

Financial Report 2016

For the year ended December 31, 2016

Management Discussion and Analysis	1
Consolidated Financial Statements	14
Notes to Consolidated Financial Statements	19
Independent Auditor's Report	74

Management Discussion and Analysis

The Kao Group has adopted International Financial Reporting Standards (IFRS) from the fiscal year ended December 31, 2016. In addition, financial figures for the previous fiscal year have been restated using IFRS for comparative analysis.

Management Policies

Management Policies of the Kao Group

The Kao Group's mission is to strive for the wholehearted satisfaction and enrichment of the lives of people globally and to contribute to the sustainability of the world, with products and brands of excellent value that are created from the consumer's and customer's perspective. This commitment is embraced by all members of the Kao Group as we work together with passion to share joy with consumers and customers in our core domains of cleanliness, beauty, health and chemicals.

The Kao Group aims to be a global company that is closest to the consumers and customers in each market, earning the respect and trust of its shareholders and all other stakeholders as it achieves "profitable growth."

In its corporate governance, the Kao Group works for ongoing innovation* and further enhances its internal control system to achieve management that is swift, efficient and sound, as well as impartial and transparent, as it continuously increases its corporate value.

* Innovation is one of the values of the Kao Way, the corporate philosophy of the Kao Group.

The corporate philosophy that forms the basis of these activities is "the Kao Way," which clearly expresses the Kao Group's unique corporate culture and the essence of its corporate spirit, and is shared and practiced by all employees.

Management Metric Used as a Target

Economic value added (EVA®*), which measures true economic profit by factoring in the cost of invested capital, is the Kao Group's principal management metric. Growth in EVA is linked to increased corporate value, which results in long-term benefits not only for shareholders but for all Kao Group stakeholders.

The Kao Group aims to conduct and invest in business activities that expand the scale of its business while also

increasing EVA. It also uses EVA to help shape long-term management strategies; to assess business performance; to evaluate investments in facilities and acquisitions; and to develop performance targets for each fiscal year.

* EVA is a registered trademark of Stern Stewart & Co. EVA is defined as net operating profit after tax (NOPAT) less a charge for the cost of capital employed in the business.

Medium-to-long-term Management Strategies of the Kao Group

Long-term Management Strategy

Long-term Targets

As its vision by 2030 based on the above management policies, the Kao Group aims to achieve its vision "make Kao a company with a global presence" by combining sustained "profitable growth," and "contributions to the sustainability of the world" with proposals to resolve social issues and social contribution activities conducted through its business operations. To achieve this vision, the Kao Group will promote the further reinforcement of the existing businesses that are its strength and the creation of new markets from a global perspective utilizing the R&D capabilities that will create value for the future, in addition to implementing basic measures to further raise the level of safety and reliability.

It is becoming difficult to predict the various changes that will occur throughout the world in all aspects, such as speed, size and direction. To deal with this situation, the Kao Group aims to achieve the above vision by fully embracing the slogan of "transforming ourselves to drive change."

The Kao Group's Vision by 2030

Make Kao a company with a global presence that

- Has a distinctive corporate image
- Is a high-profit global consumer goods company that exceeds:
 - ¥2.5 trillion in net sales (¥1.0 trillion outside Japan)
 - 17% operating margin
 - 20% ROE
- Provides a high level of returns to stakeholders

Mid-term Business Plan

The Kao Group regards its mid-term business plan for the period to 2020 as an important milestone toward achieving its vision by 2030. To enhance corporate value, it established the Kao Group Mid-term Plan 2020 “K20” targeting the four years from fiscal 2017 to fiscal 2020 and announced it publicly on December 12, 2016.

K20 Goals – Three Commitments

- Commitment to fostering a distinctive corporate image
 - Become a company that is always by the consumer’s side
- Commitment to profitable growth
 - Continue to set new record highs for profits
 - Aim for like-for-like* net sales CAGR of +5%, operating margin of 15%
 - Three ¥100 billion brands (*Merries* baby diapers, *Attack* laundry detergents, *Bioré* skin care products)

* Excluding the effect of currency translation, change of sales system, etc.
- Commitment to returns to stakeholders
 - **Shareholders:** Continuous cash dividend increases (40% payout ratio target)
 - **Employees:** Continuous improvement in compensation, benefits and health support
 - **Customers:** Maximization of win-win relationships
 - **Society:** Advanced measures to address social issues

The Kao Group has established Integrity, passed down from Kao’s founder, as one of the core Values of its corporate philosophy, the Kao Way. Under K20, this Integrity will continue to be embraced in the Group’s daily business activities as it maintains thorough quality control and information control, sincere consumer communications, strict compliance and effective crisis management. Through such endeavors, the Kao Group aims to reinforce its credibility in a global society.

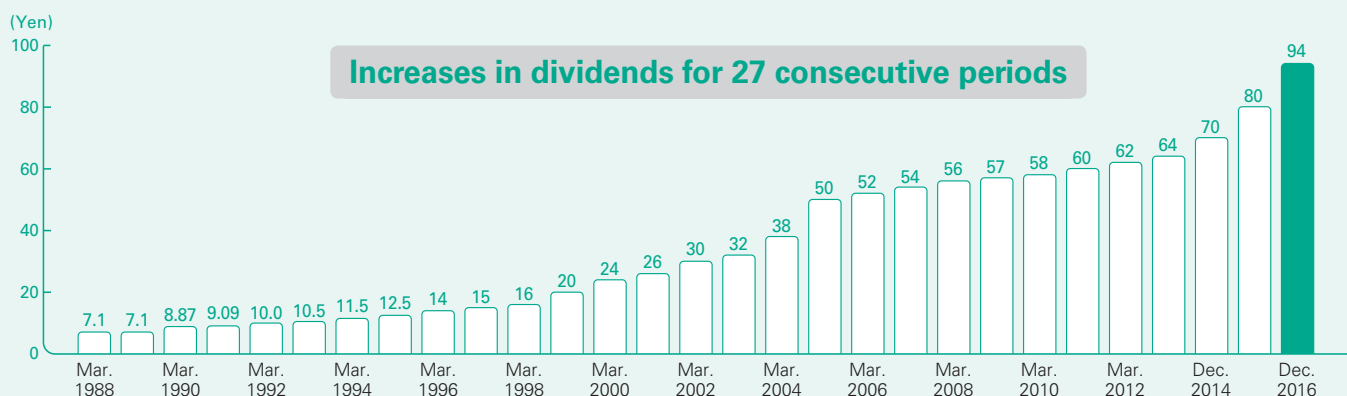
Issues for Management

With intensifying market competition, changing market structure and volatility in raw material market conditions and exchange rates, the operating environment remains uncertain. Changes in the attitudes of consumers regarding the environment, health and other matters and associated changes in their purchasing attitudes, as well as the aging society, hygiene and other social issues, are growing in significance. Moreover, amid the global expansion of business and the progress of structural changes in various fields, companies must deal with changes in the risks entailed in their businesses.

Under these conditions, the Kao Group will continuously increase corporate value by addressing and dealing appropriately with the following issues.

- (1) Regarding brightening products containing the ingredient Rhododenol sold by Kanebo Cosmetics, for which a

Cash Dividends per Share



Note: Impact of share splits is reflected retroactively.

voluntary recall was announced on July 4, 2013, Kanebo Cosmetics has been responding earnestly with support for the recovery and compensation of people who have experienced vitiligo-like symptoms. In addition, the entire Kao Group is making efforts with a view to preventing recurrence while striving to ensure greater safety and reliability.

- (2) To deal with changes in the risks entailed in its businesses, the Kao Group will define the serious company-wide risks among its main risks as corporate risks and work to prevent damage to the corporate value of the Group as a whole by further enhancing its management system.

Basic Approach to Selection of Accounting Standards

Having decided that unifying accounting standards within the Kao Group will contribute to improving the quality of its business management, the Kao Group has voluntarily adopted IFRS from the fiscal year ended December 31, 2016. This will enable management based on standardized procedures and information for each Group company and business, and the Kao Group intends to reinforce its management foundation

in order to increase its corporate value as a global company.

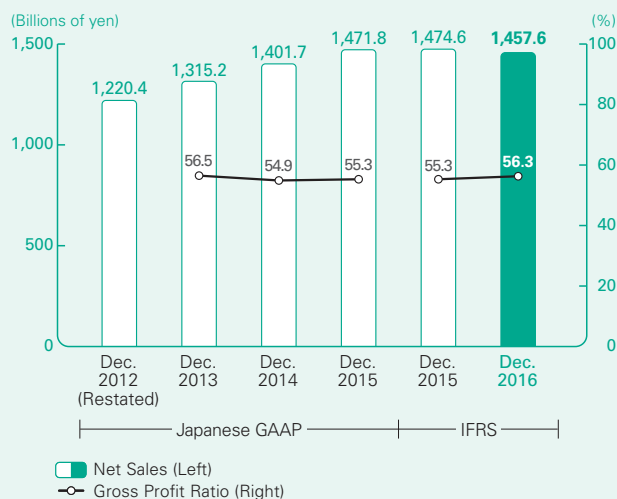
The Group also believes that the application of IFRS will facilitate the international comparability of its financial statements in capital markets.

Overview of Consolidated Results

During the fiscal year ended December 31, 2016, the global economy slowed in the first half due to factors including a trend toward normalization of monetary policy in the United States and Europe, sluggish economies in emerging nations and elsewhere, and a drop in the price of crude oil, but turned toward recovery in the second half, centered on the United States. The Japanese economy continued on a moderate recovery track, although delays in improvement have become apparent in some sectors. Moreover, it was a volatile year in foreign exchange markets. The household and personal care products market in Japan, a key market for the Kao Group, grew by 2% on a value basis and consumer purchase prices remained nearly flat compared with the previous fiscal year. The cosmetics market in Japan grew by 1%, excluding inbound demand (demand from visitors to Japan).

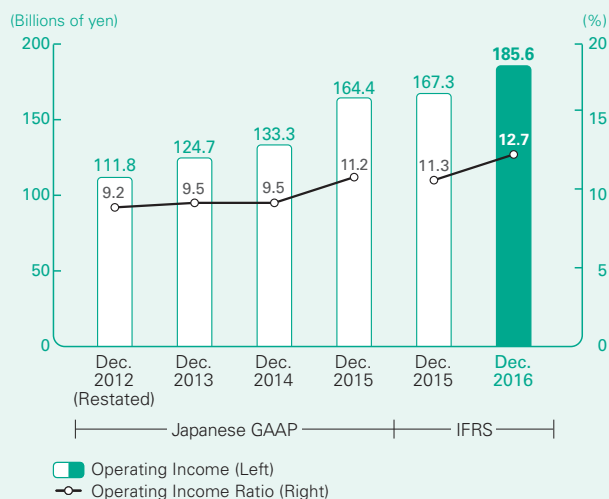
Under these circumstances, the Kao Group worked to launch and nurture products with high added value in response to

Net Sales / Gross Profit Ratio*



* The gross profit ratio has not been disclosed for the year ended December 31, 2012 (Restated)

Operating Income / Operating Income Ratio



Costs, Expenses and Income as Percentages of Net Sales

Years ended December 31, 2016, 2015 and 2014	IFRS		Japanese GAAP	
	December 2016	December 2015	December 2015	December 2014
Cost of sales.....	43.7%	44.7%	44.7%	45.1%
Gross profit.....	56.3	55.3	55.3	54.9
Selling, general and administrative expenses.....	43.5	43.6	44.1	45.4
Operating income.....	12.7	11.3	11.2	9.5
Income before income taxes and minority interests.....	—	—	11.0	9.0
Income before income taxes.....	12.6	11.3	—	—
Net income.....	—	—	6.7	5.7
Net income attributable to owners of the parent.....	8.7	7.1	—	—

changes in consumer needs based on its concept of “*Yoki-Monozukuri*,”* which emphasizes research and development geared to customers and consumers. The Kao Group also conducted cost reduction activities and other measures.

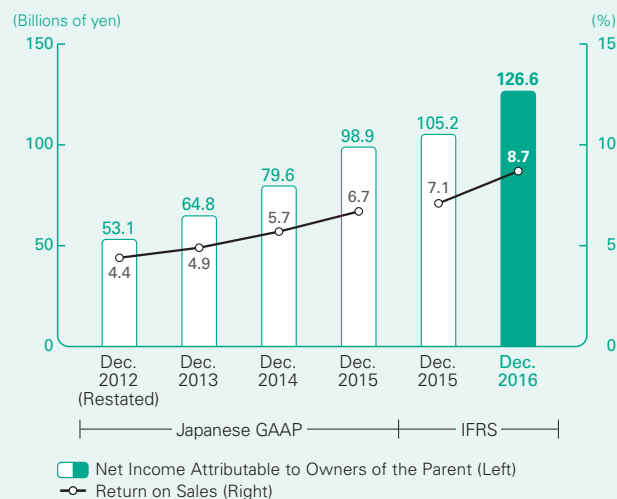
* The Kao Group defines *Yoki-Monozukuri* as a strong commitment by all members to provide products and brands of excellent value for consumer satisfaction. In Japanese, *Yoki* literally means “good/excellent,” and *Monozukuri* means “development/manufacturing of products.”

To improve capital efficiency and increase shareholder returns, Kao Corporation resolved at a meeting of its Board of Directors held on August 25, 2016 to repurchase its own shares, and repurchased shares totaling ¥50.0 billion.

Analysis of Income Statement

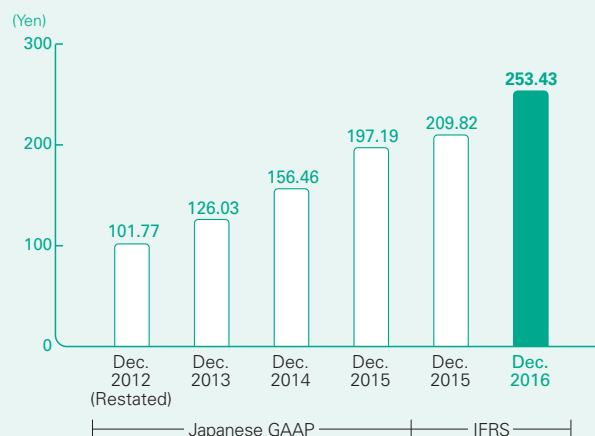
Net sales decreased 1.1% compared with the previous fiscal year to ¥1,457.6 billion. Excluding the effect of currency translation, net sales would have increased 3.2%. In the Consumer Products Business, sales increased in Japan due to factors including market growth, launches of new and improved products, and further enhancement of sales promotion activities. Outside Japan, sales in Asia increased, excluding the effect of currency translation. In the Chemical Business, sales increased compared with the previous fiscal year, excluding the effect of currency translation, as the Kao

Net Income Attributable to Owners of the Parent* / Return on Sales



* Net income attributable to owners of the parent was reported as net income under Japanese GAAP for the years ended December 31, 2012 (restated) to 2015.

Basic Earnings per Share



Group worked to adjust selling prices in response to rising costs for natural fats and oils, although sales were impacted by a decline in demand in some customer industries.

Net sales outside Japan were 33.8% of net sales compared with 35.2% for the previous year. Excluding the effect of currency translation, net sales outside Japan would have been 36.6% of net sales.

As for profits, due to the effect of increased sales in the Consumer Products Business in Japan and Asia, a decrease in the cost of petrochemical raw materials and other factors, operating income was ¥185.6 billion, an increase of ¥18.3 billion compared with the previous fiscal year, the operating margin was 12.7% and income before income taxes was ¥183.4 billion, an increase of ¥17.4 billion. Net income was ¥127.9 billion, an increase of ¥21.9 billion.

Basic earnings per share were ¥253.43, an increase of ¥43.61, or 20.8%, from ¥209.82 in the previous fiscal year.

Information by Segment

Consumer Products Business

Sales decreased 0.5% compared with the previous fiscal year to ¥1,219.8 billion. Excluding the effect of currency translation, sales would have increased 3.0%.

In Japan, sales increased 2.1% to ¥943.0 billion. The Kao Group made efforts that included working to respond to the changing lifestyles and diversifying preferences of consumers, and social issues such as the environment, health, the aging society and hygiene, by launching numerous high-value-added products and enhancing proposal-oriented sales activities.

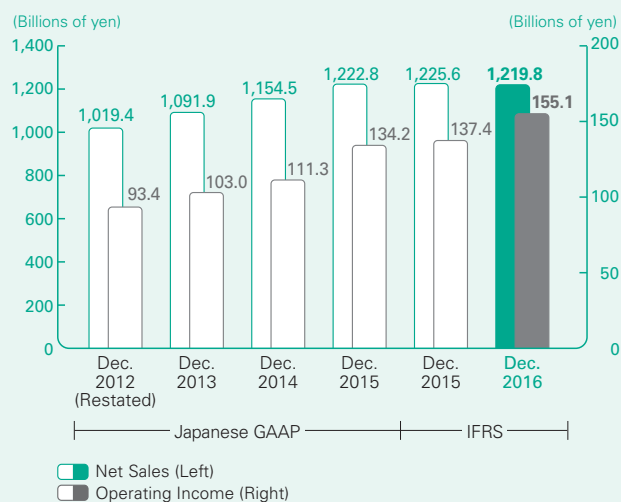
In Asia, sales decreased 1.1% to ¥180.8 billion. Excluding the effect of currency translation, sales would have increased 13.0%. Growth continued as the Kao Group worked in areas such as launching and nurturing products targeting the middle-class consumer segment, collaborating with retailers, utilizing wholesale channels and expanding sales regions.

In the Americas, sales decreased 10.7% to ¥80.1 billion. Excluding the effect of currency translation, sales would have decreased 0.5%. Although sales of skin care products and professional hair care products grew, sales of hair care products decreased compared with the previous fiscal year.

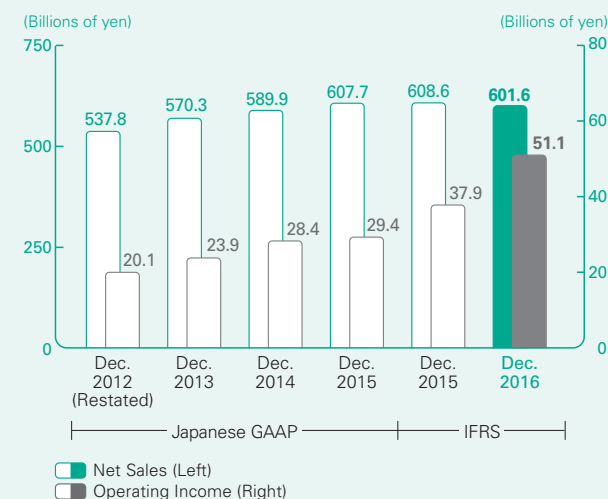
In Europe, sales decreased 13.1% to ¥78.1 billion. Excluding the effect of currency translation, sales would have decreased 0.8%. Although sales of professional hair care products were nearly flat, sales of hair care products decreased compared with the previous fiscal year.

Operating income increased ¥17.7 billion compared with the previous fiscal year to ¥155.1 billion due to factors

Consumer Products Business Net Sales / Operating Income



Beauty Care Business Net Sales / Operating Income



including the effect of increased sales in the Fabric and Home Care Business in Japan, increased sales in Asia, a decrease in the cost of raw materials and the completion of amortization of trademarks.

Note: The Kao Group's Consumer Products Business consists of the Beauty Care Business, the Human Health Care Business, and the Fabric and Home Care Business.

Beauty Care Business

Sales decreased 1.1% compared with the previous fiscal year to ¥601.6 billion. Excluding the effect of currency translation, sales would have increased 2.9%.

Sales of cosmetics were on a par with the previous fiscal year at ¥255.0 billion. Excluding the effect of currency translation, sales would have increased 2.8%. In Japan, sales increased due to factors including good performance by new products launched in 2015 and enhanced in-store sales promotion activities. Major reforms in the cosmetics business started in September 2016 and sales of the *SOFINA iP* series, for which sales channels have expanded, and of the new global brand *KANEBO* were steady. In counseling cosmetics, the *ALBLANC* skin brightening brand and the *RMK* brand performed strongly, and in self-selection cosmetics, sales of *KATE* and *media* makeup grew. Sales increased outside Japan, due in part to strong performance in China and Taiwan.

Sales of skin care products increased. In Japan, sales

increased due to growth in sales of *Bioré* facial cleanser and UV care as well as *Curél* derma care products. Sales also grew in Asia and in the Americas as *Bioré* sold strongly.

Sales of hair care products decreased. In Japan, the Kao Group conducted a complete renewal of *Essential* shampoos and conditioners and other measures, but sales were flat due to intensifying competition. The Kao Group also launched new easy-to-use, environmentally conscious refill products, which gained the support of consumers. Outside Japan, sales decreased as severe conditions continued.

Operating income increased ¥13.2 billion compared with the previous fiscal year to ¥51.1 billion, due to the effect of increased sales in Japan, the completion of amortization of trademarks related to Kanebo Cosmetics, and an impairment loss and other items recorded in the previous fiscal year.

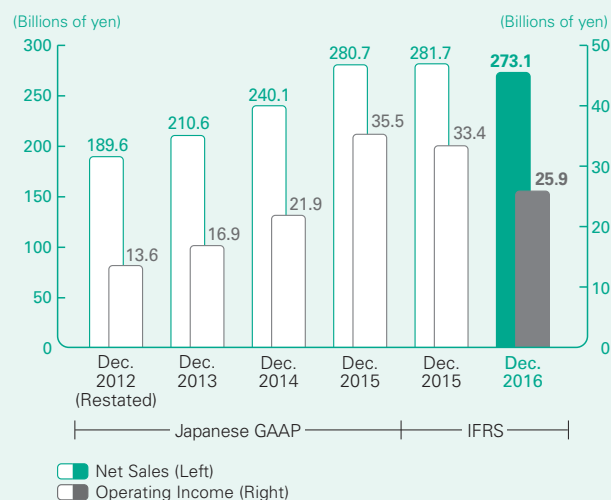
Human Health Care Business

Sales decreased 3.1% compared with the previous fiscal year to ¥273.1 billion. Excluding the effect of currency translation, sales would have increased 1.3%.

For food and beverage products, signs of recovery became apparent as the Kao Group strengthened its promotion of the function of highly concentrated tea catechins in *Healthya Green Tea*, a functional drink that enhances the body's ability to metabolize fat and facilitates reduction of body fat, and worked to cultivate new users.

Sales of sanitary products increased. Sales of the *Laurier* brand of sanitary napkins grew steadily. In Japan, a high-value-added scented version of *Laurier Slim Guard*, which offers both high absorbency and comfort, was launched and sales increased. In Asia, sales of high-value-added products increased strongly. Sales of *Merries* baby diapers were nearly flat excluding the effect of currency translation. In Japan, amid a decline in demand for purchasing with the purpose of resale in China compared with the previous fiscal year, the Kao Group began full-scale efforts for cross-border e-commerce for the Chinese market, but sales decreased. In addition, the Kao Group has mostly resolved prolonged shortages in stores, and resumed marketing activities. Market share is recovering, supported by the June 2016 launch of an improved product with even better breathability, among other factors. In China, where market growth continues, sales increased even as the Kao Group conducted a transformation of its sales structure.

Human Health Care Business Net Sales / Operating Income



In Indonesia, sales of locally produced *Merries* targeting the middle-class consumer segment were favorable.

Sales of personal health products increased. Sales of oral care products increased with good performance by *Pure Oral* toothpaste and mouthwash. Sales of bath additives increased. Although sales of *MegRhythm* steam thermo sheets decreased due to a decline in inbound demand, the product is on a recovery trend as a result of factors including enhanced in-store sales promotion activities and advertising.

Operating income decreased ¥7.4 billion compared with the previous fiscal year to ¥25.9 billion due to factors including the effect of aggressive marketing expenditures, an increase in depreciation, the effect of exchange rate fluctuations and a decrease in inbound demand.

Fabric and Home Care Business

Sales increased 2.9% compared with the previous fiscal year to ¥345.2 billion. Excluding the effect of currency translation, sales would have increased 4.7%.

Sales of fabric care products increased compared with the previous fiscal year. In Japan's fiercely competitive market environment, both sales and market share increased from responding to the larger-sized products category and the contribution of new and improved products. Sales of laundry detergents increased, centered on ultra-concentrated liquid laundry detergent *Ultra Attack Neo* and the rest of the *Neo* series, as well as conventional-type *Attack Antibacterial EX Super Clear Gel*. For fabric softeners, as the market for high-value-added products expanded, the Kao Group launched a new *Flair Fragrance* product that features a new fragrance release function, and *Flair Fragrance IROKA*, a premium fabric softener, and sales increased. *Humming Fine*, which has a strong deodorizing effect, sold strongly. Sales also increased in Asia compared with the previous fiscal year. In particular, sales were strong for *Attack Jaz1*, a powder detergent for hand washing targeting the middle-class consumer segment in Indonesia.

Sales of home care products increased. In Japan, for *CuCute* dishwashing detergent, the Kao Group launched *CuCute CLEAR Foam Spray*, a new foam spray type product. In response to the conventional notion that a sponge is used

with dishwashing detergent, the product created a new market with the entirely new concept of "spraying away residue from places a sponge can't reach." Sales of *Magiclean* household cleaners for the bath, toilet, kitchen and other areas grew with value-added offerings such as deodorizing, disinfecting and anti-staining. In addition, sales of *Resesh* clothing, fabric and air refresher and *Quickle* household cleaning mop kit grew steadily. Sales grew in Asia as *Magiclean*, a high-value-added household cleaner that responds to lifestyles in each country for use in various daily life settings, performed strongly in Thailand and elsewhere.

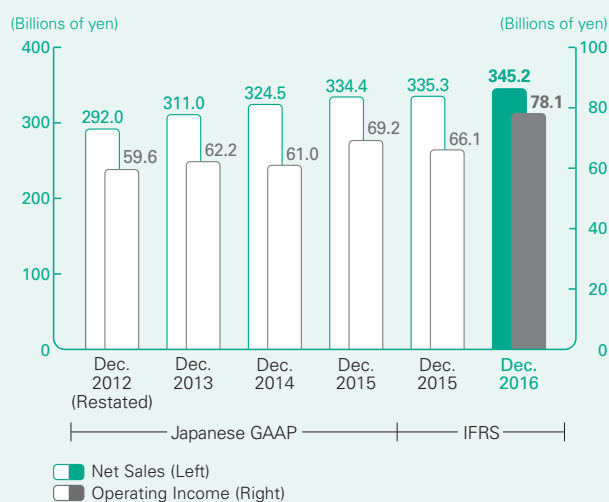
Operating income increased ¥12.0 billion compared with the previous fiscal year to ¥78.1 billion due to factors including the effect of increased sales and a decrease in the cost of raw materials.

Chemical Business

Sales decreased 5.1% compared with the previous fiscal year to ¥273.8 billion. Excluding the effect of currency translation, sales would have increased 2.5%.

In Japan, sales were impacted by a trend toward a decrease in demand in some customer industry markets, including construction materials. Outside Japan, excluding the effect of currency translation, sales increased despite the negative effects from the decrease in demand among customer

Fabric and Home Care Business
Net Sales / Operating Income



industries, as the Kao Group worked to expand sales and adjust the selling prices of oleo chemicals.

Sales of oleo chemicals continued to increase as the Kao Group worked to adjust selling prices in line with the continuing rise of raw material prices. In performance chemicals, the Kao Group worked to develop and expand sales of high-value-added products with a reduced environmental footprint, but was impacted by worsening conditions in the construction materials and other markets. Sales of specialty chemicals decreased due to ongoing sluggish demand and structural changes in the personal computer market.

Operating income increased ¥1.1 billion compared with the previous fiscal year to ¥29.7 billion as the Kao Group promoted high-value-added products, worked to adjust selling prices and conducted other measures in response to rising costs for natural fats and oils in a severe business environment.

In June 2016, the Kao Group announced the acquisition of ink companies in the United States and Europe to accelerate the development of its water-based pigment inkjet ink, which contributes to reducing environmental footprint, and the global rollout of the business. The company in the United States became a consolidated subsidiary in July 2016.

Financial Structure

Total assets increased ¥27.2 billion from December 31, 2015 to ¥1,338.3 billion. The principal increases in assets were a ¥13.9 billion increase in inventories and a ¥32.8 billion increase in property, plant and equipment. The principal decreases in assets were a ¥6.9 billion decrease in cash and cash equivalents and a ¥14.2 billion decrease in other current assets.

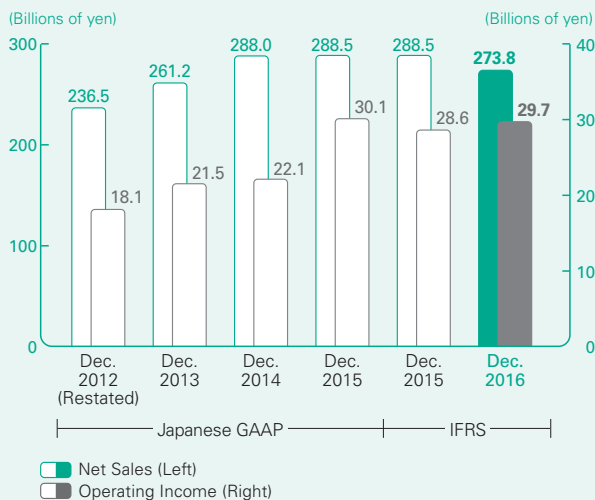
Total liabilities increased ¥27.8 billion from December 31, 2015 to ¥646.8 billion. The principal increases in liabilities were a ¥10.1 billion increase in trade and other payables, a ¥5.7 billion increase in other current liabilities and a ¥19.1 billion increase in retirement benefit liabilities. The principal decrease in liabilities was a ¥9.3 billion decrease in provisions.

Total equity decreased ¥0.5 billion from December 31, 2015 to ¥691.5 billion. The principal increase in equity was net income totaling ¥127.9 billion. The principal decreases in equity were ¥50.0 billion due to purchase of treasury shares from the market, exchange differences on translation of foreign operations of ¥16.2 billion, remeasurements of defined benefit plans totaling ¥16.1 billion and dividends totaling ¥45.1 billion.

As a result of the above factors, the ratio of equity attributable to owners of the parent to total assets was 50.8% compared with 51.9% at December 31, 2015.

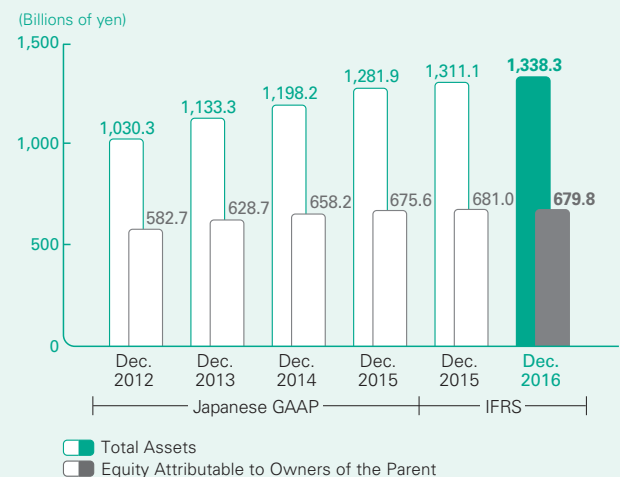
Chemical Business

Net Sales / Operating Income



Note: Net sales include intersegment sales.

Total Assets / Equity Attributable to Owners of the Parent*



* Equity attributable to owners of the parent is presented as net worth under Japanese GAAP as of December 31, 2012 to 2015. Net worth is equity, excluding minority interests and stock acquisition rights.

Cash Flows

The balance of cash and cash equivalents at December 31, 2016 decreased ¥6.9 billion compared with December 31, 2015 to ¥303.0 billion, including the effect of exchange rate changes.

Cash Flows from Operating Activities

Net cash flows from operating activities totaled ¥184.3 billion. The principal increases in net cash were income before income taxes of ¥183.4 billion, depreciation and amortization of ¥51.1 billion and increase in retirement benefit liabilities of ¥20.0 billion. The principal decreases in net cash were increase in inventories of ¥17.4 billion, other, which includes accrued expenses, of ¥7.2 billion and income taxes paid of ¥48.7 billion.

Cash Flows from Investing Activities

Net cash flows from investing activities totaled negative ¥88.6 billion. This primarily consisted of payments into time deposits of ¥11.6 billion, purchase of property, plant and equipment of ¥74.6 billion and purchase of intangible assets of ¥5.1 billion.

Free cash flow, the sum of net cash flows from operating activities and net cash flows from investing activities, was ¥95.7 billion.

Cash Flows from Financing Activities

Net cash flows from financing activities totaled negative ¥95.0 billion. This primarily consisted of ¥50.0 billion for purchase of treasury shares and ¥45.1 billion for dividends paid to owners of the parent and non-controlling interests.

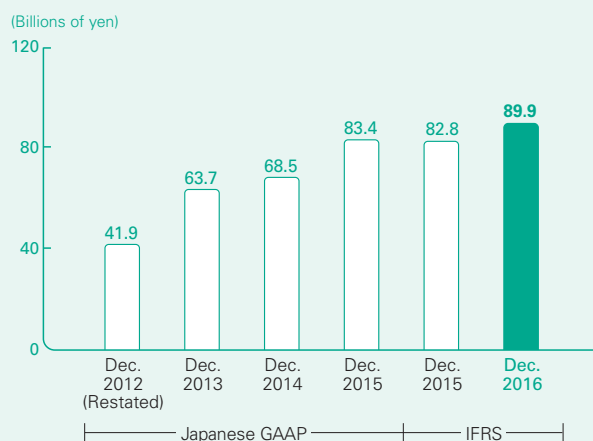
Basic Policies Regarding Distribution of Profits and Dividends for the Period

In order to achieve profitable growth, Kao Corporation (the Company) secures an internal reserve for capital investment and acquisitions from a medium-to-long-term management perspective and places priority on providing shareholders with steady and continuous dividends. In addition, the Company flexibly considers share repurchase and retirement of treasury shares from the standpoint of improving capital efficiency.

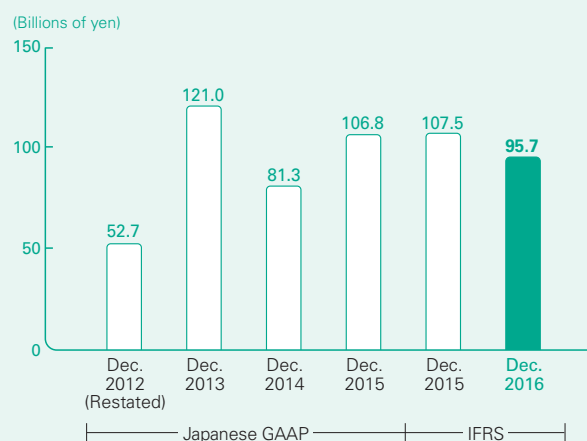
In accordance with these policies, the Company announced a year-end dividend for fiscal 2016 of ¥48.00 per share, an increase of ¥6.00 per share compared with the previous fiscal year. Consequently, cash dividends for the fiscal year increased ¥14.00 per share compared with the previous fiscal year, resulting in a total of ¥94.00 per share. The consolidated payout ratio was 37.1%.

For fiscal 2017, the Company plans to pay total cash dividends

Capital Expenditures



Free Cash Flows*



* Free cash flow is the sum of net cash flows from operating activities and net cash flows from investing activities.

of ¥108.00 yen share, an increase of ¥14.00 per share compared with the previous fiscal year. Although the operating environment is challenging, this plan is in accordance with the Company's basic policies regarding distribution of profits, and free cash flow and other factors have also been taken into consideration. As a result, the Company is aiming for its 28th consecutive fiscal year of increases in dividends.

EVA and Related Activities

In conjunction with the introduction of IFRS from the fiscal year ended December 31, 2016, the Kao Group has begun disclosing the monetary amount of EVA, its principal management metric. For the fiscal year ended December 31, 2016, EVA was ¥73.4 billion, an increase of ¥14.8 billion from the previous fiscal year due to an increase in NOPAT. The Kao Group conducted the following EVA-related activities during the fiscal year.

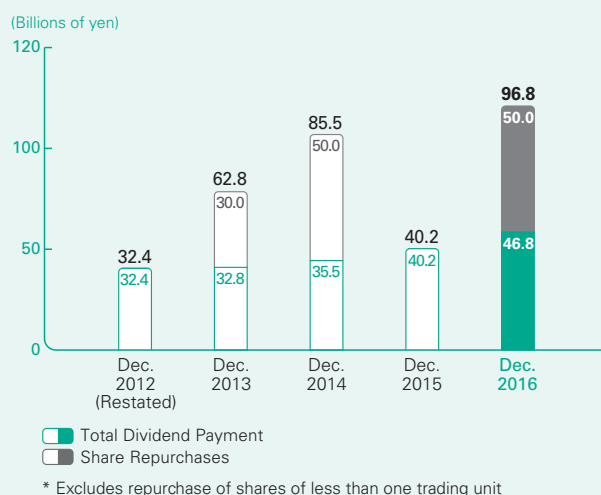
Investing for Growth: During the fiscal year ended December 31, 2016, the Kao Group invested aggressively for future growth. Capital expenditures were at a high level of ¥89.9 billion. The main item was expansion of manufacturing facilities for sanitary products and fabric and home care products in Japan,

and for consumer products in Indonesia. The Kao Group also opened a new research facility in Japan, the Beauty Research & Innovation Center, as one of the major reforms of its cosmetics business. Research and development expenditures were ¥54.6 billion, which was the equivalent of 3.7% of net sales, remaining at a high level relative to net sales.

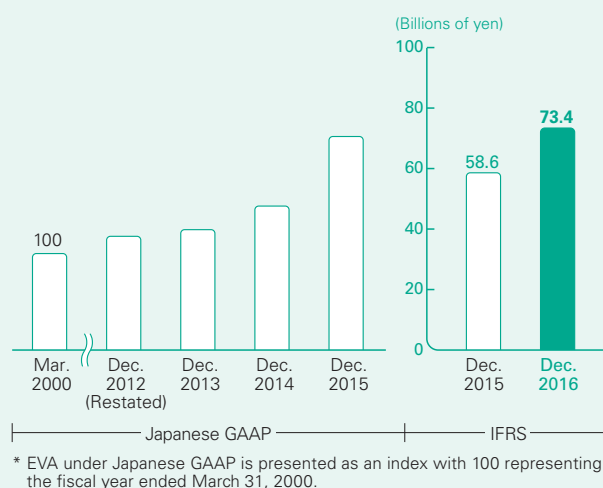
Increasing Profit: During the fiscal year ended December 31, 2016, the Kao Group invested in proactive research and development, marketing activities and major reforms of the cosmetics business. As a result, sales of the Consumer Products Business increased in Japan and continued to grow by double digits in the rest of Asia, excluding the effect of currency translation. Moreover, the Kao Group also benefitted from a decline in petrochemical raw material prices in addition to its cost reduction activities, which covered the increase in expenses and significantly improved NOPAT.

Financial Improvement: In addition to achieving its 27th consecutive fiscal period of dividend growth with cash dividends of ¥94.00 per share, a 17.5% year-on-year increase that exceeded its initial forecast, Kao Corporation repurchased ¥50.0 billion of its own shares.

Total Dividend Payment / Share Repurchases*



EVA*



Business Risks and Other Risks

Various risks arise in the course of a company's business. The Kao Group manages risks appropriately by identifying and evaluating risks to formulate and implement necessary countermeasures, among other activities. In addition, in the event a risk manifests itself, the Kao Group sets up an emergency response organization and strives to minimize damage and loss by responding promptly. However, in the event a major risk such as those described below manifests itself, it may exert a significant impact on the Kao Group's business results and financial condition. The major risks described below are not a comprehensive list of risks the Kao Group faces. Other risks exist and may have an impact on investment decisions. Any statements below concerning the future are judgments made by Kao Corporation as of the submission of its securities report to the Ministry of Finance on March 21, 2017.

(1) Consumer Products Business

1. Response to Changes in Consumer Needs

The Kao Group's Consumer Products Business is affected by business cycles and changes in consumers' values in the market of each country. The Consumer Products Business maintains and improves brand value by understanding changes in consumer needs and using the comprehensive strength of the Kao Group's product development and manufacturing in working to create high-value-added products and provide services through approaches in areas including the environment, health, the aging society and hygiene. However, as a consequence of uncertainties in these business activities due to various factors, the Consumer Products Business may be unable to provide products and services that respond to changes in consumer needs and brand value could decrease. This could have an impact on the Kao Group's business results and financial condition.

2. Response to Changes in Retailing

The Kao Group's Consumer Products Business is affected by changes in the structure of retailing, including progress in the creation of new corporate groups through retail industry mergers and integration in the market, and the emergence

and expansion of new retail channels. The Consumer Products Business conducts sales activities and makes new offerings that respond to these structural changes. However, as a consequence of uncertainties in these business activities due to various factors, the Consumer Products Business may be unable to conduct sales activities or make new offerings that respond to these structural changes. This could have an impact on the Kao Group's business results and financial condition.

(2) Chemical Business

The Kao Group's Chemical Business is affected by factors including trends in customer demand and fluctuations in raw material prices. The Chemical Business promotes creation of high-value-added products that match customer needs, conducts research and development of products in consideration of the environment, and provides such products while working to reduce costs and deal with product prices. However, as a consequence of uncertainties in these business activities due to various factors, the Chemical Business may be unable to provide products that match customer needs or respond to matters such as fluctuations in raw material prices. This could have an impact on the Kao Group's business results and financial condition.

(3) Business Acquisitions, Business Alliances and Mergers

The Kao Group may implement business acquisitions, business alliances, mergers or other such measures. When implementing them, the Kao Group makes decisions after thoroughly assessing economic value and its partner companies. However, due to various unforeseeable uncertainties in its business activities, the Kao Group may be unable to produce the results it initially expected. This could have an impact on the Kao Group's business results and financial condition.

(4) Overseas Business Expansion

As one of its growth strategies, the Kao Group is conducting operations in markets in Asia, the Americas, Europe and elsewhere, with a particular emphasis on strengthening its operations in countries where higher economic growth rates and market expansion are forecast. However, the Kao Group may be unable to strengthen its operations as a consequence

of uncertainties due to various factors in the course of business including the occurrence of a slowdown in economic growth or uncertain political or social conditions, intensifying competition, the inability to conduct sufficient cost management or the emergence of problems in relationships with retail outlets, sales agents or other trading partners. This could have an impact on the Kao Group's business results and financial condition.

(5) Procurement of Raw Materials

Market prices for natural fats and oils and petroleum-related materials used as raw materials for products of the Kao Group are affected by factors including geopolitical risks, the balance between supply and demand, abnormal weather and exchange rate fluctuations. The Kao Group has moved to reduce the effect of increases in raw material prices through measures including cost reductions and passing on increases in raw material costs into product prices. In addition, the Kao Group is conducting development of substitute raw materials for natural fats and oils through research into advanced effective utilization of non-edible raw materials. However, unexpected radical changes in market conditions and pricing could have an impact on the Kao Group's business results and financial condition.

(6) Product Quality

The Kao Group designs and manufactures products from the viewpoint of consumers, in compliance with related laws and regulations and voluntary standards. In the development stage prior to market launch, the Kao Group conducts thorough safety testing and survey research to confirm the safety of products. After market launch, the Kao Group works to further improve quality by incorporating the opinions and desires of consumers through its consumer communication centers. However, the unanticipated occurrence of a serious quality problem or concerns about product safety or reliability resulting from new scientific knowledge would not only cause difficulties for the relevant brand, but would also have a major impact on the reputation of all of the Kao Group's products. This could have an impact on the Kao Group's business results and financial condition.

(7) Response to Natural Disasters, Accidents and Other Incidents

To deal with earthquakes and other natural disasters, the Kao Group has formulated disaster countermeasures for its production facilities and primary offices and a business continuity plan (BCP), and will continue to strengthen and reinforce them in the future. However, the occurrence and consequent damage of an earthquake on a scale exceeding assumptions that hinder the supply of products to the market due to problems in areas such as securing raw materials and maintaining production, among other impediments, could have a serious impact on the Kao Group's business results and financial condition. In addition, the emergence of major changes in demand trends due to a worsening economic environment associated with the earthquake could have a serious impact on the Kao Group's business results and financial condition. Furthermore, the occurrence of an explosion or fire at production facilities, information system malfunction, problems at a supplier of raw materials, dysfunction of social infrastructures such as electric power and water, environmental pollution from harmful substances, the spread of infectious disease, terrorism, political change, riots and other incidents could hinder the supply of products to the market. This could have a serious impact on the Kao Group's reputation, business results and financial condition.

(8) Currency Exchange Rate Fluctuations

Foreign currency-denominated transactions are affected by changes in currency exchange rates. The Kao Group hedges foreign exchange risk through various measures such as settlement of transactions through foreign currency accounts, foreign exchange contracts, and currency swaps to mitigate the effect on business results. The Kao Group does not engage in derivative transactions for the purpose of speculation. However, because items on the financial statements of overseas consolidated subsidiaries are translated into Japanese yen, substantial variance in the exchange rate from the expected rate at the time of conversion will have an impact on the Kao Group's business results and financial condition.

(9) Impact of Deferred Tax Assets and Impairment

The Kao Group records various tangible fixed assets and intangible assets and deferred tax assets including assets used in the course of business and goodwill incurred in corporate acquisitions. The Kao Group may not generate the expected cash flow due to divergence from planned future business results, a decline in market value or other factors. This could have an impact on the Kao Group's business results and financial condition.

(10) Securing Human Capital

The Kao Group strives to secure diverse, superior human capital to achieve its business goals globally. Human capital with advanced expertise in areas such as research and development, production technologies, marketing and sales activities are indispensable in aiming for the *Yoki-Monozukuri* (see note on page 4) that consumers support. However, an inability to secure the necessary human capital due to changes in employment conditions or other factors could have an impact on the Kao Group's business results and financial condition.

(11) Compliance with Laws and Regulations

In the course of its business activities, the Kao Group must comply with a variety of laws and regulations concerning areas such as standards for product quality and safety, the environment and chemical substances, as well as accounting standards, tax law and regulations related to labor and transactions. The Kao Group has constructed a compliance system and strives to comply with all related laws and regulations. However, a serious legal violation by the Kao Group or by a consignee or other party could have an impact on the Kao Group's reputation, business results and financial condition. Moreover, a change in current laws and regulations, or new laws and regulations could restrict the Kao Group's business activities, require investment for compliance, or otherwise affect the Kao Group. This could have an impact on the Kao Group's business results and financial condition.

(12) Information Management

The Kao Group possesses confidential information related to matters including research and development, production, marketing and sales, as well as the personal information of numerous customers used for product development, sales promotion and other purposes. The Kao Group conducts thorough information management using guidelines for handling information and implements appropriate security measures for its information systems, including both hardware and software. However, a leak of confidential or personal information held by the Kao Group resulting from an attack on its server, unlawful access, a computer virus or other factor that exceeds expectations could have an impact on the Kao Group's reputation, business results and financial condition.

(13) Litigation

The Kao Group conducts diverse businesses globally, and various types of litigation may be brought against it. The result of such litigation could have an impact on the Kao Group's business results and financial condition.

Consolidated Statement of Financial Position

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2016 and 2015, and at the transition date

		(Millions of yen)		
Assets	Notes	2016	2015	Transition date
Current assets				
Cash and cash equivalents	8,34	303,026	309,922	228,967
Trade and other receivables	9,34	208,459	210,707	212,742
Inventories	10	165,200	151,271	151,876
Income tax receivables		1,462	2,077	1,261
Other financial assets	34	13,038	5,065	4,034
Other current assets	11	23,812	38,005	47,299
Subtotal		714,997	717,047	646,179
Non-current assets held for sale	12	344	1,330	—
Total current assets		715,341	718,377	646,179
Non-current assets				
Property, plant and equipment	13	370,835	337,997	319,282
Goodwill	14	137,783	138,251	138,751
Intangible assets	14	14,689	15,705	23,626
Investments accounted for using the equity method	15	4,701	4,209	3,544
Other financial assets	34	25,473	29,339	26,088
Other non-current assets	11,20	18,548	17,732	7,966
Deferred tax assets	16	50,939	49,454	61,194
Total non-current assets		622,968	592,687	580,451
Total assets		1,338,309	1,311,064	1,226,630
Liabilities and equity				
Liabilities	Notes	2016	2015	Transition date
Current liabilities				
Trade and other payables	19,34	216,893	206,760	193,460
Bonds and borrowings	17,34	30,289	339	21,422
Income tax payables		32,621	32,184	28,283
Other financial liabilities	18,34	8,164	6,929	5,765
Provisions	21	11,370	16,772	33,360
Other current liabilities	22	131,112	125,422	123,916
Total current liabilities		430,449	388,406	406,206
Non-current liabilities				
Bonds and borrowings	17,34	90,357	120,207	80,188
Retirement benefit liabilities	20	94,773	75,706	77,895
Other financial liabilities	18,34	11,666	11,817	12,813
Provisions	21	13,809	17,704	5,296
Other non-current liabilities		5,264	4,919	5,411
Deferred tax liabilities	16	528	318	433
Total non-current liabilities		216,397	230,671	182,036
Total liabilities		646,846	619,077	588,242
Equity				
Share capital	23	85,424	85,424	85,424
Capital surplus	23	107,648	108,659	109,561
Treasury shares	23	(57,124)	(8,202)	(9,719)
Other components of equity	23	(21,821)	(4,184)	7,601
Retained earnings	23	565,715	499,299	431,975
Equity attributable to owners of the parent		679,842	680,996	624,842
Non-controlling interests		11,621	10,991	13,546
Total equity		691,463	691,987	638,388
Total liabilities and equity		1,338,309	1,311,064	1,226,630

Consolidated Statement of Income

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2016 and 2015

	Notes	2016	2015
(Millions of yen)			
Net sales	6,26	1,457,610	1,474,550
Cost of sales	10,13,14,20	(637,502)	(658,865)
Gross profit		820,108	815,685
Selling, general and administrative expenses	13,14,20,27	(633,368)	(642,729)
Other operating income	13,28	13,677	14,099
Other operating expenses	12,13,14,20,29	(14,846)	(19,737)
Operating income	6	185,571	167,318
Financial income	6,20,30	1,389	1,416
Financial expenses	6,20,30	(5,424)	(4,213)
Share of profit in investments accounted for using the equity method	6,15	1,894	1,517
Income before income taxes	6	183,430	166,038
Income taxes	16	(55,541)	(60,086)
Net income		127,889	105,952
Attributable to:			
Owners of the parent		126,551	105,196
Non-controlling interests		1,338	756
Net income		127,889	105,952
Earnings per share			
Basic (Yen)	31	253.43	209.82
Diluted (Yen)	31	253.18	209.53

Consolidated Statement of Comprehensive Income

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2016 and 2015

		(Millions of yen)	
	Notes	2016	2015
Net income		127,889	105,952
Other comprehensive income			
Items that will not be reclassified to profit or loss:			
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	32,34	(906)	1,795
Remeasurements of defined benefit plans	32	(16,111)	(770)
Share of other comprehensive income of investments accounted for using the equity method	32	(72)	245
Total of items that will not be reclassified to profit or loss.....		(17,089)	1,270
Items that may be reclassified subsequently to profit or loss:			
Exchange differences on translation of foreign operations.....	32	(16,661)	(15,064)
Net gain (loss) on derivatives designated as cash flow hedges	32	—	12
Share of other comprehensive income of investments accounted for using the equity method	32	(10)	(19)
Total of items that may be reclassified subsequently to profit or loss		(16,671)	(15,071)
Other comprehensive income, net of taxes		(33,760)	(13,801)
Comprehensive income		94,129	92,151
Attributable to:			
Owners of the parent.....		93,284	93,011
Non-controlling interests.....		845	(860)
Comprehensive income		94,129	92,151

Consolidated Statement of Changes in Equity

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2016 and 2015

(Millions of yen)

	Notes	Equity attributable to owners of the parent											Non-controlling interests	Total equity	
		Other components of equity									Total	Retained earnings			Total
		Share capital	Capital surplus	Treasury shares	Subscription rights to shares	Exchange differences on translation of foreign operations	Net gain (loss) on derivatives designated as cash flow hedges	Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	Remeasurements of defined benefit plans	Total					
January 1, 2016		85,424	108,659	(8,202)	902	(13,513)	(3)	8,430	—	(4,184)	499,299	680,996	10,991	691,987	
Net income.....		—	—	—	—	—	—	—	—	—	126,551	126,551	1,338	127,889	
Other comprehensive income.....		—	—	—	—	(16,248)	7	(970)	(16,056)	(33,267)	—	(33,267)	(493)	(33,760)	
Comprehensive income.....		—	—	—	—	(16,248)	7	(970)	(16,056)	(33,267)	126,551	93,284	845	94,129	
Disposal of treasury shares.....	23	—	—	1,099	(189)	—	—	—	—	(189)	(404)	506	—	506	
Purchase of treasury shares.....	23	—	—	(50,021)	—	—	—	—	—	—	—	(50,021)	—	(50,021)	
Share-based payment transactions.....	33	—	—	—	227	—	—	—	—	227	—	227	—	227	
Dividends.....	25	—	—	—	—	—	—	—	—	—	(44,139)	(44,139)	(955)	(45,094)	
Changes in the ownership interest in subsidiaries.....		—	(1,011)	—	—	—	—	—	—	—	—	(1,011)	1,007	(4)	
Transfer from other components of equity to retained earnings ...		—	—	—	(29)	—	—	(435)	16,056	15,592	(15,592)	—	—	—	
Other increase (decrease).....		—	—	—	—	—	—	—	—	—	—	—	(267)	(267)	
Total transactions with the owners.....		—	(1,011)	(48,922)	9	—	—	(435)	16,056	15,630	(60,135)	(94,438)	(215)	(94,653)	
December 31, 2016		85,424	107,648	(57,124)	911	(29,761)	4	7,025	—	(21,821)	565,715	679,842	11,621	691,463	
January 1, 2015		85,424	109,561	(9,719)	980	—	(4)	6,625	—	7,601	431,975	624,842	13,546	638,388	
Net income.....		—	—	—	—	—	—	—	—	—	105,196	105,196	756	105,952	
Other comprehensive income.....		—	—	—	—	(13,513)	1	2,041	(714)	(12,185)	—	(12,185)	(1,616)	(13,801)	
Comprehensive income.....		—	—	—	—	(13,513)	1	2,041	(714)	(12,185)	105,196	93,011	(860)	92,151	
Disposal of treasury shares.....	23	—	—	1,571	(231)	—	—	—	—	(231)	(375)	965	—	965	
Purchase of treasury shares.....	23	—	—	(54)	—	—	—	—	—	—	—	(54)	—	(54)	
Share-based payment transactions.....	33	—	—	—	225	—	—	—	—	225	—	225	—	225	
Dividends.....	25	—	—	—	—	—	—	—	—	—	(37,091)	(37,091)	(1,248)	(38,339)	
Changes in the ownership interest in a subsidiary.....		—	(902)	—	—	—	—	—	—	—	—	(902)	(334)	(1,236)	
Transfer from other components of equity to retained earnings ...		—	—	—	(72)	—	—	(236)	714	406	(406)	—	—	—	
Other increase (decrease).....		—	—	—	—	—	—	—	—	—	—	—	(113)	(113)	
Total transactions with the owners.....		—	(902)	1,517	(78)	—	—	(236)	714	400	(37,872)	(36,857)	(1,695)	(38,552)	
December 31, 2015		85,424	108,659	(8,202)	902	(13,513)	(3)	8,430	—	(4,184)	499,299	680,996	10,991	691,987	

Consolidated Statement of Cash Flows

Kao Corporation and Consolidated Subsidiaries
Years ended December 31, 2016 and 2015

		(Millions of yen)	
	Notes	2016	2015
Cash flows from operating activities			
Income before income taxes		183,430	166,038
Depreciation and amortization		51,116	57,423
Interest and dividend income.....		(1,247)	(1,266)
Interest expense		1,484	1,528
Share of profit in investments accounted for using the equity method.....		(1,894)	(1,517)
(Gains) losses on sale and disposal of property, plant and equipment, and intangible assets.....		3,466	3,497
(Increase) decrease in trade and other receivables		(4,049)	(4,882)
(Increase) decrease in inventories		(17,450)	(3,964)
Increase (decrease) in trade and other payables.....		4,388	9,707
Increase (decrease) in retirement benefit liabilities		19,967	(997)
Other.....		(7,175)	2,321
Subtotal		<u>232,036</u>	<u>227,888</u>
Interest received		1,003	1,004
Dividends received.....		1,479	1,315
Interest paid.....		(1,503)	(1,462)
Income taxes paid.....		<u>(48,708)</u>	<u>(47,073)</u>
Net cash flows from operating activities		<u>184,307</u>	<u>181,672</u>
Cash flows from investing activities			
Payments into time deposits		(11,570)	(2,669)
Proceeds from withdrawal of time deposits		3,703	1,355
Purchase of property, plant and equipment		(74,637)	(69,023)
Purchase of intangible assets		(5,060)	(5,598)
Acquisition of subsidiaries		(3,659)	—
Other.....		2,584	1,811
Net cash flows from investing activities		<u>(88,639)</u>	<u>(74,124)</u>
Cash flows from financing activities			
Increase (decrease) in short-term borrowings		(44)	(1,128)
Proceeds from long-term borrowings		200	40,080
Repayments of long-term borrowings		(317)	(20,068)
Purchase of treasury shares		(50,021)	(55)
Dividends paid to owners of the parent.....		(44,188)	(37,137)
Dividends paid to non-controlling interests.....		(955)	(1,248)
Other		282	(1,217)
Net cash flows from financing activities.....		<u>(95,043)</u>	<u>(20,773)</u>
Net increase (decrease) in cash and cash equivalents		625	86,775
Cash and cash equivalents at the beginning of the year	8	309,922	228,967
Effect of exchange rate changes on cash and cash equivalents.....		(7,521)	(5,820)
Cash and cash equivalents at the end of the year	8	<u>303,026</u>	<u>309,922</u>

Notes to Consolidated Financial Statements

Kao Corporation and Consolidated Subsidiaries
Fiscal year ended December 31, 2016

1 Reporting Entity

Kao Corporation (hereinafter the "Company") is a corporation established pursuant to the Companies Act of Japan (hereinafter the "Companies Act") with its headquarters in Chuo-ku, Tokyo.

The consolidated financial statements of the Company and its subsidiaries (hereinafter the "Group") have a closing date as of December 31 and comprise the financial statements of the Group and the interests in associates of the Company.

The Group manufactures consumer products including cosmetics, skin care products, hair care products, sanitary products, fabric care products, and chemical products including fatty alcohols and surfactants. The Group delivers its products to customers through its sales companies and distributors in Japan and other countries. Details of these principal business activities of the Group are presented in Note 6 "Segment Information."

2 Basis of Preparation

(1) Compliance with International Financial Reporting Standards (hereinafter "IFRS") and Matters Concerning Its First-time Adoption

The Group's consolidated financial statements have been prepared in accordance with IFRS issued by the International Accounting Standards Board, permitted by the provision of Article 93 of the Ordinance on Terminology, Forms, and Preparation Methods of Consolidated Financial Statements (Ordinance of the Ministry of Finance of Japan No. 28 of 1976), as they satisfy the requirements for an "IFRS Specified Company" in Article 1-2 of the same ordinance.

The Group adopted IFRS for the fiscal year ended December 31, 2016. The Group made the transition to IFRS on January 1, 2015 (hereinafter the "transition date"), and applied IFRS 1 "First-time Adoption of International Financial Reporting Standards" (hereinafter "IFRS 1"). Note 39 "First-time Adoption of IFRS" presents the effect of the transition to IFRS on amounts at the transition date and comparative information for financial position, operating results and cash flows for the fiscal year ended December 31, 2015.

The Group's accounting policies are in compliance with IFRS effective as of December 31, 2016, excluding the IFRS provisions

that have not been early adopted and the exemptions available in IFRS 1.

(2) Basis of Measurement

The Group's consolidated financial statements have been prepared on the historical cost basis, except for certain assets and liabilities including financial instruments measured at fair value as presented in Note 3 "Significant Accounting Policies."

(3) Functional Currency and Presentation Currency

The Group's consolidated financial statements are presented in Japanese yen, which is the Company's functional currency. All financial information presented in Japanese yen is rounded to the nearest million yen.

(4) Early Adoption of New or Revised Standards and Interpretations

The Group has early adopted IFRS 9 "Financial Instruments" (issued in November 2009, revised in July 2014) (hereinafter "IFRS 9") in preparing its consolidated financial statements.

3 Significant Accounting Policies

(1) Basis of Consolidation

1) Subsidiaries

Subsidiaries refer to all business entities controlled by the Company. The Company controls an entity when it has exposure, or rights, to variable returns from involvement with an investee and has the ability to affect those returns through its power over the investee.

The financial statements of subsidiaries are included in the consolidated financial statements of the Group from the date the Company gains control until the date it loses control of the subsidiary.

All intergroup balances, transactions, income and expenses and unrealized gains and losses arising from intergroup transactions are eliminated in preparing the consolidated financial statements.

A change in the Company's ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction. Any difference between the amount by

which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity attributable to the Group.

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. Comprehensive income of subsidiaries is attributed to owners of the parent company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

All subsidiaries have the same closing date as the Company.

2) Associates

An associate is defined as an entity over which the Company has significant influence on financial and operating policy decisions but does not have control over the entity. The Company is presumed to have significant influence over another entity when it directly or indirectly holds at least 20%, but no more than 50% of the voting rights of that entity. Entities over which the Company is able to exercise

significant influence on financial and operating policy decisions are also included in associates, even if it holds less than 20% of the voting rights.

Investments in associates are initially recognized at cost, and are accounted for by the equity method from the date the Company gains significant influence until the date it loses that influence.

Goodwill recognized on acquisition of associates (less any accumulated impairment losses) is included in investments in associates.

The closing dates of some associates differ from that of the Company. Associates with different closing dates prepare additional financial closing as of the closing date of the Company.

(2) Business Combinations

Business combinations are accounted for using the acquisition method. The consideration of an acquisition is measured as the aggregate of the acquisition-date fair value of the assets transferred, liabilities assumed and equity securities issued by the Company to the former owners of the acquiree in exchange for control of the acquiree.

Identifiable assets and liabilities of the acquiree in business combinations are measured at their acquisition-date fair value, with the following exceptions:

- Deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognized and measured in accordance with IAS 12 "Income Taxes" and IAS 19 "Employee Benefits", respectively.
- Non-current assets and disposal groups that are classified as held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" are measured in accordance with that Standard.
- Liabilities or equity instruments related to share-based payment transactions of the acquiree or share-based payment transactions of the Company entered into to replace such transactions of the acquiree are measured in accordance with IFRS 2 "Share-based Payment."

Any excess of the consideration over the net fair value of identifiable assets acquired and liabilities assumed at the acquisition date is recognized as goodwill in the consolidated statement of financial position. Conversely, any deficit is immediately recognized as income in the consolidated statement of income.

Costs associated with business combinations, such as advisory fees, attorney fees and due diligence costs, are expensed as incurred.

The additional acquisition of non-controlling interests is accounted for as an equity transaction, and therefore no goodwill is recognized with respect to such a transaction.

Business combinations under common control are business combinations in which all of the combining entities or combining businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. These business combinations are accounted for based on the carrying amounts.

(3) Foreign Currency Translation

1) Functional currency and presentation currency

The presentation currency used in the Group's consolidated financial statements is Japanese yen, which is the Company's functional currency. Subsidiaries and associates in the Group determine their own functional currencies and each entity's transactions are measured in its functional currency.

2) Foreign currency transactions

Foreign currency transactions are translated into the functional currency at the spot exchange rate at the date of the transaction, or an exchange rate that approximates the spot rate.

At the end of each reporting period, foreign currency monetary items are translated into the functional currency using the rates at the end of each reporting period.

Non-monetary items that are measured in terms of historical cost in foreign currencies are translated using the exchange rates at the date of acquisition. Non-monetary items that are measured at fair value in foreign currencies are translated into the functional currency using the exchange rates at the date when the fair value was measured. Exchange differences arising from such translations and settlements are recognized in profit or loss. However, exchange differences arising from equity instruments measured at fair value through other comprehensive income and cash flow hedges are recognized in other comprehensive income.

3) Financial statements of foreign operations

Assets and liabilities of foreign operations are translated at the rates at the end of each reporting period. Income and expenses are translated at the average exchange rates for the period, provided that there were no significant fluctuations in the exchange rates during the period. Exchange differences arising from translation of the financial statements of foreign operations are recognized in other comprehensive income. On the disposal of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation is reclassified from equity to profit or loss when the gain or loss on disposal is recognized.

(4) Financial Instruments

The Group has early adopted IFRS 9 effective from the transition date.

1) Financial assets

(i) Initial recognition and measurement

The Group initially recognizes trade and other receivables at the date they are originated. Other financial assets are initially recognized at the transaction date when the Group becomes a party to the contractual provisions of the financial instrument.

At initial recognition, all financial assets are measured at fair value, but those that are not classified as financial assets measured at fair value through profit or loss are measured at fair value plus transaction costs directly attributable to acquisition of the financial asset. Transaction costs of financial assets measured at fair value through profit or loss are recognized in profit or loss.

(ii) Classification and subsequent measurement

The Group classifies the financial assets it holds as (a) financial assets measured at amortized cost; (b) debt instruments measured at fair value through other comprehensive income; (c) equity instruments measured at fair value through other comprehensive income; or (d) financial assets measured at fair value through profit or loss. This classification is determined at initial recognition, and measurement of financial assets after initial recognition is performed as follows according to the classification of the financial asset.

(a) Financial assets measured at amortized cost

Financial assets held by the Group are measured at amortized cost if both of the following conditions are met:

- The financial asset is held in a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

After initial recognition, the carrying amounts of financial assets measured at amortized cost are recognized using the effective interest method less impairment loss, if any. Amortization using the effective interest method and gains and losses on derecognition are recognized in profit or loss for the period.

(b) Debt instruments measured at fair value through other comprehensive income

Financial assets held by the Group are classified as debt instruments measured at fair value through other comprehensive income if both of the following conditions are met:

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial asset; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

(c) Equity instruments measured at fair value through other comprehensive income

The Group has made an irrevocable election to present subsequent changes in fair value of certain equity instruments in other comprehensive income, and classifies them in equity instruments measured at fair value through other comprehensive income.

These financial assets are measured at fair value after initial recognition, and changes in fair value are included in other comprehensive income. If the Group disposes of an investment, or if the fair value of the

investment declines significantly, the cumulative gain or loss recognized in other comprehensive income is reclassified from other components of equity to retained earnings.

Dividends from equity instruments measured at fair value through other comprehensive income are recognized as financial income in profit or loss.

(d) Financial assets measured at fair value through profit or loss

Financial assets that are not classified as financial assets measured at amortized cost, debt instruments measured at fair value through other comprehensive income, or equity instruments measured at fair value through other comprehensive income are classified as financial assets measured at fair value through profit or loss. The Group's financial assets that are measured at fair value through profit or loss include certain short-term investments and derivative assets. The Group has not irrevocably designated any financial assets as measured at fair value through profit or loss.

These financial assets are measured at fair value after initial recognition, and changes in their fair value are recognized in profit or loss. Gains and losses on financial assets measured at fair value through profit or loss are recognized in profit or loss.

(iii) Impairment of financial assets

With respect to impairment of financial assets measured at amortized cost, the Group recognizes a loss allowance for expected credit losses on such financial assets.

At each reporting date, the Group assesses whether the credit risks on the financial assets have increased significantly since initial recognition.

If credit risk on a financial instrument has not increased significantly since initial recognition, the loss allowance for that financial instrument is measured at an amount equal to the 12-month expected credit losses. If credit risk on a financial instrument has increased significantly since initial recognition, the loss allowance is measured in an amount equal to the lifetime expected credit losses.

However, the loss allowance on trade receivables and others is always measured in an amount equal to the lifetime expected credit losses.

The expected credit losses of financial assets are estimated in a way that reflects the following:

- An unbiased and probability-weighted amount determined by evaluating a range of possible outcomes
- The time value of money
- Reasonable and supportable information about past events, current conditions and forecasts of economic conditions that is available without undue cost or effort at the reporting date

The amounts of these measurements are recognized in profit or loss.

If an event that reduces an impairment loss occurs after the impairment loss has been recognized, the impairment loss will be reversed to the extent of the decrease and credited to profit or loss.

(iv) Derecognition of financial assets

The Group derecognizes financial assets only when the contractual rights to the cash flows from the financial assets expire, or when the Group transfers financial assets and substantially all the risks and rewards of ownership of the financial assets.

2) Financial liabilities

(i) Initial recognition and measurement

The Group initially recognizes bonds and borrowings at the date they are issued, and other financial liabilities at the transaction date.

Upon initial recognition, all financial liabilities are measured at fair value. However, financial liabilities measured at amortized cost are measured in the full amount after deducting directly attributable transaction costs from the fair value.

Transaction costs of financial liabilities measured at fair value through profit or loss are recognized in profit or loss.

(ii) Classification and subsequent measurement

The Group classifies financial liabilities as either financial liabilities measured at fair value through profit or loss, or financial liabilities measured at amortized cost. This classification is determined at initial recognition. Measurement of financial liabilities after initial recognition is performed as follows, according to the classification of the financial liability.

The Group's financial liabilities measured at fair value through profit or loss are derivative liabilities. The Group has not irrevocably designated any financial liabilities as measured at fair value through profit or loss at initial recognition. Financial liabilities measured at fair value through profit or loss are measured at fair value after initial recognition, and any changes in their fair value are recognized in profit or loss for the period.

Financial liabilities measured at amortized cost are subsequently measured at amortized cost using the effective interest method. Amortization using the effective interest method and gains and losses on derecognition are recognized in profit or loss for the period.

(iii) Derecognition of financial liabilities

The Group derecognizes financial liabilities when they are extinguished (i.e., when the obligation specified in the contract is discharged or cancelled or expires).

3) Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount is presented in the consolidated statement of financial position only when the Group currently has a

legally enforceable right to set off the recognized amount and intends either to settle on a net basis or realize the assets and settle the liabilities simultaneously.

4) Fair value of financial instruments

The Group recognizes the fair value of financial instruments using various valuation methodologies and inputs. The fair values recognized based on the observability of inputs into the valuation methodologies are grouped into the following three levels:

Level 1: Fair value measured with quoted prices in active markets for identical assets or liabilities

Level 2: Fair value measured with inputs other than quoted prices categorized within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Fair value measured with unobservable inputs for the asset or liability

5) Hedge accounting

The Group uses interest rate swaps and other derivatives to hedge interest rate risk. At the inception of a hedging relationship, the Group formally designates and documents the hedging relationship and the interest rate risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and the methods of assessing whether the hedging relationship meets the hedge effectiveness requirements. In addition, the Group assesses whether the hedging relationship meets the hedge effectiveness requirements, both at the inception and on an ongoing basis. Ongoing assessments are conducted either at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first.

In accordance with the Group's risk management policy, derivatives that meet the criteria for hedge accounting with respect to interest rate risk are designated as cash flow hedges and accounted for as follows.

Derivatives designated as hedging instruments in cash flow hedges are interest rate swaps to convert floating-rate financial liabilities to fixed-rate financial liabilities. The effective portion of changes in the fair values of derivatives designated as cash flow hedges is recognized in other components of equity until the associated hedged transactions are executed and profit or loss is recognized. Gains or losses on derivatives recognized in other components of equity are reclassified into profit or loss at the time when the associated hedged transactions are recognized in profit or loss. However, any ineffective portion of the change in fair value of the derivatives is recognized immediately in profit or loss.

Hedge accounting is discontinued prospectively only when the hedging relationship ceases to meet the qualifying criteria. This includes instances when the hedging instrument expires or is sold, terminated or exercised.

The Group does not use fair value hedges or net investment hedges in foreign operations.

(5) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments that are highly liquid and readily convertible to known amounts of cash subject to an insignificant risk of changes in value, and that mature or become due within three months from the date of acquisition.

Cash and cash equivalents include certificates of deposit, time deposits, commercial paper, public and corporate bonds in investment trusts, and money in trust.

(6) Inventories

Inventories are measured at the lower of cost and net realizable value. 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 the sale. The cost of inventories includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition, and are determined principally by the weighted average method.

(7) Property, Plant and Equipment

Property, plant and equipment are measured using the cost model and carried at cost less any accumulated depreciation and any accumulated impairment losses.

The cost of an item of property, plant and equipment comprises any costs directly attributable to acquisition of the asset and the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Depreciation of assets other than land and construction in progress is calculated on a straight-line basis over the estimated useful lives of the assets.

The estimated useful lives of major asset items are as follows:

- Buildings and structures: 10 to 35 years
- Machinery and vehicles: 7 to 14 years
- Tools, furniture and fixtures: 3 to 10 years

The estimated useful lives, residual values and depreciation method are reviewed at each fiscal year end, and any revisions are applied prospectively as changes in accounting estimates.

The Group changed estimated useful lives from the fiscal year ended December 31, 2016. The details are presented in Note 4 "Significant Accounting Estimates and Judgments (3) Useful Lives of Property, Plant and Equipment."

(8) Goodwill and Intangible Assets

1) Goodwill

Goodwill arising from a business combination is not amortized, and is carried at cost, determined at the acquisition date, less any accumulated impairment losses.

In addition, goodwill is allocated to the cash generating unit or group of cash-generating units that is expected to benefit from the synergies of the business combination, and is tested for impairment at least once a year by each fiscal year end or if there are indications of impairment.

Impairment loss on goodwill is recognized in profit or loss and is not reversed in subsequent periods.

Goodwill measurements at initial recognition are presented in Note 3 "Significant Accounting Policies (2) Business Combinations."

2) Intangible assets

Intangible assets are measured using the cost model and carried at cost less any accumulated amortization and any accumulated impairment losses.

The costs of separately acquired intangible assets comprise any costs directly attributable to acquisition of the assets.

The costs of intangible assets acquired in business combinations are measured at fair value at the acquisition date.

Expenditures related to internally generated intangible assets are recognized as expenses when incurred, with the exception of development expenses that meet the criteria for capitalization. Software development expense only meets the criteria for capitalization.

After initial recognition, with the exception of intangible assets with indefinite useful lives, intangible assets are amortized on a straight-line basis over their estimated useful lives.

The Group has no intangible assets with indefinite useful lives. The estimated useful lives of major intangible assets are as follows:

- Trademarks: 10 years
- Software: 5 years

The estimated useful lives, residual values and amortization method are reviewed at each fiscal year end, and any revisions are applied prospectively as changes in accounting estimates.

3) Research and development expenses

Research expenditures are expensed as incurred.

Development expenditures are capitalized only if they can be measured reliably, future economic benefits are probable, and the Group intends to, and has sufficient resources to, complete development and to use or sell the asset. If research expenditures and development expenditures cannot be clearly distinguished, they are expensed as incurred as research expenditures.

(9) Leases

The Group classifies a lease that transfers substantially all the risks and rewards incidental to ownership of an asset as a finance lease and a lease other than a finance lease as an operating lease.

In finance lease transactions, leased assets and lease obligations are initially recognized at the lower of the fair value of leased property and the present value of the minimum lease payments, each determined at the inception of the lease.

Leased assets are depreciated on a straight-line basis over the shorter of their estimated useful lives and lease terms. Lease payments are apportioned between the finance charges and the reduction of the outstanding liability using the interest method.

Lease payments under operating leases are recognized as an expense on a straight-line basis over the lease term.

Determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement, in accordance with IFRIC Interpretation 4 "Determining Whether an Arrangement Contains a Lease."

(10) Impairment of Non-financial Assets

Non-financial assets, excluding inventories, deferred tax assets, non-current assets classified as held for sale and assets arising from employee benefits, are assessed at the end of each reporting period to determine whether there is any indication of impairment. If there is an indication of impairment, the recoverable amount of the asset is estimated. For goodwill, the recoverable amount is estimated at least once a year by each fiscal year end, irrespective of whether there is any indication of impairment.

The recoverable amount of an asset or a cash-generating unit is the higher of its value in use and fair value less cost of disposal. The discount rate used in calculating the asset's value in use is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset, for which the future cash flow estimates have not been adjusted.

If it is not possible to estimate the recoverable amount of an individual asset, the recoverable amount of the cash-generating unit to which the asset belongs is measured. Goodwill acquired in business combinations is allocated to each of the cash-generating units or groups of cash-generating units of the Group that is expected to benefit from synergies of the business combinations after the acquisition date, and is tested for impairment.

Because corporate assets do not generate separate cash inflows, the recoverable amount of individual corporate assets cannot be measured unless management has decided to dispose of the asset. If there is an indication that a corporate asset may be impaired, the recoverable amount of the cash-generating unit or group of cash-generating units to which the asset belongs is measured and compared with the carrying amount.

Impairment losses are recognized in profit or loss whenever the recoverable amount is less than the carrying amount. Such impairment losses of the cash-generating unit or group of cash-generating units are recognized by first reducing the carrying amount of any goodwill allocated to the cash-generating unit or group of cash-generating units, and then allocating the rest of the losses to other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.

The Group reviews assets other than goodwill at each fiscal year end to determine whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If there are any such indications, the Group estimates the recoverable amount of the asset.

Impairment losses on assets other than goodwill that were recognized in prior fiscal years are reversed only when there have been changes in the estimates used to determine the recoverable amount of the asset since the last impairment loss was recognized. In this case, the carrying amount of the asset is increased as a reversal of impairment loss to the recoverable amount.

Impairment losses are reversed up to the carrying amount, net of amortization or depreciation, that would have been determined had no impairment loss for the asset been recognized in prior fiscal years.

(11) Employee Benefits**1) Post-employment benefits**

The Group sponsors a defined benefit plan and a defined contribution plan as post-employment benefit plans for employees.

(i) Defined benefit plan

For the defined benefit plan, the projected unit credit method is used to individually determine the present value of defined benefit obligations, related current service costs and past service costs of each plan.

The discount rate is determined by referring to market yields at the end of the fiscal year on high quality corporate bonds corresponding to the period until the expected date of future benefit payment.

The net amount of the present value of defined benefit obligations and the fair value of plan assets is accounted for as a liability or asset. However, if the defined benefit plan has surplus, the net defined benefit asset is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. Net interest on the net defined benefit liability (asset) is recognized in profit or loss as financial expenses (income).

Remeasurements of the net defined benefit liability (asset) are recognized in other comprehensive income and immediately reclassified to retained earnings in the period in which they occur.

Past service costs are recognized in profit or loss for the period in which they are incurred.

(ii) Defined contribution plan

Payments to defined contribution plan are recognized as expenses when employees have rendered services entitling them to the contributions.

2) Other employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis, and are recognized as an expense when the related services are rendered.

For bonuses, when there is a present legal or constructive obligation to make payments of bonuses, and a reliable estimate of the obligation can be made, the estimated amount to be paid is accounted for as a liability.

For the paid absence expenses, when there is a legal or constructive obligation with respect to accumulating paid absence systems and a reliable estimate of the obligation can be made, the estimated amount to be paid based on those systems is accounted for as a liability.

(12) Share-based Payments

The Company has a stock option plan accounted for as an equity-settled share-based payment plan.

Stock options are estimated using their fair value at the grant date and recognized in profit or loss as expenses over the vesting periods with corresponding increases to equity and taking into account the estimated number of options to be finally vested. The fair value of options granted is measured using the Black-Scholes model based on the terms and conditions of the options.

The terms and conditions are periodically reviewed and the estimated number of options vested is revised as necessary.

(13) Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amounts recognized as provisions are the best estimates of necessary expenditures to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties associated with the obligation. When the effect of the time value of money is material, the amount of provision is measured at the present value of the expenditures expected to be required to settle the obligation.

(14) Revenue

The Group is engaged in the sale of consumer products, including cosmetics, skin care products, hair care products, sanitary products and fabric care products, as well as chemical products, including fatty alcohols and surfactants. Revenue from the sale of these goods is recognized when the Group has transferred the significant risks and rewards of ownership of the goods to the buyer; the Group retains neither continuing managerial involvement nor effective control over the goods sold; it is probable that economic benefits related to the transaction will flow to the Group; and these benefits and corresponding costs can be measured reliably. Therefore, revenue is usually recognized at the time of delivery of goods to customers. Revenue is measured at the fair value of the consideration received or receivable less any discounts, rebates, consumption taxes and other taxes.

(15) Income Taxes

Income taxes consist of current income taxes and deferred income taxes. Income taxes are recognized as income or expenses and included in profit or loss, except for taxes related to business combinations and taxes related to items that are recognized directly in equity or in other comprehensive income.

1) Current income taxes

Current income taxes are recognized in the amount of the expected taxes payable to or receivable from the taxation authorities. Calculation of the amount of tax is based on the tax rates and tax laws enacted or substantively enacted by the end of the reporting period in countries where the Group conducts business and earns taxable income.

2) Deferred income taxes

Deferred tax assets and liabilities are recognized for temporary differences between the carrying amounts of assets or liabilities at the end of the reporting period and its tax base, and for tax loss carryforwards and tax credits.

Deferred tax assets are recognized for deductible temporary differences, the carryforwards of unused tax losses and the carryforwards of unused tax credits to the extent that it is probable that future taxable income will be available against such deferred tax assets. Deferred tax liabilities are recognized, in principle, for all taxable temporary differences.

The carrying amount of deferred tax assets is reviewed each period and reduced to the extent that it is no longer probable

that sufficient future taxable income will be available to realize benefits from all or part of the assets. Unrecognized deferred tax assets are reassessed each period and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax assets to be recovered.

Deferred tax assets and liabilities are not recognized for the following temporary differences:

- Taxable temporary differences arising from initial recognition of goodwill
- Temporary differences arising from initial recognition of assets and liabilities from transactions that are not business combinations and affect neither accounting income nor taxable income
- Taxable temporary differences on investments in subsidiaries and associates, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future
- Deductible temporary differences on investments in subsidiaries and associates, when it is probable that the temporary differences will not reverse in the foreseeable future

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the assets are realized or the liabilities are settled, based on the tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are offset if the Group has a legally enforceable right to set off current tax assets against current tax liabilities and income taxes are levied by the same taxation authority on the same taxable entity.

The Company and some of its subsidiaries have adopted the consolidated tax system.

(16) Earnings per Share

Basic earnings per share are calculated by dividing net income attributable to owners of the parent by the weighted-average number of ordinary shares outstanding during the period, adjusted for treasury shares held. Diluted earnings per share are calculated by adjusting the effects of all dilutive potential ordinary shares.

(17) Non-current Assets Held for Sale

A non-current asset or disposal group whose carrying amount is expected to be recovered principally through a sale transaction rather than through continuing use is classified as a non-current asset or disposal group held for sale if it is highly probable that the asset or disposal group will be sold within one year and is available for immediate sale in its present condition, and the Group's management is committed to a plan to sell. Non-current assets are not depreciated or amortized while they are classified as held for sale or are part of a disposal group classified as held for sale. Non-current assets or disposal groups classified as held for sale are measured at the lower of the carrying amount and fair value less costs to sell.

(18) Equity and Other Capital**1) Ordinary shares**

Ordinary shares are recognized in share capital and capital surplus at their issue price. Share issuance costs are deducted from the issue price.

2) Treasury shares

Treasury shares are recognized at cost and deducted from equity. No gain or loss is recognized on the purchase, sale or retirement of the Company's treasury shares. Any difference between the carrying amount and consideration received on the sale of treasury shares is recognized directly in equity.

(19) Dividends

Dividend distributions to shareholders of the Company are recognized as liabilities in the period in which year-end dividends are resolved upon by the General Meeting of Shareholders and interim dividends are resolved upon by the Board of Directors.

4 Significant Accounting Estimates and Judgments

The Group's consolidated financial statements include estimates and assumptions made by the management regarding income and expenses, measurement of the carrying amounts of assets and liabilities, and disclosure of contingencies and others at the end of the reporting period. These estimates and assumptions are based on management's best judgment at the end of the reporting period, and take into account historical experience and various other factors that can be considered as reasonable. However, due to their nature, actual results may differ from these estimates and assumptions.

The estimates and their underlying assumptions are reviewed by management on an ongoing basis. The effects of revisions to accounting estimates and assumptions are recognized in the period when the estimates are revised and in future periods.

Estimates and assumptions that significantly affect the amounts recognized in the Group's consolidated financial statements are as follows.

(1) Impairment of Property, Plant and Equipment, Goodwill and Intangible Assets

The Group conducts impairment tests for property, plant and equipment, goodwill and intangible assets when there is an indication that the recoverable amount of the asset or cash-generating unit is less than the carrying amount.

Triggering events for impairment testing include, for example, significant changes with adverse effects on past or projected business performance, significant changes in the use of acquired assets, or changes in overall business strategy.

Furthermore, goodwill is tested for impairment at least once a year by each fiscal year end, irrespective of indication of impairment, to verify that the recoverable amount of the cash-generating unit to which goodwill is allocated exceeds the carrying amount.

Impairment tests are performed by comparing the carrying amount and the recoverable amount of the asset or cash-generating unit. If the recoverable amount is less than the carrying amount, the carrying amount is reduced to the recoverable amount and the reduction is recognized as an impairment loss. The recoverable amount is the higher of the value in use and the fair value less cost of disposal of the asset or cash-generating unit.

In calculating the value in use, the Group makes certain assumptions about the remaining useful life and future cash flows

of the asset, discount rate, growth rate and other factors. These assumptions are based on management's best estimates and judgments, but may be affected by changes in future business plans, economic conditions or other factors. If revisions to the assumptions become necessary, such revisions could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 13 "Property, Plant and Equipment" and Note 14 "Goodwill and Intangible Assets" present the method for calculating the recoverable amount. Note 14 "Goodwill and Intangible Assets" presents sensitivity associated with goodwill.

(2) Post-employment Benefits

The Group provides a variety of post-retirement benefit plans that include a defined benefit plan. The present value of defined benefit obligations and related service costs are determined based on actuarial assumptions.

Actuarial assumptions are based on management's best estimates and judgments, but may be affected by the revision of inputs including discount rate and mortality rate due to changes in economic conditions. If revisions to the assumptions become necessary, such revisions could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 20 "Employee Benefits" presents actuarial assumptions and related sensitivity.

(3) Useful Lives of Property, Plant and Equipment

The Group focuses on machinery and equipment in making proactive capital investments, and prioritizes management issues such as global analysis to optimize production bases and enable manufacturing cost comparisons.

Consequently, the Group globally unified its property, plant and equipment systems in January 2016. The Group decided to take advantage of this change to make the estimated useful lives of machinery and equipment consistent (generally 9 or 10 years depending on the type of equipment) from the fiscal year ended December 31, 2016 to better reflect the actual use of machinery and equipment in global production.

The effect of this change in accounting estimates on the consolidated financial statements is immaterial.

(4) Provisions

The Group has recognized a provision for loss related to cosmetics, a provision for sales returns, a provision for asset retirement obligations and other provisions in the consolidated statement of financial position.

The amounts recognized are the best estimates of the expenditures required to settle the present obligations, taking into account historical experience and other factors at the end of the reporting period.

The provision for loss related to cosmetics may be affected by changes in compensation-related and other expenses.

The provision for sales returns may be affected by factors such as plans to discontinue production and sales of products.

The provision for asset retirement obligations and other provisions may be affected by factors such as changes in future business plans.

If the actual amounts paid differ from the estimates, such differences could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 21 "Provisions" presents the nature and amounts of these provisions.

(5) Income Taxes

The Group recognizes and measures income tax payables and income taxes based on reasonable estimates of the amounts to be paid to the taxation authorities in each country. Such estimates are made using the tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Calculating income tax payables and income taxes requires estimates and judgments of various factors, including interpretations of tax regulations by the Group and the taxation authorities and the experience of past tax audits.

Therefore, if the final tax outcome is different from the amount initially recognized, the difference is recognized in the period when the tax outcome is finalized.

Deferred tax assets are recognized for deductible temporary differences, the carryforwards of unused tax losses and the carryforwards of unused tax credits to the extent that it is probable that future taxable income will be available. The realizability of deferred tax assets is assessed using the tax rates that are expected to apply to the period when the asset is realized, based on tax rates and tax laws enacted or substantively enacted by the end of the reporting period.

Recognition and measurement of deferred tax assets are based on management's best estimates and judgments, but may be affected by future changes in business plans or other conditions, or by the amendment or promulgation of related laws. Any revisions that become necessary could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 16 "Income Taxes" presents income taxes and amounts.

(6) Fair Value

The Group uses various inputs, including unobservable inputs, and valuation methodologies to estimate the fair value of specific assets and liabilities. When measuring fair value, the Group maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs, and management's best estimates and judgments are required in that process.

The fair value of these assets and liabilities is based on management's best estimates and judgments, but could be affected by factors including changes in inputs due to changes in economic conditions. Any revisions that become necessary could have a material effect on the amounts recognized in the consolidated financial statements in future periods.

Note 34 "Financial Instruments" presents fair value measurement methods and amounts for major financial assets and liabilities measured at fair value.

In its first-time adoption of IFRS, the Group applies the exemption under IFRS 1 and uses the deemed cost as the acquisition cost for certain property, plant and equipment. Note 39 "First-time Adoption of IFRS" presents fair value measurement methods and amounts for these assets.

(7) Contingencies

Contingencies are disclosed when there are items that could have a material effect on future business after considering the probability of occurrence and the amount of financial impact, taking into account all available evidence at the end of the reporting period.

5 New Standards and Interpretations Not Yet Adopted

New or revised major Standards and Interpretations that were issued by the date of approval presented in Note 40 "Approval of the Consolidated Financial Statements," but were not yet adopted by the Group as of December 31, 2016 are as follows.

IFRS	Title	Mandatory adoption (From the fiscal year beginning)	Adoption by the Group	Overview of new or revised Standards and Interpretations
IFRS 15	Revenue from Contracts with Customers	January 1, 2018	Early adoption being planned in fiscal year ending December 31, 2017	Revised accounting treatment for revenue recognition and disclosure
IFRS 16	Leases	January 1, 2019	Fiscal year ending December 31, 2019	Revised lease definition, accounting treatment and disclosure

The main impact resulting from the early adoption of IFRS 15 "Revenue from Contracts with Customers" is the accounting treatment of consideration payable to customers. Some of the consideration payable to customers previously recognized as selling, general and administrative expenses will be accounted for as reductions of net sales or as cost of sales. The expected major impact on the Group's consolidated financial statements for the

fiscal year ending December 31, 2017 is a decrease of approximately 40 billion yen in net sales in the consolidated statement of income. The impact on operating income will be immaterial.

The Group is currently evaluating the possible impacts on the consolidated financial statements resulting from the adoption of IFRS 16 "Leases" and the estimates are currently not available.

6 Segment Information

(1) Summary of Reportable Segments

The Group's reportable segments are the components of the Group for which discrete financial information is available and which are regularly reviewed by the Board of Directors in deciding how to allocate resources and in assessing their performance. Net sales and operating income are the key measures used by the Board of Directors to evaluate the performance of each segment.

The Group is an organization comprising four main business units - the Beauty Care Business, the Human Health Care

Business, the Fabric and Home Care Business (collectively, the "Consumer Products Business") and the Chemical Business. In each business unit, the Group plans comprehensive business strategies and carries out business activities on a global basis.

Accordingly, the Group has four reportable segments: the Beauty Care Business, the Human Health Care Business, the Fabric and Home Care Business and the Chemical Business.

Information about major customers has been omitted as the revenue from each customer is less than 10% of the Group's net sales.

Reportable segments		Major products	
Consumer Products Business	Beauty Care Business	Cosmetics	Counseling cosmetics, self-selection cosmetics
		Skin care products	Soaps, facial cleansers, body cleansers
		Hair care products	Shampoos, conditioners, hair styling agents, hair coloring agents
	Human Health Care Business	Food and beverage products	Beverages
		Sanitary products	Sanitary napkins, baby diapers
		Personal health products	Bath additives, oral care products, men's products
Fabric and Home Care Business	Fabric care products	Laundry detergents, fabric treatments	
	Home care products	Kitchen cleaning products, house cleaning products, paper cleaning products, commercial-use products	
	Oleo chemicals	Fatty alcohols, fatty amines, fatty acids, glycerin, commercial-use edible fats and oils	
Chemical Business	Performance chemicals	Surfactants, plastics additives, superplasticizers for concrete admixtures	
	Specialty chemicals	Toner and toner binder for copiers and printers, ink and colorants for inkjet printers, fragrances and aroma chemicals	

(2) Sales and Results of Reportable Segments

Fiscal year ended December 31, 2016

(Millions of yen)

	Reportable segments							Reconciliation ¹	Consolidated
	Consumer Products Business				Chemical Business	Total			
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal					
Net sales									
Sales to customers	601,620	273,067	345,163	1,219,850	237,760	1,457,610	—	1,457,610	
Intersegment sales and transfers ²	—	—	—	—	36,025	36,025	(36,025)	—	
Total net sales	601,620	273,067	345,163	1,219,850	273,785	1,493,635	(36,025)	1,457,610	
Operating income	51,086	25,948	78,099	155,133	29,683	184,816	755	185,571	
Financial income								1,389	
Financial expenses								(5,424)	
Share of profit in investments accounted for using the equity method								1,894	
Income before income taxes								183,430	
Other items									
Depreciation and amortization ³	18,399	12,930	7,876	39,205	11,650	50,855	261	51,116	
Impairment losses ³	43	26	40	109	—	109	—	109	
Capital expenditures ⁴	20,135	41,752	16,050	77,937	11,877	89,814	86	89,900	

- Notes: 1. The operating income reconciliation of 755 million yen includes corporate expenses not allocated to reportable segments, as well as elimination of intersegment inventory transactions.
2. Intersegment sales and transfers are mainly calculated based on market price and manufacturing cost.
3. Note 13 "Property, Plant and Equipment" and Note 14 "Goodwill and Intangible Assets" present the details of depreciation, amortization and impairment losses.
4. Capital expenditures include investments in property, plant and equipment, intangible assets and other non-current assets.

Fiscal year ended December 31, 2015

(Millions of yen)

	Reportable segments							Reconciliation ¹	Consolidated
	Consumer Products Business				Chemical Business	Total			
	Beauty Care Business	Human Health Care Business	Fabric and Home Care Business	Subtotal					
Net sales									
Sales to customers	608,617	281,672	335,308	1,225,597	248,953	1,474,550	—	1,474,550	
Intersegment sales and transfers ²	—	—	—	—	39,517	39,517	(39,517)	—	
Total net sales	608,617	281,672	335,308	1,225,597	288,470	1,514,067	(39,517)	1,474,550	
Operating income	37,929	33,368	66,124	137,421	28,593	166,014	1,304	167,318	
Financial income								1,416	
Financial expenses								(4,213)	
Share of profit in investments accounted for using the equity method								1,517	
Income before income taxes								166,038	
Other items									
Depreciation and amortization ³	26,028	10,236	8,072	44,336	12,804	57,140	283	57,423	
Impairment losses ³	2,476	510	657	3,643	388	4,031	—	4,031	
Capital expenditures ⁴	20,458	30,962	15,150	66,570	16,244	82,814	34	82,848	

- Notes: 1. The operating income reconciliation of 1,304 million yen includes corporate expenses not allocated to reportable segments, as well as elimination of intersegment inventory transactions.
2. Intersegment sales and transfers are mainly calculated based on market price and manufacturing cost.
3. Note 12 "Non-current Assets Held for Sale," Note 13 "Property, Plant and Equipment," and Note 14 "Goodwill and Intangible Assets" present the details of depreciation, amortization and impairment losses.
4. Capital expenditures include investments in property, plant and equipment, intangible assets and other non-current assets.

(3) Geographical Information

Sales to customers and non-current assets (excluding financial assets, deferred tax assets and retirement benefit assets) by region consist of the following.

Sales to Customers	(Millions of yen)	
	2016	2015
Japan	964,904	956,033
Asia	251,284	249,335
China	103,346	96,565
Americas	120,782	134,080
United States	93,148	102,865
Europe	120,640	135,102
Total	1,457,610	1,474,550

Note: Sales are classified by country or region based on the location of customers.

Non-current Assets (excluding Financial Assets, Deferred Tax Assets and Retirement Benefit Assets)	(Millions of yen)		
	2016	2015	Transition date
Japan	415,993	375,831	357,162
Asia	81,927	86,362	81,980
Americas	22,854	21,535	20,738
Europe	24,731	29,126	32,238
Total	545,505	512,854	492,118

7 Business Combinations**(1) Outline of Business Combination**

Name of the acquiree:	Collins Inkjet Corporation and SAMGAM, LLC, which owns and manages its real estate and other assets used by Collins Inkjet Corporation (collectively, "Collins")
Business outline:	Development, manufacturing and sales of inkjet ink
Acquisition date:	July 1, 2016
Acquisition method:	Cash consideration to acquire shares
Percentage of voting rights acquired:	100%

(2) Primary Reason for Business Combination

Collins, based in the U.S., is engaged in development, manufacturing and sales of inkjet ink. Collins was an early entrant into the rapidly growing inkjet ink market for industrial printing. With its advanced ink designing technologies responding to a wide variety of inkjet heads and its reliability, Collins has built a wide customer network. Collins continues to focus on ink development to broaden the application range and expand business globally.

By taking advantage of newly acquired technologies, manufacturing facilities and sales networks from Collins in addition to its own technologies, the Group aims to provide global customers with innovative products and services that can contribute to the mitigation of environmental impact.

(3) Acquisition Cost of Acquiree and Its Components

Acquisition cost of acquiree:	3,715 million yen
Components of acquisition cost:	
Cash	3,715 million yen

(4) Fair Value of Assets Acquired and Liabilities Assumed at the Acquisition Date

Current assets	1,496 million yen
Non-current assets	913 million yen
Total assets	2,409 million yen
Current liabilities	377 million yen
Non-current liabilities	232 million yen
Total liabilities	609 million yen

(5) Goodwill

Goodwill recognized	1,915 million yen
Components of goodwill:	Goodwill recognized for this business combination reflects excess earning power in future from using newly acquired technologies, manufacturing systems and sales networks from Collins in addition to the Group's technologies. Certain goodwill is deductible for tax purposes.

(6) Net Sales and Income of Acquired Business

Information on income associated with this business combination after the acquisition date and information on income assuming that the business combination took place on the date of January 1, 2016 are not presented because the impacts on the consolidated statement of income are immaterial.

8 Cash and Cash Equivalents

Cash and cash equivalents consist of the following.

	2016	2015	(Millions of yen) Transition date
Cash and deposits	186,226	121,371	105,328
Short-term investments	116,800	188,551	123,639
Total	303,026	309,922	228,967

Cash and deposits include time deposits that mature or become due within three months from the date of acquisition. In addition, the balance of cash and cash equivalents presented in the consolidated statement of financial position is equal to the balance of cash and cash equivalents presented in the consolidated statement of cash flows.

9 Trade and Other Receivables

Trade and other receivables consist of the following.

	2016	2015	(Millions of yen) Transition date
Trade receivables	205,099	206,966	205,674
Other receivables	4,546	5,049	8,372
Allowance for doubtful receivables	(1,186)	(1,308)	(1,304)
Total	208,459	210,707	212,742

10 Inventories

Inventories consist of the following.

	(Millions of yen)		
	2016	2015	Transition date
Merchandise and finished goods.....	122,479	112,087	111,998
Work in progress	12,253	12,356	12,910
Materials and supplies.....	30,468	26,828	26,968
Total.....	165,200	151,271	151,876

The amount of inventories recognized as expenses and included in cost of sales for the fiscal years ended December 31, 2016 and 2015 were 636,969 million yen and 658,325 million yen, respectively.

Write-downs of inventories recognized as expenses for the fiscal years ended December 31, 2016 and 2015 were 4,534 million yen and 4,982 million yen, respectively.

11 Other Assets

Other assets consist of the following.

	(Millions of yen)		
	2016	2015	Transition date
Other current assets			
Insurance receivable	6,330	20,219	30,357
Prepaid expenses.....	9,410	8,487	8,426
Other.....	8,072	9,299	8,516
Total.....	23,812	38,005	47,299
Other non-current assets			
Insurance receivable	11,095	9,919	—
Long-term prepaid lease payments	5,337	5,818	5,175
Long-term prepaid expenses	881	754	1,563
Other.....	1,235	1,241	1,228
Total.....	18,548	17,732	7,966

12 Non-current Assets Held for Sale

Certain assets including the land for a training center and the buildings and land for sales offices were classified as non-current assets held for sale in the fiscal year ended December 31, 2015 pursuant to the decision to sell these assets. Impairment loss of 694 million yen was recognized upon classification of these assets as non-current assets held for sale and included in other operating expenses in the consolidated statement of income for the fiscal year ended December 31, 2015. The sale of these assets was largely completed in the fiscal year ended December 31, 2016.

Certain assets including the buildings and land for sales offices were classified as non-current assets held for sale in the fiscal year ended December 31, 2016 pursuant to the decision to sell these assets.

The fair value of these assets was based on third-party appraisal values using sales comparison and other approaches and sales prices determined with reference to sales contracts, and was categorized within Level 3 of the fair value hierarchy.

13 Property, Plant and Equipment

(1) Changes in Property, Plant and Equipment

The following tables present changes in acquisition costs, accumulated depreciation and accumulated impairment losses, and carrying amounts of property, plant and equipment.

Acquisition Cost							(Millions of yen)
	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total	
January 1, 2015.....	379,857	701,384	113,312	77,934	27,247	1,299,734	
Additions.....	270	556	6,033	1	70,328	77,188	
Sales and disposals.....	(5,464)	(21,628)	(7,449)	(1,228)	(24)	(35,793)	
Reclassification.....	25,689	46,784	5,126	345	(77,944)	—	
Reclassification to assets held for sale.....	(486)	—	(1)	(3,710)	—	(4,197)	
Exchange differences on translation of foreign operations.....	(5,502)	(11,298)	(1,500)	(362)	(409)	(19,071)	
Other.....	(370)	(185)	118	—	(464)	(901)	
December 31, 2015.....	393,994	715,613	115,639	72,980	18,734	1,316,960	
Additions.....	313	245	4,490	36	79,781	84,865	
Acquisitions through business combinations.....	272	175	31	126	14	618	
Sales and disposals.....	(5,355)	(29,108)	(7,642)	(97)	(13)	(42,215)	
Reclassification.....	24,591	39,877	9,055	384	(73,907)	—	
Reclassification to assets held for sale.....	(585)	(22)	(7)	(216)	—	(830)	
Exchange differences on translation of foreign operations.....	(4,410)	(10,069)	(1,860)	(194)	(64)	(16,597)	
Other.....	79	86	(94)	(1)	(57)	13	
December 31, 2016.....	408,899	716,797	119,612	73,018	24,488	1,342,814	

Accumulated Depreciation and Accumulated Impairment Losses							(Millions of yen)
	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total	
January 1, 2015.....	277,771	604,104	89,346	9,231	—	980,452	
Depreciation ¹	11,765	21,393	10,074	—	—	43,232	
Impairment losses ²	154	117	27	3,039	—	3,337	
Impairment losses reversed ²	(196)	—	—	—	—	(196)	
Sales and disposals.....	(4,841)	(20,677)	(7,200)	(96)	—	(32,814)	
Reclassification to assets held for sale.....	(336)	—	(1)	(1,853)	—	(2,190)	
Exchange differences on translation of foreign operations.....	(2,978)	(8,458)	(1,216)	—	—	(12,652)	
Other.....	(96)	(198)	88	—	—	(206)	
December 31, 2015.....	281,243	596,281	91,118	10,321	—	978,963	
Depreciation ¹	11,934	22,448	10,396	—	—	44,778	
Impairment losses ²	13	—	—	96	—	109	
Impairment losses reversed ²	(0)	—	(1)	—	—	(1)	
Sales and disposals.....	(4,990)	(28,415)	(7,264)	(1)	—	(40,670)	
Reclassification to assets held for sale.....	(497)	(22)	(7)	—	—	(526)	
Exchange differences on translation of foreign operations.....	(2,220)	(7,024)	(1,392)	—	—	(10,636)	
Other.....	(23)	(66)	51	—	—	(38)	
December 31, 2016.....	285,460	583,202	92,901	10,416	—	971,979	

Notes: 1. Depreciation of property, plant and equipment is included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

2. Impairment losses on property, plant and equipment are included in other operating expenses and impairment losses reversed are recognized in other operating income in the consolidated statement of income.

Carrying Amount	(Millions of yen)					
	Buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Land	Construction in progress	Total
January 1, 2015.....	102,086	97,280	23,966	68,703	27,247	319,282
December 31, 2015.....	112,751	119,332	24,521	62,659	18,734	337,997
December 31, 2016.....	123,439	133,595	26,711	62,602	24,488	370,835

(2) Leased Assets

The carrying amount of leased assets from finance leases included in property, plant and equipment is as follows:

	(Millions of yen)		
	Buildings and structures	Other	Total
January 1, 2015.....	6,472	125	6,597
December 31, 2015.....	5,441	83	5,524
December 31, 2016.....	4,060	54	4,114

(3) Impairment Losses

The Group allocates property, plant and equipment into cash-generating units based on the smallest identifiable group of assets that generates cash inflows that are largely independent. For idle assets, the Group considers whether to recognize impairment losses for individual properties.

Impairment losses recognized for the fiscal years ended December 31, 2016 and 2015 were 109 million yen and 3,337 million yen, respectively.

Impairment losses of 3,337 million yen for the fiscal year ended December 31, 2015 consisted mainly of impairment losses of 3,039 million yen recognized for idle land owned by the Company and Kanebo Cosmetics Inc. Based on the projection that the Group would no longer use these assets as a result of

organizational restructuring, the Group separated these assets from the cash-generating units, reduced carrying amounts to fair value less costs of disposal as independent assets, and consequently recognized impairment losses. Fair value less costs of disposal was based on third-party appraisals using a sales comparison approach, and was categorized within Level 3 of the fair value hierarchy. The assets held by the Company belong to the segments of the Beauty Care Business, the Human Health Care Business and the Fabric and Home Care Business. The assets held by Kanebo Cosmetics Inc. belong to the Beauty Care Business.

(4) Commitments

Note 37 "Commitments" presents information on commitments to acquire property, plant and equipment.

14 Goodwill and Intangible Assets

(1) Changes in Goodwill and Intangible Assets

The following tables present changes in acquisition costs, accumulated amortization and accumulated impairment losses, and carrying amounts of goodwill and intangible assets.

Acquisition Cost	(Millions of yen)				
	Goodwill	Intangible assets			Total
		Software	Trademarks	Other ¹	
January 1, 2015.....	138,751	24,031	133,526	5,317	162,874
Additions.....	—	199	—	5,432	5,631
Sales and disposals.....	—	(4,736)	(3)	(23)	(4,762)
Reclassification.....	—	5,666	—	(5,046)	620
Exchange differences on translation of foreign operations.....	(500)	(316)	—	(104)	(420)
Other.....	—	(20)	—	(15)	(35)
December 31, 2015.....	138,251	24,824	133,523	5,561	163,908
Additions.....	—	85	—	4,948	5,033
Acquisitions through business combinations.....	1,915	4	—	316	320
Sales and disposals.....	—	(2,629)	(133,523)	(361)	(136,513)
Reclassification.....	—	5,122	—	(5,115)	7
Exchange differences on translation of foreign operations.....	(2,383)	(246)	—	(164)	(410)
Other.....	—	124	—	(22)	102
December 31, 2016.....	137,783	27,284	—	5,163	32,447

Note: 1. Software in progress is included in other in intangible assets.

Accumulated Amortization and Accumulated Impairment Losses	(Millions of yen)				
	Goodwill	Intangible assets			Total
		Software	Trademarks	Other ¹	
January 1, 2015.....	—	14,037	122,222	2,989	139,248
Amortization ¹	—	4,143	9,977	71	14,191
Sales and disposals.....	—	(4,732)	(3)	—	(4,735)
Exchange differences on translation of foreign operations.....	—	(359)	—	(98)	(457)
Other.....	—	(44)	—	—	(44)
December 31, 2015.....	—	13,045	132,196	2,962	148,203
Amortization ¹	—	4,650	1,327	361	6,338
Sales and disposals.....	—	(2,626)	(133,523)	(346)	(136,495)
Exchange differences on translation of foreign operations.....	—	(225)	—	(135)	(360)
Other.....	—	71	—	1	72
December 31, 2016.....	—	14,915	—	2,843	17,758

Note: 1. Amortization of intangible assets is included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

Carrying Amount	(Millions of yen)				
	Goodwill	Intangible assets			Total
		Software	Trademarks	Other	
January 1, 2015.....	138,751	9,994	11,304	2,328	23,626
December 31, 2015.....	138,251	11,779	1,327	2,599	15,705
December 31, 2016.....	137,783	12,369	—	2,320	14,689

(2) Goodwill

The following table presents the carrying amount of goodwill recognized in the Group's consolidated statement of financial position. Goodwill arising from business combinations is allocated

at the acquisition date to cash-generating units benefiting from the business combination, and the goodwill belongs to the Beauty Care Business and the Chemical Business. The goodwill primarily relates to the acquisition of the Kanebo Cosmetics Group.

	(Millions of yen)		
	2016	2015	Transition date
Beauty Care Business	135,618	138,251	138,751
Kanebo Cosmetics Group	119,400	119,400	119,400
Molton Brown Group	11,327	13,771	14,270
Other.....	4,891	5,080	5,081
Chemical Business	2,165	—	—
Total.....	<u>137,783</u>	<u>138,251</u>	<u>138,751</u>

(3) Impairment Test for Goodwill

The Group tests goodwill for impairment each period or at least once a year by each fiscal year end, irrespective of indication of impairment.

The recoverable amount on the impairment test is calculated based on value in use. The Group primarily recognizes goodwill associated with the Kanebo Cosmetics Group.

For the goodwill associated with the Kanebo Cosmetics Group, cash flow projections that are the basis for value in use are estimated using four-year medium-term plans that reflect past year's performance. The key assumptions used in formulating these estimates include sales growth rates and discount rates and the sales growth rates are consistent with the growth rate projections of the markets in which cash-generating units operate. Estimated cash flows in years beyond the four-year forecasts approved by management were calculated using an annual growth rate of 0% and were discounted to present value using a weighted average cost of capital (WACC) of 7.4% for the fiscal

year ended December 31, 2016 (8.7% and 8.9% for the fiscal year ended December 31, 2015 and at the transition date, respectively). Management assumes the probability that material impairment will occur in this cash-generating unit is low even in cases where the key assumptions used for the impairment test change within the reasonably possible ranges for the fiscal year ended December 31, 2016. While value in use exceeded carrying amount at the transition date and at December 31, 2015, increasing the discount rate by 1.8% at the transition date or 2.8% at December 31, 2015 would result in impairment.

(4) Intangible Assets with Indefinite Useful Lives

The intangible assets above include no intangible assets with indefinite useful lives.

(5) Commitments

Note 37 "Commitments" presents information on commitments associated with the acquisition of intangible assets.

15 Investments Accounted for Using the Equity Method

Investments in associates are accounted for using the equity method in the Group's consolidated financial statements. The carrying amount of investments in associates that are not individually material is as follows:

	(Millions of yen)		
	2016	2015	Transition date
Investments accounted for using the equity method.....	4,701	4,209	3,544

Changes in the Group's share of net income and other comprehensive income of associates that are not individually material are as follows:

	(Millions of yen)	
	2016	2015
The Group's share of net income	1,894	1,517
The Group's share of other comprehensive income.....	(82)	226
The Group's share of comprehensive income	<u>1,812</u>	<u>1,743</u>

16 Income Taxes

(1) Deferred Tax Assets and Liabilities

Details of major causes of occurrence and changes in deferred tax assets and liabilities consist of the following.

Fiscal year ended December 31, 2016

(Millions of yen)

	January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2016
Deferred tax assets					
Property, plant and equipment and intangible assets	19,570	(1,292)	—	38	18,316
Retirement benefit liabilities	22,708	(1,024)	6,298	(135)	27,847
Accrued expenses	13,040	(889)	—	(224)	11,927
Unused tax losses	1,385	(135)	—	(10)	1,240
Other.....	17,739	(1,696)	—	(202)	15,841
Total deferred tax assets	74,442	(5,036)	6,298	(533)	75,171
Deferred tax liabilities					
Property, plant and equipment and intangible assets	7,959	92	—	(106)	7,945
Retirement benefit assets	(1)	1	—	—	—
Financial assets.....	3,649	—	(663)	(222)	2,764
Undistributed foreign earnings	12,390	340	—	—	12,730
Other.....	1,309	45	—	(33)	1,321
Total deferred tax liabilities	25,306	478	(663)	(361)	24,760
Deferred tax assets, net.....	49,136	(5,514)	6,961	(172)	50,411

Fiscal year ended December 31, 2015

(Millions of yen)

	January 1, 2015	Recognized in profit or loss	Recognized in other comprehensive income	Other	December 31, 2015
Deferred tax assets					
Property, plant and equipment and intangible assets	21,459	(1,582)	—	(307)	19,570
Retirement benefit liabilities	26,424	(3,212)	(482)	(22)	22,708
Accrued expenses	14,089	(725)	—	(324)	13,040
Unused tax losses	4,990	(3,562)	—	(43)	1,385
Other.....	20,428	(3,053)	(6)	370	17,739
Total deferred tax assets	87,390	(12,134)	(488)	(326)	74,442
Deferred tax liabilities					
Property, plant and equipment and intangible assets	7,758	(203)	—	404	7,959
Retirement benefit assets	1,676	(1,703)	—	26	(1)
Financial assets.....	3,381	—	405	(137)	3,649
Undistributed foreign earnings	12,500	96	—	(206)	12,390
Other.....	1,314	(115)	—	110	1,309
Total deferred tax liabilities	26,629	(1,925)	405	197	25,306
Deferred tax assets, net.....	60,761	(10,209)	(893)	(523)	49,136

Deferred tax assets and liabilities recognized in the consolidated statement of financial position are as follows:

	(Millions of yen)		
	2016	2015	Transition date
Deferred tax assets	50,939	49,454	61,194
Deferred tax liabilities	528	318	433
Deferred tax assets, net	<u>50,411</u>	<u>49,136</u>	<u>60,761</u>

Deductible temporary differences and unused tax losses for which no deferred tax asset is recognized are as follows:

	(Millions of yen)		
	2016	2015	Transition date
Unused tax losses	35,274	39,784	46,367
Deductible temporary differences	21,091	22,049	12,904
Total	<u>56,365</u>	<u>61,833</u>	<u>59,271</u>

Unused tax losses for which no deferred tax asset is recognized will expire as follows:

	(Millions of yen)		
	2016	2015	Transition date
Not later than 1 year	10,974	3,902	5,968
Later than 1 year and not later than 2 years	4,132	10,370	8,025
Later than 2 years and not later than 3 years	5,551	4,630	7,353
Later than 3 years and not later than 4 years	7,320	6,400	5,198
Later than 4 years	7,297	14,482	19,823
Total	<u>35,274</u>	<u>39,784</u>	<u>46,367</u>

The aggregate amount of taxable temporary differences associated with investments in subsidiaries and associates for which deferred tax liabilities were not recognized at December 31, 2016 and 2015, and the transition date were 12,385 million yen, 14,496 million yen and 25,767 million yen, respectively. The Group

did not recognize deferred tax liabilities for these temporary differences because it was able to control the timing of the reversal of these temporary differences, and it was probable that the temporary difference will not reverse in the foreseeable future.

(2) Income Taxes

Income taxes consist of the following.

	(Millions of yen)	
	2016	2015
Current taxes	50,027	49,877
Deferred taxes ¹	5,514	10,209
Total	<u>55,541</u>	<u>60,086</u>

Note: 1. Deferred taxes include 2,698 million yen and 3,838 million yen for the fiscal years ended December 31, 2016 and 2015, respectively, due to tax rate changes.

(3) Reconciliation of Effective Tax Rate

The details of difference between the statutory income tax rate and the Group's average actual tax rate consist of the following.

	2016	2015
Effective statutory tax rate	33.06	35.64
Tax credit for experimental research costs and other	(3.00)	(2.68)
Different tax rates applied to subsidiaries.....	(2.06)	(2.44)
Reassessment of recoverability of unused tax losses and deferred tax assets	0.32	1.94
Change in tax rates.....	1.47	2.31
Other.....	0.49	1.42
Average actual tax rate	<u>30.28</u>	<u>36.19</u>

Note: Fiscal year ended December 31, 2016

The "Act for Partial Revision of the Income Tax Act, etc." (Act. No. 15 of 2016) and the "Act for Partial Revision of the Local Tax Act, etc." (Act No. 13 of 2016) enacted in Japan on March 29, 2016 reduced the income tax rate for fiscal years beginning on or after April 1, 2016. Accordingly, the effective statutory tax rate used to measure deferred tax assets and deferred tax liabilities has changed from 32.26% to 30.86% for temporary differences expected to be reversed in the fiscal years beginning January 1, 2017 and January 1, 2018, and to 30.62% for temporary differences expected to be reversed in or after the fiscal year beginning January 1, 2019.

Fiscal year ended December 31, 2015

The "Act for Partial Revision of the Income Tax Act, etc." (Act. No. 9 of 2015) and the "Act for Partial Revision of the Local Tax Act, etc." (Act No. 2 of 2015) enacted in Japan on March 31, 2015 reduced the income tax rate for fiscal years beginning on or after April 1, 2015. Accordingly, the effective statutory tax rate used to measure deferred tax assets and deferred tax liabilities has changed from 35.64% to 33.06% for temporary differences expected to be reversed in the fiscal year beginning January 1, 2016, and to 32.26% for temporary differences expected to be reversed in or after the fiscal year beginning January 1, 2017.

17 Bonds and Borrowings

Bonds and borrowings consist of the following.

	2016	2015	Transition date	Average interest rate ¹ (%)	Maturity
Short-term borrowings	220	267	1,357	0.95	—
Current portion of long-term borrowings.....	30,069	72	20,065	0.29	—
Long-term borrowings	40,410	70,282	30,285	0.13	2019-2023
Bonds ²	49,947	49,925	49,903	—	—
Total.....	<u>120,646</u>	<u>120,546</u>	<u>101,610</u>		
Current liabilities					
Bonds and borrowings	30,289	339	21,422		
Non-current liabilities					
Bonds and borrowings	90,357	120,207	80,188		
Total.....	<u>120,646</u>	<u>120,546</u>	<u>101,610</u>		

Notes: 1. The average interest rate is the weighted-average interest rate on the balance of borrowings as of December 31, 2016.

2. Details of bonds issued are as follows:

Issuer	Bond name	Issue date	2016	2015	Transition date	Interest rate (%)	Collateral	Maturity date
The Company	3rd unsecured bonds 2018	June 14, 2013	24,982	24,970	24,958	0.39	None	June 20, 2018
The Company	4th unsecured bonds 2020	June 14, 2013	24,965	24,955	24,945	0.62	None	June 19, 2020
Total			<u>49,947</u>	<u>49,925</u>	<u>49,903</u>			

18 Leases

(1) Finance Lease Payables

As a lessee, the Group leases assets including buildings. Some lease contracts include renewal options. The Group has no lease contracts with covenants such as restrictions on additional borrowings or additional leases.

The total of future minimum lease payments and the present value under finance lease contracts consist of the following.

	Minimum lease payments			Present value of minimum lease payments		
	2016	2015	Transition date	2016	2015	Transition date
Not later than 1 year	884	968	1,050	842	917	989
Later than 1 year and not later than 5 years	2,622	3,008	3,306	2,532	2,888	3,153
Later than 5 years	634	1,125	1,786	626	1,106	1,748
Total	4,140	5,101	6,142	4,000	4,911	5,890
Financial charges	(140)	(190)	(252)	—	—	—
Present value of minimum lease payments	4,000	4,911	5,890	4,000	4,911	5,890

(2) Non-cancellable Operating Leases

As a lessee, the Group leases assets including land.

The total of future minimum lease payments under non-cancellable operating lease contracts consists of the following.

	2016	2015	Transition date
Not later than 1 year	8,808	8,649	10,291
Later than 1 year and not later than 5 years	16,660	16,889	18,030
Later than 5 years	7,627	8,815	10,156
Total	33,095	34,353	38,477

The total of minimum lease payments under operating lease contracts recognized as expenses is as follows:

	2016	2015
Total of minimum lease payments.....	9,858	11,590

19 Trade and Other Payables

Trade and other payables consist of the following.

	2016	2015	Transition date
Trade payables	130,348	134,278	130,264
Non-trade payables	86,545	72,482	63,196
Total	216,893	206,760	193,460

20 Employee Benefits

(1) Post-employment Benefits

The Company and most of its domestic subsidiaries have a cash balance plan as a defined benefit plan and a defined contribution plan as post-employment benefits (The cash balance plan is linked to market interest rates). Defined benefit plan obligations held in Japan account for a large proportion of the Group's defined benefit plan obligations.

Cash balance plan benefits are calculated using points acquired during the enrollment period and a multiplier based on the enrollment period. The Group may also pay an early retirement bonus allowance to employees who retire earlier than retirement age.

In accordance with laws and regulations, the defined benefit plan is operated as a pension fund that is legally separated from the Group. The pension fund is managed by a Board of Representatives composed of representatives elected by the participating companies and the representatives of participating employees. Pension fund management institutions manage the pension fund's assets in accordance with management policies

specified by the Board of Representatives. The Board of Representatives and the pension fund management institutions are legally required to act in the best interests of plan participants in executing their responsibilities for managing plan assets.

Certain foreign subsidiaries have defined benefit plans and/or defined contribution plans as post-employment benefits.

The defined benefit plan is exposed to the actuarial risk and to the risk of fluctuation in the fair value of plan assets. Actuarial risk primarily involves interest rate risk. Interest rate risk involves the potential for an increase in defined benefit plan obligations if the discount rate used to calculate their present value decreases, because this discount rate is based on market yields on instruments including high-quality corporate bonds. The risk of fluctuation in the fair value of plan assets involves underfunding if actual interest rates are lower than the interest rate criteria for managing plan assets.

1) Defined benefit liabilities recognized in the consolidated statement of financial position

Net defined benefit liabilities and assets recognized in the consolidated statement of financial position, defined benefit obligations and plan assets are as follows:

	(Millions of yen)		
	2016	2015	Transition date
Present value of defined benefit obligations	355,579	331,494	332,385
Fair value of plan assets	(261,857)	(256,828)	(255,541)
Funded status	93,722	74,666	76,844
Effect of asset ceiling	—	—	0
Net defined benefit liabilities	93,722	74,666	76,844
Amounts recognized in consolidated statement of financial position			
Retirement benefit liabilities	94,773	75,706	77,895
Retirement benefit assets ¹	(1,051)	(1,040)	(1,051)
Net defined benefit liabilities	93,722	74,666	76,844

Note: 1. Retirement benefit assets are included in other non-current assets in the consolidated statement of financial position.

2) Defined benefit obligations

Changes in the present value of defined benefit obligations are as follows:

	(Millions of yen)	
	2016	2015
The present value of the defined benefit obligations at beginning of year	331,494	332,385
Current service cost ¹	8,784	9,110
Interest expense ²	3,619	3,679
Remeasurements		
Actuarial (gains) losses arising from changes in demographic assumptions.....	(2,374)	4,614
Actuarial (gains) losses arising from changes in financial assumptions	28,545	(5,013)
Actuarial (gains) losses arising from experience adjustments.....	(1,245)	(468)
Benefits paid ³	(10,964)	(11,148)
Exchange differences on translation of foreign operations and other	(2,280)	(1,665)
The present value of the defined benefit obligations at end of year	355,579	331,494

Notes: 1. Current service cost is recognized in profit or loss and included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.
 2. Interest expense or interest income associated with the net of the present value of the defined benefit obligations and the fair value of plan assets is recognized in profit or loss and included in financial expenses or financial income in the consolidated statement of income.
 3. The weighted-average duration of the defined benefit obligations in Japan was mainly 17.3 years at December 31, 2016, 16.1 years at December 31, 2015 and 15.7 years at the transition date.

3) Plan assets

Changes in the fair value of plan assets are as follows:

	(Millions of yen)	
	2016	2015
The fair value of plan assets at beginning of year.....	256,828	255,541
Interest income	2,692	2,665
Remeasurements		
Return on plan assets (excluding amounts included in interest income)	2,517	(1,155)
Contributions to the plan by the employer ¹	10,768	10,483
Payments from the plan.....	(9,752)	(10,140)
Exchange differences on translation of foreign operations and other.....	(1,196)	(566)
The fair value of plan assets at end of year	261,857	256,828

Note: 1. Pursuant to laws and regulations, the Group and the pension fund review the financial condition of the pension plan regularly and recalculate contributions for allocating future benefits and maintaining the balance of pension financing when the plan is underfunded. The Group plans to contribute 8,972 million yen to the defined benefit plan for the fiscal year ending December 31, 2017.

Plan assets consist of the following.

	(Millions of yen)								
	2016			2015			Transition date		
	Market price in an active market			Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Equity securities	7,723	51,195	58,918	7,211	46,838	54,049	7,776	35,793	43,569
Japan	—	24,704	24,704	—	23,801	23,801	—	22,118	22,118
Overseas.....	7,723	26,491	34,214	7,211	23,037	30,248	7,776	13,675	21,451
Debt securities	7,489	180,216	187,705	5,779	181,072	186,851	6,083	189,992	196,075
Japan	—	116,734	116,734	—	122,107	122,107	—	169,917	169,917
Overseas.....	7,489	63,482	70,971	5,779	58,965	64,744	6,083	20,075	26,158
Other	237	14,997	15,234	2,248	13,680	15,928	2,164	13,733	15,897
Total.....	15,449	246,408	261,857	15,238	241,590	256,828	16,023	239,518	255,541

Note: Plan assets invested in pooled funds of trust banks are classified without a quoted market prices in active markets.

Pension assets in Japan account for a large proportion of the Group's plan assets. The objective in managing plan assets is to raise total returns to the greatest extent possible in order to ensure stable benefits and lump-sum payments for plan participants in the future and beneficiaries with a long-term view under acceptable risks. Specifically, the Group considers factors including expected rate of

return on investments in appropriate assets, risks of each asset, and asset combinations to set an asset mix policy for an appropriate basic portfolio in future years as the basis for maintaining asset allocation. The Group reviews the basic portfolio annually and realigns it as necessary if the asset allocation conditions have changed since the asset mix was set.

4) Significant actuarial assumptions and related sensitivity analysis

Significant actuarial assumptions are as follows:

	2016	2015	Transition date
Discount rate	Mainly 0.8%	Mainly 1.3%	Mainly 1.2%

Note: The above table presents the discount rate used by the Company and major domestic subsidiaries.

Sensitivity analysis of the effect of changes in the present value of the defined benefit obligations of the Company and major domestic subsidiaries given changes in the discount rate used as a significant actuarial assumption is as follows:

	(Millions of yen)		
	2016	2015	Transition date
The impact on defined benefit obligations			
0.5% increase in discount rate	(25,807)	(21,946)	(21,944)
0.5% decrease in discount rate	26,774	23,706	23,306

Note: This sensitivity analysis estimates the effect on the defined benefit obligations at the end of each reporting period from changes in the discount rate while all of the other assumptions remain constant.

5) Defined contribution plans

Expenses related to the defined contribution plan recognized in profit or loss were 3,551 million yen and 3,707 million yen for the fiscal years ended December 31, 2016 and 2015, respectively and included in cost of sales, selling, general and administrative expenses and other operating expenses in the consolidated statement of income.

(2) Other Employee Benefit Expenses

Other employee benefit expenses recognized in cost of sales, selling, general and administrative expenses, and other operating expenses in the consolidated statement of income for the fiscal years ended December 31, 2016 and 2015 were 258,225 million yen and 254,287 million yen, respectively.

21 Provisions

Components of and changes in provisions consist of the following.

	Provision for loss related to cosmetics	Provision for asset retirement obligations	Provision for sales returns	Other provisions	Total
January 1, 2016.....	23,447	4,022	2,083	4,924	34,476
Increase	—	260	4,749	2,030	7,039
Interest expense on discounted provision.....	8	68	—	—	76
Decrease (Provision used)	(9,601)	(87)	(2,751)	(3,210)	(15,649)
Decrease (Provision reversed)	(144)	—	(9)	(452)	(605)
Exchange differences on translation of foreign operations.....	—	(21)	(107)	(30)	(158)
December 31, 2016	13,710	4,242	3,965	3,262	25,179

(1) Provision for Loss Related to Cosmetics

The Group has recognized estimated compensation and other expenses related to cosmetics for brightening products of Kanebo Cosmetics containing the ingredient Rhododendol, for which a voluntary recall was announced on July 4, 2013. The Group expects insurance to cover 9,143 million yen of the estimated expenses.

(2) Provision for Asset Retirement Obligations

The Group recognizes asset retirement obligations principally based on or pursuant to reasonably estimated future expenditures using historical experience and other factors when the Group has a legal or contractual obligation associated with the retirement of property, plant and equipment and leased assets held for use.

These expenditures are generally expected to take place after a year or more, but are affected by factors including future business plans.

(3) Provision for Sales Returns

The Group recognizes expected losses from product returns based on reasonable estimates using historical experience and other factors when the Group expects that customers will return products that the Group has sold, primarily when the Group terminates the production and sale of products. These expenditures are generally expected to take place after a year or more, but are affected by factors including future business plans.

(4) Other Provisions

Estimated expenses for business transformation at European subsidiaries and other expenses are included.

22 Other Current Liabilities

Other current liabilities consist of the following.

	2016	2015	Transition date
Accrued expenses	104,425	100,651	96,227
Consumption tax payables	8,655	10,249	13,077
Obligation for unused paid absences	6,199	5,974	5,775
Other	11,833	8,548	8,837
Total	131,112	125,422	123,916

23 Equity and Other Equity Items

(1) Share Capital

The numbers of shares authorized and issued are as follows:

	(Shares)	
	2016	2015
Authorized.....	1,000,000,000	1,000,000,000
Issued ¹		
Beginning balance.....	504,000,000	504,000,000
Change during the year.....	—	—
Ending balance.....	504,000,000	504,000,000

Note: 1. All of the issued shares of the Company are ordinary shares that have no par value and no limitations on rights. Issued shares are fully paid.

(2) Capital Surplus

Capital surplus consists of capital reserve and other capital surplus.

The Companies Act stipulates that over half of the capital contributed from the issue of shares must be included in share capital and that the remainder must be included in capital reserve. Moreover, capital reserve may be included in share capital by resolution of the General Meeting of Shareholders.

(3) Treasury Shares

The changes in treasury shares are as follows:

	(Shares)	
	2016	2015
Beginning balance ¹	2,541,816	2,921,992
Increase ²	8,862,432	9,340
Decrease ³	(266,594)	(389,516)
Ending balance ¹	11,137,654	2,541,816

Notes: 1. 556,492 shares of treasury shares held by associates were included at December 31, 2016 and 2015, and the transition date.
 2. The increase of 8,862,432 shares of treasury shares during the fiscal year ended December 31, 2016 resulted from the acquisition of 8,858,700 shares by resolution of the Board of Directors and the purchase of 3,732 fractional shares.
 The increase of 9,340 shares of treasury shares during the fiscal year ended December 31, 2015 resulted from the purchase of fractional shares.
 3. The decrease of 266,594 shares of treasury shares during the fiscal year ended December 31, 2016 resulted from a decrease of 266,000 shares due to the exercise of stock options, and the sale of 594 fractional shares.
 The decrease of 389,516 shares of treasury shares during the fiscal year ended December 31, 2015 resulted from a decrease of 389,000 shares due to the exercise of stock options, and the sale of 516 fractional shares.

(4) Other Components of Equity

1) Subscription rights to shares

The Company employs a stock option system and issues subscription rights to shares in accordance with the Companies Act. Note 33 "Share-based Payments" presents information including terms and conditions and amounts.

2) Exchange differences on translation of foreign operations

Foreign currency translation differences arise from the translation of financial statements of foreign operations prepared in foreign currencies.

3) Net gain (loss) on derivatives designated as cash flow hedges

The Group hedges its exposure to the risk of variability in future cash flows. The effective portion of changes in the fair value of cash flow hedges is the portion of the change in the fair value of the hedging instrument recognized as effective under hedge accounting.

4) Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income

This is the accumulated amount of changes in the fair value of financial assets measured at fair value through other comprehensive income. The Group reclassifies net gain (loss) on revaluation of financial assets from other components of equity to retained earnings when it disposes of an investment or when fair value declines significantly.

5) Remeasurements of defined benefit plans

Remeasurements of defined benefit plans includes the effect of variance between actuarial assumptions at the beginning of the year and actual results, the effects of changes in actuarial assumptions, actual return on plan assets and interest income on plan assets (excluding amounts included in net interest on the net defined benefit liability (asset)), and any change in the effect of the asset ceiling (excluding amounts included in net interest on the net defined benefit liability (asset)). Remeasurements of defined benefit plans are recognized in other comprehensive income and

immediately reclassified from other components of equity to retained earnings in the period when they occur.

(5) Retained Earnings

Retained earnings consist of legal reserve and other retained earnings.

The Companies Act requires that an amount equal to one-tenth

of dividends must be appropriated as capital reserve or as legal reserve until the total of aggregate amount of capital reserve and legal reserve equals a quarter of share capital. Legal reserve may be appropriated to reduce a deficit, and also may be reversed by resolution of the General Meeting of Shareholders.

24 Basic Strategy for Capital Policy

The Group's capital policy follows a basic strategy of securing a sound financial structure to make investments for sustainable growth and tolerate the related risks, and to make stable, continuous returns to shareholders. To realize this policy, the Group uses Economic Value Added (hereinafter "EVA[®]"), a management indicator that takes capital cost into account, as its main indicator and works to enhance its corporate value by improving EVA.

The Group manages all equity and interest-bearing liabilities as subject of capital cost and intends to optimize capital cost from the viewpoint of safety and capital efficiency. For equity, the Group aims for a streamlined and sound structure from a medium- to long-term perspective with efficiency in mind and, while maintaining interest-bearing liabilities at a moderate level, aims to obtain high credit ratings which will allow it to procure capital for large-scale investments. The Group is not subject to significant capital regulations except for general requirements under the Companies Act and others.

Although the Group emphasizes shareholder returns, it realizes

that investment for growth will meet the expectations of its stakeholders, and therefore prioritizes such investment. In addition to providing stable dividends, the Group aims to continuously increase dividends to reflect improvement in business results. The Group also uses surplus funds to flexibly conduct share repurchases.

In addition to making returns to shareholders, the Group retains the capital necessary to conduct investments for growth in a timely fashion and to ensure sufficient soundness to deal with situations that exceed assumptions while improving EVA.

For the fiscal year ended December 31, 2016, EVA increased 14.8 billion yen compared with the previous fiscal year to 73.4 billion yen, due in part to an increase in net operating profit after tax (hereinafter "NOPAT") and efforts to reduce capital invested including the implementation of shareholder returns through a share repurchase.

Note: 1. EVA is a monetary metric defined as NOPAT less capital cost. EVA is a registered trademark of Stern Stewart & Co.

25 Dividends

Dividends paid are as follows:

Fiscal year ended December 31, 2016

Date of resolution	Total dividends ¹ (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
110th Annual General Meeting of Shareholders held on March 25, 2016	21,061	42	December 31, 2015	March 28, 2016
Board of Directors held on July 28, 2016	23,077	46	June 30, 2016	September 1, 2016

Note: 1. Dividends on treasury shares held by associates accounted for using the equity method are reduced by an amount corresponding to the Group's equity in these associates. The dividend resolved at the 110th Annual General Meeting of Shareholders held on March 25, 2016 was 21,085 million yen before the reduction. The dividend resolved at the meeting of the Board of Directors held on July 28, 2016 was 23,103 million yen before the reduction.

Fiscal year ended December 31, 2015

Date of resolution	Total dividends ¹ (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
109th Annual General Meeting of Shareholders held on March 25, 2015	18,039	36	December 31, 2014	March 26, 2015
Board of Directors held on July 28, 2015	19,052	38	June 30, 2015	September 1, 2015

Note: 1. Dividends on treasury shares held by associates accounted for using the equity method are reduced by an amount corresponding to the Group's equity in these associates. The dividend resolved at the 109th Annual General Meeting of Shareholders held on March 25, 2015 was 18,059 million yen before the reduction. The dividend resolved at the meeting of the Board of Directors held on July 28, 2015 was 19,073 million yen before the reduction.

Dividends with an effective date after the fiscal year end are as follows:

Fiscal year ended December 31, 2016

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
111th Annual General Meeting of Shareholders held on March 21, 2017	23,684	48	December 31, 2016	March 22, 2017

Fiscal year ended December 31, 2015

Date of Resolution	Total dividends (Millions of yen)	Dividends per share (Yen)	Record date	Effective date
110th Annual General Meeting of Shareholders held on March 25, 2016	21,085	42	December 31, 2015	March 28, 2016

26 Net Sales

Net sales consist of the following.

	(Millions of yen)	
	2016	2015
Sale of goods.....	1,456,950	1,473,956
Rendering of services.....	660	594
Total	<u>1,457,610</u>	<u>1,474,550</u>

27 Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of the following.

	(Millions of yen)	
	2016	2015
Freight/warehouse.....	58,168	60,737
Advertising.....	97,437	94,745
Sales promotion.....	83,161	79,910
Employee benefits.....	191,122	191,392
Depreciation	11,236	11,695
Amortization	6,173	13,957
Research and development	54,567	52,699
Other	131,504	137,594
Total	<u>633,368</u>	<u>642,729</u>

28 Other Operating Income

Other operating income consists of the following.

	(Millions of yen)	
	2016	2015
Revenue of logistics services to third party.....	8,300	8,885
Royalty income	1,022	829
Other	4,355	4,385
Total	<u>13,677</u>	<u>14,099</u>

29 Other Operating Expenses

Other operating expenses consist of the following.

	(Millions of yen)	
	2016	2015
Expenses of logistics services to third party	7,454	8,159
Losses on sale and disposal of property, plant and equipment	3,817	3,910
Impairment losses ¹	109	4,031
Loss related to cosmetics	—	1,961
Expenses for business transformation at European subsidiaries	1,776	—
Other	1,690	1,676
Total	14,846	19,737

Note: 1. Note 12 “Non-current Assets Held for Sale” and Note 13 “Property, Plant and Equipment” present impairment losses.

30 Financial Income and Financial Expenses

Financial income consists of the following.

	(Millions of yen)	
	2016	2015
Interest income		
Financial assets measured at amortized cost	1,012	1,048
Retirement benefit assets	26	21
Dividend income		
Financial assets measured at fair value through other comprehensive income		
Financial assets derecognized during the year	9	46
Financial assets held at year end	205	135
Financial assets measured at fair value through profit or loss	21	37
Other	116	129
Total	1,389	1,416

Financial expenses consist of the following.

	(Millions of yen)	
	2016	2015
Foreign exchange loss ¹	2,859	1,633
Interest expenses ²		
Financial liabilities measured at amortized cost	1,484	1,528
Retirement benefit liabilities	953	1,035
Other	128	17
Total	5,424	4,213

Notes: 1. Valuation gains or losses on currency derivatives that are not designated as hedges are included in foreign exchange loss.

2. Valuation gains or losses on interest rate derivatives that are not designated as hedges are included in interest expenses.

31 Earnings per Share**(1) The Basis for Calculating Basic Earnings per Share**

	(Millions of yen, unless otherwise noted)	
	2016	2015
Net income attributable to owners of the parent	126,551	105,196
Amounts not attributable to ordinary shareholders of the parent.....	—	—
Net income used to calculate basic earnings per share	<u>126,551</u>	<u>105,196</u>
Weighted average number of ordinary shares (Thousands of shares)	499,355	501,352
Basic earnings per share (Yen)	253.43	209.82

(2) The Basis for Calculating Diluted Earnings per Share

	(Millions of yen, unless otherwise noted)	
	2016	2015
Net income used to calculate basic earnings per share	126,551	105,196
Adjustments to net income	—	—
Net income used to calculate diluted earnings per share.....	<u>126,551</u>	<u>105,196</u>
Weighted average number of ordinary shares (Thousands of shares)	499,355	501,352
Increase in ordinary shares		
Subscription rights to shares (Thousands of shares)	483	701
Weighted average number of ordinary shares after dilution (Thousands of shares)	<u>499,838</u>	<u>502,053</u>
Diluted earnings per share (Yen)	253.18	209.53
Summary of potential ordinary shares not included in the calculation of diluted earnings per share because they have no dilutive effect	—	—

32 Other Comprehensive Income

Amount arising during the fiscal year, reclassification adjustments to profit or loss and tax effects for each component of other comprehensive income are as follows:

Fiscal year ended December 31, 2016	(Millions of yen)				
	Gains (losses) arising for the year	Reclassification adjustments	Before tax effect	Tax effect	After tax effect
Other comprehensive income that will not be reclassified to profit or loss					
Gains (losses) on financial assets measured at fair value through other comprehensive income	(1,569)	—	(1,569)	663	(906)
Remeasurements of defined benefit pension plans.....	(22,409)	—	(22,409)	6,298	(16,111)
Share of other comprehensive income of associates accounted for by the equity method	(128)	—	(128)	56	(72)
Total of other comprehensive income that will not be reclassified to profit or loss	<u>(24,106)</u>	<u>—</u>	<u>(24,106)</u>	<u>7,017</u>	<u>(17,089)</u>
Other comprehensive income that can be reclassified to profit or loss					
Exchange differences on translation of foreign operations	(16,661)	—	(16,661)	—	(16,661)
Share of other comprehensive income of associates accounted for by the equity method	(7)	—	(7)	(3)	(10)
Total of other comprehensive income that can be reclassified to profit or loss	<u>(16,668)</u>	<u>—</u>	<u>(16,668)</u>	<u>(3)</u>	<u>(16,671)</u>
Total	<u>(40,774)</u>	<u>—</u>	<u>(40,774)</u>	<u>7,014</u>	<u>(33,760)</u>

Fiscal year ended December 31, 2015

(Millions of yen)

	Gains (losses) arising for the year	Reclassification adjustments	Before tax effect	Tax effect	After tax effect
Other comprehensive income that will not be reclassified to profit or loss					
Gains (losses) on financial assets measured at fair value through other comprehensive income	2,200	—	2,200	(405)	1,795
Remeasurements of defined benefit pension plans.....	(288)	—	(288)	(482)	(770)
Share of other comprehensive income of associates accounted for by the equity method.....	332	—	332	(87)	245
Total of other comprehensive income that will not be reclassified to profit or loss	2,244	—	2,244	(974)	1,270
Other comprehensive income that can be reclassified to profit or loss					
Exchange differences on translation of foreign operations.....	(14,236)	(828)	(15,064)	—	(15,064)
Effective portion of changes in the fair value of cash flow hedges.....	18	—	18	(6)	12
Share of other comprehensive income of associates accounted for by the equity method.....	(26)	1	(25)	6	(19)
Total of other comprehensive income that can be reclassified to profit or loss	(14,244)	(827)	(15,071)	—	(15,071)
Total	(12,000)	(827)	(12,827)	(974)	(13,801)

33 Share-based Payments

(1) Share-based Payment System

The Company issues the following two types of stock options to directors, executive officers and employees of the Group.

1) Stock options for share-based payment

Stock options for share-based payment are granted as compensation for directors and executive officers who do not concurrently serve as directors. These stock options are intended to motivate and inspire recipients to enhance the Company's results and value of shares and to further enhance corporate value by aligning the interests of recipients with those of shareholders by further increasing the linkage among the compensation of recipients, the Company's results and value of shares.

- Vesting conditions: Set on date of grant
- Settlement: Shares settled

- Exercise period: Five years from July 1 of two years after the subscription rights to shares are granted

2) Conventional stock options

Conventional stock options were granted to the employees of the Company and the directors and employees of its subsidiaries and associates as incentives. These stock options were intended to further enhance corporate value by aligning the interests of recipients with those of shareholders. The Group has ceased granting these stock options since the fiscal year ended December 31, 2012 after reviewing its system of compensation and incentives for managers.

- Vesting conditions: Set on date of grant
- Settlement: Shares settled
- Exercise period: Five years from September 1 of two years after the subscription rights to shares are granted

(2) Number of Stock Options and Weighted Average Exercise Price

	2016		2015	
	Number of shares (Shares)	Weighted average exercise price (Yen)	Number of shares (Shares)	Weighted average exercise price (Yen)
Beginning balance of outstanding	846,000	1,654	1,343,000	2,100
Granted	40,000	1	40,000	1
Exercised	(266,000)	1,886	(389,000)	2,473
Expired at maturity.....	(71,000)	2,355	(148,000)	3,100
Ending balance of outstanding	549,000	1,331	846,000	1,654
Ending balance of exercisable	469,000	1,558	766,000	1,827

Notes: 1. The weighted average share price on the date of exercise for the fiscal years ended December 31, 2016 and 2015 was 5,821 yen and 5,443 yen, respectively.

2. The exercise price and the weighted average remaining contractual life for stock options outstanding at the end of the period are as follows:

2016			2015		
Range of exercise price	Number of shares	Weighted average remaining contractual life	Range of exercise price	Number of shares	Weighted average remaining contractual life
(Yen)	(Shares)	(Years)	(Yen)	(Shares)	(Years)
1	222,000	4.0	1	231,000	4.1
2,190 - 2,254	327,000	1.4	2,190 - 2,355	615,000	1.8
Total	549,000	2.4	Total	846,000	2.4

(3) Fair Value of and Assumptions for Stock Options Issued during the Fiscal Year

The weighted average fair value of stock options issued was estimated using the Black-Scholes model with the following assumptions.

	Stock option 2016	Stock option 2015
Fair value at date of grant	5,681 yen	5,630 yen
Share price at date of grant	5,956 yen	5,871 yen
Exercise price	1 yen	1 yen
Expected volatility	25.723%	21.458%
Expected remaining life	3.5 years	3.5 years
Expected dividend yield	1.343%	1.192%
Risk-free interest rate	(0.235)%	0.018%

Expected volatility is calculated using actual recent share prices for the expected remaining life.

(4) Share-based Payment Expenses

Share-based payment expenses recognized in the consolidated statement of income for the fiscal years ended December 31, 2016 and 2015 were 227 million yen and 225 million yen, respectively.

34 Financial Instruments

(1) Classification of Financial Instruments

The amounts of each classification of financial assets are as follows:

Financial assets	2016	2015	(Millions of yen) Transition date
Financial assets measured at amortized cost			
Cash and cash equivalents (Note 8)	268,126	240,363	181,323
Trade and other receivables (Note 9)	208,459	210,707	212,742
Other	22,404	14,319	13,140
Financial assets measured at fair value through profit or loss			
Cash and cash equivalents (Note 8)	34,900	69,559	47,644
Derivatives	791	2,240	656
Other	2,888	2,858	2,853
Financial assets measured at fair value through other comprehensive income			
Equity securities	12,428	14,987	13,473
Total	549,996	555,033	471,831
Current assets			
Cash and cash equivalents	303,026	309,922	228,967
Trade and other receivables	208,459	210,707	212,742
Other financial assets	13,038	5,065	4,034
Subtotal	524,523	525,694	445,743
Non-current assets			
Other financial assets	25,473	29,339	26,088
Total	549,996	555,033	471,831

Equity securities held by the Group are mainly issued by the entities that maintain business relationships with the Group and held for the long-term without speculative purposes. The Group has designated such equity securities as financial assets measured at fair value through other comprehensive income. Names of major equity securities and their fair values are as follows:

As of December 31, 2016		(Millions of yen)
Company name	Fair value	
Seven & i Holdings Co., Ltd.....	2,863	
Seven Bank, Ltd.	1,675	
Tokio Marine Holdings, Inc.	913	
Saiwai Trading Co., Ltd.....	863	
Livedo Corporation	835	
Aeon Co., Ltd.....	687	
Settsu Oil Mill, Inc.	533	
Izumi Co., Ltd.	502	
Japan Alcohol Trading Co., Ltd.	462	
Keytrading Co., Ltd.....	359	

As of December 31, 2015		(Millions of yen)
Company name	Fair value	
Seven & i Holdings Co., Ltd.....	3,568	
Seven Bank, Ltd.	2,665	
Tokio Marine Holdings, Inc.	1,000	
Livedo Corporation	831	
Saiwai Trading Co., Ltd.....	766	
Aeon Co., Ltd.....	728	
Settsu Oil Mill, Inc.	621	
Izumi Co., Ltd.	468	
Japan Alcohol Trading Co., Ltd.	418	
Keytrading Co., Ltd.....	353	

As of the transition date		(Millions of yen)
Company name	Fair value	
Seven & i Holdings Co., Ltd.....	2,801	
Seven Bank, Ltd.	2,540	
Tokio Marine Holdings, Inc.	1,043	
Livedo Corporation	784	
Saiwai Trading Co., Ltd.....	571	
Aeon Co., Ltd.....	491	
Settsu Oil Mill, Inc.	473	
Izumi Co., Ltd.	422	
Japan Alcohol Trading Co., Ltd.	386	
Keytrading Co., Ltd.....	364	

The Group derecognizes some financial assets measured at fair value through other comprehensive income by sale for reasons including asset efficiency and changes in business relationships. The total amounts of the fair value of such financial assets at the time of sale and the cumulative gains or losses on sales are as follows:

			(Millions of yen)
		2016	2015
Fair value	1,036	690	
Cumulative gains (losses)	658	367	

The Group transfers to retained earnings the cumulative gains or losses arising from changes in the fair value of financial assets measured at fair value through other comprehensive income recognized as other components of equity when it disposes of an investment or when fair value declines significantly. Cumulative gains or losses of other comprehensive income, net of taxes, that were transferred to retained earnings for the fiscal years ended December 31, 2016 and 2015 were 435 million yen and 236 million yen, respectively.

The amounts of each classification of financial liabilities are as follows.

	(Millions of yen)		
Financial liabilities	2016	2015	Transition date
Financial liabilities measured at amortized cost			
Trade and other payables (Note 19)	216,893	206,760	193,460
Bonds and borrowings (Note 17)	120,646	120,546	101,610
Other	19,057	17,919	17,492
Financial liabilities measured at fair value through profit or loss			
Derivatives	773	827	1,086
Total	357,369	346,052	313,648
Current liabilities			
Trade and other payables	216,893	206,760	193,460
Bonds and borrowings	30,289	339	21,422
Other financial liabilities	8,164	6,929	5,765
Subtotal	255,346	214,028	220,647
Non-current liabilities			
Bonds and borrowings	90,357	120,207	80,188
Other financial liabilities	11,666	11,817	12,813
Subtotal	102,023	132,024	93,001
Total	357,369	346,052	313,648

There are no significant assets pledged for the above financial liabilities. Deposits received, which is interest-bearing liability in other financial liabilities at December 31, 2016 and 2015, and the transition date, was 13,275 million yen, 11,986 million yen and 10,561 million yen, respectively. The average interest rate on deposits received as of December 31, 2016 is 0.14%.

(2) Risk Management on Financial Instruments

The Group manages financial instrument risk based on the following policies to avoid and mitigate market risk, credit risk and liquidity risk.

1) Market risk management

The Group is exposed to the risk of market variability such as fluctuations in exchange rates, interest rates and share prices. The Group appropriately manages market risk to mitigate risk. In addition, the Group uses derivatives mainly consisting of foreign exchange forward contracts, currency swaps and interest rate swaps with the objective of appropriately managing market risk. The Group executes and manages derivatives in accordance with internal policies that define objective, position limit, scope, organizational structure and others. The Group limits the use of derivatives to actual risk

mitigation needs, and does not use derivatives for trading or speculative purposes. Therefore, as a rule, changes in the fair value of derivative instruments that the Group holds effectively offset changes in the fair value or cash flow.

(i) Exchange rate risk

The Group also operates outside Japan, and therefore is exposed to the risks of exchange rate fluctuations associated with transactions conducted in foreign currencies and with net investments in foreign operations. The Group minimizes the effect of exchange rate fluctuations on operating results by settling transactions denominated in foreign currency through foreign currency accounts, and by hedging the risk of exchange rate fluctuations using derivative instruments such as foreign exchange forward and currency swaps.

Details of foreign exchange forward contracts and currency swaps between the Japanese yen, which is the Group's functional currency, and its main foreign currencies including the U.S. dollar, the euro and the Chinese yuan are as follows:

The Group did not apply hedge accounting for these derivative transactions, but determined that these transactions effectively offset the impact of fluctuations in exchange rates.

Derivatives transactions	(Millions of yen)								
	2016			2015			Transition date		
	Contract amount	Contract amount over 1 year	Carrying amount (fair value) ¹	Contract amount	Contract amount over 1 year	Carrying amount (fair value) ¹	Contract amount	Contract amount over 1 year	Carrying amount (fair value) ¹
Foreign exchange forward contracts:									
Selling									
U.S. dollar.....	16,308	7,280	60	16,824	9,729	(83)	—	—	—
Euro.....	74	—	3	76	—	(0)	54	—	1
Chinese yuan	1,065	—	(1)	4,578	3,379	110	3,053	3,053	(67)
Buying									
Euro.....	151	—	(6)	43	—	1	55	—	(1)
Chinese yuan	701	701	(52)	778	778	(100)	808	808	(114)
Currency swaps:									
Receiving Japanese yen, paying									
Chinese yuan	2,279	2,279	(158)	2,279	2,279	(417)	2,279	2,279	(602)

Note: 1. Note 34 "Financial Instruments (4) Fair Value of Financial Instruments" presents the method of measuring the fair value of the above derivatives.

The above assets or liabilities related to derivative transactions are included in other financial assets or other financial liabilities in the consolidated statement of financial position.

Net exposure to exchange rate risk consists of the following. Amounts hedged against exchange rate fluctuation risk with derivatives are excluded.

As of December 31, 2016	(Millions of yen)		
	U.S. dollar	Euro	Chinese yuan
Net exposure	2,210	707	5,342

As of December 31, 2015	(Millions of yen)		
	U.S. dollar	Euro	Chinese yuan
Net exposure	1,598	1,354	4,183

The following table illustrates the impact on income before income taxes in the consolidated statement of income from foreign currency-denominated financial instruments held by the Group at the end of each fiscal year if the Japanese yen appreciated by 10% against the U.S. dollar, the euro and the Chinese yuan.

The effects of translating financial instruments denominated in the Group's functional currency, and the assets, liabilities, income and expenses of foreign operations are not included in the analysis. The analysis also assumes that currencies other than those used in the calculation remain constant.

	(Millions of yen)	
	2016	2015
U.S. dollar	(221)	(160)
Euro	(71)	(135)
Chinese yuan	(534)	(418)

(ii) Interest rate fluctuation risk

The Group finances through long-term borrowings and bonds for maintaining an appropriate cost of capital and strengthening its financial base for investment for growth. The Group considers interest rate market movements and the balance between floating and fixed interest rates in making decisions about long-term funding. The Group's short-term borrowings generally have floating interest rates. The Group hedges interest rate risk as necessary

using derivative instruments such as interest rate swaps, and therefore estimates its exposure to interest rate fluctuation risk is limited.

(iii) Share price fluctuation risk

The Group held marketable equity securities, primarily those of companies with which the Group has business relationships, totaled at 8,956 million yen, 11,775 million yen and 10,476 million yen at December 31, 2016 and 2015,

and the transition date, respectively. These equity securities are exposed to share price fluctuation risk. However, the Group annually evaluates the rationale and reviews ongoing advisability and position size of these holdings. Fluctuations in their prices do not affect net profit or loss because all of these equity securities are designated as financial assets measured at fair value through other comprehensive income.

2) Credit risk management

The Group is exposed to credit risk such as a counterparty's default on its contractual obligations resulting in financial losses to the Group.

(i) Trade and other receivables

Notes and accounts receivable are trade receivables that expose the Group to customer credit risk. The Group manages that risk with an internal process for investigating and approving customer credit on initial transactions, and by obtaining deposits, collateral or other guaranties as necessary. The Group also manages due dates and outstanding balances by customer, and periodically reconfirms creditworthiness of major customers. Non-trade receivables expose the Group to business partner credit risk, but these receivables are almost entirely settled in the short-term.

(ii) Short-term investments

Short-term investments are recognized in cash and cash equivalents and other financial assets. They are highly safe and liquid financial instruments that include commercial paper issued by entities with high bond ratings, bond investment trusts, and money held in trust.

(iii) Loan receivables

Loan receivables expose the Group to borrower credit risk. The Group manages this risk with an internal process for investigating and approving borrower credit on initial lending transactions, and by obtaining deposits, collateral or other guaranties as necessary. The Group also periodically reconfirms creditworthiness of borrowers.

(iv) Derivatives

The Group executes and manages derivatives in accordance with internal policies that define objective, position limit, scope and organizational structure. The Group limits the use of derivatives to actual risk mitigation needs, and does not use derivatives for trading or speculative purposes, and reduces credit risk by limiting transactions to highly creditworthy financial institutions.

The carrying amount after impairment of financial assets in the consolidated financial statements of financial position represents the Group's maximum exposure to the credit risk of financial assets. The Group is not exposed to excessive credit risk associated with a particular customer that requires exceptional management.

The Group recognizes an allowance for doubtful receivables for trade receivables and other financial assets measured at amortized cost by estimating future credit losses in consideration of recoverability and significant increases in credit risk. The Group determines if credit risk has increased significantly by evaluating changes in default risk with reference to factors including downgrading of internal credit ratings, the decline of counterparty results, and delinquency information.

Trade receivables are particularly important financial assets for the Group. The Group collectively measures expected credit losses of the financial assets for the entire period to recognize the allowance for doubtful receivables. In the following situations that would adversely affect future cash flows, however, the Group measures expected credit losses individually by treating each receivable as a credit-impaired financial asset.

- Where the customer has serious financial difficulties
- Where the customer defaults or becomes delinquent in accounts receivable payments despite repeated demands for payment
- Where it is more likely that the customer will go into bankruptcy or face a situation that forces it to reconstruct its business

The Group directly writes down carrying amount if it does not reasonably expect to recover all or part of the trade receivables, following an internal process of investigation and approval.

The Group held security deposits for credit enhancement totaling 6,413 million yen, 6,271 million yen, and 6,105 million yen at December 31, 2016 and 2015, and the transition date, respectively.

The carrying amount of trade receivables and changes in the related allowance for doubtful receivables are as follows:

Fiscal year ended December 31, 2016 (Millions of yen)

Trade receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2016	206,494	472	206,966
Change during the year			
(Recognition and derecognition)	2,472	(36)	2,436
Transfer to credit-impaired financial assets	28	(28)	—
Other changes	(4,258)	(45)	(4,303)
December 31, 2016	204,736	363	205,099

(Millions of yen)

Allowance for doubtful receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2016	803	465	1,268
Increase during the year	217	18	235
Decrease during the year (charge-offs)	(85)	(28)	(113)
Decrease during the year (other)	(72)	(36)	(108)
Transfer to credit-impaired financial assets	(6)	6	—
Other changes	(76)	(43)	(119)
December 31, 2016	781	382	1,163

Fiscal year ended December 31, 2015 (Millions of yen)

Trade receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2015	205,186	488	205,674
Change during the year			
(Recognition and derecognition)	5,749	(104)	5,645
Transfer to credit-impaired financial assets	(146)	146	—
Other changes	(4,295)	(58)	(4,353)
December 31, 2015	206,494	472	206,966

(Millions of yen)

Allowance for doubtful receivables	Financial assets for which loss allowances are always measured at an amount equal to expected credit losses for the entire period	Credit-impaired financial assets	Total
January 1, 2015	775	475	1,250
Increase during the year	236	126	362
Decrease during the year (charge-offs)	(115)	(35)	(150)
Decrease during the year (other)	(46)	(49)	(95)
Transfer to credit-impaired financial assets	(7)	7	—
Other changes	(40)	(59)	(99)
December 31, 2015	803	465	1,268

Notes to Consolidated Financial Statements

The following tables present an analysis of the carrying amount of trade receivables and the allowance for doubtful receivables by days past due.

As of December 31, 2016 (Millions of yen unless otherwise noted)

	Not due	Days past due				Total
		Less than 30 days	Over 30 days	Over 60 days	Over 90 days	
Trade receivables.....	197,543	4,315	1,248	553	1,440	205,099
Allowance for doubtful receivables	256	82	30	60	735	1,163
Expected credit loss (%).....	0.1	1.9	2.4	10.9	51.0	0.6

As of December 31, 2015 (Millions of yen unless otherwise noted)

	Not due	Days past due				Total
		Less than 30 days	Over 30 days	Over 60 days	Over 90 days	
Trade receivables.....	196,783	6,795	1,414	504	1,470	206,966
Allowance for doubtful receivables	245	89	28	34	872	1,268
Expected credit loss (%).....	0.1	1.3	2.0	6.6	59.3	0.6

As of the transition date (Millions of yen unless otherwise noted)

	Not due	Days past due				Total
		Less than 30 days	Over 30 days	Over 60 days	Over 90 days	
Trade receivables.....	197,825	4,853	1,142	511	1,343	205,674
Allowance for doubtful receivables	356	26	43	39	786	1,250
Expected credit loss (%).....	0.2	0.5	3.8	7.6	58.6	0.6

3) Liquidity Risk Management

Liquidity risk is the risk that the Group may not be able to fulfill its obligation to pay financial liabilities that come due.

The Group uses methods such as scheduled medium- and long-term financing plans to understand its liquidity and

consistently ensure the availability of sufficient funding.

The Group has also implemented the Global Cash Management System to reduce liquidity risk through the focused and efficient management of the Group's capital in Japan and overseas.

Financial liabilities including derivative instruments by maturity date consist of the following.

As of December 31, 2016 (Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 2 years	Later than 2 years but not later than 3 years	Later than 3 years but not later than 4 years	Later than 4 years but not later than 5 years	Later than 5 years
Non-derivative financial liabilities								
Trade and other receivables.....	216,893	216,893	216,869	24	—	—	—	—
Bonds and borrowings.....	120,646	120,699	30,289	25,066	40,045	25,038	235	26
Lease obligations	4,000	4,140	884	779	684	667	492	634
Long-term deposits payable	6,413	6,413	—	—	—	—	—	6,413
Derivative financial liabilities								
Currency related	758	758	337	159	—	—	262	—
Interest rate related	15	15	7	8	—	—	—	—
Total	348,725	348,918	248,386	26,036	40,729	25,705	989	7,073

As of December 31, 2015

(Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 2 years	Later than 2 years but not later than 3 years	Later than 3 years but not later than 4 years	Later than 4 years but not later than 5 years	Later than 5 years
Non-derivative financial liabilities								
Trade and other receivables.....	206,760	206,760	206,732	28	—	—	—	—
Bonds and borrowings.....	120,546	120,621	339	30,070	25,067	40,046	25,038	61
Lease obligations.....	4,911	5,101	968	882	782	683	661	1,125
Long-term deposits payable.....	6,271	6,271	—	—	—	—	—	6,271
Derivative financial liabilities								
Currency related.....	790	790	54	54	515	58	109	—
Interest rate related.....	37	37	—	25	12	—	—	—
Total.....	339,315	339,580	208,093	31,059	26,376	40,787	25,808	7,457

As of the transition date

(Millions of yen)

	Carrying amount	Contract amount	Not later than 1 year	Later than 1 year but not later than 2 years	Later than 2 years but not later than 3 years	Later than 3 years but not later than 4 years	Later than 4 years but not later than 5 years	Later than 5 years
Non-derivative financial liabilities								
Trade and other receivables.....	193,460	193,460	193,460	—	—	—	—	—
Bonds and borrowings.....	101,610	101,707	21,422	63	30,061	25,058	37	25,066
Lease obligations.....	5,890	6,142	1,050	967	880	780	679	1,786
Long-term deposits payable.....	6,105	6,105	—	—	—	—	—	6,105
Derivative financial liabilities								
Currency related.....	1,007	1,007	338	—	—	669	—	—
Interest rate related.....	79	79	79	—	—	—	—	—
Total.....	308,151	308,500	216,349	1,030	30,941	26,507	716	32,957

(3) Hedge Accounting

As described in Note 34 "Financial Instruments (2) Risk Management on Financial Instruments," the Group designates interest rate swaps as cash flow hedges to hedge interest rate fluctuation risk for floating-rate liabilities. When applying hedge accounting, the Group periodically evaluates whether the hedged item and the hedging instrument meets key criteria and is closely matched in order to confirm an offsetting economic relationship between fluctuations in the cash flow of the hedged item attributable to the risk being hedged and fluctuations in the cash flow of the hedging instrument. The Group also assesses hedge effectiveness by quantitatively evaluating whether changes in the cash flows of the hedged item and the hedging instrument have an offsetting relationship due to the same risk. In addition, the Group sets hedge ratios that are appropriate in light of the economic

relationship between the hedging instrument and the hedged item and the Group's risk management strategy. The Group's hedges generally do not have a significant ineffective hedge portion because the Group only applies the hedge accounting when the hedged item and the hedging instrument meet key criteria.

The effective portion of changes in the fair value of derivatives designated as cash flow hedges is recognized in other comprehensive income. Gains or losses on derivatives recognized in other components of equity are transferred to profit or loss when changes in the future cash flows associated with hedged items are recognized in profit or loss. Any ineffective portion is recognized in profit or loss. The Group discontinues hedge accounting for a hedging relationship if the risk management objective has changed.

The carrying amount (fair value) of derivatives designated as cash flow hedges consists of the following. There was no hedging relationship for which the Group discontinued hedge accounting.

(Millions of yen)

Type of risk	Consolidated statement of financial position line item	Hedging instrument	2016			2015			Transition date		
			Nominal amount	Contract amount later than 1 year	Carrying amount (fair value)	Nominal amount	Contract amount later than 1 year	Carrying amount (fair value)	Nominal amount	Contract amount later than 1 year	Carrying amount (fair value)
Interest Rate Risk	Other financial liabilities in current liabilities	Interest rate swap (pay fixed / receive variable) ¹	—	—	—	—	—	—	20,000	—	(18)

Note: 1. The details of this swap contract are: pay fixed 0.53%, receive variable TIBOR+0.05%.

Derivatives designated as cash flow hedges that the Group recognized in other components of equity and in profit and loss (before tax effect) consist of the following.

As of December 31, 2016

None applicable.

As of December 31, 2015

Type of risk	(Millions of yen)			
	Beginning of year: Effective portion of changes in the fair value of cash flow hedge	Hedge profit or loss recognized in other comprehensive income	Amount reclassified to other components of equity	End of year: Effective portion of changes in the fair value of cash flow hedge
Interest rate risk	(18)	18	—	—

(4) Fair Value of Financial Instruments

1) Fair value hierarchy levels

For financial instruments measured at fair value, the fair values developed based on the observability of inputs into the valuation techniques used in measurement are categorized within the following three levels.

Level 1: Fair value measured with quoted prices in active markets for identical assets or liabilities

Level 2: Fair value measured with inputs other than quoted prices categorized within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Fair value measured with inputs not based on observable market data for the asset or liability

2) Financial instruments measured at fair value

The measurement methods for the main financial instruments measured at fair value are as follows.

- (i) Short-term investments (excluding short-term investments measured at amortized cost)
Short-term investments are included in cash and cash equivalents, and are designated as financial assets measured at fair value through profit or loss. Short-term investments primarily consist of bond investment trusts and money held in trust, and are measured with a model using observable inputs such as interest rates.

(ii) Derivative assets and derivative liabilities

Derivative assets and derivative liabilities are included in other financial assets and other financial liabilities, and are designated as financial assets and financial liabilities measured at fair value through profit or loss. Consisting of instruments including foreign exchange forward contracts, currency swaps and interest rate swaps, derivative assets and derivative liabilities are primarily measured with a model using observable inputs such as exchange rates and interest rates.

(iii) Equity securities

Equity securities are included in other financial assets, and are designated as financial assets measured at fair value through other comprehensive income. Equity securities that are categorized within Level 1 are publicly listed and traded in active markets, and are measured using market prices on exchanges. Equity securities that are categorized within Level 3 are unlisted, and are primarily measured using a net asset valuation model, which measures corporate value based on the net asset of the issuing company with adjustments based on fair value.

The fair value hierarchy of financial instruments measured at fair value is as follows.

The Group recognizes transfers of financial instruments between levels of the fair value hierarchy at the end of each fiscal year. No financial instruments were transferred between levels of the fair value hierarchy for the fiscal years ended December 31, 2016 or 2015.

As of December 31, 2016				(Millions of yen)
	Level 1	Level 2	Level 3	Total
Financial assets				
Financial assets measured at fair value through profit or loss				
Short-term investments	—	34,900	—	34,900
Derivative assets	—	791	—	791
Other	—	2,888	—	2,888
Financial assets measured at fair value through other comprehensive income				
Equity securities	8,956	—	3,472	12,428
Total	8,956	38,579	3,472	51,007
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	773	—	773
Total	—	773	—	773

As of December 31, 2015				(Millions of yen)
	Level 1	Level 2	Level 3	Total
Financial assets				
Financial assets measured at fair value through profit or loss				
Short-term investments	—	69,559	—	69,559
Derivative assets	—	2,240	—	2,240
Other	—	2,858	—	2,858
Financial assets measured at fair value through other comprehensive income				
Equity securities	11,775	—	3,212	14,987
Total	11,775	74,657	3,212	89,644
Financial liabilities				
Financial liabilities measured at fair value through profit or loss...				
Derivative liabilities	—	827	—	827
Total	—	827	—	827

As of the transition date				(Millions of yen)
	Level 1	Level 2	Level 3	Total
Financial assets				
Financial assets measured at fair value through profit or loss				
Short-term investments	—	47,644	—	47,644
Derivative assets	—	656	—	656
Other	—	2,853	—	2,853
Financial assets measured at fair value through other comprehensive income				
Equity securities	10,476	—	2,997	13,473
Total	10,476	51,153	2,997	64,626
Financial liabilities				
Financial liabilities measured at fair value through profit or loss				
Derivative liabilities	—	1,086	—	1,086
Total	—	1,086	—	1,086

Changes in financial instruments categorized within Level 3 are as follows:

	(Millions of yen)	
	2016	2015
Beginning balance	3,212	2,997
Gains (Losses) ¹	231	290
Purchases	30	—
Sales	—	(73)
Other changes	(1)	(2)
Ending balance	<u>3,472</u>	<u>3,212</u>

Note: 1. All gains and losses are associated with financial assets measured at fair value through other comprehensive income at the end of each reporting period. These gains and losses are recognized in net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income in the consolidated statement of comprehensive income.

Financial instruments categorized within Level 3 are primarily unlisted equity securities. Each responsible department of the Group refers to the Group accounting policies in measuring the fair value of unlisted equity securities each quarter using recently available data, and reports any changes in fair value and the reasons to the department manager, and to senior management as necessary.

3) Financial instruments measured at amortized cost

The following tables present the measurement techniques for measuring the fair value of major financial instruments measured at amortized cost. Financial instruments for which carrying amounts are a reasonable approximation of fair value or financial instruments that are not material are not included in the tables.

- (i) Cash and cash equivalents (excluding short-term investments measured at fair value), trade and other

receivables, and trade and other payables

Carrying amounts approximate fair value because these are settled in the short-term.

- (ii) Bonds and borrowings

The fair value of bonds is based on market prices. The fair value of borrowings is the present value of remaining principal and interest discounted using a deemed interest rate on equivalent new borrowings.

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost are as follows:

As of December 31, 2016 (Millions of yen)

	Carrying amount	Fair value			Total
		Level 1	Level 2	Level 3	
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	49,947	—	50,548	—	50,548
Borrowings	70,699	—	71,084	—	71,084

As of December 31, 2015 (Millions of yen)

	Carrying amount	Fair value			Total
		Level 1	Level 2	Level 3	
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	49,925	—	50,650	—	50,650
Borrowings	70,621	—	70,933	—	70,933

As of the transition date (Millions of yen)

	Carrying amount	Fair value			Total
		Level 1	Level 2	Level 3	
Financial liabilities					
Financial liabilities measured at amortized cost					
Bonds	49,903	—	50,910	—	50,910
Borrowings	51,707	—	51,935	—	51,935

35 Principal Subsidiaries

Principal subsidiaries consist of the following. Voting rights at December 31, 2016 did not significantly change from a year earlier.

Company name	Country	Principal businesses	Voting rights (%)
Kao Group Customer Marketing Co., Ltd.	Japan	Control of sales companies and other subsidiaries in Japan	100.0
Kao Customer Marketing Co., Ltd.	Japan	Beauty Care Human Health Care Fabric and Home Care	100.0
Kanebo Cosmetics Inc.	Japan	Beauty Care	100.0
Kanebo Cosmetics Sales Inc.	Japan	Beauty Care	100.0
Kao Transport & Logistics Co., Ltd.	Japan	Logistics and related services in Japan	100.0
Kao (China) Holding Co., Ltd.	China	Control of subsidiaries in China Beauty Care	100.0
Kao Corporation Shanghai	China	Beauty Care Human Health Care Fabric and Home Care	100.0
Kao (Hefei) Co., Ltd.	China	Human Health Care	100.0
Kao Commercial (Shanghai) Co., Ltd.	China	Beauty Care Human Health Care Fabric and Home Care	100.0
Kanebo Cosmetics (China) Co., Ltd.	China	Beauty Care	100.0
Kao (Shanghai) Chemical Industries Co., Ltd.	China	Chemical	100.0
Kao (Taiwan) Corporation	Taiwan	Beauty Care Human Health Care Fabric and Home Care Chemical	92.2
Pilipinas Kao, Inc.	Philippines	Chemical	100.0
Kao Industrial (Thailand) Co., Ltd.	Thailand	Beauty Care Human Health Care Fabric and Home Care Chemical	100.0
Kao Commercial (Thailand) Co., Ltd.	Thailand	Beauty Care Human Health Care Fabric and Home Care	100.0
Fatty Chemical (Malaysia) Sdn. Bhd.	Malaysia	Chemical	70.0
PT Kao Indonesia	Indonesia	Beauty Care Human Health Care Fabric and Home Care	72.2
Kao USA Inc.	U.S.A.	Beauty Care	100.0
Kao America Inc.	U.S.A.	Corporate service to subsidiaries in U.S. Holding company for Chemical Business in the U.S.	100.0
Kao Specialties Americas LLC	U.S.A.	Chemical	100.0
Kao Germany GmbH	Germany	Beauty Care	100.0
Kao Manufacturing Germany GmbH	Germany	Beauty Care	100.0
Kao Chemicals GmbH	Germany	Chemical	100.0
Molton Brown Limited	U.K.	Beauty Care	100.0
Kao Chemicals Europe, S.L.	Spain	Control of subsidiaries in Chemical Business in Europe, etc.	100.0
Kao Corporation S.A.	Spain	Chemical	100.0

36 Related Parties**(1) Transactions with Related Parties**

Disclosure is omitted because there is no material related party transaction.

(2) Primary Executive Management Compensation

Primary executive management compensation consists of the following. The Group's primary executive management includes members of the Board of Directors and executive officers of the Company for each fiscal year.

	(Millions of yen)	
	2016	2015
Short-term benefits	1,131	951
Post-retirement benefits	39	50
Share-based payment	227	225
Total	<u>1,397</u>	<u>1,226</u>

37 Commitments

Commitments to acquire property, plant and equipment and intangible assets after the end of each reporting period are as follows:

	(Millions of yen)		
	2016	2015	Transition date
Acquisition of property, plant and equipment	27,100	23,130	19,958
Acquisition of intangible assets	1,306	689	625
Total	<u>28,406</u>	<u>23,819</u>	<u>20,583</u>

38 Significant Subsequent Events

The Board of Directors, at the meeting of the Board of Directors held on February 2, 2017, resolved to retire treasury shares in accordance with Article 178 of the Companies Act and the Company retired treasury shares of the Company. The number of shares retired corresponds to the number of shares of the Company's shares purchased from the market during the fiscal year

ended December 31, 2016.

- Shares retired: Ordinary shares of the Company
- Number of shares retired: 9,000,000 shares
- Total amount of shares retired: 48,429 million yen
- Retirement date: March 1, 2017

39 First-time Adoption of IFRS

The Group presents consolidated financial statements that comply with IFRS from the fiscal year ended December 31, 2016. The most recent consolidated financial statements prepared in accordance with generally accepted accounting principles in Japan (hereinafter "Japanese GAAP") were for the fiscal year ended December 31, 2015, and the transition date is January 1, 2015.

The first-time adopter shall, in principle, apply the standards required under IFRS retrospectively. However, an entity may elect to use the exemptions contained in IFRS 1 and shall apply the exceptions prohibiting retrospective application of some aspects of other IFRS. The Group mainly applies the following exemptions.

IFRS 1 Exemptions

(1) Business Combinations

Under IFRS 1, an entity may elect to apply IFRS 3 "Business Combinations" (hereinafter "IFRS 3") either retrospectively or prospectively. The Group has elected not to apply IFRS 3 retrospectively to past business combinations that occurred before the transition date. As a result, the Group has applied the accounting treatment under Japanese GAAP to the business combinations that occurred before the transition date, which were not restated.

With respect to goodwill arising in business combinations, the Group has kept the Japanese GAAP carrying amounts that had been applied before the transition to IFRS, in principle, and has translated all goodwill denominated in a foreign currency at the closing rate for the retrospective application of IAS 21 "The Effects of Changes in Foreign Exchange Rates."

Goodwill is tested for impairment at the transition date, regardless of any indications of impairment.

(2) Deemed Cost

Under IFRS 1, an entity may elect to measure property, plant and equipment at its fair value at the transition date and use the fair value as its deemed cost at the transition date. The Group used fair value at the transition date as the deemed cost for certain property, plant and equipment.

(3) Cumulative Translation Differences for Foreign Operations

Under IFRS 1, the cumulative translation differences for all foreign operations are deemed to be zero at the transition date, or recalculated retrospectively up until the date the subsidiary or associate was established or acquired. The Group elected to reset the cumulative translation differences to zero at the transition date.

(4) Designation of Previously Recognized Financial Instruments

Under IFRS 1, an entity may designate financial instruments recognized before the transition date in accordance with IFRS 9 on the basis of the facts and circumstances that exist at the transition date. The Group designated financial instruments in accordance with IFRS 9 on the basis of the facts and circumstances that existed at the transition date.

Mandatory Exceptions of IFRS 1

IFRS 1 prohibits retrospective application of IFRS for estimates, derecognition of financial assets and financial liabilities, hedge accounting, non-controlling interests, classification and measurement of financial assets, and impairment of financial assets. The Group has prospectively applied IFRS for these items from the transition date.

The table below presents reconciliations required in first-time adoption of IFRS.

In the table, items that do not affect retained earnings and comprehensive income are included in the "Reclassification" column, differences from Japanese GAAP resulting from a review of the scope of consolidation under IFRS are included in the "Consolidation scope differences" column, and items that affect retained earnings and comprehensive income are included in the "Recognition and measurement differences" column.

Reconciliations of Equity as of the Transition Date (January 1, 2015)

(Millions of yen)

Accounts under Japanese GAAP	Japanese GAAP	Reclassification	Consolidation scope differences	Recognition and measurement differences	IFRS	Notes	Accounts under IFRS
							Assets
							Assets
							Current assets
Cash and time deposits	107,412	121,251	304	—	228,967	(13), (14)	Cash and cash equivalents
Notes and accounts receivable - trade	204,060	7,279	1,290	113	212,742	(14)	Trade and other receivables
Short-term investments	110,639	(110,639)	—	—	—	(13)	
Inventories	157,787	(2,892)	1,161	(4,180)	151,876	(1), (14)	Inventories
Prepaid expenses	6,832	(6,832)	—	—	—		
Deferred tax assets	20,232	(20,232)	—	—	—	(13)	
	—	1,023	238	—	1,261	(14)	Income tax receivables
	—	4,130	(96)	—	4,034	(13), (14)	Other financial assets
Other	36,420	10,428	(33)	484	47,299	(13), (14)	Other current assets
Allowance for doubtful receivables	(1,648)	1,648	—	—	—		
Total current assets	641,734	5,164	2,864	(3,583)	646,179		Total current assets
							Non-current assets
							Property, plant and equipment
Property, plant and equipment	307,615	10,432	2,119	(884)	319,282	(2), (13), (14)	Property, plant and equipment
							Goodwill
Goodwill	139,941	—	—	(1,190)	138,751	(3)	Goodwill
Trademarks	15,145	(15,145)	—	—	—		
Other	12,844	(12,844)	—	—	—		
	—	27,965	7	(4,346)	23,626	(4), (14)	Intangible assets
							Investments accounted for using the equity method
Investment securities	20,984	(20,984)	—	—	—		
	—	9,264	(5,505)	(215)	3,544	(14)	Investments accounted for using the equity method
Long-term loans	1,432	(1,432)	—	—	—		
Long-term prepaid expenses	17,281	(17,281)	—	—	—	(13)	
Asset for retirement benefits	9,692	(9,692)	—	—	—		
	—	23,916	424	1,748	26,088	(5), (13), (14)	Other financial assets
Other	11,612	4,982	44	(8,672)	7,966	(9), (14)	Other non-current assets
Deferred tax assets	20,630	20,232	1,189	19,143	61,194	(6), (13), (14)	Deferred tax assets
Allowance for doubtful receivables	(677)	677	—	—	—		
Total fixed assets	556,499	20,090	(1,722)	5,584	580,451		Total non-current assets
Total assets	1,198,233	25,254	1,142	2,001	1,226,630		Total assets

(Millions of yen)

Accounts under Japanese GAAP	Japanese GAAP	Reclassification	Consolidation scope differences	Recognition and measurement differences	IFRS	Notes	Accounts under IFRS
Liabilities							Liabilities
Current liabilities							Current liabilities
Notes and accounts payable - trade.....	129,711	65,491	(1,742)	—	193,460	(14)	Trade and other payables
Short-term loans	1,137	(1,137)	—	—	—		
Current portion of long-term loans	20,013	(20,013)	—	—	—		
Accounts payable - other	—	21,150	272	—	21,422	(14)	Bonds and borrowings
Accrued expenses	66,230	(66,230)	—	—	—		
Income taxes payable	94,666	(94,666)	—	—	—		
Income taxes payable	28,108	112	63	—	28,283	(14)	Income tax payables
Liability for loss related to cosmetics.....	8,220	(8,220)	—	—	—	(13)	
	—	10,122	(4,375)	18	5,765	(13), (14)	Other financial liabilities
	—	35,962	(2)	(2,600)	33,360	(7), (13), (14)	Provisions
Other.....	32,451	81,754	4,210	5,501	123,916	(8), (13), (14)	Other current liabilities
Total current liabilities	380,536	24,325	(1,574)	2,919	406,206		Total current liabilities
Long-term liabilities							Non-current liabilities
Bonds.....	50,000	(50,000)	—	—	—		
Long-term loans	30,083	(30,083)	—	—	—		
	—	80,083	202	(97)	80,188	(14)	Bonds and borrowings
Liability for retirement benefits.....	42,414	798	763	33,920	77,895	(9), (14)	Retirement benefit liabilities
	—	11,877	936	—	12,813	(13), (14)	Other financial liabilities
	—	4,447	370	479	5,296	(13), (14)	Provisions
Other.....	22,807	(19,614)	108	2,110	5,411	(10), (13), (14)	Other non-current liabilities
	—	3,421	—	(2,988)	433	(6), (13)	Deferred tax liabilities
Total long-term liabilities	145,304	929	2,379	33,424	182,036		Total non-current liabilities
Total liabilities.....	525,840	25,254	805	36,343	588,242		Total liabilities
Net assets							Equity
Common stock.....	85,424	—	—	—	85,424		Share capital
Capital surplus.....	109,561	—	—	—	109,561		Capital surplus
Treasury stock, at cost.....	(9,719)	—	—	—	(9,719)		Treasury shares
Unrealized gain on available-for-sale securities.....	5,507	(5,507)	—	—	—		
Deferred gain (loss) on derivatives under hedge accounting.....	8	(8)	—	—	—		
Foreign currency translation adjustments.....	(4,853)	4,853	—	—	—		
Remeasurements of defined benefit plans.....	3,619	(3,619)	—	—	—		
Stock acquisition rights	944	(944)	—	—	—		
	—	5,225	(302)	2,678	7,601	(11), (14)	Other components of equity
Retained earnings	468,684	—	151	(36,860)	431,975	(12), (14)	Retained earnings
					624,842		Equity attributable to owners of the parent
Minority interests.....	13,218	—	488	(160)	13,546	(14)	Non-controlling interests
Total net assets.....	672,393	—	337	(34,342)	638,388		Total equity
Total liabilities and net assets.....	1,198,233	25,254	1,142	2,001	1,226,630		Total liabilities and equity

Notes on Reconciliations of Equity as of the Transition Date
(January 1, 2015)

(1) Adjustment to Inventories

Mainly, goods for sales promotion recognized in supplies under Japanese GAAP are recognized in an adjustment to retained earnings as they do not meet the definition of assets under IFRS.

(2) Adjustment to Property, Plant and Equipment

Property, plant and equipment is adjusted mainly by applying deemed cost as follows.

The Group used fair value as the deemed cost at the transition date for certain items of property, plant and equipment. At the transition date, the carrying amount of property, plant and equipment to which deemed cost was applied was 1,851 million yen under Japanese GAAP, and the fair value was 848 million yen.

As a result of the above, property, plant and equipment at the transition date decreased by 1,003 million yen, and the adjustment was recognized in retained earnings.

Fair value is based on valuation by independent appraisers with appropriate qualifications and other methods, and is categorized within Level 3.

(3) Adjustment to Goodwill

Under Japanese GAAP, certain foreign currency-denominated goodwill was translated at the exchange rate at the acquisition date, whereas under IFRS all foreign currency-denominated goodwill is translated at the closing rate and recognized in adjustments to retained earnings.

(4) Adjustment to Intangible Assets

Certain intangible assets recognized under Japanese GAAP are recognized in adjustments to retained earnings as they do not meet the definition of assets under IFRS.

(5) Adjustment to Other Financial Assets (Non-current Assets)

Under Japanese GAAP, non-marketable equity instruments were carried at the acquisition cost, and impairment loss was recognized as required depending on the financial condition of the issuing company. Under IFRS, these equity instruments are designated as financial assets measured at fair value through other comprehensive income, and are measured at fair value, irrespective of the existence of market activity, with the change recognized as other comprehensive income and reclassified to retained earnings in case of derecognition or a significant decrease in fair value.

(6) Adjustments to Deferred Tax Assets and Deferred Tax Liabilities

The amounts of deferred tax assets and deferred tax liabilities are adjusted mainly due to taxable temporary differences arising as a result of adjustments from Japanese GAAP to IFRS.

(7) Adjustment to Provisions (Current Liabilities)

Under Japanese GAAP, future expenses that fulfilled the required conditions were recognized as provisions, but are recognized in an adjustment to retained earnings as they do not meet the conditions for recognition of provisions under IFRS.

(8) Adjustment to Other Current Liabilities

Mainly, obligation for unused paid absences that was not recognized as a liability under Japanese GAAP is recognized as a liability under IFRS and recognized in an adjustment to retained earnings.

(9) Adjustments to Retirement Benefit Liabilities and Other Non-current Assets

Under Japanese GAAP, actuarial gains and losses were recognized in other comprehensive income as incurred, and were recognized in profit or loss from the fiscal year when incurred, amortized on a straight-line basis over a certain number of years no longer than the average remaining service period of employees. Under IFRS, these actuarial gains and losses are recognized in other comprehensive income as incurred, and immediately reclassified to retained earnings. Moreover, under Japanese GAAP, past service costs were recognized in other comprehensive income as incurred, and were recognized in profit or loss from the fiscal year when incurred, amortized on a straight-line basis over a certain number of years no longer than the average remaining service period of employees whereas under IFRS they are recognized in profit or loss as incurred.

Under Japanese GAAP, the Company adopted the "Accounting Standard for Retirement Benefits" of the Accounting Standards Board of Japan (hereinafter "ASBJ") (ASBJ Statement No. 26 issued on May 17, 2012, hereinafter "Retirement Benefits Accounting Standard"), and the "Guidance on Accounting Standard for Retirement Benefits" (ASBJ Guidance No. 25 issued on March 26, 2015, hereinafter "Retirement Benefits Guidance") from the fiscal year ended December 31, 2015, revising the methods for calculating retirement benefit obligations and service costs and changing the method for calculating projected retirement benefits from the straight-line basis to the benefit formula basis. In addition, determination of the discount rate changed from a method based on the number of years for the underlying obligations approximating the average remaining years of service of the eligible employees to a method using several discount rates set for each expected retirement benefit payment period. In accordance with the transitional handling set forth in Article 37 of the Retirement Benefits Accounting Standard, the effect associated with the change in the method of calculating retirement benefit obligations and service costs was recognized by adjusting retained earnings at the beginning of the fiscal year ended December 31, 2015. Consequently, as the changes due to the revisions of the Retirement Benefits Accounting Standard and the Retirement Benefits Guidance were not recognized in the consolidated balance sheet under Japanese GAAP, which was already disclosed as of the transition date, the differences with the consolidated statement of financial position are recognized in retained earnings under IFRS.

(10) Adjustment to Other Non-current Liabilities

Special paid leave and bonuses granted conditional on a certain number of years of employment, which were not recognized as liabilities under Japanese GAAP, are recognized as liabilities under IFRS and recognized in adjustments to retained earnings.

(11) Adjustment to Other Components of Equity

- 1) As an exemption elected under IFRS 1, the cumulative translation differences for all foreign operations were reclassified to retained earnings as of January 1, 2015, the transition date. As a result, other components of equity increased by 4,853 million yen.
- 2) Based on the fair value of non-marketable equity instruments stated in (5) above, other components of equity increased by 1,120 million yen.
- 3) Due to the impact of adjustment to retirement benefit liabilities stated in (9) above, other components of equity decreased by 3,318 million yen.

(12) Adjustments to Retained Earnings

	(Millions of yen)
	Transition date January 1, 2015
Adjustment to inventories	(4,180)
Adjustment to property, plant and equipment.....	(884)
Adjustment to goodwill.....	(1,190)
Adjustment to intangible assets	(4,346)
Adjustment to provisions (current liabilities)	2,600
Adjustment to other current liabilities.....	(5,501)
Adjustment to retirement benefit liabilities.....	(36,366)
Adjustment to other non-current liabilities	(2,110)
Adjustment to exchange differences on translation of foreign operations.....	(4,853)
Other adjustments.....	402
Subtotal.....	(56,428)
Adjustment for tax effects.....	19,414
Adjustment for non-controlling interests.....	154
Total.....	(36,860)

(13) Reclassifications

Reclassifications are made to comply with the provisions of IFRS. The main reclassifications are as follows:

- 1) Time deposits with deposit terms of more than three months in "Cash and time deposits" under Japanese GAAP are classified as "Other financial assets" in current assets under IFRS. Among "Short-term investments" and "Other (current assets)" under Japanese GAAP, short-term investments redeemable within three months from the date of acquisition are classified as "Cash and cash equivalents" under IFRS.
- 2) "Deferred tax assets" and "Deferred tax liabilities" classified as current items under Japanese GAAP are classified as non-current items under IFRS.
- 3) Store fixtures for cosmetics were classified as "Long-term prepaid expenses" under Japanese GAAP, but are classified as "Property, plant and equipment" under IFRS.
- 4) Financial assets and financial liabilities are disclosed separately based on the requirements of IFRS.
- 5) The provision for sales returns and asset retirement obligations, which were included in "Other (current liabilities)" and "Other (non-current liabilities)" and the gross amount of liability for loss related to cosmetics under Japanese GAAP, are classified as "Provisions" under IFRS.

(14) Differences in Scope of Consolidation

Certain subsidiaries of minor importance were not included in the scope of consolidation under Japanese GAAP and the equity method was applied, but all subsidiaries are included in the scope of consolidation under IFRS.

Reconciliations of Equity as of December 31, 2015

(Millions of yen)

Accounts under Japanese GAAP	Japanese GAAP	Reclassifi- cation	Consolidation scope differences	Recognition and measurement differences	IFRS	Notes	Accounts under IFRS
							Assets
							Current assets
Cash and time deposits	125,159	184,279	484	—	309,922	(11), (12)	Cash and cash equivalents
Notes and accounts receivable - trade	205,603	3,921	1,147	36	210,707	(12)	Trade and other receivables
Short-term investments	158,651	(158,651)	—	—	—	(11)	
Inventories	158,134	(2,953)	814	(4,724)	151,271	(1), (12)	Inventories
Prepaid expenses	7,048	(7,048)	—	—	—		
Deferred tax assets	20,763	(20,763)	—	—	—	(11)	
	—	1,899	178	—	2,077	(12)	Income tax receivables
	—	5,301	(236)	—	5,065	(11), (12)	Other financial assets
Other	59,501	(21,971)	15	460	38,005	(11), (12)	Other current assets
Allowance for doubtful receivables	(1,626)	1,626	—	—	—		
	733,233	(14,360)	2,402	(4,228)	717,047		Subtotal
	—	1,330	—	—	1,330	(11)	Non-current assets held for sale
Total current assets	733,233	(13,030)	2,402	(4,228)	718,377		Total current assets
							Non-current assets
							Property, plant and equipment
Property, plant and equipment ..	327,730	9,299	1,865	(897)	337,997	(2), (11), (12)	Property, plant and equipment
							Goodwill
Intangible assets							Goodwill
Goodwill	127,099	—	—	11,152	138,251	(3)	Goodwill
Trademarks	1,791	(1,791)	—	—	—		
Other	14,832	(14,832)	—	—	—		
	—	16,602	2	(899)	15,705	(4), (12)	Intangible assets
							Investments accounted for using the equity method
Investments and other assets							Investments accounted for using the equity method
Investment securities	22,331	(22,331)	—	—	—		
	—	9,384	(4,956)	(219)	4,209	(12)	
Long-term loans	1,171	(1,171)	—	—	—		
Long-term prepaid expenses	17,583	(17,583)	—	—	—	(11)	
Asset for retirement benefits	1,027	(1,027)	—	—	—		
	—	26,862	440	2,037	29,339	(5), (11), (12)	Other financial assets
Other	11,860	5,846	61	(35)	17,732	(12)	Other non-current assets
Deferred tax assets	23,896	20,763	995	3,800	49,454	(6), (11), (12)	Deferred tax assets
Allowance for doubtful receivables	(684)	684	—	—	—		
Total fixed assets	548,636	30,705	(1,593)	14,939	592,687		Total non-current assets
Total assets	1,281,869	17,675	809	10,711	1,311,064		Total assets

(Millions of yen)

Accounts under Japanese GAAP	Japanese GAAP	Reclassification	Consolidation scope differences	Recognition and measurement differences	IFRS	Notes	Accounts under IFRS
							Liabilities
							Liabilities
							Current liabilities
Current liabilities							Current liabilities
Notes and accounts payable - trade.....	133,728	74,741	(1,709)	—	206,760	(12)	Trade and other payables
Short-term loans	47	(47)	—	—	—		
Current portion of long-term loans	15	(15)	—	—	—		
	—	62	277	—	339	(12)	Bonds and borrowings
Accounts payable - other	76,078	(76,078)	—	—	—		
Accrued expenses	99,033	(99,033)	—	—	—		
Income taxes payable	32,073	—	111	—	32,184	(12)	Income tax payables
Liability for loss related to cosmetics.....	2,891	(2,891)	—	—	—	(11)	
	—	11,335	(4,406)	—	6,929	(11), (12)	Other financial liabilities
	—	16,712	—	60	16,772	(11)	Provisions
Other.....	33,628	82,225	3,920	5,649	125,422	(7), (11), (12)	Other current liabilities
Total current liabilities	377,493	7,011	(1,807)	5,709	388,406		Total current liabilities
							Non-current liabilities
Long-term liabilities							Non-current liabilities
Bonds.....	50,000	(50,000)	—	—	—		
Long-term loans.....	70,060	(70,060)	—	—	—		
	—	120,060	222	(75)	120,207	(12)	Bonds and borrowings
Liability for retirement benefits	74,178	804	724	—	75,706	(12)	Retirement benefit liabilities
Liability for loss related to cosmetics.....	2,474	(2,474)	—	—	—	(11)	
	—	11,093	724	—	11,817	(11), (12)	Other financial liabilities
	—	16,880	365	459	17,704	(11), (12)	Provisions
Other.....	20,531	(17,790)	83	2,095	4,919	(8), (11), (12)	Other non-current liabilities
	—	2,151	—	(1,833)	318	(6), (11)	Deferred tax liabilities
Total long-term liabilities	217,243	10,664	2,118	646	230,671		Total non-current liabilities
Total liabilities	594,736	17,675	311	6,355	619,077		Total liabilities
							Equity
Net assets							Equity
Common stock.....	85,424	—	—	—	85,424		Share capital
Capital surplus.....	108,659	—	—	—	108,659		Capital surplus
Treasury stock, at cost.....	(8,202)	—	—	—	(8,202)		Treasury shares
Unrealized gain on available-for-sale securities.....	7,063	(7,063)	—	—	—		
Deferred gain (loss) on derivatives under hedge accounting.....	(3)	3	—	—	—		
Foreign currency translation adjustments.....	(19,315)	19,315	—	—	—		
Remeasurements of defined benefit plans.....	(152)	152	—	—	—		
Stock acquisition rights	889	(889)	—	—	—		
	—	(11,518)	(218)	7,552	(4,184)	(9), (12)	Other components of equity
Retained earnings	502,134	—	246	(3,081)	499,299	(10), (12)	Retained earnings
					680,996		Equity attributable to owners of the parent
Minority interests.....	10,636	—	470	(115)	10,991	(12)	Non-controlling interests
Total net assets	687,133	—	498	4,356	691,987		Total equity
Total liabilities and net assets.....	1,281,869	17,675	809	10,711	1,311,064		Total liabilities and equity

Notes on Reconciliations of Equity as of December 31, 2015

(1) Adjustment to Inventories

Mainly, goods for sales promotion recognized in supplies under Japanese GAAP are recognized in an adjustment to retained earnings as they do not meet the definition of assets under IFRS.

(2) Adjustment to Property, Plant and Equipment

Property, plant and equipment is adjusted mainly by applying deemed cost as follows.

The Group used fair value as the deemed cost at the transition date for certain items of property, plant and equipment. As a result, property, plant and equipment at the transition date decreased by 1,003 million yen, and the adjustment was recognized in retained earnings. At the transition date, the carrying amount of property, plant and equipment to which deemed cost was applied was 1,851 million yen under Japanese GAAP, and the fair value was 848 million yen.

Fair value is based on valuation by independent appraisers with appropriate qualifications and other methods, and is categorized within Level 3.

(3) Adjustment to Goodwill

- 1) Under Japanese GAAP, the amortization period of goodwill was effectively estimated and goodwill was amortized over the amortization period, but under IFRS amortization of goodwill has been discontinued since the transition date.
- 2) Under Japanese GAAP, certain foreign currency-denominated goodwill was translated at the exchange rate at the acquisition date, whereas under IFRS all foreign currency-denominated goodwill is translated at the closing rate and recognized in adjustments to other components of equity.

(4) Adjustment to Intangible Assets

Certain intangible assets that were recognized under Japanese GAAP are recognized in adjustments to retained earnings as they do not meet the definition of assets under IFRS.

(10) Adjustments to Retained Earnings

	(Millions of yen)
	December 31, 2015
Adjustment to inventories	(4,724)
Adjustment to property, plant and equipment.....	(897)
Adjustment to goodwill.....	11,687
Adjustment to intangible assets	(899)
Adjustment to other current liabilities.....	(5,649)
Adjustment to retirement benefit liabilities.....	(220)
Adjustment to other non-current liabilities.....	(2,095)
Adjustment to exchange differences on translation of foreign operations.....	(6,070)
Other adjustments.....	(33)
Subtotal.....	(8,900)
Adjustment for tax effects.....	5,755
Adjustment for non-controlling interests.....	64
Total.....	(3,081)

(5) Adjustment to Other Financial Assets (Non-current Assets)

Under Japanese GAAP, non-marketable equity instruments were carried at the acquisition cost, and impairment loss was recognized as required depending on the financial condition of the issuing company. Under IFRS, these equity instruments are designated as financial assets measured at fair value through other comprehensive income, and are measured at fair value, irrespective of the existence of market activity, with the change recognized as other comprehensive income and reclassified to retained earnings in case of derecognition or a significant decrease in fair value.

(6) Adjustments to Deferred Tax Assets and Deferred Tax Liabilities

The amounts of deferred tax assets and deferred tax liabilities are adjusted mainly due to temporary differences arising as a result of adjustments from Japanese GAAP to IFRS.

(7) Adjustment to Other Current Liabilities

Mainly, obligation for unused paid absences that was not recognized as a liability under Japanese GAAP is recognized as a liability under IFRS and recognized in adjustments to retained earnings.

(8) Adjustment to Other Non-current Liabilities

Special paid leave and bonuses granted conditional on a certain number of years of employment, which were not recognized as liabilities under Japanese GAAP, are recognized as liabilities under IFRS and recognized in adjustments to retained earnings.

(9) Adjustment to Other Components of Equity

- 1) As an exemption elected under the provisions of IFRS 1, the cumulative translation differences for all foreign operations were reclassified to retained earnings as of January 1, 2015, the transition date. In addition, under IFRS, the cumulative translation differences associated with the liquidation of foreign operations during the fiscal year were reclassified to retained earnings. As a result, other components of equity increased by 6,070 million yen.
- 2) Based on the fair value of non-marketable equity instruments stated in (5) above, other components of equity increased by 1,368 million yen.

(11) Reclassifications

Reclassifications are made to comply with the provisions of IFRS. The main reclassifications are as follows:

- 1) Time deposits with deposit terms of more than three months in "Cash and time deposits" under Japanese GAAP are classified as "Other financial assets" in current assets under IFRS. Among "Short-term investments" and "Other (current assets)" under Japanese GAAP, short-term investments redeemable within three months from the date of acquisition are classified as "Cash and cash equivalents" under IFRS.
- 2) "Deferred tax assets" and "Deferred tax liabilities" classified as current items under Japanese GAAP are classified as non-current items under IFRS.
- 3) Store fixtures for cosmetics were classified as "Long-term prepaid expenses" under Japanese GAAP, but are classified as

"Property, plant and equipment" under IFRS.

- 4) Financial assets, financial liabilities and non-current assets held for sale are disclosed separately based on the requirements of IFRS.
- 5) The provision for losses on returned products and asset retirement obligations, which were included in "Other (current liabilities)" and "Other (non-current liabilities)" and the gross amount of liability for loss related to cosmetics under Japanese GAAP, are classified as "Provisions" under IFRS.

(12) Differences in Scope of Consolidation

Certain subsidiaries of minor importance were not included in the scope of consolidation under Japanese GAAP and the equity method was applied, but all subsidiaries are included in the scope of consolidation under IFRS.

Reconciliations of Profit or Loss and Comprehensive Income for the Fiscal Year Ended December 31, 2015 (January 1 to December 31, 2015)

(Millions of yen)

Accounts under Japanese GAAP	Japanese GAAP	Reclassification	Consolidation scope differences	Recognition and measurement differences	IFRS	Notes	Accounts under IFRS
Net sales.....	1,471,791	—	2,759	—	1,474,550	(6)	Net sales
Cost of sales.....	(658,221)	(647)	198	(195)	(658,865)	(2), (6)	Cost of sales
Gross profit.....	813,570	(647)	2,957	(195)	815,685		Gross profit
Selling, general and administrative expenses	(649,190)	(3,882)	(2,234)	12,577	(642,729)	(1), (2), (6)	Selling, general and administrative expenses
	—	4,403	9,758	(62)	14,099	(4), (6)	Other operating income
	—	(9,627)	(8,824)	(1,286)	(19,737)	(4), (6)	Other operating expenses
Operating income	164,380	(9,753)	1,657	11,034	167,318		Operating income
	—	1,788	3	(375)	1,416	(4), (6)	Financial income
	—	2,508	(85)	(6,636)	(4,213)	(1), (2), (4), (6)	Financial expenses
	—	2,656	(1,113)	(26)	1,517	(4), (6)	Share of profit in investments accounted for using the equity method
Non-operating income	7,600	(7,600)	—	—	—	(4)	
Non-operating expenses.....	(2,707)	2,707	—	—	—	(4)	
Extraordinary gain	1,561	(1,561)	—	—	—	(4)	
Extraordinary loss	(9,255)	9,255	—	—	—	(4)	
Income before income taxes and minority interests.....	161,579	—	462	3,997	166,038		Income before income taxes
Total income taxes	(62,099)	—	(596)	2,609	(60,086)	(3), (6)	Income taxes
Income before minority interests ...	99,480	—	(134)	6,606	105,952		Net income
	—	98,862	(182)	6,516	105,196		Attributable to:
Minority interests	618	—	48	90	756		Owners of the parent
Net income	98,862	(98,862)	—	—	—		Non-controlling interests

(Millions of yen)

Accounts under Japanese GAAP	Japanese GAAP	Reclassification	Consolidation scope differences	Recognition and measurement differences	IFRS	Notes	Accounts under IFRS
Income before minority interests ...	99,480	—	(134)	6,606	105,952		Net income
Other comprehensive income							Other comprehensive income
							Items that will not be reclassified to profit or loss:
							Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income
Unrealized gain (loss) on available-for-sale securities	1,310	—	0	485	1,795	(6)	
Remeasurements of defined benefit plans	(3,712)	—	6	2,936	(770)	(5), (6)	Remeasurements of defined benefit plans
							Share of other comprehensive income of investments accounted for using the equity method
	—	167	78	—	245	(6)	
					1,270		Total of items that will not be reclassified to profit or loss
							Items that may be reclassified subsequently to profit or loss:
							Exchange differences on translation of foreign operations
Foreign currency translation adjustments	(15,793)	—	(213)	942	(15,064)	(6)	
							Net gain (loss) on derivatives designated as cash flow hedges
	—	—	—	12	12		
							Share of other comprehensive income of investments accounted for using the equity method
Share in other comprehensive income of associates applied for equity method	(9)	(167)	150	7	(19)	(6)	
					(15,071)		Total of items that may be reclassified subsequently to profit or loss
Other comprehensive income	(18,204)	—	21	4,382	(13,801)		Other comprehensive income, net of taxes
Comprehensive income	81,276	—	(113)	10,988	92,151		Comprehensive income

Notes on Reconciliations of Profit or Loss and Comprehensive Income for the Year Ended December 31, 2015 (January 1 to December 31, 2015)

(1) Adjustment to Selling, General and Administrative Expenses

1) Under Japanese GAAP, expected return on plan assets and interest expenses relating to retirement benefits were included in cost of sales and selling, general and administrative expenses as retirement benefit expenses, but net interest relating to retirement benefits is classified as financial expenses under IFRS. As a result, negative 3,863 million yen was reclassified from selling, general and administrative expenses to financial expenses.

2) Under Japanese GAAP, actuarial gains and losses relating to retirement benefits were recognized in other comprehensive income as incurred, and were recognized in profit or loss from the fiscal year when incurred, amortized on a straight-line basis over a certain number of years no longer than the average remaining service period of employees. Under IFRS, these actuarial gains and losses are recognized in other comprehensive income as incurred, and immediately reclassified to retained earnings. Moreover, under Japanese GAAP, past service costs were recognized in other comprehensive income as incurred, and were recognized in profit or loss from the fiscal year when incurred, amortized on a straight-line basis over a certain number

of years no longer than the average remaining service period of employees, whereas under IFRS, they are recognized in profit or loss as incurred. As a result, defined benefit cost increased by 1,152 million yen compared with Japanese GAAP.

- 3) Under Japanese GAAP, the amortization period of goodwill was effectively estimated and goodwill was amortized over the amortization period, but amortization of goodwill is discontinued under IFRS. As a result, amortization of goodwill decreased by 12,879 million yen compared with Japanese GAAP.
- 4) The intangible assets recognized under Japanese GAAP that do not meet the definition of assets under IFRS are not recognized as assets. As a result, amortization of intangible assets decreased by 3,329 million yen compared with Japanese GAAP.
- 5) Under Japanese GAAP, future expenses that fulfilled the required conditions were recognized as provisions, but are recognized in an adjustment to retained earnings as they do not meet the conditions for recognition of provisions under IFRS. As a result, selling, general and administrative expenses increased by 1,710 million yen compared with Japanese GAAP.

(2) Adjustment to Financial Expenses

- 1) Under Japanese GAAP, expected return on plan assets and interest expenses relating to retirement benefits were recognized in cost of sales and selling, general and administrative expenses as retirement benefit expenses, but net interest relating to retirement benefits is classified as financial expenses under IFRS. As a result, 4,529 million yen was reclassified from cost of sales and selling, general and administrative expenses to financial expenses.
- 2) Under Japanese GAAP, interest expenses, determined by multiplying the discount rate by retirement benefit obligations, and expected return on plan assets, determined by multiplying the expected rate of return on plan assets by plan assets, respectively, were recognized as retirement benefit expenses, but under IFRS the net interest amount determined by multiplying the net amount of retirement benefit obligations and the plan assets by the discount rate is recognized as retirement benefit expenses. As a result, financial expenses increased by 5,558 million yen.
- 3) As an exemption elected under the provisions of IFRS 1, the cumulative translation differences for all foreign operations were reclassified to retained earnings as of January 1, 2015, the

transition date. As a result, foreign exchange losses associated with the liquidation of foreign operations during the fiscal year increased by 1,064 million yen compared with Japanese GAAP.

(3) Adjustment to Income Taxes

The amount of income taxes is adjusted due to temporary differences that arise as a result of adjustment from Japanese GAAP to IFRS.

(4) Other Reclassifications

In addition to the above, reclassifications are made to comply with the provisions of IFRS. The main reclassifications are as follows.

Among items that were classified as non-operating income, non-operating expenses, extraordinary gain and extraordinary loss under Japanese GAAP, finance-related items and foreign exchange gain or loss are classified as financial income or financial expenses under IFRS and other items are classified as other operating income, other operating expenses or share of profit in investments accounted for using the equity method.

(5) Adjustment to Remeasurements of Defined Benefit Plans

Under Japanese GAAP, actuarial gains and losses were recognized in other comprehensive income as incurred, and were recognized in profit or loss from the fiscal year when incurred, amortized on a straight-line basis over a certain number of years no longer than the average remaining service period of employees. Under IFRS, these actuarial gains and losses are recognized in other comprehensive income as incurred, and immediately reclassified to retained earnings. Moreover, under Japanese GAAP, past service costs were recognized in other comprehensive income as incurred, and were recognized in profit or loss from the fiscal year when incurred, amortized on a straight-line basis over a certain number of years no longer than the average remaining service period of employees, whereas under IFRS, they are recognized in profit or loss as incurred.

(6) Differences in Scope of Consolidation

Certain subsidiaries of minor importance were not included in the scope of consolidation under Japanese GAAP and the equity method was applied, but all subsidiaries are included in the scope of consolidation under IFRS.

Reconciliations of Cash Flows for the Fiscal Year Ended December 31, 2015 (January 1 to December 31, 2015)

There are no significant differences between the disclosed consolidated statement of cash flows under Japanese GAAP and the disclosed consolidated statement of cash flows under IFRS.

40 Approval of the Consolidated Financial Statements

The Consolidated Financial Statements were approved by Michitaka Sawada, President and Chief Executive Officer, and by Kenichi Yamauchi, Executive Officer, Senior Vice President, Accounting and Finance, on March 14, 2017.

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Kao Corporation:

We have audited the accompanying consolidated statement of financial position of Kao Corporation and its subsidiaries as of December 31, 2016, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year then ended, and notes to consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kao Corporation and its subsidiaries as of December 31, 2016, and the consolidated results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte Touche Tohmatsu LLC

March 14, 2017

Member of
Deloitte Touche Tohmatsu Limited

KaO

Enriching lives, in harmony with nature.

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