided by operating activities	**333,805**	358,461
Net cash used in investing activities	**(155,439)**	(228,568)
Free cash flow	**178,366**	129,893

OFF-BALANCE SHEET ARRANGEMENTS

As part of its ongoing business, Canon does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Canon provides guarantees for its employees, affiliates and other companies. The guarantees for the employees are principally made for their housing loans. The guarantees for affiliates and other companies are made for their lease obligations and bank loans to ensure that those companies operate with less financial risk.

Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract terms. The contract terms are 1 year to 15 years in case of employees with housing loans, and 1 year to 5 years in case of affiliates and other companies with lease obligations and bank loans. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥2,568 million at December 31, 2020. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2020 were not significant.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following summarizes Canon's contractual obligations at December 31, 2020.

		Payments due by period			
Millions of yen	**Total**	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obiligations:					
Long-term debt:					
Loan from the banks	**344,000**	344,000	—	—	—
Other debt	**6,608**	1,774	1,570	665	2,599
Operating lease obligations	**115,813**	35,769	43,545	20,970	15,529
Purchase commitments for:					
Property, plant and equipment	**42,434**	42,434	—	—	—
Parts and raw materials	**121,031**	121,031	—	—	—
Other long-term liabilities:					
Contribution to defined benefit pension plans	**30,846**	30,846	—	—	—
Total	**660,732**	575,854	45,115	21,635	18,128

Note: The table does not include provisions for uncertain tax positions and related accrued interest and penalties, as the specific timing of future payments related to these obligations cannot be projected with reasonable certainty. See Note 11, Income Taxes in the Notes to Consolidated Financial Statements for further details. Contribution to defined benefit pension plans reflects the expected amount only for the next fiscal year, since contributions beyond the next fiscal year are not currently determinable due to uncertainties related to changes in actuarial assumptions, returns on plan assets and changes to plan membership.

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are recorded at the time revenue is recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December

31, 2020 accrued product warranty costs are included in accrued expenses and amounted to ¥14,300 million.

At December 31, 2020, commitments outstanding for the purchase of property, plant and equipment were approximately ¥42,434 million, and commitments outstanding for the purchase of parts and raw materials were approximately ¥121,031 million, both for use in the ordinary course of its business. Canon anticipates that funds needed to fulfill these commitments will be generated internally through operations.

During 2021, Canon expects to contribute ¥14,414 million to its Japanese defined benefit pension plans and ¥16,432 million to its foreign defined benefit pension plans.

Canon's management believes that current financial resources, cash generated from operations and Canon's potential capacity for additional debt and/or equity financing will be sufficient to fund current and future capital requirements.

RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

Since its founding, Canon has diversified its business by developing and diversifying core competence management that comprises various core competence technologies ("core technologies") to create industry-leading core products and basic component technologies that form the basis of technology accumulation. In addition, Canon incorporates technology and expertise that support the Canon brand accumulated during the company's growth, that is, technology that supports quality, cost and delivery, into core competence management as basic technologies for value creation. Canon's key R&D strategies are as follows:

- Reinforce basic component technologies and basic technologies for value creation
- Create future businesses based on strong core technologies and basic component technologies
- Enhance innovation-type R&D in response to the demands of the current age

Canon strives to implement the above R&D strategies as follows:

- Reinforce basic component technologies and basic technologies for value creation:
  Contribute to higher efficiency of existing businesses by further evolving basic technologies for value creation. Alongside this, extract the essence of a wide range of core technologies possessed by each business group, deepen basic component technologies and inject them into core technologies of new businesses. In doing so, Canon will promote core competence management for strengthening existing businesses and growing new business groups.
- Create future businesses based on strong core technologies and basic component technologies:
  Promote development of new business areas through technology diversification. For example, Canon will develop devices that utilize functional materials technology –the foundation of ink and toner materials- as well as materials with unique properties, and work on development of next-generation technologies that lead to business creation.
- Enhance innovation-type R&D in response to the demands of the current age:
  Build upon trends such as Digital transformation ("DX") and carbon neutrality, promote R&D that leads to corporate value improvement. In particular, focus on cyber-physical systems that closely integrate cyberspace, which enables the combination of various services, with physical (real world) space, the point of contact with people.
  Develop cyber-physical technologies that stay one step ahead by incorporating advanced cyber technology and utilize business alliances to develop world-class core technologies in the physical field.

R&D expenses were ¥272,312 million in fiscal 2020 and ¥298,503 million in fiscal 2019. The R&D expenses to net sales ratios were 8.6% in fiscal 2020 and 8.3% in fiscal 2019.

Canon believes that new products protected by a robust patent portfolio will not easily allow competitors to surpass them, and will give the company an advantage in establishing standards in the market and industry.

Canon obtained the third greatest number of patents in the United States in 2020, according to the annual ranking list, released by IFI CLAIMS® Patent Services.

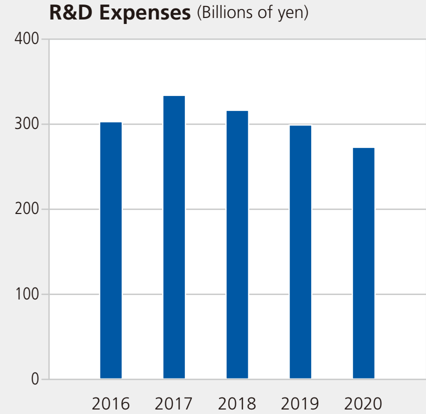
MARKET RISK EXPOSURES

Canon is exposed to market risks, including changes in foreign currency exchange rates, interest rates and prices of marketable securities and investments. In order to hedge the risk of changes in foreign currency exchange rates, Canon uses derivative financial instruments.

Equity price risk

Canon holds marketable securities included in current assets, which consist generally of highly-liquid and low-risk instruments. Investments included in noncurrent assets are held as long-term investments. Canon does not hold marketable securities and investments for trading purposes.

R&D Expenses (Billions of yen)



Maturities and fair values of such marketable securities and investments with original maturities of more than three months were as follows at December 31, 2020.

	Millions of yen
	Fair value
Fund trusts	532
Equity securities	18,683
	19,215

Foreign currency exchange rate and interest rate risk

Canon operates internationally, exposing it to the risk of changes in foreign currency exchange rates. Derivative financial instruments are comprised principally of foreign currency exchange contracts utilized by the Company and certain of its subsidiaries to reduce the risk. Canon assesses foreign currency exchange rate risk by continually monitoring changes in the exposures and by evaluating hedging opportunities. Canon does not hold or issue derivative financial instruments for trading purposes. Canon is also exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments, but it is not expected that any counterparties will fail to meet their obligations. Most of the counterparties are internationally recognized financial institutions and selected by Canon taking into account their financial condition, and contracts are diversified across a number of major financial institutions.

Canon's international operations expose Canon to the risk of changes in foreign currency exchange rates. Canon uses foreign exchange contracts to manage certain foreign currency exchange exposures principally from the exchange of U.S. dollars and euros into Japanese yen. These contracts are primarily used to hedge the foreign currency exposure of forecasted intercompany sales and intercompany trade receivables which are denominated in foreign currencies. In accordance with Canon's policy, a specific portion of foreign currency exposure resulting from forecasted intercompany sales are hedged using foreign exchange contracts which principally mature within three months.

The following table provides information about Canon's major derivative financial instruments related to foreign currency exchange transactions existing at December 31, 2020. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2021.

Millions of yen	U.S.$	Euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	50,258	75,689	11,774	137,721
Estimated fair value	686	(992)	(133)	(439)
Forwards to buy foreign currencies:				
Contract amounts	17,302	2,712	7,206	27,220
Estimated fair value	(216)	(4)	(33)	(253)

Canon expects that fair value changes and cash flows resulting from reasonable near-term changes in interest rates will be immaterial. Accordingly, Canon believes interest rate risk is insignificant. See also Note 8 of the Notes to Consolidated Financial Statements.

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign exchange contracts associated with forecasted intercompany sales, are reported in accumulated other comprehensive income (loss). These amounts are subsequently reclassified into earnings in the same period as the hedged items affect earnings. Substantially all amounts recorded in accumulated other comprehensive income (loss) as of December 31, 2020 are expected to be recognized in net sales over the next twelve months. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings.

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2018. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) were ¥682 million for the years ended December 31, 2018.

Canon has entered into certain foreign currency exchange contracts to manage its foreign currency exposures. These foreign currency exchange contracts have not been designated as hedges. Accordingly, the changes in fair values of these contracts are recorded in earnings immediately.

LOOKING FORWARD

Under the corporate philosophy of kyosei—living and working together for the common good—Canon's basic management policy is to contribute to the prosperity and well-being of the world while endeavoring to become a truly excellent global corporation targeting continued growth and development.

Based on this basic management policy, Canon launched the Excellent Global Corporation Plan in 1996 and, from Phase I through to Phase IV, has worked to strengthen its management base and improve corporate value. In 2016, under the slogan "Embracing the challenge of new growth through a grand strategic transformation," Canon embarked on a new five-year initiative: Phase V of the Excellent Global Corporation Plan. Under this plan, Canon aims to facilitate growth through structural transformation by reinforcing existing businesses and taking steps to cultivate and strengthen new businesses.

The global economy in 2021 is expected to recover moderately with the various economic measures and fiscal policies in each country and region over the long term.

In the markets in which Canon operates, for office MFDs, demand for the imageRUNNER ADVANCE DX series with advanced scan functions and cloud functionality is expected to increase and print volumes are expected to recover. For laser printers, demand is also expected to increase due to signs of recovery of operating conditions in office. As for interchangeable-lens digital cameras, although the overall market is expected to continue to shrink, sales promotion efforts will be strengthened amid the shift to mirrorless and the product mix will be improved. As for inkjet printers, demand is expected not to decrease significantly given the increase of print volumes while remote working and education needs remain stable due to the ongoing pandemic. As for the medical equipment market, demand is expected to remain at around the same level as the previous year due to the risk of additional COVID-19 infections. For semiconductor lithography equipment, while demand for memory devices is expected to remain firm, demand for image sensors and automotive devices is expected to continue to increase. For FPD lithography equipment and OLED panel manufacturing equipment, demand will remain solid as panel manufacturers are expected to increase capital investments. As for network cameras, the market is also expected to trend towards expansion due to increasing demand for high-resolution cameras and the video analysis solutions that require them.

In 2021, Under a new five-year management plan, Phase VI of the "Excellent Global Corporation Plan," which begins in 2021, we will implement the following measures under the basic policy of group-wide productivity improvement and the enhancement of new businesses.

(1) Printing group

While expanding commercial printing business including catalog printing, the Printing Group will also firmly establish itself in the industrial printing field including label printing, package printing and the like. In the office market, Canon will expand and strengthen the product lineup by exploiting the advantages of both electrophotographic technology and inkjet technology. In addition, Canon will effectively respond to DX.

(2) Optical Industry Group

Canon will enter in-car camera business by leveraging the optical and network technology that Canon has refined over its long history and will aim to expand its business domains focusing on social infrastructure, such as observation camera systems to support the realization of smart city.

(3) Industrial Equipment Group

Canon will further expand the competitiveness of OLED manufacturing equipment through innovation and cost reduction. In addition, Canon will strive to increase our share in semiconductor lithography equipment and FPD lithography equipment.

(4) Medical Group

Canon will strengthen the competitiveness of our core products including CT, magnetic resonance imaging (MRI), and ultrasound diagnostic systems, as well as diagnostic solutions and image analysis applications that make use of AI, to expand medical diagnostic equipment business. Canon will also aim to boldly enter domains on the periphery of diagnostic equipment, such as test reagents, and accelerate the growth of its business.

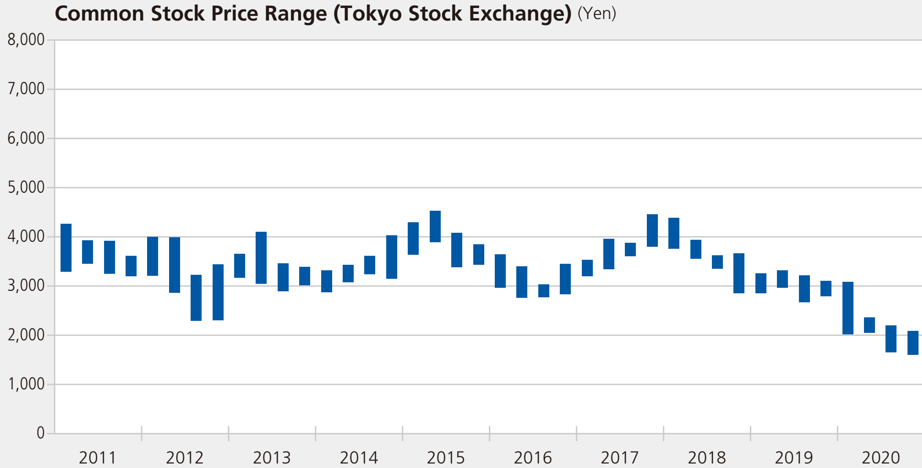
Forward looking statements

The foregoing discussion and other disclosure in this report contains forward-looking statements that reflect management's current views with respect to certain future events and financial performance. Actual results may differ materially from those projected or implied in the forward-looking statements. Further, certain forward-looking statements are based upon assumptions of future events that may not prove to be accurate. The following important factors could cause actual results to differ materially from those projected or implied in any forward-looking statements: foreign currency exchange rate fluctuations; the uncertainty of Canon's ability to implement its plans to localize production and other measures to reduce the impact of foreign currency exchange rate fluctuations; uncertainty as to economic conditions in Canon's major markets; uncertainty of continued demand for Canon's high-value-added products; Canon's ability to continue to develop products and to market products that incorporate new technology on a timely basis, are competitively priced, and achieve market acceptance; the possibility of losses resulting from foreign currency transactions designed to reduce financial risks from changes in foreign currency exchange rates; and inventory risk due to shifts in market demand. In addition, new waves of COVID-19 infections are being seen in some regions, and it is still difficult to predict when COVID-19 will be brought under control. However, each country and region continues to pursue both the infection control and economic activities. Although the global economy is expected to recover in 2021, it is expected that some regions would continue to be affected by COVID-19.

TEN-YEAR FINANCIAL SUMMARY

	Millions of yen (except per share amounts)			
	2020	2019	2018	2017
Net sales:				
Domestic	**806,305**	872,534	869,577	884,828
Overseas	**2,353,938**	2,720,765	3,082,360	3,195,187
Total	**3,160,243**	3,593,299	3,951,937	4,080,015
Percentage of previous year	**87.9%**	90.9%	96.9%	119.9%
Net income attributable to Canon Inc.	**83,318**	124,964	252,441	242,081
Percentage of sales	**2.6%**	3.5%	6.4%	5.9%
Advertising	**31,273**	46,665	58,729	61,207
Research and development expenses	**272,312**	298,503	315,842	333,371
Depreciation of property, plant and equipment	**162,733**	170,418	175,771	189,712
Increase in property, plant and equipment	**132,302**	178,088	159,316	147,542
Long-term debt, excluding current installments	**4,834**	357,340	361,962	493,238
Canon Inc. shareholders' equity	**2,575,031**	2,685,496	2,820,644	2,863,986
Total assets	**4,625,614**	4,771,918	4,902,955	5,201,626
Per share data:				
Net income attributable to Canon Inc. shareholders per share:				
Basic	**79.37**	116.79	233.80	223.03
Diluted	**79.35**	116.77	233.78	223.03
Dividend per share	**80.00**	160.00	160.00	160.00
Stock price:				
High	**3,099**	3,338	4,395	4,472
Low	**1,627**	2,688	2,877	3,218
Average number of common shares in thousands	**1,049,802**	1,069,957	1,079,753	1,085,439
Number of employees	**181,897**	187,041	195,056	197,776

Common Stock Price Range (Tokyo Stock Exchange) (Yen)



						Thousands of U.S. dollars (except per share amounts)
2016	2015	2014	2013	2012	2011	**2020**
706,979	714,280	724,317	715,863	720,286	694,450	**$ 7,752,933**
2,694,508	3,085,991	3,002,935	3,015,517	2,759,502	2,862,983	**22,634,019**
3,401,487	3,800,271	3,727,252	3,731,380	3,479,788	3,557,433	**30,386,952**
89.5%	102.0%	99.9%	107.2%	97.8%	96.0%	**87.9%**
150,334	219,943	254,627	229,829	224,854	248,214	**801,135**
4.4%	5.8%	6.8%	6.2%	6.5%	7.0%	**2.6%**
58,707	80,907	79,765	86,398	83,134	81,232	**300,702**
306,537	332,678	311,896	307,500	296,281	308,900	**2,618,385**
199,133	223,759	213,739	223,158	211,973	210,179	**1,564,740**
171,597	195,120	182,343	188,826	270,457	226,869	**1,272,135**
611,289	881	1,148	1,448	2,117	3,368	**$ 46,481**
2,776,327	2,959,929	2,971,963	2,904,212	2,592,630	2,545,447	**24,759,913**
5,142,279	4,431,720	4,464,854	4,246,796	3,959,542	3,934,992	**44,477,058**
137.66	201.41	228.88	200.21	191.59	204.15	**$ 0.76**
137.66	201.40	228.88	200.21	191.58	204.14	**0.76**
150.00	150.00	150.00	130.00	130.00	120.00	**0.77**
3,656	4,539	4,045	4,115	4,015	4,280	**29.80**
2,780	3,402	2,889	2,913	2,308	3,220	**15.64**
1,092,071	1,092,018	1,112,510	1,147,934	1,173,648	1,215,832	
197,673	189,571	191,889	194,151	196,968	198,307	

Notes: 1. U.S. dollar amounts are translated from yen at the rate of U.S.$1 = JPY104, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2020.

2. Canon adopted ASU No. 2017-07 from the quarter beginning January 1, 2018. The adoption of the new presentation requirement of the service cost component and the other components of net benefit cost resulted in reclassification from cost of sales, and selling, general and administrative expenses, and research and development expenses into other income (deductions) for the years ended December 31 from 2017 to 2011 respectively.

3. Certain figures prior to the fiscal year ended December 31, 2019 presented in the table above have been revised from the versions previously disclosed. The effect on the consolidated financial statements was immaterial, respectively. For further details regarding the circumstances of the revision, please refer to Note 1 (y) of the Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

Canon Inc. and Subsidiaries
December 31, 2020 and 2019

	Millions of yen	
ASSETS	**2020**	2019
Current assets:		
Cash and cash equivalents (Note 1)	**407,684**	412,814
Short-term investments (Note 2)	**71**	1,767
Trade receivables, net of allowance for credit losses of ¥11,645 and ¥10,359 (Note 3)	**535,126**	559,836
Inventories (Note 4)	**562,807**	584,756
Prepaid expenses and other current assets, net of allowance for credit losses of ¥1,101 and ¥994 (Notes 6, 14 and 17)	**283,455**	286,792
Total current assets	**1,789,143**	1,845,965
Noncurrent receivables (Note 19)	**17,276**	17,135
Investments (Notes 2 and 21)	**49,994**	48,361
Property, plant and equipment, net (Notes 5 and 6)	**1,037,680**	1,089,671
Operating lease right-of-use assets (Note 18)	**107,361**	114,418
Intangible assets, net (Note 7)	**318,497**	347,921
Goodwill (Note 7)	**915,564**	898,661
Other assets, net of allowance for credit losses of ¥1,967 and ¥1,633 (Notes 6, 10 and 11)	**390,099**	409,786
Total assets	**4,625,614**	4,771,918
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term loans and current portion of long-term debt (Note 8)	**392,235**	42,034
Trade payables (Note 9)	**303,809**	305,312
Accrued income taxes (Note 11)	**18,761**	18,801
Accrued expenses (Notes 10 and 19)	**317,716**	336,396
Current operating lease liabilities (Note 18)	**32,307**	31,884
Other current liabilities (Notes 5, 14 and 17)	**261,361**	237,576
Total current liabilities	**1,326,189**	972,003
Long-term debt, excluding current installments (Notes 8 and 20)	**4,834**	357,340
Accrued pension and severance cost (Note 10)	**345,897**	368,507
Noncurrent operating lease liabilities (Note 18)	**76,796**	83,688
Other noncurrent liabilities (Note 11)	**87,857**	106,400
Total liabilities	**1,841,573**	1,887,938
Commitments and contingent liabilities (Note 19)		
Equity:		
Canon Inc. shareholders' equity:		
Common stock		
Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2020 and 2019	**174,762**	174,762
Additional paid-in capital	**404,620**	405,017
Legal reserve (Note 12)	**69,436**	67,572
Retained earnings (Note 12)	**3,409,371**	3,455,083
Accumulated other comprehensive income (loss) (Note 13)	**(324,789)**	(308,442)
Treasury stock, at cost; 287,989,819 shares in 2020 and 269,928,993 shares in 2019	**(1,158,369)**	(1,108,496)
Total Canon Inc. shareholders' equity	**2,575,031**	2,685,496
Noncontrolling interests	**209,010**	198,484
Total equity	**2,784,041**	2,883,980
Total liabilities and equity	**4,625,614**	4,771,918

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

Canon Inc. and Subsidiaries
Years ended December 31, 2020, 2019 and 2018

	Millions of yen		
	2020	2019	2018
Net sales (Notes 6, 14 and 17)			
Products and Equipment	**2,489,829**	2,835,428	3,194,724
Services	**670,414**	757,871	757,213
	3,160,243	3,593,299	3,951,937
Cost of sales (Notes 5, 7, 10 and 18)			
Products and Equipment	**1,463,637**	1,627,858	1,762,171
Services	**320,738**	355,408	354,212
	1,784,375	1,983,266	2,116,383
Gross profit	**1,375,868**	1,610,033	1,835,554
Operating expenses (Notes 1, 5, 7, 10, 15, 18 and 19):			
Selling, general and administrative expenses	**993,009**	1,137,110	1,177,260
Research and development expenses	**272,312**	298,503	315,842
	1,265,321	1,435,613	1,493,102
Operating profit	**110,547**	174,420	342,452
Other income (deductions):			
Interest and dividend income	**2,923**	5,526	6,604
Interest expense	**(854)**	(1,038)	(797)
Other, net (Notes 1, 2, 10, 13 and 17)	**17,664**	16,585	14,133
	19,733	21,073	19,940
Income before income taxes	**130,280**	195,493	362,392
Income taxes (Note 11)	**34,337**	56,146	95,995
Consolidated net income	**95,943**	139,347	266,397
Less: Net income attributable to noncontrolling interests	**12,625**	14,383	13,956
Net income attributable to Canon Inc.	**83,318**	124,964	252,441
	Yen		
Net income attributable to Canon Inc. shareholders per share (Note 16):			
Basic	**79.37**	116.79	233.80
Diluted	**79.35**	116.77	233.78

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Canon Inc. and Subsidiaries
Years ended December 31, 2020, 2019 and 2018

	Millions of yen		
	2020	2019	2018
Consolidated net income	**95,943**	139,347	266,397
Other comprehensive income (loss), net of tax (Note 13):			
Foreign currency translation adjustments	**(17,354)**	(32,157)	(93,146)
Net unrealized gains and losses on securities	**—**	—	(141)
Net gains and losses on derivative instruments	**970**	(1,068)	488
Pension liability adjustments	**1,382**	(3,630)	(30,570)
	(15,002)	(36,855)	(123,369)
Comprehensive income (loss)	**80,941**	102,492	143,028
Less: Comprehensive income attributable to noncontrolling interests	**13,961**	16,353	6,887
Comprehensive income (loss) attributable to Canon Inc.	**66,980**	86,139	136,141

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF EQUITY

Canon Inc. and Subsidiaries
Years ended December 31, 2020, 2019 and 2018

	Millions of yen									
	Common stock	Additional paid-in capital	Legal reserve	Other retained earnings	Total retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total Canon Inc. shareholders' equity	Non-controlling interests	Total equity
Balance at December 31, 2017	174,762	401,386	66,879	3,422,668	3,489,547	(143,228)	(1,058,481)	2,863,986	224,766	3,088,752
Cumulative effects of accounting standard update—adoption of ASU No.2014-09				(106)	(106)			(106)	(76)	(182)
Cumulative effects of accounting standard update—adoption of ASU No. 2016-01				5,343	5,343	(5,343)		—	—	—
Equity transactions with noncontrolling interests and other		3,003				(4,200)		(1,197)	(36,518)	(37,715)
Dividends to Canon Inc. shareholders (165.00 yen per share)*				(178,159)	(178,159)			(178,159)		(178,159)
Dividends to noncontrolling interests									(5,558)	(5,558)
Transfers to legal reserve			237	(237)	—			—		—
Comprehensive income:										
Net income				252,441	252,441			252,441	13,956	266,397
Other comprehensive income (loss), net of tax (Note 13):										
Foreign currency translation adjustments						(89,823)		(89,823)	(3,323)	(93,146)
Net unrealized gains and losses on securities						(141)		(141)	—	(141)
Net gains and losses on derivative instruments						488		488	—	488
Pension liability adjustments						(26,824)		(26,824)	(3,746)	(30,570)
Total comprehensive income (loss)								136,141	6,887	143,028
Repurchases of treasury stock							(25)	(25)		(25)
Reissuance of treasury stock							4	4		4
Balance at December 31, 2018	174,762	404,389	67,116	3,501,950	3,569,066	(269,071)	(1,058,502)	2,820,644	189,501	3,010,145
Cumulative effects of accounting standard update—adoption of ASU No. 2017-12				122	122	(122)		—	—	—
Equity transactions with noncontrolling interests and other		641				(424)		217	(1,813)	(1,596)
Dividends to Canon Inc. shareholders (160.00 yen per share)*				(171,487)	(171,487)			(171,487)		(171,487)
Dividends to noncontrolling interests									(5,557)	(5,557)
Transfers to legal reserve			456	(456)	—			—		—
Comprehensive income:										
Net income				124,964	124,964			124,964	14,383	139,347
Other comprehensive income (loss), net of tax (Note 13):										
Foreign currency translation adjustments						(32,043)		(32,043)	(114)	(32,157)
Net gains and losses on derivative instruments						(1,073)		(1,073)	5	(1,068)
Pension liability adjustments						(5,709)		(5,709)	2,079	(3,630)
Total comprehensive income (loss)								86,139	16,353	102,492
Repurchases of treasury stock							(50,015)	(50,015)		(50,015)
Reissuance of treasury stock		(13)		(10)	(10)		21	(2)		(2)
Balance at December 31, 2019	174,762	405,017	67,572	3,455,083	3,522,655	(308,442)	(1,108,496)	2,685,496	198,484	2,883,980
Cumulative effects of accounting standard update—adoption of ASU No. 2016-13				**(159)**	**(159)**			**(159)**	**—**	**(159)**
Equity transactions with noncontrolling interests and other		**(316)**				**(9)**	**(15)**	**(340)**	**1,091**	**751**
Dividends to Canon Inc. shareholders (120.00 yen per share)*				**(126,938)**	**(126,938)**			**(126,938)**		**(126,938)**
Dividends to noncontrolling interests									**(4,526)**	**(4,526)**
Transfers to legal reserve			**1,864**	**(1,864)**	**—**			**—**		**—**
Comprehensive income:										
Net income				**83,318**	**83,318**			**83,318**	**12,625**	**95,943**
Other comprehensive income (loss), net of tax (Note 13):										
Foreign currency translation adjustments						**(17,355)**		**(17,355)**	**1**	**(17,354)**
Net gains and losses on derivative instruments						**987**		**987**	**(17)**	**970**
Pension liability adjustments						**30**		**30**	**1,352**	**1,382**
Total comprehensive income (loss)								**66,980**	**13,961**	**80,941**
Repurchases of treasury stock							**(50,008)**	**(50,008)**		**(50,008)**
Reissuance of treasury stock		**(81)**		**(69)**	**(69)**		**150**	**0**		**0**
Balance at December 31, 2020	**174,762**	**404,620**	**69,436**	**3,409,371**	**3,478,807**	**(324,789)**	**(1,158,369)**	**2,575,031**	**209,010**	**2,784,041**

*Canon changed the presentation of cash dividends per share which were previously presented in the consolidated statements of income.
See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Canon Inc. and Subsidiaries
Years ended December 31, 2020, 2019 and 2018

	Millions of yen		
	2020	2019	2018
Cash flows from operating activities:			
Consolidated net income	**95,943**	139,347	266,397
Adjustments to reconcile consolidated net income to net cash provided by operating activities:			
Depreciation and amortization	**227,825**	237,327	251,554
Loss on disposal of fixed assets	**4,326**	5,991	5,726
Equity in earnings of affiliated companies	**994**	311	(1,414)
Deferred income taxes	**(15,542)**	(6,523)	(12,004)
Decrease (increase) in trade receivables	**15,120**	43,504	(17,724)
Decrease (increase) in inventories	**16,075**	19,895	(61,755)
Decrease in trade payables	**(4,636)**	(35,509)	(31,212)
Increase (decrease) in accrued income taxes	**43**	(22,279)	(35,284)
(Decrease) increase in accrued expenses	**(16,413)**	9,738	3,041
Decrease in accrued (prepaid) pension and severance cost	**(16,601)**	(13,722)	(17,738)
Other, net (Note 6)	**26,671**	(19,619)	15,706
Net cash provided by operating activities	**333,805**	358,461	365,293
Cash flows from investing activities:			
Purchases of fixed assets (Note 5)	**(164,719)**	(215,671)	(191,399)
Proceeds from sale of fixed assets (Note 5)	**7,815**	885	9,634
Purchases of securities	**(592)**	(4,907)	(2,311)
Proceeds from sale and maturity of securities	**558**	828	1,615
Decrease (increase) in time deposits, net	**1,652**	(1,511)	401
Acquisitions of businesses, net of cash acquired	**(127)**	(8,880)	(13,346)
Other, net	**(26)**	688	(209)
Net cash used in investing activities	**(155,439)**	(228,568)	(195,615)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt (Note 8)	**2,100**	—	439
Repayments of long-term debt (Note 8)	**(11,095)**	(8,678)	(136,094)
Increase in short-term loans, net (Note 8)	**5,642**	4,913	2,501
Transaction with noncontrolling interests	**1,376**	(1,769)	(37,942)
Dividends paid	**(126,938)**	(171,487)	(178,159)
Repurchases and reissuance of treasury stock	**(50,008)**	(50,012)	(21)
Other, net	**(4,526)**	(5,557)	(5,554)
Net cash used in financing activities	**(183,449)**	(232,590)	(354,830)
Effect of exchange rate changes on cash and cash equivalents	**(47)**	(5,134)	(16,017)
Net change in cash and cash equivalents	**(5,130)**	(107,831)	(201,169)
Cash and cash equivalents at beginning of year	**412,814**	520,645	721,814
Cash and cash equivalents at end of year	**407,684**	412,814	520,645
Supplemental disclosure for cash flow information:			
Cash paid during the year for:			
Interest	**1,028**	888	749
Income taxes	**45,471**	77,654	131,616

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Canon Inc. and Subsidiaries

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

(a) Description of Business

Canon Inc. (the "Company") and subsidiaries (collectively "Canon") is one of the world's leading manufacturers in such fields as office products, imaging system products, medical system products and industry and other products. Office products consist mainly of office multifunction devices ("MFDs"), laser multifunction printers ("MFPs"), laser printers, digital continuous feed presses, digital sheet-fed presses, wide-format printers and document solutions. Imaging system products consist mainly of interchangeable-lens digital cameras, digital compact cameras, interchangeable lenses, compact photo printers, inkjet printers, large format inkjet printers, commercial photo printers, image scanners and calculators. Medical system products consist mainly of digital radiography systems, diagnostic X-ray systems, computed tomography ("CT") systems, magnetic resonance imaging ("MRI") systems, diagnostic ultrasound systems, clinical chemistry analyzers and ophthalmic equipment. Industry and other products consist mainly of semiconductor lithography equipment, FPD (Flat panel display) lithography equipment, vacuum thin-film deposition equipment, organic LED ("OLED") panel manufacturing equipment, die bonders, network cameras, digital camcorders, digital cinema cameras, multimedia projectors, broadcast equipment, micromotors, handy terminals and document scanners. Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographic area. Further segment information is described in Note 22.

Canon sells laser printers on an OEM basis to HP Inc.; such sales constituted 11.4%, 13.0% and 13.6% of consolidated net sales for the years ended December 31, 2020, 2019 and 2018, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 29 plants in Japan and 14 overseas plants which are located in countries and regions such as the United States, Germany, France, the Netherlands, Taiwan, China, Malaysia, Thailand, Vietnam and Philippines.

(b) Basis of Presentation

The Company and its domestic subsidiaries maintain their books of account in conformity with financial accounting standards of Japan. Foreign subsidiaries maintain their books of account in conformity with financial accounting standards of the countries of their domicile.

Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to conform with U.S. generally accepted accounting principles ("U.S. GAAP"). These adjustments were not recorded in the statutory books of account.

(c) Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its majority owned subsidiaries and those variable interest entities where the Company or its consolidated subsidiaries are the primary beneficiaries. All significant intercompany balances and transactions have been eliminated.

(d) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant estimates and assumptions are reflected in valuation and disclosure of accounts including: revenue recognition, allowance for credit losses, inventories, long-lived assets, leases, goodwill and other intangible assets with indefinite useful lives, environmental liabilities, deferred tax assets, uncertain tax positions and employee retirement and severance benefit obligations. Actual results could differ materially from those estimates. In addition, new waves of COVID-19 infections are being seen in some regions, and it is still difficult to predict when COVID-19 will be brought under control. However, each country and region continues to pursue both the infection control and economic activities. Although the global economy is expected to recover in 2021, it is expected that some regions would continue to be affected by COVID-19.

(e) Translation of Foreign Currencies

Assets and liabilities of the Company's subsidiaries located outside Japan with functional currencies other than Japanese yen are translated into Japanese yen at the rates of exchange in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the year. Gains and losses resulting from translation of financial statements are excluded from earnings and are reported in other comprehensive income (loss).

Gains and losses resulting from foreign currency transactions and translation of assets and liabilities denominated in foreign currencies are included in other income (deductions) in the consolidated statements of income. Foreign currency exchange gains and losses were net losses of ¥4,451 million, ¥4,236 million and ¥6,044 million for the years ended December 31, 2020, 2019 and 2018, respectively.

(f) Cash Equivalents

All highly liquid investments acquired with original maturities of three months or less are considered to be cash equivalents. Certain debt securities with original maturities of less than three months, classified as available-for-sale securities of ¥500 million and ¥506 million at December 31, 2020 and 2019, respectively, are included in cash and cash equivalents in the consolidated balance sheets.

(g) Investments

Investments consist primarily of time deposits with original maturities of more than three months, debt and equity securities and investments in affiliated companies.

Canon classifies investments in debt securities as available-for-sale securities. Canon does not hold any trading securities which are bought and held primarily for the purpose of sale in the near term, or any held-to-maturity securities. Canon reports investments with maturities of less than one year as short-term investments.

Available-for-sale debt securities and equity securities with readily determinable fair value that are not accounted for under the equity method are recorded at fair value which is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate. The changes in fair value for equity securities are included in other, net in the consolidated statements of income. The changes in fair value for available-for-sale debt securities are included in net unrealized gains and losses on securities in the consolidated statements of comprehensive income.

Available-for-sale debt securities are regularly reviewed for other-than-temporary declines in the carrying amount based on criteria that include the length of time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer and Canon's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value. For available-for-sale securities for which the declines are deemed to be other-than-temporary and there is no intent to sell, the impairment is separated into the amount related to credit loss, which is recognized in earnings and the amount related to all other factors is recognized in other comprehensive income (loss). For available-for-sale securities for which the declines are deemed to be other-than-temporary and there is an intent to sell, the impairment in its entirety is recognized in earnings. Canon recognizes an impairment loss to the extent the cost basis of the investment exceeds the fair value of the investment.

Canon measures non-marketable equity securities without readily determinable fair value at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for an identical or a similar investment of the same issuer.

Realized gains and losses are determined by the average cost method and reflected in earnings.

Investments in affiliated companies over which Canon has the ability to exercise significant influence, but does not hold a controlling financial interest, are accounted for by the equity method.

(h) Allowance for credit losses

Allowance for credit losses for trade and finance receivables is maintained for all customers based on a current expected credit loss model (Please refer to Note 1 (x) Recently adopted accounting guidance), considering various factors, including aging analysis, macroeconomic conditions and historical experience. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted. When all collection options are exhausted including legal recourse, the accounts or portions thereof are deemed to be uncollectable and charged against the allowance.

(i) Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined by the average method for domestic inventories and principally by the first-in, first-out method for overseas inventories.

(j) Impairment of Long-Lived Assets

Long-lived assets, such as property, plant and equipment, and acquired intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset and the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of by sale are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

(k) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is calculated principally by the declining-balance method, except for certain assets which are depreciated by the straight-line method over the estimated useful lives of the assets.

The depreciation period ranges from 3 years to 60 years for buildings and 1 year to 20 years for machinery and equipment.

(l) Leases

As for lessor accounting, Canon provides leasing arrangements to its customers primarily for the sale of office products. Revenue from the sale of these products under sales-type leases is recognized at the inception of the lease. Interest income on sales-type leases and direct-financing leases is recognized over the life of each respective lease using the interest method. Leases not qualifying as sales-type leases or direct-financing leases are accounted for as operating leases and related revenue is recognized ratably over the lease term. When product leases are bundled with maintenance contracts, revenue is allocated based upon the estimated standalone selling prices of the lease and non-lease components. Lease components generally include product and financing while non-lease components generally consist of maintenance contracts and supplies. Some of the contracts include options to extend or to terminate the lease. Canon takes such options into account to determine the lease term when it is reasonably certain that it will exercise these options. The majority of Canon's lease contracts do not contain bargain purchase options for their customers. Assets leased to others under operating leases are stated at cost and depreciated to the estimated residual value of the assets by the straight-line method over the lease term, generally from 2 years to 50 years.

As for lessee accounting, Canon has operating and finance leases for various assets including office buildings, warehouses, employees' accommodations, and vehicles. Canon determines if an arrangement is a lease at the inception of each contract. Some of the contracts include options to extend or to terminate the lease. Canon takes such options into account to determine the lease term when it is reasonably certain that it will exercise these options. Canon's lease arrangements do not contain material residual value guarantees or material restrictive covenants. As a rate implicit in most of Canon's leases cannot be determined, Canon uses incremental borrowing rates based on the information available at commencement to determine the present values of lease payments. Canon has lease contracts with lease and non-lease components, which are accounted for separately. Canon allocates the consideration in the lease contract to the lease and non-lease components based upon the estimated standalone prices. Costs associated with operating lease assets are recognized on a straight-line basis over the term of the lease.

(m) Goodwill and other intangible assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon recognizes an impairment charge in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit.

Intangible assets with finite useful lives consist primarily of software, trademarks, patents and developed technology, license fees and customer relationships, which are amortized using the straight-line method. The estimated useful lives of software are from 3 years to 8 years, trademarks are 15 years, patents and developed technology are from 5 years to 18 years, license fees are 8 years, and customer relationships are 15 years, respectively. Certain costs incurred in connection with developing or obtaining internal-use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal-use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(n) Environmental Liabilities

Liabilities for environmental remediation and other environmental costs are accrued when environmental assessments or remedial efforts are probable and the costs can be reasonably estimated, and are included in other noncurrent liabilities in the consolidated balance sheets. Such liabilities are adjusted as further information develops or circumstances change. Costs of future obligations are not discounted to their present values.

(o) Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Canon records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not realizable.

Canon recognizes the financial statement effects of tax positions when it is more likely than not, based on the technical merits, that the tax positions will be sustained upon examination by the tax authorities. Benefits from tax positions that meet the more-likely-than-not recognition threshold are measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. Interest and penalties accrued related to unrecognized tax benefits are included in income taxes in the consolidated statements of income.

(p) Stock-Based Compensation

Canon measures stock-based compensation cost at the grant date, based on the fair value of the award, and recognizes the cost on a straight-line basis over the requisite service period, which is the vesting period.

(q) Net Income Attributable to Canon Inc. Shareholders per Share

Basic net income attributable to Canon Inc. shareholders per share is computed by dividing net income attributable to Canon Inc. by the weighted-average number of common shares outstanding during each year. Diluted net income attributable to Canon Inc. shareholders per share includes the effect from potential issuances of common stock based on the assumptions that all stock options were exercised.

(r) Revenue Recognition

Canon generates revenue principally through the sale of office, imaging system and medical system products, industrial equipment, supplies and related services under separate contractual arrangements. Revenue is recognized when, or as, control of promised goods or services transfers to customers in an amount that reflects the consideration to which Canon expects to be entitled in exchange for transferring these goods or services. For further information, please refer to Note 14.

(s) Research and Development Costs

Research and development costs are expensed as incurred.

(t) Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were ¥31,273 million, ¥46,665 million and ¥58,729 million for the years ended December 31, 2020, 2019 and 2018, respectively.

(u) Shipping and Handling Costs

Shipping and handling costs totaled ¥47,721 million, ¥51,718 million and ¥54,844 million for the years ended December 31, 2020, 2019 and 2018, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(v) Derivative Financial Instruments

All derivatives are recognized at fair value and are included in prepaid expenses and other current assets, or other current liabilities in the consolidated balance sheets.

Canon uses and designates certain derivatives as a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (“cash flow” hedge). Canon formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. Canon also formally assesses, both at the hedge’s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, Canon discontinues hedge accounting prospectively. Changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge are recorded in other comprehensive income (loss), until earnings are affected by the variability in cash flows of the hedged item, and reclassified in the same income statement line item in which the earnings effect of the hedged item is reported.

Canon also uses certain derivative financial instruments which are not designated as hedges. The changes in fair values of these derivative financial instruments are immediately recorded in earnings.

Canon classifies cash flows from derivatives as cash flows from operating activities in the consolidated statements of cash flows.

(w) Guarantees

Canon recognizes, at the inception of a guarantee, a liability for the fair value of the obligation it has undertaken in issuing guarantees.

(x) Recent Accounting Guidance

Recently adopted accounting guidance

In June 2016, the Financial Accounting Standards Board issued ASU No. 2016-13, Financial Instruments – Credit Losses – (Topic 326): Measurement of Credit Losses on Financial Instruments, which requires entities to use a current expected credit loss model to measure impairments of certain financial assets. Using this model results in earlier recognition of losses than under the incurred loss approach, which requires waiting to recognize a loss until it is probable of being incurred. Canon adopted the guidance from the quarter beginning January 1, 2020 with the modified retrospective basis through a cumulative effect adjustment directly to retained earnings as of the beginning of the period. The adoption of this guidance did not have a material impact on its consolidated results of operation and financial condition. Under the adoption of ASU No. 2016-13, Canon changed the presentation related to the allowance for credit losses in the consolidated balance sheets, from “ trade receivables, net” to “trade receivables, net of allowance for credit losses”, “prepaid expenses and other current assets” to “prepaid expenses and other current assets, net of allowance for credit losses” and other assets” to “other assets, net of allowance for credit losses”.

(y) Correction of an Immaterial Error

During the year ended December 31, 2020, Canon corrected an error in its previously issued consolidated financial statements related to accounting for the Company and domestic subsidiaries’ compensated absence carryforward in accordance with ASC 710 “Compensation.” In evaluating whether the previously issued consolidated financial statements were materially misstated for the annual periods prior to December 31, 2020, Canon applied the guidance of ASC 250, “Accounting Changes and Error Corrections,” SEC Staff Accounting Bulletin (“SAB”) Topic 1.M “Assessing Materiality” and SAB Topic 1.N “Considering the Effects of Prior Period Misstatements when Quantifying Misstatements in Current Year Financial Statements,” and concluded that the effect of the error on prior period financial statements was immaterial; however, the cumulative effect of correcting the prior period misstatements in the current year would be material to the current year consolidated financial statements. As a result, Canon revised its consolidated financial statements as follows:

Consolidated balance sheet

As of December 31	Millions of yen	
	2019	
	As revised	As previously reported
Other assets	409,786	406,219
Accrued expenses	336,396	324,891
Retained earnings	3,455,083	3,462,182
Noncontrolling interests	198,484	199,323

Consolidated statements of income

Year ended December 31	Millions of yen			
	2019		2018	
	As revised	As previously reported	As revised	As previously reported
Selling, general and administrative expenses	1,137,110	1,136,863	1,177,260	1,176,760
Operating profit	174,420	174,667	342,452	342,952
Income before income taxes	195,493	195,740	362,392	362,892
Income taxes	56,146	56,223	95,995	96,150
Consolidated net income	139,347	139,517	266,397	266,742
Less: Net income attributable to noncontrolling interests	14,383	14,412	13,956	13,987
Net income attributable to Canon Inc.	124,964	125,105	252,441	252,755
	Yen			
Net income attributable to Canon Inc. shareholders per share:				
Basic	116.79	116.93	233.80	234.09
Diluted	116.77	116.91	233.78	234.08

Consolidated statements of comprehensive income

Year ended December 31	Millions of yen			
	2019		2018	
	As revised	As previously reported	As revised	As previously reported
Consolidated net income	139,347	139,517	266,397	266,742
Less: Comprehensive income attributable to noncontrolling interests	16,353	16,382	6,887	6,918
Comprehensive income (loss) attributable to Canon Inc.	86,139	86,280	136,141	136,455

Consolidated statements of cash flows

Year ended December 31	Millions of yen			
	2019		2018	
	As revised	As previously reported	As revised	As previously reported
Consolidated net income	139,347	139,517	266,397	266,742
Increase in accrued expenses	9,738	9,491	3,041	2,541
Deferred income taxes	(6,523)	(6,446)	(12,004)	(11,849)

The consolidated statements of equity have been revised, accordingly.

2. INVESTMENTS

The unrealized and realized gains and losses related to equity securities for the year ended December 31, 2020, 2019 and 2018 are as follows:

Years ended December 31	Millions of yen		
	2020	2019	2018
Net gains and (losses) recognized during the period on equity securities	**1,959**	2,148	(6,092)
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	**477**	(76)	675
Unrealized gains and (losses) recognized during the period on equity securities still held at December 31	**1,482**	2,224	(6,767)

The carrying amount of non-marketable equity securities without readily determinable fair value totaled ¥8,559 million and ¥8,448 million at December 31, 2020 and 2019, respectively. The impairment or other adjustments resulting from observable price changes recorded during the year ended December 31, 2020 and 2019 were not significant.

There were no available-for-sale debt securities included in short-term investments and investments at December 31, 2020 and 2019, respectively.

The unrealized and realized gains and losses related to debt securities were not significant for the years ended December 31, 2020, 2019 and 2018, respectively.

Time deposits with original maturities of more than three months are ¥71 million and ¥1,767 million at December 31, 2020 and 2019, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

Investments in affiliated companies accounted for by the equity method amounted to ¥19,634 million and ¥19,988 million at December 31, 2020 and 2019, respectively. Canon's share of the net earnings in affiliated companies accounted for by the equity method, included in other income (deductions), were losses of ¥994 million and ¥311 million for the year ended December 31, 2020 and 2019 respectively, and earnings of ¥1,414 million for the years ended December 31, 2018.

3. TRADE RECEIVABLES

Trade receivables are summarized as follows:

December 31	Millions of yen	
	2020	2019
Notes	**34,922**	32,952
Accounts	**511,849**	537,243
Less allowance for credit losses	**(11,645)**	(10,359)
	535,126	559,836

4. INVENTORIES

Inventories are summarized as follows:

December 31	Millions of yen	
	2020	2019
Finished goods	**352,513**	367,332
Work in process	**160,696**	165,399
Raw materials	**49,598**	52,025
	562,807	584,756

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and are summarized as follows:

December 31	Millions of yen	
	2020	2019
Land	**270,308**	273,014
Buildings	**1,687,921**	1,658,270
Machinery and equipment	**1,806,185**	1,802,624
Construction in progress	**37,324**	77,953
Finance lease right-of-use assets	**6,048**	4,999
	3,807,786	3,816,860
Less accumulated depreciation	**(2,770,106)**	(2,727,189)
	1,037,680	1,089,671

Depreciation expenses for the years ended December 31, 2020, 2019 and 2018 were ¥162,733 million, ¥170,418 million and ¥175,771 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥27,688 million and ¥30,601 million at December 31, 2020 and 2019, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows include property, plant and equipment and intangible assets.

6. LESSOR ACCOUNTING

Lease income is included in Products and Equipment sales in the accompanying consolidated statements of income. Supplemental income statement information is as follows:

Years ended December 31	Millions of yen	
	2020	2019
Lease income - sales-type and direct financing leases		
Revenue at lease commencement	**92,133**	114,312
Interest income on lease receivables	**18,594**	20,382
	110,727	134,694
Lease income – operating leases	**23,878**	25,403
Variable lease income	**5,343**	6,216
	139,948	166,313

Finance Receivables and Operating Leases

Finance receivables represent financing leases which consist of sales-type leases and direct financing leases resulting from the sales of Canon's and complementary third-party products. These receivables typically have terms ranging from 1 year to 7 years. The components of the finance receivables, which are included in prepaid expenses and other current assets, and other assets in the accompanying consolidated balance sheets, are as follows:

December 31	Millions of yen	
	2020	2019
Total minimum lease payments receivable	**337,265**	360,146
Unguaranteed residual values	**11,459**	13,070
Executory costs	**—**	—
Unearned income	**(29,541)**	(33,338)
	319,183	339,878
Less allowance for credit losses	**(3,068)**	(2,627)
	316,115	337,251
Less current portion	**(108,837)**	(113,892)
	207,278	223,359

Allowance for Credit Losses

The activities in the allowance for credit losses are as follows:

Years ended December 31	Millions of yen	
	2020	2019
Balance at beginning of year	**2,627**	2,675
Charge-offs	**(2,199)**	(1,653)
Provision	**2,351**	1,495
Translation adjustments and other	**289**	110
Balance at end of year	**3,068**	2,627

Canon has policies in place to ensure that its products are sold to customers with an appropriate credit history and continuously monitors its customers' credit quality based on information including length of period in arrears, macroeconomic conditions, initiation of legal proceedings against customers and bankruptcy filings. The allowance for credit losses of finance receivables is evaluated collectively based on historical experiences of credit losses, and reasonable and supportable forecasts. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. Finance receivables which are past due or are individually evaluated for impairment at December 31, 2020 and December 31, 2019 are not significant.

Equipment leased to customers

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2020 and 2019 was ¥132,763 million and ¥116,681 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2020 and 2019 was ¥81,345 million and ¥82,633 million, respectively.

Maturity Analysis

The following is a schedule by year of the future minimum lease payments to be received under finance leases and non-cancellable operating leases at December 31, 2020.

Year ending December 31:	Millions of yen	
	Financing leases	Operating leases
2021	121,577	9,273
2022	91,568	5,156
2023	62,913	3,154
2024	36,652	1,450
2025	16,868	617
Thereafter	7,687	129
	337,265	19,779

Information about transferring finance receivables

Canon has syndication arrangements to sell its entire interests in finance receivables to the third-party financial institutions. The transactions under the arrangements are accounted for as sales in accordance with ASC 860 "Transfers and Servicing." The sales of finance receivables were ¥19,185 million, ¥11,710 million and ¥21,909 million for the year ended December 31, 2020, 2019 and 2018. The amounts remaining uncollected were ¥36,339 million, ¥28,616 million and ¥22,956 million at December 31, 2020, 2019 and 2018, respectively. Cash proceeds from the transactions are included in other, net under the cash flow from operating activities in the consolidated statements of cash flows. Canon continues to provide collection and administrative services for the financial institutions. The amount associated with the servicing liability measured at fair value was not material at December 31, 2020, 2019 and 2018, respectively. Canon also retains limited recourse obligations which cover credit defaults. The recourse obligation was not material at December 31, 2020, 2019 and 2018, respectively.

7. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible assets subject to amortization acquired during the year ended December 31, 2020, including those recorded from businesses acquired, totaled ¥31,413 million, which primarily consist of software of ¥29,137 million. The weighted average amortization periods for intangible assets in total acquired during the year ended December 31, 2020 are approximately 6 years. The weighted average amortization period for software acquired during the year ended December 31, 2020 is approximately 5 years.

Intangible assets subject to amortization acquired during the year ended December 31, 2019, including those recorded from businesses acquired, totaled ¥34,259 million, which primarily consist of software of ¥32,334 million. The weighted average amortization periods for intangible assets in total acquired during the year ended December 31, 2019 are approximately 5 years. The weighted average amortization period for software acquired during the year ended December 31, 2019 is approximately 5 years.

The components of intangible assets subject to amortization at December 31, 2020 and 2019 were as follows:

December 31	2020		2019	
Millions of yen	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Software	379,504	279,372	370,178	262,405
Customer relationships	155,648	46,613	153,708	35,276
Patents and developed technology	124,315	59,328	123,609	46,263
Trademarks	44,914	17,800	41,688	13,582
License fees	13,651	6,065	15,944	8,482
Other	17,163	9,235	18,972	11,846
	735,195	418,413	724,099	377,854

Aggregate amortization expense for the years ended December 31, 2020, 2019 and 2018 was ¥65,092 million, ¥66,909 million and ¥75,783 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥58,160 million in 2021, ¥46,939 million in 2022, ¥39,001 million in 2023, ¥31,291 million in 2024, and ¥27,405 million in 2025.

Intangible assets not subject to amortization other than goodwill at December 31, 2020 and 2019 were not significant.

For management reporting purposes, goodwill is not allocated to the reporting unit. Goodwill has been allocated to its respective reporting unit for impairment testing.

The changes in the carrying amount of goodwill by segment for the years ended December 31, 2020 and 2019 were as follows:

Year ended December 31 Millions of yen	Office	Imaging System	Medical System	Industry and Others	Total
2020: Goodwill -gross	135,862	46,953	508,907	238,229	929,951
Accumulated impairment losses	(31,290)	—	—	—	(31,290)
Balance at beginning of year	104,572	46,953	508,907	238,229	898,661
Goodwill acquired during the year	—	—	—	—	—
Translation adjustments and other	1,997	2,398	(2,394)	14,902	16,903
Goodwill - gross	138,985	49,351	506,513	253,131	947,980
Accumulated impairment losses	(32,416)	—	—	—	(32,416)
Balance at end of year	106,569	49,351	506,513	253,131	915,564

Year ended December 31 Millions of yen	Office	Imaging System	Medical System	Industry and Others	Total
2019: Goodwill -gross	139,518	48,670	500,896	251,855	940,939
Accumulated impairment losses*	(32,428)	—	—	—	(32,428)
Balance at beginning of year	107,090	48,670	500,896	251,855	908,511
Goodwill acquired during the year	—	—	8,330	—	8,330
Translation adjustments and other	(2,518)	(1,717)	(319)	(13,626)	(18,180)
Goodwill - gross	135,862	46,953	508,907	238,229	929,951
Accumulated impairment losses*	(31,290)	—	—	—	(31,290)
Balance at end of year	104,572	46,953	508,907	238,229	898,661

* Based on the realignment of Canon's internal reporting and management structure, from the beginning of the first quarter of 2020, Canon has reclassified certain businesses from the Industry and Others Business Unit to the Office Business Unit. Prior period amounts also have been reclassified.

8. SHORT-TERM LOANS AND LONG-TERM DEBT

Short-term loans consisting of bank borrowings at December 31, 2020 and 2019 were ¥46,461 million and ¥40,800 million, respectively. The weighted average interest rate on short-term borrowings outstanding at December 31, 2020 and 2019 were 0.26% and 0.21%, respectively. Unused overdraft facilities at December 31, 2020 were ¥750,000 million. The overdraft facilities bear interest at a rate equal to a base rate plus a spread.

Long-term debt consisted of the following:

December 31	Millions of yen	
	2020	2019
Loan from banks; bearing interest of 0.09% at December 31, 2020 and 0.08% at December 31, 2019*1	**344,000**	354,000
Other debt*2	**6,608**	4,574
	350,608	358,574
Less current portion	**(345,774)**	(1,234)
	4,834	357,340

*1 Canon has unsecured revolving credit facility contracts expiring in December 2021. Canon prepaid ¥10,000 million of the loan with cash flows generated during the year ended December 31, 2020. The outstanding loans under the credit facilities are ¥344,000 million at a floating interest of 0.09% and Canon has no unused credit facilities as of December 31, 2020.
*2 The other debt consisted of term-loans and finance lease obligations as of December 31, 2020 and 2019.

The aggregate annual maturities of long-term debt outstanding at December 31, 2020 were as follows:

Year ending December 31:	Millions of yen
2021	345,774
2022	868
2023	702
2024	434
2025	231
Thereafter	2,599
	350,608

Both short-term and long-term bank loans are primarily made under general agreements which provide that security and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right to offset cash deposits against obligations that have become due or, in the event of default, against all obligations due to the bank.

9. TRADE PAYABLES

Trade payables are summarized as follows:

December 31	Millions of yen	
	2020	2019
Notes	**83,468**	56,865
Accounts	**220,341**	248,447
	303,809	305,312

10. EMPLOYEE RETIREMENT AND SEVERANCE BENEFITS

The Company and certain of its subsidiaries have contributory and noncontributory defined benefit pension plans covering substantially all of their employees. Benefits payable under the plans are based on employee earnings and years of service. The Company and certain of its subsidiaries also have defined contribution pension plans covering substantially all of their employees. Canon Medical Systems Corporation ("CMSC") temporarily participated in Toshiba Corporate Pension Funds ("Toshiba Funds") after CMSC was acquired by Canon in 2016. In April 2018, CMSC established a new pension provision which provides participants an equivalent level of benefits as compared to the Toshiba Funds. As of December 31, 2018, a majority of plan participants had been transferred from the Toshiba Funds into the new pension provision. Canon calculated the projected benefit obligations for the remaining participants within the Toshiba Funds based on the benefit level of the Toshiba Funds and included the proportional share of the plan assets to which CMSC had a legal right in the following tables for the remaining participants as of December 31, 2018. In March 2019, CMSC settled the pension obligations attributed to the remaining participants within the Toshiba Funds. The loss recognized due to the settlement in the consolidated statement of income for the year ended December 31, 2019 was not significant.

Obligations and funded status

Reconciliations of beginning and ending balances of the projected benefit obligations and the fair value of the plan assets are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2020	2019	**2020**	2019
Change in benefit obligations:				
Projected benefit obligations at beginning of year	**925,390**	927,006	**439,624**	385,949
Service cost	**30,604**	30,903	**5,303**	6,264
Interest cost	**4,064**	5,074	**6,087**	8,643
Plan participants' contributions	**—**	—	**860**	1,432
Actuarial (gain) loss	**(11,432)**	15,289	**43,202**	52,261
Benefits paid	**(36,646)**	(35,372)	**(12,351)**	(10,863)
Plan amendments	**(859)**	—	**(1,463)**	362
Curtailments and settlements	**—**	(17,510)	**(6,004)**	(3,608)
Foreign currency exchange rate changes	**—**	—	**2,079**	(816)
Projected benefit obligations at end of year	**911,121**	925,390	**477,337**	439,624
Change in plan assets:				
Fair value of plan assets at beginning of year	**704,169**	682,695	**294,829**	248,642
Actual return on plan assets	**36,060**	54,170	**23,912**	35,298
Employer contributions	**13,360**	12,367	**13,605**	18,016
Plan participants' contributions	**—**	—	**860**	1,432
Benefits paid	**(29,550)**	(28,549)	**(12,351)**	(10,863)
Settlements	**—**	(16,514)	**(805)**	—
Foreign currency exchange rate changes	**—**	—	**1,663**	2,304
Fair value of plan assets at end of year	**724,039**	704,169	**321,713**	294,829
Funded status at end of year	**(187,082)**	(221,221)	**(155,624)**	(144,795)

Amounts recognized in the consolidated balance sheets at December 31, 2020 and 2019 are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2020	2019	**2020**	2019
Other assets	**2,684**	1,904	**2,236**	2,342
Accrued expenses	**(791)**	(818)	**(938)**	(937)
Accrued pension and severance cost	**(188,975)**	(222,307)	**(156,922)**	(146,200)
	(187,082)	(221,221)	**(155,624)**	(144,795)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2020 and 2019 before the effect of income taxes are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2020	2019	**2020**	2019
Actuarial loss	**192,931**	231,811	**142,455**	118,247
Prior service credit	**(28,633)**	(36,506)	**(520)**	268
	164,298	195,305	**141,935**	118,515

The accumulated benefit obligation for all defined benefit plans was as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2020	2019	**2020**	2019
Accumulated benefit obligation	**879,136**	892,154	**460,536**	421,460

The projected benefit obligations and the fair value of plan assets for the pension plans with projected benefit obligations in excess of plan assets, and the accumulated benefit obligations and the fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2020	2019	**2020**	2019
Plans with projected benefit obligations in excess of plan assets:				
Projected benefit obligations	**897,669**	916,562	**475,137**	437,780
Fair value of plan assets	**707,708**	693,437	**318,079**	290,643
Plans with accumulated benefit obligations in excess of plan assets:				
Accumulated benefit obligations	**874,327**	887,138	**453,120**	414,729
Fair value of plan assets	**707,708**	688,754	**312,748**	285,341

Components of net periodic benefit cost and other amounts recognized in other comprehensive income (loss)

Net periodic benefit cost for Canon's employee retirement and severance defined benefit plans for the years ended December 31, 2020, 2019 and 2018 consisted of the following components:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen			Millions of yen		
	2020	2019	2018	**2020**	2019	2018
Service cost	**30,604**	30,903	31,241	**5,303**	6,264	7,982
Interest cost	**4,064**	5,074	5,419	**6,087**	8,643	8,691
Expected return on plan assets	**(21,013)**	(19,553)	(21,983)	**(12,006)**	(11,919)	(12,601)
Amortization of prior service credit	**(8,732)**	(11,877)	(13,001)	**(675)**	(133)	(217)
Amortization of actuarial loss	**12,401**	15,247	11,900	**6,122**	4,345	5,108
(Gain) loss on curtailments and settlements	**—**	(36)	—	**236**	(2,197)	—
	17,324	19,758	13,576	**5,067**	5,003	8,963

Service cost component of net periodic benefit cost for Canon's employee retirement and severance defined benefit plans is included in cost of sales and operating expenses in the consolidated statements of income. The components other than the service cost component are included in other, net of other income (deductions) in the consolidated statements of income.

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2020, 2019 and 2018 are summarized as follows:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen			Millions of yen		
	2020	2019	2018	**2020**	2019	2018
Current year actuarial (gain) loss	**(26,479)**	(19,328)	58,149	**31,296**	28,882	(5,654)
Current year prior service credit	**(859)**	—	(3,963)	**(1,463)**	362	3,257
Amortization of actuarial loss	**(12,401)**	(15,247)	(11,900)	**(6,122)**	(4,345)	(5,108)
Amortization of prior service credit	**8,732**	11,877	13,001	**675**	133	217
Curtailments and settlements	**—**	(960)	—	**(966)**	(1,411)	(63)
	(31,007)	(23,658)	55,287	**23,420**	23,621	(7,351)

Assumptions

Weighted-average assumptions used to determine benefit obligations are as follows:

December 31	Japanese plans		Foreign plans	
	2020	2019	**2020**	2019
Discount rate	**0.5%**	0.5%	**1.5%**	1.6%
Assumed rate of increase in future compensation levels	**2.6%**	2.6%	**0.9%**	1.0%
Interest crediting rate for cash balance plans	**1.9%**	1.9%	**1.0%**	1.0%

Weighted-average assumptions used to determine net periodic benefit cost are as follows:

Years ended December 31	Japanese plans			Foreign plans		
	2020	2019	2018	**2020**	2019	2018
Discount rate	**0.5%**	0.6%	0.6%	**1.6%**	2.4%	2.2%
Assumed rate of increase in future compensation levels	**2.6%**	2.6%	2.6%	**1.0%**	1.9%	1.8%
Expected long-term rate of return on plan assets	**3.0%**	3.0%	2.9%	**4.8%**	5.2%	4.4%
Interest crediting rate for cash balance plans	**1.9%**	1.9%	1.9%	**1.0%**	1.0%	1.0%

Canon determines the expected long-term rate of return based on the expected long-term return of the various asset categories in which it invests. Canon considers the current expectations for future returns and the actual historical returns of each plan asset category.

Plan assets

Canon's investment policies are designed to ensure adequate plan assets are available to provide future payments of pension benefits to eligible participants. Taking into account the expected long-term rate of return on plan assets, Canon formulates a "model" portfolio comprised of the optimal combination of equity securities and debt securities. Plan assets are invested in individual equity and debt securities using the guidelines of the "model" portfolio in order to produce a total return that will match the expected return on a mid-term to long-term basis. Canon evaluates the gap between expected return and actual return of invested plan assets on an annual basis to determine if such differences necessitate a revision in the formulation of the "model" portfolio. Canon revises the "model" portfolio when and to the extent considered necessary to achieve the expected long-term rate of return on plan assets.

Canon's model portfolio for Japanese plans consists of three major components: approximately 25% is invested in equity securities, approximately 50% is invested in debt securities, and approximately 25% is invested in other investment vehicles, primarily consisting of investments in life insurance company general accounts.

Outside Japan, investment policies vary by country, but the long-term investment objectives and strategies remain consistent. Canon's model portfolio for foreign plans has been developed as follows: approximately 25% is invested in equity securities, approximately 25% is invested in debt securities, and approximately 50% is invested in other investment vehicles, such as investments in real estate assets.

The equity securities are selected primarily from stocks that are listed on securities exchanges. Prior to investing, Canon investigates the business condition of the investee companies, and appropriately diversifies investments by type of industry and other relevant factors. The debt securities are selected primarily from government bonds, public debt instruments, and corporate bonds. Prior to investing, Canon investigates the quality of the issue, including rating, interest rate, and repayment dates, and appropriately diversifies the investments. Pooled funds are selected using strategies consistent with the equity and debt securities described above. As for investments in life insurance company general accounts, the contracts with the insurance companies include a guaranteed interest rate and return of capital. With respect to investments in foreign investment vehicles, Canon investigates the stability of the underlying governments and economies, the market characteristics such as settlement systems and the taxation systems. For each such investment, Canon selects the appropriate investment country and currency.

The three levels of input used to measure fair value are more fully described in Note 21. The fair values of Canon's pension plan assets at December 31, 2020 and 2019, by asset category, are as follows:

December 31, 2020	Millions of yen							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (a)	**80,201**	**—**	**—**	**80,201**	**—**	**—**	**—**	**—**
Foreign companies	**9,807**	**—**	**—**	**9,807**	**10,267**	**—**	**—**	**10,267**
Pooled funds (b)	**—**	**168,745**	**—**	**168,745**		**37,538**		**37,538**
Debt securities:								
Government bonds (c)	**136,771**	**—**	**—**	**136,771**	**—**	**—**	**—**	**—**
Municipal bonds	**—**	**1,126**	**—**	**1,126**	**—**	**2,324**	**—**	**2,324**
Corporate bonds	**—**	**15,617**	**—**	**15,617**	**—**	**6,375**	**—**	**6,375**
Pooled funds (d)	**—**	**140,825**	**—**	**140,825**	**—**	**108,499**	**—**	**108,499**
Mortgage backed securities (and other asset backed securities)	**—**	**8,308**	**—**	**8,308**	**—**	**2,696**	**—**	**2,696**
Life insurance company general accounts	**—**	**117,762**	**—**	**117,762**	**—**	**27,953**	**—**	**27,953**
Other assets	**—**	**28,731**	**1,356**	**30,087**	**—**	**102,159**	**—**	**102,159**
Investment measured at net asset value	**—**	**—**	**—**	**14,790**	**—**	**—**	**—**	**23,902**
	226,779	**481,114**	**1,356**	**724,039**	**10,267**	**287,544**	**—**	**321,713**

December 31, 2019	Millions of yen							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (e)	77,484	—	—	77,484	—	—	—	—
Foreign companies	5,164	—	—	5,164	10,298	—	—	10,298
Pooled funds (f)	—	164,662	—	164,662		63,557		63,557
Debt securities:								
Government bonds (g)	130,180	—	—	130,180	—	—	—	—
Municipal bonds	—	1,202	—	1,202	—	2,302	—	2,302
Corporate bonds	—	11,711	—	11,711	—	6,472	—	6,472
Pooled funds (h)	—	136,655	—	136,655	—	64,259	—	64,259
Mortgage backed securities (and other asset backed securities)	—	12,090	—	12,090	—	2,511	—	2,511
Life insurance company general accounts	—	121,573	—	121,573	—	9,676	—	9,676
Other assets	—	26,979	218	27,197	—	115,102	—	115,102
Investment measured at net asset value	—	—	—	16,251	—	—	—	20,652
	212,828	474,872	218	704,169	10,298	263,879	—	294,829

(a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥282 million.
(b) These funds invest in listed equity securities consisting of approximately 30% Japanese companies and 70% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
(c) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
(d) These funds invest in approximately 25% Japanese government bonds, 55% foreign government bonds, 5% Japanese municipal bonds, and 15% corporate bonds for Japanese plans. These funds invest in approximately 60% foreign government bonds and 40% corporate bonds for foreign plans.
(e) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥118 million.
(f) These funds invest in listed equity securities consisting of approximately 30% Japanese companies and 70% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
(g) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
(h) These funds invest in approximately 25% Japanese government bonds, 55% foreign government bonds, 5% Japanese municipal bonds, and 15% corporate bonds for Japanese plans. These funds invest in approximately 75% foreign government bonds and 25% corporate bonds for foreign plans.

Each level into which assets are categorized is based on inputs used to measure the fair value of the assets, and does not necessarily indicate the risks or ratings of the assets.

Level 1 assets are comprised principally of equity securities and government bonds, which are valued using unadjusted quoted market prices in active markets with sufficient volume and frequency of transactions. Level 2 assets are comprised principally of pooled funds that invest in equity and debt securities, corporate bonds, investments in life insurance company general accounts and other assets. Pooled funds are valued at their net asset values that are calculated by the sponsor of the fund and have daily liquidity. Corporate bonds are valued using quoted prices for identical assets in markets that are not active. Investments in life insurance company general accounts are valued at conversion value. Other assets are comprised principally of interest bearing cash and hedge funds.

The fair values of Level 3 asset, consisting of hedge funds, were ¥1,356 million and ¥218 million at December 31, 2020 and 2019, respectively. Amounts of actual returns on, purchases and sales of these assets during the years ended December 31, 2020 and 2019 were not significant.

Contributions

Canon expects to contribute ¥14,414 million to its Japanese defined benefit pension plans and ¥16,432 million to its foreign defined benefit pension plans for the year ending December 31, 2021.

Estimated future benefit payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Year ending December 31:	Japanese plans	Foreign plans
	Millions of yen	Millions of yen
2021	39,523	13,273
2022	41,562	14,055
2023	43,080	14,862
2024	43,251	15,783
2025	44,391	16,609
2026 – 2030	224,816	99,803

Multiemployer pension plans

The amounts of cost recognized for the multiemployer pension plans primarily in the Netherlands for the years ended December 31, 2020, 2019 and 2018 were ¥4,224 million, ¥4,321 million and ¥4,452 million, respectively. The multiemployer pension plan in which the subsidiaries in the Netherlands participated was 99% funded as of December 31, 2019. The collective bargaining agreements have no expiration date. Canon is not liable for other participating employers' obligations under the terms and conditions of the agreements.

Defined contribution plans

The amounts of cost recognized for the defined contribution pension plans of the Company and certain of its subsidiaries for the years ended December 31, 2020, 2019 and 2018 were ¥16,334 million, ¥17,414 million and ¥19,570 million, respectively.

11. INCOME TAXES

Domestic and foreign components of income before income taxes and the current and deferred income tax expense attributable to such income are summarized as follows:

Years ended December 31	Millions of yen		
	Japanese	Foreign	Total
2020: Income before income taxes	**48,186**	**82,094**	**130,280**
Income taxes:			
Current	**24,063**	**25,816**	**49,879**
Deferred	**(6,007)**	**(9,535)**	**(15,542)**
	18,056	**16,281**	**34,337**
2019: Income before income taxes	107,082	88,411	195,493
Income taxes:			
Current	39,483	23,186	62,669
Deferred	(4,276)	(2,247)	(6,523)
	35,207	20,939	56,146
2018: Income before income taxes	240,974	121,418	362,392
Income taxes:			
Current	75,556	32,443	107,999
Deferred	(6,707)	(5,297)	(12,004)
	68,849	27,146	95,995

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 31% for the years ended December 31, 2020, 2019 and 2018.

A reconciliation of the Japanese statutory income tax rate and the effective income tax rate as a percentage of income before income taxes is as follows:

Years ended December 31	2020	2019	2018
Japanese statutory income tax rate	**31.0%**	31.0%	31.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	**2.3**	1.7	0.6
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	**(5.8)**	(2.9)	(2.6)
Tax credit for research and development expenses	**(1.7)**	(2.3)	(3.4)
Change in valuation allowance	**2.4**	(1.6)	0.4
Deferred tax liabilities on undistributed earnings of foreign subsidiaries	**2.6**	2.4	0.9
Tax credit at foreign subsidiaries	**(1.3)**	(1.1)	(0.7)
Effect of enacted changes in tax laws	**(1.5)**	(0.2)	(0.1)
Other	**(1.6)**	1.7	0.4
Effective income tax rate	**26.4%**	28.7%	26.5%

Net deferred income tax assets and liabilities are included in the accompanying consolidated balance sheets under the following captions:

December 31	Millions of yen	
	2020	2019
Other assets	**154,226**	157,515
Other noncurrent liabilities	**(48,247)**	(59,888)
	105,979	97,627

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2020 and 2019 are presented below:

December 31	Millions of yen	
	2020	2019
Deferred tax assets:		
Inventories	**10,551**	10,225
Accrued business tax	**1,629**	1,282
Accrued pension and severance cost	**95,386**	107,463
Research and development – costs capitalized for tax purposes	**4,989**	4,751
Property, plant and equipment	**34,923**	32,040
Operating lease liabilities	**20,163**	25,646
Accrued expenses	**28,243**	29,412
Net operating losses carried forward	**29,591**	21,294
Other	**42,741**	41,759
	268,216	273,872
Less valuation allowance	**(30,752)**	(27,678)
Total deferred tax assets	**237,464**	246,194
Deferred tax liabilities:		
Undistributed earnings of foreign subsidiaries	**(9,147)**	(8,769)
Tax deductible reserve	**(4,040)**	(4,050)
Financing lease revenue	**(15,041)**	(19,029)
Operating lease right-of-use assets	**(19,425)**	(25,249)
Intangible assets	**(54,948)**	(59,350)
Other	**(28,884)**	(32,120)
Total deferred tax liabilities	**(131,485)**	(148,567)
Net deferred tax assets	**105,979**	97,627

The net changes in the total valuation allowance were an increase of ¥3,074 million, a decrease of ¥3,056 million and a decrease of ¥49 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Based on the level of historical taxable income and projections for future taxable income over the periods which the net deductible temporary differences are expected to reverse, management believes it is more likely than not that Canon will realize the benefits of these deferred tax assets, net of the valuation allowance, at December 31, 2020.

At December 31, 2020, Canon had net operating losses which can be carried forward for income tax purposes of ¥176,489 million to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to an indefinite period as follows:

	Millions of yen
Within one year	981
After one year through five years	12,332
After five years through ten years	48,181
After ten years through twenty years	11,321
Indefinite period	103,674
	176,489

Income taxes have not been accrued on undistributed earnings of domestic subsidiaries as the tax law provides a means by which the dividends from a domestic subsidiary can be received tax free.

Canon has not recognized deferred tax liabilities of ¥24,236 million for a portion of undistributed earnings of foreign subsidiaries of ¥1,008,414 million as of December 31, 2020 because Canon intends to permanently reinvest such undistributed earnings of foreign subsidiaries. Deferred tax liabilities will be recognized when such undistributed earnings are no longer permanently reinvested.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Years ended December 31	Millions of yen		
	2020	2019	2018
Balance at beginning of year	**8,120**	8,649	10,282
Additions for tax positions of the current year	**—**	—	45
Additions for tax positions of prior years	**208**	204	178
Reductions for tax positions of prior years	**(49)**	(44)	(17)
Settlements with tax authorities	**—**	(402)	(1,286)
Other	**293**	(287)	(553)
Balance at end of year*	**8,572**	8,120	8,649

* The unrecognized tax benefits were offset by deferred tax assets in the amount of ¥1,412 million, ¥933 million and ¥2,043 million as of December 31, 2020, 2019 and 2018, respectively, and reported under "other noncurrent liabilities" on the consolidated balance sheets.

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, were ¥8,572 million and ¥8,120 million at December 31, 2020 and 2019, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax examination settlements and any related litigation could affect the effective tax rate in a future period. Based on each of the items of which Canon is aware at December 31, 2020, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2020 and 2019, and interest and penalties included in income taxes for the years ended December 31, 2020, 2019 and 2018 were not significant.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2017. Canon is also no longer subject to a transfer pricing examination by the tax authority for years before 2017. In other major foreign tax jurisdictions, including the United States and the Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2009 with few exceptions.

12. LEGAL RESERVE AND RETAINED EARNINGS

The Corporation Law of Japan provides that an amount equal to 10% of distributions from retained earnings paid by the Company and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriations are required when the total amount of the additional paid-in capital and the legal reserve equals 25% of their respective stated capital. The Corporation Law of Japan also provides that additional paid-in capital and legal reserve are available for appropriations by resolution of the shareholders. Certain foreign subsidiaries are also required to appropriate their earnings to legal reserves under the laws of their respective countries.

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2020, 2019 and 2018 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2020 did not reflect current year-end dividends in the amount of ¥41,831 million which were approved by the shareholders in March 2021.

The amount available for dividends under the Corporation Law of Japan is based on the amount recorded in the Company's nonconsolidated books of account in accordance with financial accounting standards of Japan. Such amount was ¥719,353 million at December 31, 2020.

Retained earnings at December 31, 2020 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥16,597 million.

13. OTHER COMPREHENSIVE INCOME (LOSS)

Changes in accumulated other comprehensive income (loss) for the years ended December 31, 2020, 2019 and 2018 are as follows:

Millions of yen	Foreign currency translation adjustments	Unrealized gains and losses on securities	Gains and losses on derivative instruments	Pension liability adjustments	Total
Balance at December 31, 2017	30,208	5,484	(180)	(178,740)	(143,228)
Cumulative effects of accounting standard update—adoption of ASU No. 2016-01	—	(5,343)	—	—	(5,343)
Equity transactions with noncontrolling interests and other	(4,200)	—	—	—	(4,200)
Other comprehensive income (loss) before reclassifications	(89,823)	—	(457)	(29,909)	(120,189)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(141)	945	3,085	3,889
Net change during the year	(94,023)	(141)	488	(26,824)	(120,500)
Balance at December 31, 2018	(63,815)	—	308	(205,564)	(269,071)
Cumulative effects of accounting standard update—adoption of ASU No. 2017-12	—	—	(122)	—	(122)
Equity transactions with noncontrolling interests and other	(424)	—	—	—	(424)
Other comprehensive income (loss) before reclassifications	(31,889)	—	(1,723)	(12,763)	(46,375)
Amounts reclassified from accumulated other comprehensive income (loss)	(154)	—	650	7,054	7,550
Net change during the year	(32,467)	—	(1,073)	(5,709)	(39,249)
Balance at December 31, 2019	**(96,282)**	**—**	**(887)**	**(211,273)**	**(308,442)**
Equity transactions with noncontrolling interests and other	**(9)**	**—**	**—**	**—**	**(9)**
Other comprehensive income (loss) before reclassifications	**(17,355)**	**—**	**(1,199)**	**(7,530)**	**(26,084)**
Amounts reclassified from accumulated other comprehensive income (loss)	**—**	**—**	**2,186**	**7,560**	**9,746**
Net change during the year	**(17,364)**	**—**	**987**	**30**	**(16,347)**
Balance at December 31, 2020	**(113,646)**	**—**	**100**	**(211,243)**	**(324,789)**

Reclassifications out of accumulated other comprehensive income (loss) for the years ended December 31, 2020, 2019 and 2018 are as follows:

Years ended December 31	Amount reclassified from accumulated other comprehensive income (loss)*			Affected line items in consolidated statements of income
	Millions of yen			
	2020	2019	2018	
Foreign currency translation adjustments	**—**	(154)	—	Other, net
	—	—	—	Income taxes
	—	(154)	—	Consolidated net income
	—	—	—	Net income attributable to noncontrolling interests
	—	(154)	—	Net income attributable to Canon Inc.
Unrealized gains and losses on securities	**—**	—	(178)	Other, net
	—	—	37	Income taxes
	—	—	(141)	Consolidated net income
	—	—	—	Net income attributable to noncontrolling interests
	—	—	(141)	Net income attributable to Canon Inc.
Gains and losses on derivative instruments	**3,034**	661	1,341	Net Sales
	(775)	(2)	(392)	Income taxes
	2,259	659	949	Consolidated net income
	(73)	(9)	(4)	Net income attributable to noncontrolling interests
	2,186	650	945	Net income attributable to Canon Inc.
Pension liability adjustments	**10,082**	9,953	3,853	Other, net
	(2,484)	(2,523)	(699)	Income taxes
	7,598	7,430	3,154	Consolidated net income
	(38)	(376)	(69)	Net income attributable to noncontrolling interests
	7,560	7,054	3,085	Net income attributable to Canon Inc.
Total amount reclassified, net of tax and noncontrolling interests	**9,746**	7,550	3,889	

* Amounts in parentheses indicate gains in consolidated statements of income.

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments, including amounts attributable to noncontrolling interests, are as follows:

Years ended December 31	Millions of yen		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2020:			
Foreign currency translation adjustments:			
Amount arising during the year	**(17,583)**	**229**	**(17,354)**
Reclassification adjustments for gains and losses realized in net income	**—**	**—**	**—**
Net change during the year	**(17,583)**	**229**	**(17,354)**
Net gains and losses on derivative instruments:			
Amount arising during the year	**(1,731)**	**442**	**(1,289)**
Reclassification adjustments for gains and losses realized in net income	**3,034**	**(775)**	**2,259**
Net change during the year	**1,303**	**(333)**	**970**
Pension liability adjustments:			
Amount arising during the year	**(2,495)**	**(3,721)**	**(6,216)**
Reclassification adjustments for gains and losses realized in net income	**10,082**	**(2,484)**	**7,598**
Net change during the year	**7,587**	**(6,205)**	**1,382**
Other comprehensive income (loss)	**(8,693)**	**(6,309)**	**(15,002)**
2019:			
Foreign currency translation adjustments:			
Amount arising during the year	(32,396)	393	(32,003)
Reclassification adjustments for gains and losses realized in net income	(154)	—	(154)
Net change during the year	(32,550)	393	(32,157)
Net unrealized gains and losses on securities:			
Amount arising during the year	—	—	—
Reclassification adjustments for gains and losses realized in net income	—	—	—
Net change during the year	—	—	—
Net gains and losses on derivative instruments:			
Amount arising during the year	(2,180)	453	(1,727)
Reclassification adjustments for gains and losses realized in net income	661	(2)	659
Net change during the year	(1,519)	451	(1,068)
Pension liability adjustments:			
Amount arising during the year	(9,916)	(1,144)	(11,060)
Reclassification adjustments for gains and losses realized in net income	9,953	(2,523)	7,430
Net change during the year	37	(3,667)	(3,630)
Other comprehensive income (loss)	(34,032)	(2,823)	(36,855)
2018:			
Foreign currency translation adjustments:			
Amount arising during the year	(93,955)	809	(93,146)
Reclassification adjustments for gains and losses realized in net income	—	—	—
Net change during the year	(93,955)	809	(93,146)
Net unrealized gains and losses on securities:			
Amount arising during the year	—	—	—
Reclassification adjustments for gains and losses realized in net income	(178)	37	(141)
Net change during the year	(178)	37	(141)
Net gains and losses on derivative instruments:			
Amount arising during the year	(586)	125	(461)
Reclassification adjustments for gains and losses realized in net income	1,341	(392)	949
Net change during the year	755	(267)	488
Pension liability adjustments:			
Amount arising during the year	(51,789)	18,065	(33,724)
Reclassification adjustments for gains and losses realized in net income	3,853	(699)	3,154
Net change during the year	(47,936)	17,366	(30,570)
Other comprehensive income (loss)	(141,314)	17,945	(123,369)

14. REVENUE

Revenue from sales of office products, such as office MFDs and laser printers, and imaging system products, such as digital cameras and inkjet printers, is recognized upon shipment or delivery, depending upon when the customer obtains controls of these products.

Revenue from sales of equipment that are sold with customer acceptance provisions related to their functionality including optical equipment such as semiconductor lithography equipment and FPD lithography equipment, and certain medical equipment such as CT systems and MRI systems, is recognized when the equipment is installed at the customer site and the agreed-upon specifications are objectively satisfied.

Most of Canon's service revenue is generated from maintenance service in the office and medical system products which is recognized over time. For the service contracts of office products, the customer typically pays a variable amount based on usage, a stated fixed fee or a stated base fee plus a variable amount which frequently include the provision of consumables as well as break fix activities. The majority portion of service revenue from the office products is recognized as billed since the invoiced amount directly correlates with the value to the customer of the underlying performance obligation to date. For the service contracts of medical system products, the customer typically pays a stated fixed fee for the stand ready maintenance service and revenue is recognized ratably over the contract period.

The majority of service arrangements for office products are executed in combination with related products. Transaction prices for products and services need to be allocated to each performance obligation on a relative standalone selling price basis where judgements are required. Canon estimates the standalone selling price using a range of prices that would meet the allocation objective based on all the information that is reasonably available including market conditions and other observable inputs. If transaction prices of the product or service contracts are not within the acceptable range then the revenue is subject to allocation based on the estimated standalone selling prices. Canon recognizes the incremental costs of obtaining a contract as an expense when related office products are sold.

Revenue from sales of certain industrial equipment which do not have alternative use and for which Canon has enforceable right to payment to the customers for the performance completed to date is recognized over time with progress towards completion measured using the cost based input method as the basis to recognize revenue and an estimated margin. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses become evident. Changes in job performance, job conditions, estimated margin and final contract settlements may result in revisions to projected costs and revenue and are recognized in the period in which the revisions to estimates are identified and the amounts can be reasonably estimated. Factors that may affect future project costs and margins include, production efficiencies, availability and costs of labor and materials. These factors can impact the accuracy of our estimates and materially impact future reported revenue and cost of sales.

The transaction prices that Canon is entitled to receive in exchange for transferring goods or services to the customer include certain forms of variable consideration, including product discounts, customer promotions and volume-based rebates mainly for imaging system products, which are sold predominantly through distributors and retailers. Canon includes estimated amounts in the transaction price only to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Variable considerations are estimated based upon historical trends and other known factors at the time of sale, and are subsequently adjusted in each period based on current information. In addition, Canon may provide a right of return on our products for a short time period after a sale. These rights are accounted for as variable consideration when determining the transaction price, and accordingly Canon recognizes revenue based on the estimated amount to which Canon expects to be entitled after considering expected returns.

Disaggregated revenue by timing is as follows. Disaggregated revenue by business unit, product and geographic area are described in Note 22.

	Millions of yen					
	Office	Imaging System	Medical System	Industry and Others	Corporate and eliminations	Consolidated
2020:						
Revenue recognized at a point in time	**958,698**	**701,658**	**287,849**	**527,120**	**(83,094)**	**2,392,231**
Revenue recognized over time	**481,514**	**10,580**	**148,225**	**127,693**	**—**	**768,012**
Total	**1,440,212**	**712,238**	**436,074**	**654,813**	**(83,094)**	**3,160,243**
2019:						
Revenue recognized at a point in time	1,187,284	793,832	290,702	582,178	(93,180)	2,760,816
Revenue recognized over time	564,823	13,582	147,823	106,255	—	832,483
Total	1,752,107	807,414	438,525	688,433	(93,180)	3,593,299
2018:						
Revenue recognized at a point in time	1,286,079	957,518	305,457	635,929	(106,318)	3,078,665
Revenue recognized over time	582,276	12,917	132,121	145,958	—	873,272
Total	1,868,355	970,435	437,578	781,887	(106,318)	3,951,937

Revenue recognized over time includes primarily revenue from maintenance service in the office and medical system products and sales of certain industrial equipment which do not have alternative use and for which Canon has enforceable right to payment to the customers for the performance completed to date.

Canon recognizes contract assets primarily for unbilled receivables mainly arising from services contracts for office products. Contract assets at December 31, 2020 and 2019 were ¥42,752 million and ¥43,783 million, respectively, and are included in prepaid expenses and other current assets in the consolidated balance sheets.

Canon typically bills to the customer when the performance obligation is satisfied and collects the payment in relatively short term except for certain maintenance service of office and medical products and certain industrial equipment for which Canon occasionally receives the payment in advance from customers. The amount received in excess of revenue recognized is recognized as deferred revenue until the performance obligation for distinct goods or services are satisfied. Deferred revenue at December 31, 2020 and 2019 were ¥135,455 million and ¥113,030 million, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Revenue recognized for the year ended December 31, 2020, which had been included in the deferred revenue balance at December 31, 2019, was ¥79,042 million.

Remaining performance obligations for products and equipment at December 31, 2020 primarily arise from the sales of certain industrial equipment, amounting to ¥235,825 million, 89% of which is expected to be recognized as revenue within one year and remaining 11% is within two years. Disclosure of remaining performance obligations is not required for the majority of services since the related revenue is recognized on an as billed basis applying the right to invoice practical expedient or is generated from the contracts with original expected duration of less than one year. The portion of fixed maintenance service contract for office and medical products with original expected duration of more than one year is approximately 12% of total service revenue and the average remaining period for these fixed contracts as of December 31, 2020 is about two years.

Taxes collected from customers and remitted to governmental authorities are excluded from revenues in the consolidated statements of income.

15. STOCK-BASED COMPENSATION

On May 1, 2020, based on the board of the directors, the Company granted stock options to its directors and executive officers to acquire 88,600 shares of common stock. Those to whom stock acquisition rights are granted (the "Holder(s)") shall be entitled to exercise all the stock acquisition rights together within 10 days (in case the last day is not a business day, the following business day) from after the date when they cease to hold any position as a director or an executive officer of the Company. These option awards have a 30 year exercisable period. The grant-date fair value per share of the stock options granted during the year ended December 31, 2020 was ¥1,459.

On March 25, 2020, based on the board of the directors, the Company granted stock options to its executive officer to acquire 10,300 shares of common stock. The Holder shall be entitled to exercise all the stock acquisition rights together within 10 days (in case the last day is not a business day, the following business day) from after the date when they cease to hold any position as a director or an executive officer of the Company. These option awards have a 30 year exercisable period. The grant-date fair value per share of the stock options granted during the year ended December 31, 2020 was ¥1,703.

On April 26, 2019, based on the board of the directors, the Company granted stock options to its directors and executive officers to acquire 116,300 shares of common stock. The Holders shall be entitled to exercise all the stock acquisition rights together within 10 days (in case the last day is not a business day, the following business day) from after the date when they cease to hold any position as a director or an executive officer of the Company. These option awards have a 30 year exercisable period. The grant-date fair value per share of the stock options granted during the year ended December 31, 2019 was ¥2,281.

The compensation cost recognized for these stock options for the years ended December 31, 2020 was ¥147 million and 2019 was ¥265 million and 2018 was ¥218 million, and it is included in selling, general and administrative expenses in the consolidated statements of income.

The fair value of the option award was estimated on the date of grant using the Black-Sholes option pricing model that incorporates the assumptions presented below:

Years ended December 31	2020		2019
	Granted on March 25, 2020	Granted on May 1, 2020	
Expected term of option (in years)	**6.0**	**6.0**	6.0
Expected volatility	**20.32%**	**20.92%**	19.97%
Dividend yield	**6.25%**	**6.97%**	5.05%
Risk-free interest rate	**(0.12%)**	**(0.17%)**	(0.16%)

A summary of option activity under the stock option plans as of and for the years ended December 31, 2020, 2019 and 2018 is presented below:

	Shares	Weighted-average exercise price	Weighted-average remaining contractual term	Aggregate intrinsic value
		Yen	Year	Millions of yen
Outstanding at January 1, 2018	—	—		—
Granted	74,000	1		
Outstanding at December 31, 2018	74,000	1	29.3	222
Granted	116,300	1		
Exercised	(4,500)	1		
Outstanding at December 31, 2019	185,800	1	29.0	555
Granted	**98,900**	**1**		
Exercised	**(37,100)**	**1**		
Outstanding at December 31, 2020	**247,600**	**1**	**28.4**	**324**
Exercisable at December 31, 2020	**247,600**	**1**	**28.4**	**324**

The total fair values of shares vested during the years ended December 31, 2020 and 2019 were ¥147 million and ¥265 million, respectively, and 2018 was ¥218 million. Cash received from the exercise of stock options for the year ended December 31, 2020 and 2019 were not significant, and for the years ended December 31, 2018 was nil.

16. NET INCOME ATTRIBUTABLE TO CANON INC. SHAREHOLDERS PER SHARE

A reconciliation of the numerators and denominators of basic and diluted net income attributable to Canon Inc. shareholders per share computations is as follows:

Years ended December 31	Millions of yen		
	2020	2019	2018
Basic net income attributable to Canon Inc.	**83,318**	124,964	252,441
Diluted net income attributable to Canon Inc.	**83,315**	124,962	252,441

	Number of shares		
Average common shares outstanding	**1,049,802,197**	1,069,956,767	1,079,753,008
Effect of dilutive securities:			
Stock options	**229,691**	158,173	49,319
Diluted common shares outstanding	**1,050,031,888**	1,070,114,940	1,079,802,327

	Yen		
Net income attributable to Canon Inc. shareholders per share:			
Basic	**79.37**	116.79	233.80
Diluted	**79.35**	116.77	233.78

17. DERIVATIVES AND HEDGING ACTIVITIES

Risk management policy

Canon operates internationally, exposing it to the risk of changes in foreign currency exchange rates. Derivative financial instruments are comprised principally of foreign exchange contracts utilized by the Company and certain of its subsidiaries to reduce the risk. Canon assesses foreign currency exchange rate risk by continually monitoring changes in the exposures and by evaluating hedging opportunities. Canon does not hold or issue derivative financial instruments for trading purposes. Canon is also exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments, but it is not expected that any counterparties will fail to meet their obligations. Most of the counterparties are internationally recognized financial institutions and selected by Canon taking into account their financial condition, and contracts are diversified across a number of major financial institutions.

Foreign currency exchange rate risk management

Canon's international operations expose Canon to the risk of changes in foreign currency exchange rates. Canon uses foreign exchange contracts to manage certain foreign currency exchange exposures principally from the exchange of U.S. dollars and euros into Japanese yen. These contracts are primarily used to hedge the foreign currency exposure of forecasted intercompany sales and intercompany trade receivables that are denominated in foreign currencies. In accordance with Canon's policy, a specific portion of foreign currency exposure resulting from forecasted intercompany sales are hedged using foreign exchange contracts which principally mature within three months.

Cash flow hedge

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign exchange contracts associated with forecasted intercompany sales, are reported in accumulated other comprehensive income (loss). These amounts are subsequently reclassified into earnings in the same period as the hedged items affect earnings. Substantially all amounts recorded in accumulated other comprehensive income (loss) as of December 31, 2020 are expected to be recognized in net sales over the next twelve months. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings.

Derivatives not designated as hedges

Canon has entered into certain foreign exchange contracts to primarily offset the earnings impact related to fluctuations in foreign currency exchange rates associated with certain assets denominated in foreign currencies. Although these foreign exchange contracts have not been designated as hedges as required in order to apply hedge accounting, the contracts are effective from an economic perspective. The changes in the fair value of these contracts are recorded in earnings immediately.

Contract amounts of foreign exchange contracts at December 31, 2020 and 2019 are set forth below:

December 31	Millions of yen	
	2020	2019
To sell foreign currencies	**137,721**	180,242
To buy foreign currencies	**27,220**	32,618

Fair value of derivative instruments in the consolidated balance sheets

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheets at December 31, 2020 and 2019.

Derivatives designated as hedging instruments

December 31		Fair value	
		Millions of yen	
	Balance sheet location	**2020**	2019
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	**426**	34
Liabilities:			
Foreign exchange contracts	Other current liabilities	**416**	828

Derivatives not designated as hedging instruments

December 31		Fair value	
		Millions of yen	
	Balance sheet location	**2020**	2019
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	**107**	317
Liabilities:			
Foreign exchange contracts	Other current liabilities	**809**	1,745

Effect of derivative instruments in the consolidated statements of income

The following tables present the effect of Canon's derivative instruments in the consolidated statements of income for the years ended December 31, 2020, 2019 and 2018.

Derivatives in cash flow hedging relationships

Years ended December 31	Gain (loss) recognized in OCI	Gain (loss) reclassified from accumulated OCI into income	
Millions of yen	Amount	Location	Amount
2020: Foreign exchange contracts	**(1,731)**	Net sales	**(3,034)**
2019: Foreign exchange contracts	(2,180)	Net sales	(661)

Year ended December 31	Gain (loss) recognized in OCI (effective portion)	Gain (loss) reclassified from accumulated OCI into income (effective portion)		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
Millions of yen	Amount	Location	Amount	Location	Amount
2018: Foreign exchange contracts	(586)	Other, net	(1,341)	Other, net	(682)

Derivatives not designated as hedging instruments

Years ended December 31		Gain (loss) recognized in income on derivative		
		Millions of yen		
	Location	**2020**	2019	2018
Foreign exchange contracts	Other, net	**104**	805	5,284

18. LESSEE ACCOUNTING

Lease costs are included in cost of goods sold or selling general and administrative expense in accompanying consolidated statements of income. Supplemental income statement information is as follows:

Years ended December 31	Millions of yen	
	2020	2019
Operating lease cost	**40,053**	43,236
Short-term lease cost	**14,245**	14,374
Other lease cost	**120**	168
	54,418	57,778

Operating lease cash flow

Supplemental cash flow information is as follows:

Years ended December 31	Millions of yen	
	2020	2019
Cash paid for amount included in the measurement of lease liabilities		
Operating cash flows from operating leases	**36,733**	41,368
Noncash activity - Rights of use assets obtained in exchange for lease liabilities		
Operating leases	**30,700**	33,939

Maturity Analysis

The following is a schedule by year of the future minimum lease payments under operating leases at December 31, 2020.

Years ending December 31:	Millions of yen
2021	35,769
2022	26,492
2023	17,053
2024	12,403
2025	8,567
Thereafter	15,529
Total future minimum lease payments	115,813
Less Imputed Interest	(6,709)
	109,104

Remaining lease term and discount rate

The following is remaining lease term and discount rate under operating leases at December 31, 2020 and 2019.

December 31	**2020**	2019
Weighted-average remaining lease term	**56 months**	62 months
Weighted-average discount rate	**2.1%**	2.2%

19. COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

At December 31, 2020, commitments outstanding for the purchase of property, plant and equipment approximated ¥42,434 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥121,031 million.

Guarantees

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits mainly for restoration made under such arrangements aggregated ¥10,962 million and ¥11,778 million at December 31, 2020 and 2019, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets.

Canon provides guarantees for its employees, affiliates and other companies. The guarantees for the employees are principally made for their housing loans. The guarantees for affiliates and other companies are made for their lease obligations and bank loans to ensure that those companies operate with less financial risk.

Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract terms. The contract terms are 1 year to 15 years in case of employees with housing loans, and 1 year to 5 years in case of affiliates and other companies with lease obligations and bank loans. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥2,568 million at December 31, 2020. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2020 were not significant.

Canon also offers assurance-type warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. Estimated product warranty costs are recorded at the time revenue is recognized and are included in selling, general and administrative expenses in the accompanying consolidated statements of income. Estimates for accrued product warranty costs are based on historical experience. Accrued product warranty costs are included in accrued expenses in the accompanying consolidated balance sheets and the changes for the years ended December 31, 2020 and 2019 are summarized as follows:

Years ended December 31	Millions of yen	
	2020	2019
Balance at beginning of year	**15,846**	17,318
Additions	**11,355**	15,945
Utilization	**(10,657)**	(14,488)
Other	**(2,244)**	(2,929)
Balance at end of year	**14,300**	15,846

Legal proceedings

Canon is involved in various claims and legal actions arising in the ordinary course of business. Canon has recorded provisions for liabilities when it is probable that liabilities have been incurred and the amount of loss can be reasonably estimated. Canon reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of the negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Based on its experience, although litigation is inherently unpredictable, Canon believes that any damage amounts claimed in outstanding matters are not a meaningful indicator of Canon's potential liability. In the opinion of management, any reasonably possible range of losses from outstanding matters would not have a material adverse effect on Canon's consolidated financial position, results of operations, and cash flows.

20. DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATIONS OF CREDIT RISK

Fair value of financial instruments

The estimated fair values of Canon's financial instruments at December 31, 2020 and 2019 are set forth below. The following summary excludes cash and cash equivalents, trade receivables, finance receivables, noncurrent receivables, short-term loans, trade payables and accrued expenses, and the fair values of these instruments approximate their carrying amounts. The summary also excludes investments and derivative instruments which are disclosed in Note 2 and Note 21, and Note 17, respectively.

December 31	Millions of yen			
	2020		2019	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Long-term debt, including current installments	**(346,317)**	**(346,275)**	(354,444)	(354,444)

The following methods and assumptions are used to estimate the fair value in the above table.

Long-term debt

Canon's long-term debt instruments are classified as Level 2 instruments and valued based on the present value of future cash flows associated with each instrument discounted using current market borrowing rates for similar debt instruments of comparable maturity. The levels are more fully described in Note 21.

Limitations of fair value estimates

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Concentrations of credit risk

At December 31, 2020 and 2019, one customer accounted for approximately 8% and 10% of consolidated trade receivables, respectively. Although Canon does not expect that the customer will fail to meet its obligations, Canon is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

21. FAIR VALUE MEASUREMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. A three-level fair value hierarchy that prioritizes the inputs used to measure fair value is as follows:

Level 1 – Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.

Assets and liabilities measured at fair value on a recurring basis

The following tables present Canon's assets and liabilities that are measured at fair value on a recurring basis consistent with the fair value hierarchy at December 31, 2020 and 2019.

December 31 Millions of yen	Level 1	Level 2	Level 3	Total
2020: Assets:				
Cash and cash equivalents	**—**	**500**	**—**	**500**
Investments:				
Fund trusts and others	**284**	**248**	**—**	**532**
Equity securities	**18,683**	**—**	**—**	**18,683**
Prepaid expenses and other current assets:				
Derivatives	**—**	**533**	**—**	**533**
Total assets	**18,967**	**1,281**	**—**	**20,248**
Liabilities:				
Other current liabilities:				
Derivatives	**—**	**1,225**	**—**	**1,225**
Total liabilities	**—**	**1,225**	**—**	**1,225**

Millions of yen	Level 1	Level 2	Level 3	Total
2019: Assets:				
Cash and cash equivalents	—	506	—	506
Investments:				
Fund trusts and others	489	241	—	730
Equity securities	16,740	—	—	16,740
Prepaid expenses and other current assets:				
Derivatives	—	351	—	351
Total assets	17,229	1,098	—	18,327
Liabilities:				
Other current liabilities:				
Derivatives	—	2,573	—	2,573
Total liabilities	—	2,573	—	2,573

Level 1 investments are comprised principally of Japanese equity securities, which are valued using an unadjusted quoted market price in active markets with sufficient volume and frequency of transactions. Level 2 cash and cash equivalents are valued based on market approach, using quoted prices for identical assets in markets that are not active.

Derivative financial instruments are comprised of foreign exchange contracts. Level 2 derivatives are valued using quotes obtained from counterparties or third parties, which are periodically validated by pricing models using observable market inputs, such as foreign currency exchange rates and interest rates, based on market approach.

Assets and liabilities measured at fair value on a nonrecurring basis

There were no significant assets or liabilities to be measured at fair value on a nonrecurring basis during the year ended December 31, 2020 and 2019.

22. SEGMENT INFORMATION

Canon operates its business in four segments: the Office Business Unit, the Imaging System Business Unit, the Medical System Business Unit, and the Industry and Others Business Unit, which are based on the organizational structure and information reviewed by Canon's management to evaluate results and allocate resources.

Based on the realignment of Canon's internal reporting and management structure, from the beginning of the first quarter of 2020, Canon has reclassified certain businesses from the Industry and Others Business Unit to the Office Business Unit. Prior period amounts also have been reclassified.

The primary products included in each segment are as follows:

Office Business Unit:
Office multifunction devices (MFDs) /
Laser multifunction printers (MFPs) / Laser printers /
Digital continuous feed presses / Digital sheet-fed presses /
Wide-format printers / Document solutions

Imaging System Business Unit:
Interchangeable-lens digital cameras /
Digital compact cameras / Interchangeable lenses /
Compact photo printers /Inkjet printers /
Large format inkjet printers / Commercial photo printers /
Image scanners / Calculators

Medical System Business Unit:
Digital radiography systems / Diagnostic X-ray systems /
Computed tomography (CT) systems /
Magnetic resonance imaging (MRI) systems /
Diagnostic ultrasound systems / Clinical chemistry analyzers /
Ophthalmic equipment

Industry and Others Business Unit:
Semiconductor lithography equipment /
FPD (Flat panel display) lithography equipment/
Vacuum thin-film deposition equipment /
Organic LED (OLED) panel manufacturing equipment /
Die bonders / Network cameras / Digital camcorders /
Digital cinema cameras / Multimedia projectors /
Broadcast equipment / Micromotors / Handy terminals /
Document scanners

The accounting policies of the segments are substantially the same as those described in the significant accounting policies in Note 1. Canon evaluate results and allocate resources for each segment based on income before income taxes.

Information about operating results and assets for each segment as of and for the years ended December 31, 2020, 2019 and 2018 is as follows:

Millions of yen	Office	Imaging System	Medical System	Industry and Others	Corporate and eliminations	Consolidated
2020: Net sales:						
External customers	**1,437,188**	**711,317**	**435,368**	**577,130**	**(760)**	**3,160,243**
Intersegment	**3,024**	**921**	**706**	**77,683**	**(82,334)**	**—**
Total	**1,440,212**	**712,238**	**436,074**	**654,813**	**(83,094)**	**3,160,243**
Operating cost and expenses	**1,358,843**	**640,433**	**410,830**	**641,588**	**(1,998)**	**3,049,696**
Operating profit	**81,369**	**71,805**	**25,244**	**13,225**	**(81,096)**	**110,547**
Other income (deductions)	**5,114**	**(735)**	**300**	**1,090**	**13,964**	**19,733**
Income before income taxes	**86,483**	**71,070**	**25,544**	**14,315**	**(67,132)**	**130,280**
Total assets	**812,553**	**242,923**	**286,749**	**446,674**	**2,836,715**	**4,625,614**
Depreciation and amortization	**56,814**	**30,381**	**11,781**	**40,406**	**88,443**	**227,825**
Capital expenditures	**46,536**	**19,814**	**7,244**	**24,079**	**64,054**	**161,727**
2019: Net sales:						
External customers	1,749,165	806,425	437,456	598,653	1,600	3,593,299
Intersegment	2,942	989	1,069	89,780	(94,780)	—
Total	1,752,107	807,414	438,525	688,433	(93,180)	3,593,299
Operating cost and expenses*	1,587,111	759,247	411,781	669,041	(8,301)	3,418,879
Operating profit	164,996	48,167	26,744	19,392	(84,879)	174,420
Other income (deductions)	5,439	1,499	539	33	13,563	21,073
Income before income taxes	170,435	49,666	27,283	19,425	(71,316)	195,493
Total assets	878,705	313,141	273,525	409,587	2,896,960	4,771,918
Depreciation and amortization	59,061	35,805	11,760	40,732	89,969	237,327
Capital expenditures	51,680	24,016	7,074	33,458	95,000	211,228
2018: Net sales:						
External customers	1,865,056	969,660	437,305	679,916	—	3,951,937
Intersegment	3,299	775	273	101,971	(106,318)	—
Total	1,868,355	970,435	437,578	781,887	(106,318)	3,951,937
Operating cost and expenses	1,651,272	843,599	408,739	722,501	(16,626)	3,609,485
Operating profit	217,083	126,836	28,839	59,386	(89,692)	342,452
Other income (deductions)	8,280	4,179	640	2,284	4,557	19,940
Income before income taxes	225,363	131,015	29,479	61,670	(85,135)	362,392
Total assets	937,607	371,944	247,282	390,282	2,955,840	4,902,955
Depreciation and amortization	66,107	38,054	9,365	39,926	98,102	251,554
Capital expenditures	48,415	25,712	7,454	23,887	95,036	200,504

* During 2019, the Company implemented a restructuring plan centered in Europe with the goal of reorganizing sales structure and improving profitability mainly in the Office Business Unit. The employee severance charges in the Office Business Unit under the plan for the year ended December 31, 2019 were ¥15,621 million and most of the charges are included in selling, general and administrative expenses in the consolidated statements of income. The balance of the related employee severance liability as of December 31, 2019 is ¥10,225 million. The restructuring charges for the years ended December 31, 2020 and 2018 were not significant.

Intersegment sales are recorded at the same prices used in transactions with third parties. Expenses not directly associated with specific segments are allocated based on the most reasonable measures applicable. Corporate expenses include certain corporate research and development expenses. Amortization costs of identified intangible assets resulting from the purchase price allocation of CMSC are also included in corporate expenses. Segment assets are based on those directly associated with each segment. Corporate assets primarily consist of cash and cash equivalents, investments, deferred tax assets, goodwill, identified intangible assets from acquisitions and corporate properties. Capital expenditures represent the additions to property, plant and equipment and intangible assets measured on an accrual basis.

Information about sales by product and service to external customers for each segment for the years ended December 31, 2020, 2019 and 2018 is as follows:

Years ended December 31	Millions of yen		
	2020	2019	2018
Office			
Monochrome copiers	**204,574**	261,964	280,035
Color copiers	**304,689**	382,845	403,522
Printers	**502,156**	624,601	702,378
Others	**425,769**	479,755	479,121
Total	**1,437,188**	1,749,165	1,865,056
Imaging System			
Cameras	**347,240**	466,306	594,567
Inkjet printers	**317,371**	285,821	318,382
Others	**46,706**	54,298	56,711
Total	**711,317**	806,425	969,660
Medical System			
Diagnostic equipment	**435,368**	437,456	437,305
Industry and Others			
Lithography equipment	**142,516**	157,160	199,722
Others	**434,614**	441,493	480,194
Total	**577,130**	598,653	679,916
Corporate	**(760)**	1,600	—
Consolidated	**3,160,243**	3,593,299	3,951,937

Information by major geographic area as of and for the years ended December 31, 2020, 2019 and 2018 is as follows:

	Millions of yen		
	2020	2019	2018
Net sales:			
Japan	**806,305**	872,534	869,577
Americas	**852,451**	1,029,078	1,076,402
Europe	**795,616**	882,480	1,015,428
Asia and Oceania	**705,871**	809,207	990,530
Total	**3,160,243**	3,593,299	3,951,937
Long-lived assets:			
Japan	**1,011,109**	1,053,074	1,046,065
Americas	**133,648**	148,669	129,989
Europe	**175,516**	191,050	169,357
Asia and Oceania	**143,265**	159,217	136,602
Total	**1,463,538**	1,552,010	1,482,013

Net sales are attributed to areas based on the location where the product is shipped and the service is performed to the customers. Other than in Japan and the United States, Canon does not conduct business in any individual country in which its sales in that country exceed 10% of consolidated net sales. Net sales in the United States were ¥801,376 million, ¥958,442 million and ¥995,245 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Long-lived assets represent property, plant and equipment, intangible assets, and operating lease right-of-use assets for each geographic area.

23. SUBSEQUENT EVENT

On January 19, 2021, Canon borrowed ¥20,000 million under its existing overdraft facilities with Mizuho Bank, Ltd. and MUFG Bank, Ltd. for required operating funds. The overdraft facilities bear interest at a rate equal to a base rate plus a spread.

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

Years ended December 31 Millions of yen	Balance at beginning of period	Addition-charged to income	Deduction bad debts written off	Translation adjustments and other	Balance at end of period
2020: Allowance for credit losses					
Trade receivables	**10,359**	**3,419**	**(1,983)**	**(150)**	**11,645**
Finance receivables	**2,627**	**2,351**	**(2,199)**	**289**	**3,068**
2019: Allowance for credit losses					
Trade receivables	11,477	1,840	(2,189)	(769)	10,359
Finance receivables	2,675	1,495	(1,653)	110	2,627
2018: Allowance for credit losses					
Trade receivables	13,378	1,347	(2,789)	(459)	11,477
Finance receivables	2,681	938	(1,284)	340	2,675

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Canon is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-l5(f) promulgated under the Exchange Act, as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

An effective internal control system, no matter how well designed, has inherent limitations, including the possibility of human error or overriding of controls, and therefore can provide only reasonable assurance with respect to reliable financial reporting. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Canon's management assessed the effectiveness of internal control over financial reporting and concluded that Canon's internal control over financial reporting was not effective as of December 31, 2020 due to identified material weaknesses. In making this assessment, management used the criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that a reasonable possibility exists that a material misstatement of the annual or interim financial statements would not be prevented or detected on a timely basis.

Canon's management identified deficiencies in the risk assessment and control activities principles associated with the COSO framework, which, either individually or in the aggregate, constitute material weaknesses relating to (i) identifying and analyzing significant changes that could impact the system of internal control and control activities, and (ii) integrating control activities to ensure that responses to risks are performed in a timely manner. Factors contributing to the material weaknesses described above included the failure to generate or maintain sufficient evidence supporting Canon's consideration of the significant changes and the impact on its internal controls over financial reporting.

Canon's independent registered public accounting firm, Deloitte Touche Tohmatsu LLC, has issued an audit report on the effectiveness of Canon's internal control over financial reporting. This report appears in Item 18.

Remediation Efforts to Address the Material Weakness

Canon's management plans to improve the agility in identifying and analyzing the significant changes that could impact the system of internal control and control activities through frequent and open communications within the organization, and to improve the process to generate and maintain sufficient evidence for significant changes.

Fujio Mitarai
Chairman & CEO

Toshizo Tanaka
Executive Vice President & CFO

March 30, 2021

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Deloitte.

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To the Shareholders and the Board of Directors of
Canon Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of Canon Inc. and subsidiaries (the "Company") as of December 31, 2020, the related consolidated statements of income, comprehensive income, equity, and cash flows for the year ended December 31, 2020, and the related notes and the schedule listed in the Index at Item 18 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020, and the results of its operations and its cash flows for the year ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 30, 2021, expressed an adverse opinion on the Company's internal control over financial reporting because of material weaknesses.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Goodwill—Medical System Reporting Unit—Refer to Notes 1 and 7 to the Financial Statements

Critical Audit Matter Description

The Company tests goodwill for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Fair value of a reporting unit is determined primarily based on the discounted cash flow analysis, which involves estimates of projected future cash flows and discount rates. Estimates of projected future cash flows are primarily based on the Company's forecast of future growth rates. The Company's total consolidated goodwill was ¥915,564 million as of December 31, 2020, of which ¥506,513 million was allocated to the Medical System reporting unit. With regard to the goodwill attributed to the Medical System reporting unit, fair value in excess of reported carrying value as a percentage is lower than other reporting units. As a result, a future reduction in cash flows of the Medical System reporting unit could trigger an impairment.

Given the significant judgements made by management to estimate the fair value of the Medical System reporting unit, performing audit procedures to evaluate the reasonableness of management's estimates and assumptions related to the projected future cash flows and selection of the discount rate required a high degree of auditor judgment and an increased extent of effort, including the need to involve fair value specialists.

How the Critical Audit Matter Was Addressed in the Audit

Our audit procedures related to the projected future cash flows and selection of the discount rate used by management to estimate the fair value of the Medical System reporting unit included the following, among others:

- We evaluated management's ability to accurately project future cash flows by comparing actual results to management's historical projections.
- We evaluated the reasonableness of management's projected future cash flows by comparing the projections to:
  - —Historical cash flows
  - —Internal communications to management and the Board of Directors
  - —Projected information included in Company press releases as well as in analyst and industry reports for the Company and certain of its peer companies
- With the assistance of our fair value specialists, we evaluated the reasonableness of the (1) valuation methodology and (2) discount rate by:
  - —Testing whether the methodology, assumptions, and models used were consistent with existing valuation practices that are both generally accepted in practice and recognized as appropriate in similar circumstances and testing the use and weighting of valuation techniques
  - —Testing the source information underlying the determination of the discount rate and the mathematical accuracy of the calculation
  - —Developing a range of independent estimates and comparing those to the discount rate selected by management

Revenue—Long-Term Contracts—Industry and Others Segment—Refer to Note 14 to the Financial Statements

Critical Audit Matter Description

The Company recognized revenue on long-term contracts of certain industrial equipment in the Industry and Others segment totaling ¥127,693 million for the year ended December 31, 2020. The Company recognized revenue over the contract term ("over time") for long-term contracts of certain industrial equipment for which there is no alternative use and for which the Company has an enforceable right to payment from customers for performance completed to date. The Company considers costs incurred and future project costs in accordance with the input method to determine progress, and as such, revenue is recognized over time based on costs incurred to date plus the estimate of margins at completion. Changes in job performance, job conditions, estimated margin and final contract settlements may result in revisions to projected costs and revenue and are recognized in the period in which the revisions to estimates are identified and the amounts can be reasonably estimated. Factors that may affect future project costs and margins include production efficiencies and availability and costs of labor and materials.

Given the complexity of certain of the Company's long-term contracts of certain industrial equipment in the Industry and Others segment and the judgments necessary to estimate future project costs and the margins at completion for these long-term contracts, auditing these estimates for certain contracts required extensive audit effort and a high degree of auditor judgment, including the need to involve our legal specialists in evaluating the legal framework for determining the impact of changes in final contract settlements.

How the Critical Audit Matter Was Addressed in the Audit

Our audit procedures related to the estimates of future costs and the margins at completion for certain long-term contracts of industrial equipment in the Industry and Others segment included the following, among others:

- We evaluated management's ability to estimate future costs and margins at completion accurately by comparing actual costs and margins at completion for similar contracts that were previously completed to management's historical estimates for such contracts.
- We evaluated the reasonableness of management's estimates of future costs and margins at completion by comparing the estimates to management's work plans, engineering specifications, meeting minutes and fee proposals, and by performing corroborating inquiries with management, project managers, and engineers.
- We selected samples from actual costs incurred subsequent to December 31, 2020 and traced them to the future costs estimate schedule to test whether the selected cost was properly included in the future costs.
- With the assistance of our legal specialists, we evaluated the legal framework for the transaction price when it had a variable nature.

Deloitte Touche Tohmatsu LLC

March 30, 2021

We have served as the Company's auditor since 2020.

Deloitte.

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To the Shareholders and the Board of Directors of
Canon Inc.

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Canon Inc. and subsidiaries (the "Company") as of December 31, 2020, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, because of the effect of the material weaknesses identified below on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2020, of the Company and our report dated March 30, 2021, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Material Weaknesses

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in Management's Report on Internal Control over Financial Reporting:

The Company identified deficiencies in the risk assessment and control activities principles associated with the COSO framework, which, either individually or in the aggregate, constitute material weaknesses relating to (i) identifying and analyzing significant changes that could impact the system of internal control and control activities, and (ii) integrating control activities to ensure that responses to risks are performed in a timely manner. Factors contributing to the material weaknesses described above included the failure to generate or maintain sufficient evidence supporting the Company's consideration of the significant changes and the impact on its internal controls over financial reporting.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements as of and for the year ended December 31, 2020, of the Company, and this report does not affect our report on such financial statements.

Deloitte Touche Tohmatsu LLC

March 30, 2021

Ernst & Young ShinNihon LLC
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To the Shareholders and the Board of Directors of
Canon Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of Canon Inc. and subsidiaries (the Company) as of December 31, 2019, the related consolidated statements of income, comprehensive income, equity and cash flows for each of the two years in the period ended December 31, 2019, and the related notes and financial statement schedule listed in the Index at Item 18 (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2019, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2019, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Ernst & Young ShinNihon LLC

We served as the Company’s auditor for SEC reporting purposes from 2004, and as its Japanese statutory auditor from 1978, to 2020.

Tokyo, Japan
March 27, 2020,
except for the effects on the consolidated financial statement of the correction of an error as described in Note 1(y) and the realignment of segments described in Note 22, as to which the date is
March 30, 2021