

CANON INC  
Form 20-F/A  
June 10, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 20-F/A  
(Amendment No. 1)

- o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
- OR
- p ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

- OR
- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_
- OR
- o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Date of event requiring this shell company report \_\_\_\_\_

Commission file number 001-15122

CANON KABUSHIKI KAISHA  
(Exact name of Registrant in Japanese as specified in its charter)  
CANON INC.

(Exact name of Registrant in English as specified in its charter)  
**JAPAN**

(Jurisdiction of incorporation or organization)  
30-2, Shimomaruko 3-chome, Ohta-ku, Tokyo 146-8501, Japan  
(Address of principal executive offices)

Shinichiro Hanabusa, +81-3-3758-2111, +81-3-5482-9680, 30-2, Shimomaruko 3-chome, Ohta-ku, Tokyo 146-8501, Japan

(Name, Telephone, Facsimile number and Address of Company Contact Person)  
Securities registered or to be registered pursuant to Section 12(b) of the Act.

| <b>Title of each class</b>  | <b>Name of each exchange on which registered</b> |
|---|--|
| (1) Common Stock (the shares )  | New York Stock Exchange*                         |
| (2) American Depositary Shares ( ADSs ), each of which represents one share | New York Stock Exchange                          |

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None  
(Title of Class)

Securities for which there is a reporting obligation pursuant  
to Section 15(d) of the Act.

None  
(Title of Class)

\* Not for trading, but only for technical purposes in connection with the registration of ADSs.

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2009, 1,234,475,463 shares of common stock, including 50,443,092  
ADSs, were outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

If "other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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**Explanatory Note**

This Amendment No. 1 on Form 20-F/A has been filed by Canon Inc. (the Company ) to amend the annual report on Form 20-F for the fiscal year ended December 31, 2009 filed on March 30, 2010. This amendment presents Item 18. The only change to Item 18 is to add the conformed signature of our independent registered public accounting firm, Ernst & Young ShinNihon LLC, to the audit reports.

The Company does not intend to revise, update, amend or restate the information presented in any other items of such annual report on Form 20-F or reflect any events that have occurred after the filing of such annual report on Form 20-F. Among other things, forward-looking statements and risk factors contained in such annual report on Form 20-F have not been revised to reflect events, results or developments that have occurred or facts that became known to the Company after filing such annual report on Form 20-F, and such forward-looking statements and risk factors should be read in their historical context.

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**Item 18. Financial Statements**

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| All other schedules are omitted as permitted by the rules and regulations of the Securities and Exchange Commission as not applicable. |                        |

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of  
Canon Inc.

We have audited the accompanying consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2009. Our audits also included the financial statement schedule listed in the Index at Item 18. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our report dated March 16, 2009, we expressed an opinion that, except for the omission of segment reporting information, the 2008 and 2007 consolidated financial statements presented fairly, in all material respects, the consolidated financial position, results of operations and cash flows of Canon Inc. and subsidiaries, in conformity with U.S. generally accepted accounting principles. As described in Note 21, in 2009 the Company adopted segment reporting guidance and revised the disclosures in its 2008 and 2007 consolidated financial statements to conform with U.S. generally accepted accounting principles. Accordingly, our present opinion on the 2008 and 2007 consolidated financial statements, as presented herein, is unqualified rather than qualified.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, in 2009 the Company adopted new accounting guidance for noncontrolling interests in consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 30, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young ShinNihon LLC

Tokyo, Japan  
March 30, 2010

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of  
Canon Inc.

We have audited Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Canon Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Canon Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2009, and our report dated March 30, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young ShinNihon LLC

Tokyo, Japan  
March 30, 2010



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Consolidated Balance Sheets

|  | <b>December 31</b>       |             |
|--|--------------------------|-------------|
|  | <b>2009</b>              | <b>2008</b> |
|  | <b>(As adjusted)</b>     |             |
|  | <b>(Note 1)</b>          |             |
|  | <b>(Millions of yen)</b> |             |
| <b>Assets</b>  |                          |             |
| Current assets:  |                          |             |
| Cash and cash equivalents <i>(Note 1)</i>                              | ¥ 795,034                | ¥ 679,196   |
| Short-term investments <i>(Note 2)</i>                                 | 19,089                   | 7,651       |
| Trade receivables, net <i>(Note 3)</i>                                 | 556,572                  | 595,422     |
| Inventories <i>(Note 4)</i>  | 373,241                  | 506,919     |
| Prepaid expenses and other current assets <i>(Notes 6 and 11)</i>      | 273,843                  | 275,660     |
| Total current assets   | 2,017,779                | 2,064,848   |
| Noncurrent receivables <i>(Note 18)</i>                                | 14,936                   | 14,752      |
| Investments <i>(Note 2)</i>  | 114,066                  | 88,825      |
| Property, plant and equipment, net <i>(Notes 5 and 6)</i>              | 1,269,785                | 1,357,186   |
| Intangible assets, net <i>(Note 7)</i>                                 | 117,396                  | 119,140     |
| Other assets <i>(Notes 6, 7, 10 and 11)</i>                            | 313,595                  | 325,183     |
| Total assets   | ¥ 3,847,557              | ¥ 3,969,934 |
| <b>Liabilities and equity</b>  |                          |             |
| Current liabilities:   |                          |             |
| Short-term loans and current portion of long-term debt <i>(Note 8)</i> | ¥ 4,869                  | ¥ 5,540     |
| Trade payables <i>(Note 9)</i>   | 339,113                  | 406,746     |
| Accrued income taxes <i>(Note 11)</i>                                  | 50,105                   | 69,961      |
| Accrued expenses <i>(Notes 10 and 18)</i>                              | 274,300                  | 277,117     |
| Other current liabilities <i>(Notes 5 and 11)</i>                      | 115,303                  | 184,636     |
| Total current liabilities  | 783,690                  | 944,000     |
| Long-term debt, excluding current installments <i>(Note 8)</i>         | 4,912                    | 8,423       |
| Accrued pension and severance cost <i>(Note 10)</i>                    | 115,904                  | 110,784     |
| Other noncurrent liabilities <i>(Note 11)</i>                          | 63,651                   | 55,745      |
| Total liabilities  | 968,157                  | 1,118,952   |
| Commitments and contingent liabilities <i>(Note 18)</i>                |                          |             |
| Equity:  |                          |             |
| Canon Inc. stockholders' equity:                                       |                          |             |
| Common stock   |                          |             |
| Authorized 3,000,000,000 shares;                                       |                          |             |
| issued 1,333,763,464 shares in 2009 and in 2008 <i>(Note 12)</i>       | 174,762                  | 174,762     |
| Additional paid-in capital <i>(Note 12)</i>                            | 404,293                  | 403,790     |
| Legal reserve <i>(Note 13)</i>   | 54,687                   | 53,706      |

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|  |                    |             |
|--|--------------------|-------------|
| Retained earnings ( <i>Note 13</i> )   | <b>2,871,437</b>   | 2,876,576   |
| Accumulated other comprehensive income (loss) ( <i>Note 14</i> )                 | <b>(260,818)</b>   | (292,820)   |
| Treasury stock, at cost; 99,288,001 shares in 2009 and 99,275,245 shares in 2008 | <b>(556,252)</b>   | (556,222)   |
| Total Canon Inc. stockholders' equity  | <b>2,688,109</b>   | 2,659,792   |
| Noncontrolling interests   | <b>191,291</b>     | 191,190     |
| Total equity   | <b>2,879,400</b>   | 2,850,982   |
| Total liabilities and equity   | <b>¥ 3,847,557</b> | ¥ 3,969,934 |

*See accompanying Notes to Consolidated Financial Statements.*

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Canon Inc. and Subsidiaries  
Consolidated Statements of Income

|  | Years ended December 31 |                                |             |
|--|-------------------------|--------------------------------|-------------|
|  | 2009                    | 2008<br>(As adjusted) (Note 1) | 2007        |
|  | (Millions of yen)       |                                |             |
| Net sales  | ¥ 3,209,201             | ¥ 4,094,161                    | ¥ 4,481,346 |
| Cost of sales <i>(Notes 5, 7, 10 and 18)</i>                                       | 1,781,808               | 2,156,153                      | 2,234,365   |
| Gross profit   | 1,427,393               | 1,938,008                      | 2,246,981   |
| Operating expenses <i>(Notes 1, 5, 7, 10, 15 and 18)</i> :                         |                         |                                |             |
| Selling, general and administrative expenses                                       | 905,738                 | 1,067,909                      | 1,122,047   |
| Research and development expenses  | 304,600                 | 374,025                        | 368,261     |
|  | 1,210,338               | 1,441,934                      | 1,490,308   |
| Operating profit   | 217,055                 | 496,074                        | 756,673     |
| Other income (deductions):   |                         |                                |             |
| Interest and dividend income   | 5,202                   | 19,442                         | 32,819      |
| Interest expense   | (336)                   | (837)                          | (1,471)     |
| Other, net <i>(Notes 1, 2 and 17)</i>  | (2,566)                 | (33,532)                       | (19,633)    |
|  | 2,300                   | (14,927)                       | 11,715      |
| Income before income taxes   | 219,355                 | 481,147                        | 768,388     |
| Income taxes <i>(Note 11)</i>  | 84,122                  | 160,788                        | 264,258     |
| Consolidated net income  | 135,233                 | 320,359                        | 504,130     |
| Less: Net income attributable to noncontrolling interests                          | 3,586                   | 11,211                         | 15,798      |
| Net income attributable to Canon Inc.  | ¥ 131,647               | ¥ 309,148                      | ¥ 488,332   |
|  |                         | (Yen)                          |             |
| Net income attributable to Canon Inc. stockholders per share<br><i>(Note 16)</i> : |                         |                                |             |
| Basic  | ¥ 106.64                | ¥ 246.21                       | ¥ 377.59    |
| Diluted  | 106.64                  | 246.20                         | 377.53      |
| Cash dividends per share   | 110.00                  | 110.00                         | 110.00      |

*See accompanying Notes to Consolidated Financial Statements.*

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Canon Inc. and Subsidiaries  
Consolidated Statements of Equity

|  | Common<br>stock   | Additional<br>paid-in<br>capital | Legal<br>reserve | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income<br>(loss) | Treasury<br>stock | Total<br>Canon Inc.<br>equity | Non-<br>controlling<br>interests | Total<br>equity |
|--|-------------------|----------------------------------|------------------|----------------------|---|-------------------|-------------------------------|----------------------------------|-----------------|
|  | (Millions of yen) |                                  |                  |                      |   |                   |                               |                                  |                 |
| <b>at December 31, 2006</b>  | ¥ 174,603         | ¥ 403,510                        | ¥ 43,600         | ¥ 2,368,047          | ¥ 2,718   | ¥ (5,872)         | ¥ 2,986,606                   | ¥ 216,801                        | ¥ 3,203,407     |
| Reverse effect of a change in accounting principle - adoption of new guidance for annual leave and other similar items, net of tax |                   |                                  |                  | (2,204)              |   |                   | (2,204)                       |                                  |                 |
| Issuance of convertible debt   | 95                | 95                               |                  |                      |   |                   | 190                           |                                  |                 |
| Transactions with noncontrolling interests and other stockholders  |                   | (617)                            |                  |                      |   |                   | (617)                         | (12,185)                         |                 |
| Dividends paid to Canon Inc. stockholders  |                   |                                  |                  | (131,612)            |   |                   | (131,612)                     |                                  | (131,612)       |
| Dividends paid to noncontrolling stockholders  |                   |                                  |                  |                      |   |                   |                               | (4,612)                          |                 |
| Contribution to legal reserve  |                   |                                  | 2,417            | (2,417)              |   |                   |                               |                                  |                 |
| Other comprehensive income:  |                   |                                  |                  | 488,332              |   |                   | 488,332                       | 15,798                           | 504,130         |
| Net comprehensive income   |                   |                                  |                  |                      |   |                   |                               |                                  |                 |
| Net of tax (Note 14):  |                   |                                  |                  |                      |   |                   |                               |                                  |                 |
| Currency translation adjustments   |                   |                                  |                  |                      | (62)  |                   | (62)                          | (26)                             |                 |
| Realized gains and losses on investments   |                   |                                  |                  |                      | (1,778)   |                   | (1,778)                       | (577)                            |                 |
| Gains and losses on derivative instruments   |                   |                                  |                  |                      | 814   |                   | 814                           | 7                                |                 |
| Liability adjustments  |                   |                                  |                  |                      | 32,978  |                   | 32,978                        | 7,664                            |                 |
| Other comprehensive income   |                   |                                  |                  |                      |   |                   | 520,284                       | 22,866                           | 543,150         |
| Change of treasury stock, net  |                   | 3                                |                  |                      |   | (450,314)         | (450,311)                     |                                  | (450,308)       |
| <b>at December 31, 2007</b>  | 174,698           | 402,991                          | 46,017           | 2,720,146            | 34,670  | (456,186)         | 2,922,336                     | 222,870                          | 3,149,202       |
| Issuance of convertible debt   | 64                | 63                               |                  |                      |   |                   | 127                           |                                  |                 |
| Transactions with noncontrolling interests and other stockholders  |                   | 761                              |                  |                      |   |                   | 761                           | (26,218)                         |                 |
| Dividends paid to Canon Inc. stockholders  |                   |                                  |                  | (145,024)            |   |                   | (145,024)                     |                                  | (145,024)       |
| Dividends paid to noncontrolling stockholders  |                   |                                  |                  |                      |   |                   |                               | (5,123)                          |                 |
| Contribution to legal reserve  |                   |                                  | 7,689            | (7,689)              |   |                   |                               |                                  |                 |

|                                 |           |           |          |             |             |             |             |           |             |             |
|---------------------------------|-----------|-----------|----------|-------------|-------------|-------------|-------------|-----------|-------------|-------------|
| Comprehensive income (loss):    |           |           |          |             |             |             |             |           |             |             |
| Income                          |           | 309,148   |          |             |             | 309,148     |             | 11,211    |             | 309,148     |
| Comprehensive income            |           |           |          |             |             |             |             |           |             |             |
| Net of tax (Note 14):           |           |           |          |             |             |             |             |           |             |             |
| Currency translation            |           |           |          |             |             |             |             |           |             |             |
| Adjustments                     |           |           |          |             |             |             |             |           |             |             |
| Realized gains and losses       |           |           |          |             |             |             |             |           |             |             |
| Activities                      |           |           |          |             |             |             |             |           |             |             |
| Gains and losses on derivative  |           |           |          |             |             |             |             |           |             |             |
| Adjustments                     |           |           |          |             |             |             |             |           |             |             |
| Liability adjustments           |           |           |          |             |             |             |             |           |             |             |
| Comprehensive income            |           |           |          |             |             |             |             |           |             |             |
|                                 |           |           |          |             |             |             |             |           |             |             |
| Decrease of treasury stock, net | (25)      | (5)       |          |             | (100,036)   | (100,066)   |             |           |             | (100,036)   |
| <b>at December 31, 2008</b>     | ¥ 174,762 | ¥ 403,790 | ¥ 53,706 | ¥ 2,876,576 | ¥ (292,820) | ¥ (556,222) | ¥ 2,659,792 | ¥ 191,190 | ¥ 2,876,576 | ¥ 2,876,576 |

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Canon Inc. and Subsidiaries  
Consolidated Statements of Equity (continued)

|   | Common<br>stock | Additional<br>paid-in<br>capital | Legal<br>reserve | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income<br>(loss)<br>(Millions<br>of yen) | Treasury<br>stock | Total<br>Canon Inc.<br>stockholders<br>equity | Non-<br>controlling<br>interests | Total<br>equity  |
|---|-----------------|----------------------------------|------------------|----------------------|---|-------------------|---|----------------------------------|------------------|
| <b>Balance at<br/>December 31,<br/>2008</b>                       | ¥ 174,762       | ¥ 403,790                        | ¥ 53,706         | ¥ 2,876,576          | ¥ (292,820)   | ¥ (556,222)       | ¥ 2,659,792                                   | ¥ 191,190                        | ¥ 2,850,982      |
| Equity transactions with noncontrolling interests and other       |                 | <b>503</b>                       |                  |                      |   |                   | <b>503</b>                                    | <b>(1,376)</b>                   | <b>(873)</b>     |
| Dividends paid to Canon Inc. stockholders                         |                 |                                  |                  | <b>(135,793)</b>     |   |                   | <b>(135,793)</b>                              |                                  | <b>(135,793)</b> |
| Dividends paid to noncontrolling interests                        |                 |                                  |                  |                      |   |                   |   | <b>(3,326)</b>                   | <b>(3,326)</b>   |
| Transfer to legal reserve   |                 |                                  | <b>981</b>       | <b>(981)</b>         |   |                   |   |                                  |                  |
| Comprehensive income:   |                 |                                  |                  |                      |   |                   |   |                                  |                  |
| Net income  |                 |                                  |                  | <b>131,647</b>       |   |                   | <b>131,647</b>                                | <b>3,586</b>                     | <b>135,233</b>   |
| Other comprehensive income (loss), net of tax ( <i>Note 14</i> ): |                 |                                  |                  |                      |   |                   |   |                                  |                  |
| Foreign currency translation adjustments                          |                 |                                  |                  |                      | <b>33,340</b>   |                   | <b>33,340</b>                                 | <b>30</b>                        | <b>33,370</b>    |
| Net unrealized gains and losses on securities                     |                 |                                  |                  |                      | <b>2,150</b>  |                   | <b>2,150</b>                                  | <b>67</b>                        | <b>2,217</b>     |
| Net gains and losses on derivative instruments                    |                 |                                  |                  |                      | <b>(1,422)</b>  |                   | <b>(1,422)</b>                                | <b>(1)</b>                       | <b>(1,423)</b>   |
|   |                 |                                  |                  |                      | <b>(2,066)</b>  |                   | <b>(2,066)</b>                                | <b>1,121</b>                     | <b>(945)</b>     |

|                                     |           |           |          |             |             |             |             |           |             |
|-------------------------------------|-----------|-----------|----------|-------------|-------------|-------------|-------------|-----------|-------------|
| Pension liability adjustments       |           |           |          |             |             |             |             |           |             |
| Total comprehensive income          |           |           |          |             |             | 163,649     | 4,803       | 168,452   |             |
| Repurchase of treasury stock, net   |           |           | (12)     |             | (30)        | (42)        |             | (42)      |             |
| <b>Balance at December 31, 2009</b> | ¥ 174,762 | ¥ 404,293 | ¥ 54,687 | ¥ 2,871,437 | ¥ (260,818) | ¥ (556,252) | ¥ 2,688,109 | ¥ 191,291 | ¥ 2,879,400 |

*See accompanying Notes to Consolidated Financial Statements.*

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Canon Inc. and Subsidiaries  
Consolidated Statements of Cash Flows

|  | Years ended December 31 |           |           |
|--|-------------------------|-----------|-----------|
|  | 2009                    | 2008      | 2007      |
|  | (As adjusted) (Note 1)  |           |           |
|  | (Millions of yen)       |           |           |
| Cash flows from operating activities:  |                         |           |           |
| Consolidated net income  | ¥ 135,233               | ¥ 320,359 | ¥ 504,130 |
| Adjustments to reconcile consolidated net income to net cash provided by operating activities: |                         |           |           |
| Depreciation and amortization  | 315,393                 | 341,337   | 341,694   |
| Loss on disposal of property, plant and equipment  | 8,215                   | 11,811    | 9,985     |
| Impairment loss of fixed assets (Note 5)   | 15,466                  | 13,503    | 15,908    |
| Deferred income taxes  | 20,712                  | (32,497)  | (35,021)  |
| Equity in (earnings) losses of affiliated companies  | 12,649                  | 20,047    | (5,634)   |
| (Increase) decrease in trade receivables   | 48,244                  | 83,521    | (10,722)  |
| (Increase) decrease in inventories   | 143,580                 | 49,547    | (26,643)  |
| Increase (decrease) in trade payables  | (76,843)                | (36,719)  | 21,136    |
| Increase (decrease) in accrued income taxes  | (21,023)                | (77,340)  | 14,988    |
| Increase (decrease) in accrued expenses  | (9,827)                 | (30,694)  | 43,035    |
| Increase (decrease) in accrued (prepaid) pension and severance cost                            | 4,765                   | (12,128)  | (15,387)  |
| Other, net   | 14,671                  | (34,063)  | (18,200)  |
| Net cash provided by operating activities  | 611,235                 | 616,684   | 839,269   |
| Cash flows from investing activities:  |                         |           |           |
| Purchases of fixed assets (Note 5)   | (327,983)               | (428,168) | (474,285) |
| Proceeds from sale of fixed assets (Note 5)  | 8,893                   | 7,453     | 9,635     |
| Purchases of available-for-sale securities   | (3,253)                 | (7,307)   | (2,281)   |
| Proceeds from sale and maturity of available-for-sale securities                               | 2,460                   | 4,320     | 8,614     |
| Proceeds from maturity of held-to-maturity securities  |                         | 10,000    | 10,000    |
| (Increase) decrease in time deposits, net  | (11,345)                | 2,892     | 31,681    |
| Acquisitions of subsidiaries, net of cash acquired   | (2,979)                 | (5,999)   | (15,675)  |
| Purchases of other investments   | (37,981)                | (45,473)  | (2,432)   |
| Other, net   | 1,944                   | (10,198)  | 2,258     |
| Net cash used in investing activities  | (370,244)               | (472,480) | (432,485) |
| Cash flows from financing activities:  |                         |           |           |
| Proceeds from issuance of long-term debt   | 3,361                   | 6,841     | 2,635     |
| Repayments of long-term debt   | (6,282)                 | (15,397)  | (13,046)  |
| Decrease in short-term loans, net  | (280)                   | (2,643)   | (358)     |
| Dividends paid   | (135,793)               | (145,024) | (131,612) |
| Repurchases of treasury stock, net   | (42)                    | (100,066) | (450,311) |
| Other, net   | (3,343)                 | (21,276)  | (11,691)  |
| Net cash used in financing activities  | (142,379)               | (277,565) | (604,383) |



|  |                  |           |           |
|--|------------------|-----------|-----------|
| Effect of exchange rate changes on cash and cash equivalents | <b>17,226</b>    | (131,906) | (13,564)  |
| Net change in cash and cash equivalents                      | <b>115,838</b>   | (265,267) | (211,163) |
| Cash and cash equivalents at beginning of year               | <b>679,196</b>   | 944,463   | 1,155,626 |
| Cash and cash equivalents at end of year                     | <b>¥ 795,034</b> | ¥ 679,196 | ¥ 944,463 |

## Supplemental disclosure for cash flow information :

## Cash paid during the year for:

|              |               |         |         |
|--------------|---------------|---------|---------|
| Interest     | ¥ <b>384</b>  | ¥ 901   | ¥ 1,476 |
| Income taxes | <b>82,906</b> | 263,392 | 273,888 |

*See accompanying Notes to Consolidated Financial Statements.*

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements

**1. Basis of Presentation and Significant Accounting Policies**

(a) Description of Business

Canon Inc. (the Company) and subsidiaries (collectively Canon) is one of the world's leading manufacturers in such fields as office products, consumer products and industry and other products. Office products consist mainly of network multifunction devices (MFDs), copying machines, laser printers and large format inkjet printers. Consumer products consist mainly of digital single-lens reflex (SLR) cameras, compact digital cameras, interchangeable lenses, digital video camcorders, inkjet multifunction peripherals, single function inkjet printers, image scanners and broadcasting equipment. Industry and other products consist mainly of semiconductor production equipment, mirror projection mask aligners for liquid crystal display (LCD) panels, and medical equipment. Canon's consolidated net sales for the years ended December 31, 2009, 2008 and 2007 were distributed as follows: the Office Business Unit 51%, 55% and 55%, the Consumer Business Unit 41%, 35% and 36%, the Industry and Others Business Unit 11%, 13% and 12%, and elimination between segments 3%, 3% and 3%, respectively. These percentages were computed by dividing segment net sales, including intersegment sales, by consolidated net sales, based on the segment operating results described in Note 21.

Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographic area. Approximately 78%, 79% and 79% of consolidated net sales for the years ended December 31, 2009, 2008 and 2007 were generated outside Japan, with 28%, 28% and 30% in the Americas, 31%, 33% and 33% in Europe, and 19%, 18% and 16% in other areas, respectively.

Canon sells laser printers on an OEM basis to Hewlett-Packard Company; such sales constituted approximately 20%, 23% and 22% of consolidated net sales for the years ended December 31, 2009, 2008 and 2007, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 25 plants in Japan and 16 overseas plants which are located in countries or regions such as the United States, Germany, France, Taiwan, China, Malaysia, Thailand and Vietnam.

(b) Basis of Presentation

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

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

(c) Principles of Consolidation

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

(d) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant estimates and assumptions are reflected in valuation and disclosure of revenue recognition, allowance for doubtful receivables, valuation of inventories, impairment of long-lived assets, environmental liabilities, valuation of deferred tax assets, uncertain tax positions and employee retirement and severance benefit plans. Actual results could differ materially from those estimates.

(e) Translation of Foreign Currencies

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

Gains and losses resulting from foreign currency transactions, including foreign exchange contracts, and translation of assets and liabilities denominated in foreign currencies are included in other income (deductions) in the consolidated statements of income. Foreign currency exchange gains and losses was a net gain of ¥1,842 million for the year ended December 31, 2009, and were net losses of ¥11,212 million and ¥31,943 million for the years ended December 31, 2008 and 2007, respectively.

(f) Cash Equivalents

All highly liquid investments acquired with original maturities of three months or less are considered to be cash equivalents. Certain debt securities with original maturities of less than three months classified as available-for-sale securities of ¥184,856 million and ¥194,030 million at December 31, 2009 and 2008, respectively, are included in cash and cash equivalents in the consolidated balance sheets. Additionally, certain debt securities with original maturities of less than three months classified as held-to-maturity securities of ¥999 million and ¥997 million at December 31, 2009 and 2008, respectively, are also included in cash and cash equivalents. Fair value for these securities approximates their cost.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Basis of Presentation and Significant Accounting Policies (continued)**

(g) Investments

Investments consist primarily of time deposits with original maturities of more than three months, debt and marketable equity securities, investments in affiliated companies and non-marketable equity securities. Canon reports investments with maturities of less than one year as short-term investments.

Canon classifies investments in debt and marketable equity securities as available-for-sale or held-to-maturity securities. Canon does not hold any trading securities, which are bought and held primarily for the purpose of sale in the near term.

Available-for-sale securities are recorded at fair value. Fair value is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate. Unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of other comprehensive income (loss) until realized. Held-to-maturity securities are recorded at amortized cost, adjusted for amortization of premiums and accretion of discounts.

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

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

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

Non-marketable equity securities in companies over which Canon does not have the ability to exercise significant influence are stated at cost and reviewed periodically for impairment.

(h) Allowance for Doubtful Receivables

Allowance for doubtful trade and finance receivables is maintained for all customers based on a combination of factors, including aging analysis, macroeconomic conditions, significant one-time events, and historical experience. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted. When all collection options are exhausted including legal recourse, the accounts or portions thereof are deemed to be uncollectable and charged against the allowance.

(i) Inventories

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

(j) Impairment of Long-Lived Assets

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

(k) Property, Plant and Equipment

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

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

Assets leased to others under operating leases are stated at cost and depreciated to the estimated residual value of the assets by the straight-line method over the period ranging from 2 years to 5 years.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Basis of Presentation and Significant Accounting Policies (continued)****(l) Goodwill and Other Intangible Assets**

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. Intangible assets with finite useful lives, consisting primarily of software and license fees, are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Certain costs incurred in connection with developing or obtaining internal use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

**(m) Environmental Liabilities**

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

**(n) Income Taxes**

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

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

**(o) Stock-Based Compensation**

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

**(p) Net Income Attributable to Canon Inc. Stockholders per Share**

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

(q) Revenue Recognition

Canon generates revenue principally through the sale of office and consumer products, equipment, supplies, and related services under separate contractual arrangements. Canon recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have been transferred to the customer or services have been rendered, the sales price is fixed or determinable, and collectibility is probable.

Revenue from sales of office products, such as office network digital MFDs and laser printers, and consumer products, such as digital cameras and inkjet multifunction peripherals, is recognized upon shipment or delivery, depending upon when title and risk of loss transfer to the customer.

Revenue from sales of optical equipment, such as steppers and aligners that are sold with customer acceptance provisions related to their functionality, is recognized when the equipment is installed at the customer site and the specific criteria of the equipment functionality are successfully tested and demonstrated by Canon. Service revenue is derived primarily from separately priced product maintenance contracts on equipment sold to customers and is measured at the stated amount of the contract and recognized as services are provided.

Canon also offers separately priced product maintenance contracts for most office products, for which the customer typically pays a stated base service fee plus a variable amount based on usage. Revenue from these service maintenance contracts is measured at the stated amount of the contract and recognized as services are provided and variable amounts are earned.

Revenue from the sale of equipment under sales-type leases is recognized at the inception of the lease. Income on sales-type leases and direct-financing leases is recognized over the life of each respective lease using the interest method. Leases not qualifying as sales-type leases or direct-financing leases are accounted for as operating leases and related revenue is recognized ratably over the lease term. When equipment leases are bundled with product maintenance contracts, revenue is first allocated considering the relative fair value of the lease and non-lease deliverables based upon the estimated relative fair values of each element. Lease deliverables generally include equipment, financing and executory costs, while non-lease deliverables generally consist of product maintenance contracts and supplies.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Basis of Presentation and Significant Accounting Policies (continued)**

(q) Revenue Recognition (continued)

For all other arrangements with multiple elements, Canon allocates revenue to each element based on its relative fair value if such element meets the criteria for treatment as a separate unit of accounting. Otherwise, revenue is deferred until the undelivered elements are fulfilled and accounted for as a single unit of accounting.

Canon records estimated reductions to sales at the time of sale for sales incentive programs including product discounts, customer promotions and volume-based rebates. Estimated reductions in sales are based upon historical trends and other known factors at the time of sale. In addition, Canon provides price protection to certain resellers of its products, and records reductions to sales for the estimated impact of price protection obligations when announced.

Estimated product warranty costs are recorded at the time revenue is recognized and are included in selling, general and administrative expenses in the consolidated statements of income. Estimates for accrued product warranty costs are based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure.

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

(r) Research and Development Costs

Research and development costs are expensed as incurred.

(s) Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were ¥78,009 million, ¥112,810 million and ¥132,429 million for the years ended December 31, 2009, 2008 and 2007, respectively.

(t) Shipping and Handling Costs

Shipping and handling costs totaled ¥45,966 million, ¥62,128 million and ¥63,708 million for the years ended December 31, 2009, 2008 and 2007, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(u) Derivative Financial Instruments

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

Canon uses and designates certain derivatives as a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ( cash flow hedge). Canon formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. Canon also formally assesses, both at the



at the inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, Canon discontinues hedge accounting prospectively. Changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge are recorded in other comprehensive income (loss), until earnings are affected by the variability in cash flows of the hedged item. Gains and losses from hedging ineffectiveness are included in other income (deductions). Gains and losses related to the components of hedging instruments excluded from the assessment of hedge effectiveness are included in other income (deductions).

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

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

(v) Guarantees

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

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**1. Basis of Presentation and Significant Accounting Policies (continued)**

## (w) Recently Issued Accounting Guidance

In June 2009, the Financial Accounting Standards Board ( FASB ) issued the Accounting Standards Codification ( ASC ). The ASC has become the source of authoritative U.S.GAAP. Additionally, rules and interpretive releases of the U.S. Securities and Exchange Commission ( SEC ) under authority of the federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. The ASC did not change current U.S GAAP, but was intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. This Codification is effective for fiscal years and interim periods ending after September 15, 2009 and was adopted by Canon beginning from the quarter ended September 30, 2009. This adoption did not have a material impact on Canon s consolidated results of operations and financial condition. However, throughout the notes to the consolidated financial statements, references that were previously made to various former authoritative U.S. GAAP pronouncements have been removed.

In December 2007, the FASB issued new accounting guidance for business combinations. This guidance establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired in a business combination. This guidance also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. This guidance is effective for fiscal years beginning on or after December 15, 2008 and was adopted by Canon for any business combinations with an acquisition date on or after January 1, 2009. This adoption did not have a material impact on Canon s consolidated results of operations and financial condition.

In December 2007, the FASB issued new accounting guidance for noncontrolling interests in consolidated financial statements. This guidance establishes accounting and reporting guidance for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. This guidance also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This guidance is effective for fiscal years beginning on or after December 15, 2008 on a prospective basis, except for certain presentation and disclosure requirements, which must be applied retrospectively for all periods presented, and was adopted by Canon in the first quarter beginning January 1, 2009. Upon the adoption of this guidance, noncontrolling interests, which were previously referred to as minority interests and classified between total liabilities and stockholders equity on the consolidated balance sheets, are now included as a separate component of total equity. In addition, consolidated net income on the consolidated statements of income now includes the net income (loss) attributable to noncontrolling interests. These financial statement presentation requirements have been adopted retrospectively and prior year amounts in the consolidated financial statements have been reclassified or adjusted to conform to this guidance. This adoption did not have a material impact on Canon s consolidated results of operations and financial condition.

In October 2009, the FASB issued new accounting guidance for revenue recognition under multiple-deliverable arrangements. This guidance modifies the criteria for separating consideration under multiple-deliverable arrangements and requires allocation of the overall consideration to each deliverable using the estimated selling price in the absence of vendor-specific objective evidence or third-party evidence of selling price for deliverables. As a result, the residual method of allocating arrangement consideration will no longer be permitted. The guidance also requires additional disclosures about how a vendor allocates revenue in its arrangements and

about the significant judgments made and their impact on revenue recognition. This guidance is effective for fiscal years beginning on or after June 15, 2010 and is required to be adopted by Canon no later than the first quarter beginning January 1, 2011 (with early adoption permitted). The provisions are effective prospectively for revenue arrangements entered into or materially modified after the effective date, or retrospectively for all prior periods. Canon is currently evaluating the effect that the adoption of this guidance will have on its consolidated results of operations and financial condition.

In October 2009, the FASB issued new accounting guidance for software revenue recognition. This guidance modifies the scope of the software revenue recognition guidance to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. This guidance is effective for fiscal years beginning on or after June 15, 2010 and is required to be adopted by Canon no later than the first quarter beginning January 1, 2011 (with early adoption permitted) using the same effective date and the same transition method used to adopt the guidance for revenue recognition under multiple-deliverable arrangements. Canon is currently evaluating the effect that the adoption of this guidance will have on its consolidated results of operations and financial condition.

(x) Reclassifications

Certain reclassifications have been made to the prior years' consolidated statements of cash flows to conform to the current year presentation.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**2. Investments**

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities included in short-term investments and investments by major security type at December 31, 2009 and 2008 were as follows:

|                   | <b>December 31, 2009</b> |   |  |                       |
|-------------------|--------------------------|---|--|-----------------------|
|                   | <b>Cost</b>              | <b>Gross<br/>unrealized<br/>holding<br/>gains<br/>(Millions of yen)</b> | <b>Gross<br/>unrealized<br/>holding<br/>losses<br/>(Millions of yen)</b> | <b>Fair<br/>value</b> |
| Current:          |                          |   |  |                       |
| Government bonds  | ¥ 222                    | ¥   | ¥  | ¥ 222                 |
| Noncurrent:       |                          |   |  |                       |
| Government bonds  | ¥ 225                    | ¥   | ¥ 21   | ¥ 204                 |
| Corporate bonds   | 1,397                    | 27  | 55   | 1,369                 |
| Fund trusts       | 2,275                    | 300   | 7  | 2,568                 |
| Equity securities | 11,932                   | 7,295   | 1,501  | 17,726                |
|                   | <b>¥15,829</b>           | <b>¥7,622</b>   | <b>¥ 1,584</b>   | <b>¥21,867</b>        |
|                   |                          |   |  |                       |
|                   | <b>December 31, 2008</b> |   |  |                       |
|                   | <b>Cost</b>              | <b>Gross<br/>unrealized<br/>holding<br/>gains<br/>(Millions of yen)</b> | <b>Gross<br/>unrealized<br/>holding<br/>losses<br/>(Millions of yen)</b> | <b>Fair<br/>value</b> |
| Current:          |                          |   |  |                       |
| Government bonds  | ¥ 1                      | ¥   | ¥  | ¥ 1                   |
| Fund trusts       | 133                      | 16  |  | 149                   |
|                   | ¥ 134                    | ¥ 16  | ¥  | ¥ 150                 |
| Noncurrent:       |                          |   |  |                       |
| Government bonds  | ¥ 431                    | ¥   | ¥ 18   | ¥ 413                 |
| Corporate bonds   | 1,593                    | 27  | 32   | 1,588                 |
| Fund trusts       | 2,366                    | 40  | 170  | 2,236                 |
| Equity securities | 10,522                   | 2,532   | 836  | 12,218                |
|                   | <b>¥ 14,912</b>          | <b>¥ 2,599</b>  | <b>¥ 1,056</b>   | <b>¥ 16,455</b>       |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**2. Investments (continued)**

Maturities of available-for-sale debt securities and fund trusts included in short-term investments and investments in the accompanying consolidated balance sheets were as follows at December 31, 2009:

|  | Cost              | Fair value     |
|--|-------------------|----------------|
|  | (Millions of yen) |                |
| Due within one year                    | ¥ 222             | ¥ 222          |
| Due after one year through five years  | 3,274             | 3,568          |
| Due after five years through ten years | 623               | 573            |
|  | <b>¥ 4,119</b>    | <b>¥ 4,363</b> |

Gross realized gains were ¥277 million, ¥116 million and ¥1,512 million for the years ended December 31, 2009, 2008 and 2007, respectively. Gross realized losses, including write-downs for impairments that were other than temporary, were ¥2,482 million and ¥7,868 million for the years ended December 31, 2009 and 2008, respectively, and were not significant for the year ended December 31, 2007.

At December 31, 2009, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than 12 months.

Time deposits with original maturities of more than three months are ¥18,852 million and ¥7,430 million at December 31, 2009 and 2008, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

Aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥28,567 million and ¥10,684 million at December 31, 2009 and 2008, respectively. Investments with an aggregate cost of ¥28,087 million were not evaluated for impairment because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥61,595 million and ¥59,428 million at December 31, 2009 and 2008, respectively. Canon's share of the net earnings (losses) in affiliated companies accounted for by the equity method, included in other income (deductions), were losses of ¥12,649 million and ¥20,047 million for the years ended December 31, 2009 and 2008, respectively, and earnings of ¥5,634 million for the year ended December 31, 2007.

**3. Trade Receivables**

Trade receivables are summarized as follows:

|   | December 31       |                  |
|---|-------------------|------------------|
|   | 2009              | 2008             |
|   | (Millions of yen) |                  |
| Notes                                   | ¥ 13,037          | ¥ 20,303         |
| Accounts                                | 554,878           | 584,437          |
|   | <b>567,915</b>    | 604,740          |
| Less allowance for doubtful receivables | <b>(11,343)</b>   | (9,318)          |
|   | <b>¥ 556,572</b>  | <b>¥ 595,422</b> |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**4. Inventories**

Inventories are summarized as follows:

|                 | <b>December 31</b>       |             |
|-----------------|--------------------------|-------------|
|                 | <b>2009</b>              | <b>2008</b> |
|                 | <b>(Millions of yen)</b> |             |
| Finished goods  | <b>¥228,161</b>          | ¥316,533    |
| Work in process | <b>129,824</b>           | 171,511     |
| Raw materials   | <b>15,256</b>            | 18,875      |
|                 | <b>¥373,241</b>          | ¥506,919    |

**5. Property, Plant and Equipment**

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

|                               | <b>December 31</b>       |             |
|-------------------------------|--------------------------|-------------|
|                               | <b>2009</b>              | <b>2008</b> |
|                               | <b>(Millions of yen)</b> |             |
| Land                          | <b>¥ 258,824</b>         | ¥ 247,602   |
| Buildings                     | <b>1,299,154</b>         | 1,268,388   |
| Machinery and equipment       | <b>1,422,076</b>         | 1,395,451   |
| Construction in progress      | <b>105,713</b>           | 81,346      |
|                               | <b>3,085,767</b>         | 2,992,787   |
| Less accumulated depreciation | <b>(1,815,982)</b>       | (1,635,601) |
|                               | <b>¥ 1,269,785</b>       | ¥ 1,357,186 |

Depreciation expense for the years ended December 31, 2009, 2008 and 2007 was ¥277,399 million, ¥304,622 million and ¥309,815 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥29,030 million and ¥98,398 million at December 31, 2009 and 2008, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows include property, plant and equipment and intangible assets.

As a result of continued sluggish demand in the semiconductor manufacturing industry and diminished profitability of the semiconductor production equipment business, Canon recognized impairment losses related primarily to property, plant and equipment of its semiconductor production equipment business, which are included in the results of the Industry and Others Business Unit for the year ended December 31, 2009. Long-lived assets with a carrying amount of ¥15,390 million were written down to their fair value of zero, which was estimated using discounted future cash flows expected to be generated over their remaining useful life. The impairment losses were included in selling, general and administrative expenses in the consolidated statement of income.

Canon also recognized impairment losses of ¥11,164 million related primarily to property, plant and equipment of its semiconductor production equipment business, which are included in the results of the Industry and Others Business Unit for the year ended December 31, 2008, mainly as a result of declining demand in the semiconductor manufacturing industry. The impairment losses were estimated using discounted cash flows and included in selling, general and administrative expenses in the consolidated statement of income.



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**6. Finance Receivables and Operating Leases**

Finance receivables represent financing leases which consist of sales-type leases and direct-financing leases resulting from the marketing of Canon's and complementary third-party products. These receivables typically have terms ranging from 1 year to 6 years. The components of the finance receivables, which are included in prepaid expenses and other current assets, and other assets in the accompanying consolidated balance sheets, are as follows:

|   | <b>December 31</b>       |             |
|---|--------------------------|-------------|
|   | <b>2009</b>              | <b>2008</b> |
|   | <b>(Millions of yen)</b> |             |
| Total minimum lease payments receivable | <b>¥206,267</b>          | ¥198,611    |
| Unguaranteed residual values            | <b>14,630</b>            | 16,310      |
| Executory costs                         | <b>(1,973)</b>           | (1,729)     |
| Unearned income                         | <b>(26,994)</b>          | (26,658)    |
|   | <b>191,930</b>           | 186,534     |
| Less allowance for doubtful receivables | <b>(9,023)</b>           | (8,268)     |
|   | <b>182,907</b>           | 178,266     |
| Less current portion                    | <b>(65,146)</b>          | (59,608)    |
|   | <b>¥117,761</b>          | ¥118,658    |

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2009 and 2008 was ¥53,807 million and ¥50,388 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2009 and 2008 was ¥39,992 million and ¥37,284 million, respectively.

The following is a schedule by year of the future minimum lease payments to be received under financing leases and non-cancelable operating leases at December 31, 2009.

|                                 | <b>Financing<br/>leases</b> | <b>Operating<br/>leases</b> |
|---------------------------------|-----------------------------|-----------------------------|
|                                 | <b>(Millions of yen)</b>    |                             |
| <b>Year ending December 31:</b> |                             |                             |
| 2010                            | ¥ 82,058                    | ¥ 4,685                     |
| 2011                            | 59,342                      | 2,304                       |
| 2012                            | 38,834                      | 1,627                       |
| 2013                            | 18,580                      | 814                         |
| 2014                            | 6,396                       | 51                          |
| Thereafter                      | 1,057                       | 10                          |
|                                 | <b>¥206,267</b>             | <b>¥ 9,491</b>              |



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**7. Goodwill and Other Intangible Assets**

Intangible assets developed or acquired during the year ended December 31, 2009 totaled ¥43,461 million, which are subject to amortization and primarily consist of software of ¥39,303 million, which is mainly for internal use, and license fees of ¥2,797 million, in addition to those recorded from acquired businesses. The weighted average amortization period for software, license fees and intangible assets in total is approximately 4 years, 7 years and 4 years, respectively.

The components of intangible assets subject to amortization at December 31, 2009 and 2008 were as follows:

|              | December 31, 2009     |                          | December 31, 2008     |                          |
|--------------|-----------------------|--------------------------|-----------------------|--------------------------|
|              | Gross carrying amount | Accumulated amortization | Gross carrying amount | Accumulated amortization |
|              | (Millions of yen)     |                          |                       |                          |
| Software     | ¥ 198,276             | ¥ 114,410                | ¥ 187,920             | ¥ 103,535                |
| License fees | 23,889                | 13,546                   | 21,537                | 11,104                   |
| Other        | 30,610                | 8,258                    | 34,341                | 10,925                   |
|              | ¥ 252,775             | ¥ 136,214                | ¥ 243,798             | ¥ 125,564                |

Aggregate amortization expense for the years ended December 31, 2009, 2008 and 2007 was ¥37,994 million, ¥36,715 million and ¥31,879 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥36,633 million in 2010, ¥26,309 million in 2011, ¥16,959 million in 2012, ¥10,846 million in 2013, and ¥6,411 million in 2014.

Intangible assets not subject to amortization other than goodwill at December 31, 2009 and 2008 were not significant. The changes in the carrying amount of goodwill, which is included in other assets in the consolidated balance sheets, for the years ended December 31, 2009 and 2008 were as follows:

|                                   | Years ended December 31 |          |
|-----------------------------------|-------------------------|----------|
|                                   | 2009                    | 2008     |
|                                   | (Millions of yen)       |          |
| Balance at beginning of year      | ¥ 50,754                | ¥ 56,783 |
| Goodwill acquired during the year | 4,805                   | 4,975    |
| Translation adjustments and other | 312                     | (11,004) |
| Balance at end of year            | ¥ 55,871                | ¥ 50,754 |

Almost all of the goodwill has been allocated to the Office Business Unit and the Consumer Business Unit at December 31, 2009 and 2008 for impairment testing.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**8. Short-Term Loans and Long-Term Debt**

Short-term loans consisting of bank borrowings at December 31, 2008 were ¥220 million. The weighted average interest rate on short-term loans outstanding at December 31, 2008 was 6.21%.

Long-term debt consisted of the following:

|  | <b>December 31</b>       |             |
|--|--------------------------|-------------|
|  | <b>2009</b>              | <b>2008</b> |
|  | <b>(Millions of yen)</b> |             |
| Loans, principally from banks, maturing in installments through 2017; bearing weighted average interest of 0.30% and 2.93% at December 31, 2009 and 2008, respectively | ¥ 20                     | ¥ 95        |
| Capital lease obligations  | 9,761                    | 13,648      |
|  | <b>9,781</b>             | 13,743      |
| Less current portion   | <b>(4,869)</b>           | (5,320)     |
|  | <b>¥ 4,912</b>           | ¥ 8,423     |

The aggregate annual maturities of long-term debt outstanding at December 31, 2009 were as follows:

|                                 | <b>(Millions of yen)</b> |       |
|---------------------------------|--------------------------|-------|
| <b>Year ending December 31:</b> |                          |       |
| 2010                            | ¥                        | 4,869 |
| 2011                            |                          | 3,357 |
| 2012                            |                          | 1,068 |
| 2013                            |                          | 352   |
| 2014                            |                          | 98    |
| Thereafter                      |                          | 37    |
|                                 | ¥                        | 9,781 |

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

**9. Trade Payables**

Trade payables are summarized as follows:

|          | <b>December 31</b>       |             |
|----------|--------------------------|-------------|
|          | <b>2009</b>              | <b>2008</b> |
|          | <b>(Millions of yen)</b> |             |
| Notes    | ¥ 7,608                  | ¥ 14,544    |
| Accounts | 331,505                  | 392,202     |
|          | <b>¥ 339,113</b>         | ¥ 406,746   |



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits**

The Company and certain of its subsidiaries have contributory and noncontributory defined benefit pension plans covering substantially all of their employees. Benefits payable under the plans are based on employee earnings and years of service. The Company and certain of its subsidiaries also have defined contribution pension plans covering substantially all of their employees.

The amounts of cost recognized for the defined contribution pension plans of the Company and certain of its subsidiaries for the years ended December 31, 2009, 2008 and 2007 were ¥9,148 million, ¥10,840 million and ¥10,262 million, respectively.

**Obligations and funded status**

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

|  | Japanese plans    |            | Foreign plans |            |
|--|-------------------|------------|---------------|------------|
|  | December 31       |            | December 31   |            |
|  | 2009              | 2008       | 2009          | 2008       |
|  | (Millions of yen) |            |               |            |
| Change in benefit obligations:                 |                   |            |               |            |
| Benefit obligations at beginning of year       | ¥ 521,985         | ¥ 493,478  | ¥ 78,468      | ¥ 113,833  |
| Service cost                                   | 21,759            | 20,786     | 2,426         | 3,141      |
| Interest cost                                  | 12,535            | 12,253     | 4,251         | 4,991      |
| Plan participants' contributions               |                   |            | 1,177         | 1,460      |
| Amendments                                     | (674)             | (204)      |               | (86)       |
| Actuarial (gain) loss                          | 10,822            | 10,160     | 3,533         | (4,521)    |
| Benefits paid                                  | (15,107)          | (14,488)   | (1,784)       | (2,210)    |
| Foreign currency exchange rate changes         |                   |            | 6,099         | (38,140)   |
| Benefit obligations at end of year             | 551,320           | 521,985    | 94,170        | 78,468     |
| Change in plan assets:                         |                   |            |               |            |
| Fair value of plan assets at beginning of year | 429,870           | 511,450    | 62,996        | 92,908     |
| Actual return on plan assets                   | 26,616            | (81,981)   | 4,844         | (8,453)    |
| Employer contributions                         | 15,173            | 14,716     | 3,059         | 8,317      |
| Plan participants' contributions               |                   |            | 1,177         | 1,460      |
| Benefits paid                                  | (14,451)          | (14,315)   | (1,784)       | (1,556)    |
| Foreign currency exchange rate changes         |                   |            | 4,766         | (29,680)   |
| Fair value of plan assets at end of year       | 457,208           | 429,870    | 75,058        | 62,996     |
| Funded status at end of year                   | ¥ (94,112)        | ¥ (92,115) | ¥ (19,112)    | ¥ (15,472) |

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)***Obligations and funded status (continued)*

Amounts recognized in the consolidated balance sheets at December 31, 2009 and 2008 are as follows:

|                                    | Japanese plans<br>December 31 |           | Foreign plans<br>December 31 |           |
|------------------------------------|-------------------------------|-----------|------------------------------|-----------|
|                                    | 2009                          | 2008      | 2009                         | 2008      |
|                                    | (Millions of yen)             |           |                              |           |
| Other assets                       | ¥ 707                         | ¥ 806     | ¥ 2,069                      | ¥ 2,461   |
| Accrued expenses                   |                               |           | (96)                         | (70)      |
| Accrued pension and severance cost | (94,819)                      | (92,921)  | (21,085)                     | (17,863)  |
|                                    | ¥(94,112)                     | ¥(92,115) | ¥(19,112)                    | ¥(15,472) |

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2009 and 2008 before the effect of income taxes are as follows:

|                           | Japanese plans<br>December 31 |           | Foreign plans<br>December 31 |          |
|---------------------------|-------------------------------|-----------|------------------------------|----------|
|                           | 2009                          | 2008      | 2009                         | 2008     |
|                           | (Millions of yen)             |           |                              |          |
| Actuarial loss            | ¥ 237,822                     | ¥ 251,731 | ¥19,411                      | ¥ 15,650 |
| Prior service credit      | (155,928)                     | (168,904) | (670)                        | (768)    |
| Net transition obligation | 1,444                         | 2,166     |                              |          |
|                           | ¥ 83,338                      | ¥ 84,993  | ¥18,741                      | ¥ 14,882 |

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

|                                | Japanese plans<br>December 31 |           | Foreign plans<br>December 31 |          |
|--------------------------------|-------------------------------|-----------|------------------------------|----------|
|                                | 2009                          | 2008      | 2009                         | 2008     |
|                                | (Millions of yen)             |           |                              |          |
| Accumulated benefit obligation | ¥ 522,582                     | ¥ 493,559 | ¥ 80,361                     | ¥ 71,627 |

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)*****Obligations and funded status (continued)***

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

|  | Japanese plans<br>December 31 |          | Foreign plans<br>December 31 |         |
|--|-------------------------------|----------|------------------------------|---------|
|  | 2009                          | 2008     | 2009                         | 2008    |
|  | (Millions of yen)             |          |                              |         |
| Plans with projected benefit obligations in excess of plan assets: |                               |          |                              |         |
| Projected benefit obligations                                      | ¥ 545,466                     | ¥516,646 | ¥ 94,123                     | ¥77,083 |
| Fair value of plan assets  | 450,647                       | 423,725  | 72,942                       | 59,150  |

Plans with accumulated benefit obligations in excess of plan assets:

|                                 |           |          |          |         |
|---------------------------------|-----------|----------|----------|---------|
| Accumulated benefit obligations | ¥ 509,638 | ¥485,436 | ¥ 80,314 | ¥69,471 |
| Fair value of plan assets       | 442,756   | 420,341  | 72,942   | 59,089  |

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

Net periodic benefit cost for Canon's employee retirement and severance defined benefit plans for the years ended December 31, 2009, 2008 and 2007 consisted of the following components:

|   | Japanese plans<br>Years ended December 31 |          |          | Foreign plans<br>Years ended December 31 |         |         |
|---|---|----------|----------|--|---------|---------|
|   | 2009                                      | 2008     | 2007     | 2009                                     | 2008    | 2007    |
|   | (Millions of yen)                         |          |          |  |         |         |
| Service cost                              | ¥ 21,759                                  | ¥ 20,786 | ¥ 20,161 | ¥ 2,426                                  | ¥ 3,141 | ¥ 4,016 |
| Interest cost                             | 12,535                                    | 12,253   | 11,888   | 4,251                                    | 4,991   | 4,947   |
| Expected return on plan assets            | (15,808)                                  | (19,721) | (21,148) | (4,211)                                  | (5,519) | (5,427) |
| Amortization of net transition obligation | 722                                       | 722      | 722      |  |         |         |
| Amortization of prior service credit      | (13,650)                                  | (13,373) | (13,479) | (98)                                     | (271)   | (86)    |
| Amortization of actuarial loss            | 13,923                                    | 7,068    | 4,868    | 1,014                                    | 898     | 887     |
|   | ¥ 19,481                                  | ¥ 7,735  | ¥ 3,012  | ¥ 3,382                                  | ¥ 3,240 | ¥ 4,337 |

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)****Components of net periodic benefit cost and other amounts recognized in other comprehensive income (loss) (continued)**

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2009 and 2008 are summarized as follows:

|   | Japanese plans          |           | Foreign plans           |         |
|---|-------------------------|-----------|-------------------------|---------|
|   | Years ended December 31 |           | Years ended December 31 |         |
|   | 2009                    | 2008      | 2009                    | 2008    |
|   | (Millions of yen)       |           |                         |         |
| Current year actuarial (gain) loss        | ¥ 14                    | ¥ 111,862 | ¥ 2,900                 | ¥ 9,451 |
| Amortization of actuarial loss            | (13,923)                | (7,068)   | (1,014)                 | (898)   |
| Prior service credit due to amendments    | (674)                   | (204)     |                         | (86)    |
| Amortization of prior service credit      | 13,650                  | 13,373    | 98                      | 271     |
| Amortization of net transition obligation | (722)                   | (722)     |                         |         |
|   | ¥ (1,655)               | ¥ 117,241 | ¥ 1,984                 | ¥ 8,738 |

The estimated net transition obligation, prior service credit and actuarial loss for the defined benefit pension plans that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost over the next year are summarized as follows:

|                           | Japanese plans    | Foreign plans |
|---------------------------|-------------------|---------------|
|                           | (Millions of yen) |               |
| Net transition obligation | ¥ 722             | ¥             |
| Prior service credit      | (12,873)          | (117)         |
| Actuarial loss            | 12,639            | 1,245         |

**Assumptions**

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

|  | Japanese plans |      | Foreign plans |      |
|--|----------------|------|---------------|------|
|  | December 31    |      | December 31   |      |
|  | 2009           | 2008 | 2009          | 2008 |
| Discount rate  | 2.3%           | 2.4% | 5.2%          | 5.3% |
| Assumed rate of increase in future compensation levels | 3.0%           | 3.0% | 3.5%          | 3.1% |

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

|  | Japanese plans          |      |      | Foreign plans           |      |      |
|--|-------------------------|------|------|-------------------------|------|------|
|  | Years ended December 31 |      |      | Years ended December 31 |      |      |
|  | 2009                    | 2008 | 2007 | 2009                    | 2008 | 2007 |
| Discount rate  | 2.4%                    | 2.5% | 2.5% | 5.3%                    | 5.1% | 4.5% |
| Assumed rate of increase in future compensation levels | 3.0%                    | 2.9% | 2.9% | 3.1%                    | 3.1% | 2.9% |
| Expected long-term rate of return on plan assets       | 3.7%                    | 3.7% | 3.9% | 6.2%                    | 6.5% | 6.0% |

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



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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)****Plan assets**

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

Canon's model portfolio for Japanese plans consists of three major components: approximately 30% is invested in equity securities, approximately 50% is invested in debt securities, and approximately 20% is invested in other investment vehicles, primarily consisting of investments in life insurance company general accounts.

Outside Japan, investment policies vary by country, but the long-term investment objectives and strategies remain consistent. However, Canon's model portfolio for foreign plans has been developed as follows: approximately 70% is invested in equity securities, approximately 25% is invested in debt securities, and approximately 5% is invested in other investment vehicles, primarily consisting of investments in real estate assets.

The equity securities are selected primarily from stocks that are listed on the securities exchanges. Prior to investing, Canon has investigated the business condition of the investee companies, and appropriately diversified investments by type of industry and other relevant factors. The debt securities are selected primarily from government bonds, public debt instruments, and corporate bonds. Prior to investing, Canon has investigated the quality of the issue, including rating, interest rate, and repayment dates, and has appropriately diversified the investments. Pooled funds are selected using strategies consistent with the equity and debt securities described above. As for investments in life insurance company general accounts, the contracts with the insurance companies include a guaranteed interest rate and return of capital. With respect to investments in foreign investment vehicles, Canon has investigated the stability of the underlying governments and economies, the market characteristics such as settlement systems and the taxation systems. For each such investment, Canon has selected the appropriate investment country and currency. The three levels of input used to measure fair value are more fully described in Note 20.

The fair values of Canon's pension plan assets at December 31, 2009, by asset category, are as follows:

|                                       | Japanese plans |         |         | Total<br>(Millions of yen) | Foreign plans |         |         | Total  |
|---------------------------------------|----------------|---------|---------|----------------------------|---------------|---------|---------|--------|
|                                       | Level 1        | Level 2 | Level 3 |                            | Level 1       | Level 2 | Level 3 |        |
| Equity securities:                    |                |         |         |                            |               |         |         |        |
| Japanese companies                    |                |         |         |                            |               |         |         |        |
| (a)                                   | ¥48,844        | ¥       | ¥       | ¥ 48,844                   | ¥             | ¥       | ¥       | ¥      |
| Foreign companies                     | 5,444          |         |         | 5,444                      | 3,898         |         |         | 3,898  |
| Pooled funds (b)                      |                | 85,353  |         | 85,353                     |               | 47,290  |         | 47,290 |
| Debt securities:                      |                |         |         |                            |               |         |         |        |
| Government bonds                      |                |         |         |                            |               |         |         |        |
| (c)                                   | 14,803         |         |         | 14,803                     | 1,581         |         |         | 1,581  |
| Municipal bonds                       |                | 879     |         | 879                        |               |         |         |        |
| Corporate bonds                       |                | 7,665   |         | 7,665                      |               | 6,673   |         | 6,673  |
| Pooled funds (d)                      |                | 189,870 |         | 189,870                    |               | 9,343   |         | 9,343  |
| Mortgage backed securities (and other |                | 943     |         | 943                        |               | 256     |         | 256    |

|   |                 |                  |               |                  |                |                 |                 |
|---|-----------------|------------------|---------------|------------------|----------------|-----------------|-----------------|
| asset backed securities)                |                 |                  |               |                  |                |                 |                 |
| Life insurance company general accounts | <b>94,269</b>   |                  | <b>94,269</b> |                  |                |                 |                 |
| Other assets                            | <b>8,367</b>    | <b>771</b>       | <b>9,138</b>  |                  | <b>6,017</b>   |                 | <b>6,017</b>    |
|   | <b>¥ 69,091</b> | <b>¥ 387,346</b> | <b>¥ 771</b>  | <b>¥ 457,208</b> | <b>¥ 5,479</b> | <b>¥ 69,579</b> | <b>¥ 75,058</b> |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)*****Plan assets (continued)***

- (a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥950 million at December 31, 2009.
- (b) These funds invest in listed equity securities consisting of approximately 50% Japanese companies and 50% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
- (c) This class includes approximately 80% Japanese government bonds and 20% foreign government bonds.
- (d) These funds invest in approximately 55% Japanese government bonds, 25% foreign government bonds, 10% Japanese municipal bonds, and 10% corporate bonds.

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

Level 1 assets are comprised principally of equity securities and government bonds, which are valued using unadjusted quoted market prices in active markets with sufficient volume and frequency of transactions. Level 2 assets are comprised principally of pooled funds that invest in equity and debt securities, corporate bonds and investments in life insurance company general accounts. Pooled funds are valued at their net asset values that are calculated by the sponsor of the fund and have daily liquidity. Corporate bonds are valued using quoted prices for identical assets in markets that are not active. Investments in life insurance company general accounts are valued at conversion value. The fair value of Level 3 assets, consisting of hedge funds, was ¥771 million and ¥712 million at December 31, 2009 and 2008, respectively. Amounts of actual returns on, and purchases and sales of, these assets during the year ended December 31, 2009 were not significant.

***Contributions***

Canon expects to contribute ¥14,116 million to its Japanese defined benefit pension plans and ¥3,650 million to its foreign defined benefit pension plans for the year ending December 31, 2010.

***Estimated future benefit payments***

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

| <b>Year ending December 31:</b> | <b>Japanese<br/>plans</b> | <b>Foreign<br/>plans</b> |
|---------------------------------|---------------------------|--------------------------|
|                                 | <b>(Millions of yen)</b>  |                          |
| 2010                            | ¥ 13,029                  | ¥ 1,765                  |
| 2011                            | 14,571                    | 1,867                    |
| 2012                            | 15,643                    | 1,972                    |
| 2013                            | 17,120                    | 2,004                    |
| 2014                            | 17,961                    | 2,074                    |
| 2015 - 2019                     | 114,536                   | 12,939                   |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**11. Income Taxes**

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

|                            | <b>Year ended December 31, 2009</b> |                |              |
|----------------------------|-------------------------------------|----------------|--------------|
|                            | <b>Japanese</b>                     | <b>Foreign</b> | <b>Total</b> |
|                            | (Millions of yen)                   |                |              |
| Income before income taxes | ¥ 130,857                           | ¥ 88,498       | ¥ 219,355    |
| Income taxes:              |                                     |                |              |
| Current                    | ¥ 45,079                            | ¥ 18,331       | ¥ 63,410     |
| Deferred                   | 15,415                              | 5,297          | 20,712       |
|                            | ¥ 60,494                            | ¥ 23,628       | ¥ 84,122     |
|                            |                                     |                |              |
|                            | <b>Year ended December 31, 2008</b> |                |              |
|                            | <b>Japanese</b>                     | <b>Foreign</b> | <b>Total</b> |
|                            | (Millions of yen)                   |                |              |
| Income before income taxes | ¥ 382,299                           | ¥ 98,848       | ¥ 481,147    |
| Income taxes:              |                                     |                |              |
| Current                    | ¥ 168,428                           | ¥ 24,857       | ¥ 193,285    |
| Deferred                   | (34,073)                            | 1,576          | (32,497)     |
|                            | ¥ 134,355                           | ¥ 26,433       | ¥ 160,788    |
|                            |                                     |                |              |
|                            | <b>Year ended December 31, 2007</b> |                |              |
|                            | <b>Japanese</b>                     | <b>Foreign</b> | <b>Total</b> |
|                            | (Millions of yen)                   |                |              |
| Income before income taxes | ¥ 575,017                           | ¥ 193,371      | ¥ 768,388    |
| Income taxes:              |                                     |                |              |
| Current                    | ¥ 238,921                           | ¥ 60,358       | ¥ 299,279    |
| Deferred                   | (31,930)                            | (3,091)        | (35,021)     |
|                            | ¥ 206,991                           | ¥ 57,267       | ¥ 264,258    |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**11. Income Taxes (continued)**

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 40% for the years ended December 31, 2009, 2008 and 2007. A reconciliation of the Japanese statutory income tax rate and the effective income tax rate as a percentage of income before income taxes is as follows:

|  | <b>Years ended December 31</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2009</b>                    | <b>2008</b> | <b>2007</b> |
| Japanese statutory income tax rate   | <b>40.0%</b>                   | 40.0%       | 40.0%       |
| Increase (reduction) in income taxes resulting from:                           |                                |             |             |
| Expenses not deductible for tax purposes                                       | <b>0.9</b>                     | 0.5         | 0.3         |
| Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate | <b>(5.4)</b>                   | (2.6)       | (2.8)       |
| Tax credit for research and development expenses                               | <b>(2.8)</b>                   | (4.6)       | (4.5)       |
| Change in valuation allowance  | <b>5.4</b>                     | 0.1         | 0.1         |
| Other  | <b>0.2</b>                     | 0.0         | 1.3         |
| Effective income tax rate  | <b>38.3%</b>                   | 33.4%       | 34.4%       |

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

|   | <b>December 31</b>       |             |
|---|--------------------------|-------------|
|   | <b>2009</b>              | <b>2008</b> |
|   | <b>(Millions of yen)</b> |             |
| Prepaid expenses and other current assets | <b>¥ 94,798</b>          | ¥ 96,613    |
| Other assets                              | <b>117,263</b>           | 130,378     |
| Other current liabilities                 | <b>(2,018)</b>           | (2,491)     |
| Other noncurrent liabilities              | <b>(36,278)</b>          | (29,075)    |
|   | <b>¥ 173,765</b>         | ¥ 195,425   |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**11. Income Taxes (continued)**

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2009 and 2008 are presented below:

|   | <b>December 31</b>       |                  |
|---|--------------------------|------------------|
|   | <b>2009</b>              | <b>2008</b>      |
|   | <b>(Millions of yen)</b> |                  |
| Deferred tax assets:  |                          |                  |
| Inventories   | ¥ 24,121                 | ¥ 36,817         |
| Accrued business tax  | 3,861                    | 5,183            |
| Accrued pension and severance cost                          | 52,639                   | 51,713           |
| Research and development costs capitalized for tax purposes | 45,718                   | 41,661           |
| Property, plant and equipment                               | 53,011                   | 58,682           |
| Accrued expenses  | 29,409                   | 27,748           |
| Net operating losses carried forward                        | 12,305                   | 6,745            |
| Other   | 44,709                   | 44,894           |
|   | <b>265,773</b>           | <b>273,443</b>   |
| Less valuation allowance                                    | <b>(22,188)</b>          | <b>(10,817)</b>  |
| Total deferred tax assets                                   | <b>243,585</b>           | <b>262,626</b>   |
| Deferred tax liabilities:                                   |                          |                  |
| Undistributed earnings of foreign subsidiaries              | <b>(8,023)</b>           | (10,407)         |
| Net unrealized gains on securities                          | <b>(2,052)</b>           | (607)            |
| Tax deductible reserve                                      | <b>(7,797)</b>           | (8,119)          |
| Financing lease revenue                                     | <b>(35,505)</b>          | (31,035)         |
| Prepaid pension and severance cost                          | <b>(314)</b>             | (2,644)          |
| Other   | <b>(16,129)</b>          | (14,389)         |
| Total deferred tax liabilities                              | <b>(69,820)</b>          | <b>(67,201)</b>  |
| Net deferred tax assets                                     | <b>¥ 173,765</b>         | <b>¥ 195,425</b> |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**11. Income Taxes (continued)**

The net changes in the total valuation allowance were increases of ¥11,371 million, ¥1,490 million and ¥2,827 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Based upon the level of historical taxable income and projections for future taxable income over the periods which the net deductible temporary differences are expected to reverse, management believes it is more likely than not that Canon will realize the benefits of these deferred tax assets, net of the existing valuation allowance, at December 31, 2009.

At December 31, 2009, Canon had net operating losses which can be carried forward for income tax purposes of ¥34,410 million to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to ten years as follows:

|                                    | (Millions of<br>yen) |
|------------------------------------|----------------------|
| Within one year                    | ¥ 1,534              |
| After one year through five years  | 7,209                |
| After five years through ten years | 17,501               |
| Indefinite period                  | 8,166                |
| <br>Total                          | <br>¥ 34,410         |

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

Canon has not recognized deferred tax liabilities of ¥28,092 million for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2009 and prior years because Canon currently does not expect to have such amounts distributed or paid as dividends to the Company in the foreseeable future. Deferred tax liabilities will be recognized when Canon expects that it will realize those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. At December 31, 2009, such undistributed earnings of these subsidiaries were ¥769,380 million.

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

|   | Years ended December 31 |              |              |
|---|-------------------------|--------------|--------------|
|   | 2009                    | 2008         | 2007         |
|   | (Millions of yen)       |              |              |
| Balance at beginning of year                    | ¥ 12,689                | ¥ 15,791     | ¥ 16,087     |
| Additions for tax positions of the current year |                         | 8,700        | 994          |
| Additions for tax positions of prior years      | 1,442                   | 1,354        | 1,902        |
| Reductions for tax positions of prior years     | (1,106)                 | (8,512)      | (1,340)      |
| Lapse of the applicable statute of limitations  |                         |              | (1,311)      |
| Settlements with tax authorities                |                         | (1,208)      | (322)        |
| Other   | 210                     | (3,436)      | (219)        |
| <br>Balance at end of year                      | <br>¥ 13,235            | <br>¥ 12,689 | <br>¥ 15,791 |

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, are ¥4,746 million and ¥4,405 million at December 31, 2009 and 2008, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax audit settlements and any related litigation could affect the effective tax rate in

the future period. Based on each of the items of which Canon is aware at December 31, 2009, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2009 and 2008, and interest and penalties included in income taxes for the years ended December 31, 2009, 2008 and 2007 are not material.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2006. While there has been no specific indication by the tax authority that Canon will be subject to a transfer pricing examination in the near future, the tax authority could conduct a transfer pricing examination for years after 2002. In other major foreign tax jurisdictions, including the United States and Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2004 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2005 in Japan and for certain years after 2003 in major foreign tax jurisdictions.



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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**12. Common Stock**

For the years ended December 31, 2008 and 2007, the Company issued 127,254 shares and 190,380 shares of common stock, respectively, in connection with the conversion of convertible debt. In accordance with the Corporation Law of Japan, conversion into common stock of convertible debt is accounted for by crediting one-half or more of the conversion price to the common stock account and the remainder to the additional paid-in capital account.

**13. Legal Reserve and Retained Earnings**

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

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2009, 2008 and 2007 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2009 did not reflect current year-end dividends in the amount of ¥67,896 million which were approved by the stockholders in March 2010.

The amount available for dividends under the Corporation Law of Japan is based on the amount recorded in the Company's nonconsolidated books of account in accordance with financial accounting standards of Japan. Such amount was ¥1,307,735 million at December 31, 2009.

Retained earnings at December 31, 2009 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥10,301 million.

**14. Other Comprehensive Income (Loss)**

Changes in accumulated other comprehensive income (loss) are as follows:

|   | <b>Years ended December 31</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2009</b>                    | <b>2008</b> | <b>2007</b> |
|   | (Millions of yen)              |             |             |
| Foreign currency translation adjustments:       |                                |             |             |
| Balance at beginning of year                    | ¥ (235,968)                    | ¥ 22,796    | ¥ 22,858    |
| Adjustments for the year                        | 33,340                         | (258,764)   | (62)        |
| Balance at end of year                          | (202,628)                      | (235,968)   | 22,796      |
| Net unrealized gains and losses on securities:  |                                |             |             |
| Balance at beginning of year                    | 1,135                          | 6,287       | 8,065       |
| Adjustments for the year                        | 2,150                          | (5,152)     | (1,778)     |
| Balance at end of year                          | 3,285                          | 1,135       | 6,287       |
| Net gains and losses on derivative instruments: |                                |             |             |
| Balance at beginning of year                    | 1,493                          | (849)       | (1,663)     |
| Adjustments for the year                        | (1,422)                        | 2,342       | 814         |
| Balance at end of year                          | 71                             | 1,493       | (849)       |
| Pension liability adjustments:                  |                                |             |             |
| Balance at beginning of year                    | (59,480)                       | 6,436       | (26,542)    |
| Adjustments for the year                        | (2,066)                        | (65,916)    | 32,978      |
| Balance at end of year                          | (61,546)                       | (59,480)    | 6,436       |

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|  |                   |            |          |
|--|-------------------|------------|----------|
| Total accumulated other comprehensive income (loss): |                   |            |          |
| Balance at beginning of year                         | <b>(292,820)</b>  | 34,670     | 2,718    |
| Adjustments for the year                             | <b>32,002</b>     | (327,490)  | 31,952   |
| Balance at end of year                               | <b>¥(260,818)</b> | ¥(292,820) | ¥ 34,670 |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**14. Other Comprehensive Income (Loss) (continued)**

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

|  | Years ended December 31 |   |                      |
|--|-------------------------|---|----------------------|
|  | Before-tax<br>amount    | Tax<br>(expense)<br>or benefit<br>(Millions of yen) | Net-of-tax<br>amount |
| <b>2009:</b>   |                         |   |                      |
| Foreign currency translation adjustments                                 | ¥ 35,459                | ¥ (2,089)   | ¥ 33,370             |
| Net unrealized gains and losses on securities:                           |                         |   |                      |
| Amount arising during the year   | 2,231                   | (1,333)   | 898                  |
| Reclassification adjustments for gains and losses realized in net income | 2,205                   | (886)   | 1,319                |
| Net change during the year   | 4,436                   | (2,219)   | 2,217                |
| Net gains and losses on derivative instruments:                          |                         |   |                      |
| Amount arising during the year   | 298                     | (119)   | 179                  |
| Reclassification adjustments for gains and losses realized in net income | (2,670)                 | 1,068   | (1,602)              |
| Net change during the year   | (2,372)                 | 949   | (1,423)              |
| Pension liability adjustments:   |                         |   |                      |
| Amount arising during the year   | (4,115)                 | 1,891   | (2,224)              |
| Reclassification adjustments for gains and losses realized in net income | 1,911                   | (632)   | 1,279                |
| Net change during the year   | (2,204)                 | 1,259   | (945)                |
| Other comprehensive income (loss)  | ¥ 35,319                | ¥ (2,100)   | ¥ 33,219             |
| <b>2008:</b>   |                         |   |                      |
| Foreign currency translation adjustments                                 | ¥ (266,568)             | ¥ 5,893   | ¥ (260,675)          |
| Net unrealized gains and losses on securities:                           |                         |   |                      |
| Amount arising during the year   | (17,485)                | 6,992   | (10,493)             |
| Reclassification adjustments for gains and losses realized in net income | 7,752                   | (3,101)   | 4,651                |
| Net change during the year   | (9,733)                 | 3,891   | (5,842)              |
| Net gains and losses on derivative instruments:                          |                         |   |                      |
| Amount arising during the year   | 23,121                  | (9,248)   | 13,873               |
| Reclassification adjustments for gains and losses realized in net income | (19,219)                | 7,688   | (11,531)             |
| Net change during the year   | 3,902                   | (1,560)   | 2,342                |
| Pension liability adjustments:   |                         |   |                      |

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|  |             |          |             |
|--|-------------|----------|-------------|
| Amount arising during the year   | (111,215)   | 39,233   | (71,982)    |
| Reclassification adjustments for gains and losses realized in net income | (4,956)     | 2,073    | (2,883)     |
| Net change during the year   | (116,171)   | 41,306   | (74,865)    |
| Other comprehensive income (loss)  | ¥ (388,570) | ¥ 49,530 | ¥ (339,040) |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**14. Other Comprehensive Income (Loss) (continued)**

|  | Years ended December 31 |   |                      |
|--|-------------------------|---|----------------------|
|  | Before-tax<br>amount    | Tax<br>(expense)<br>or benefit<br>(Millions of yen) | Net-of-tax<br>amount |
| <b>2007:</b>   |                         |   |                      |
| Foreign currency translation adjustments                                 | ¥ (396)                 | ¥ 308   | ¥ (88)               |
| Net unrealized gains and losses on securities:                           |                         |   |                      |
| Amount arising during the year   | (7,721)                 | 3,231   | (4,490)              |
| Reclassification adjustments for gains and losses realized in net income | (580)                   | 2,715   | 2,135                |
| Net change during the year   | (8,301)                 | 5,946   | (2,355)              |
| Net gains and losses on derivative instruments:                          |                         |   |                      |
| Amount arising during the year   | 589                     | (236)   | 353                  |
| Reclassification adjustments for gains and losses realized in net income | 780                     | (312)   | 468                  |
| Net change during the year   | 1,369                   | (548)   | 821                  |
| Pension liability adjustments:   |                         |   |                      |
| Amount arising during the year   | 71,364                  | (26,586)  | 44,778               |
| Reclassification adjustments for gains and losses realized in net income | (7,088)                 | 2,952   | (4,136)              |
| Net change during the year   | 64,276                  | (23,634)  | 40,642               |
| Other comprehensive income (loss)  | ¥ 56,948                | ¥ (17,928)  | ¥ 39,020             |

**15. Stock-Based Compensation**

On May 1, 2009, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 954,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2009 was ¥699.

On May 1, 2008, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 592,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2008 was ¥1,247.

The compensation cost recognized for these stock options for the years ended December 31, 2009 and 2008 was ¥564 million and ¥246 million, respectively, and is included in selling, general and administrative expenses in the consolidated statements of income.

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

Years ended December  
31

|                                    | <b>2009</b>   | <b>2008</b> |
|------------------------------------|---------------|-------------|
| Expected term of option (in years) | <b>4.0</b>    | 4.0         |
| Expected volatility                | <b>40.08%</b> | 37.39%      |
| Dividend yield                     | <b>3.51%</b>  | 2.10%       |
| Risk-free interest rate            | <b>0.64%</b>  | 0.95%       |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**15. Stock-Based Compensation (continued)**

A summary of option activity under the stock option plans as of and for the years ended December 31, 2009 and 2008 is presented below:

|   | Shares           | Weighted-average<br>exercise price<br>(Yen)<br>¥ | Weighted-average<br>remaining<br>contractual<br>term<br>(Year) | Aggregate<br>intrinsic<br>value<br>(Millions of<br>yen) |
|---|------------------|--|--|---|
| <b>Outstanding at January 1, 2008</b>   |                  |  |  |   |
| Granted                                 | 592,000          | 5,502  |  |   |
| Forfeited                               |                  |  |  |   |
| <b>Outstanding at December 31, 2008</b> | <b>592,000</b>   | <b>5,502</b>                                     | <b>3.3</b>   | <b>¥</b>  |
| Granted                                 | 954,000          | 3,287  |  |   |
| Forfeited                               | (34,000)         | 4,851  |  |   |
| <b>Outstanding at December 31, 2009</b> | <b>1,512,000</b> | <b>¥ 4,119</b>                                   | <b>3.0</b>   | <b>¥ 588</b>  |

At December 31, 2009, all option awards were nonvested but expected to be vested, and there was ¥558 million of total unrecognized compensation cost related to these nonvested stock options. That cost is expected to be recognized over a weighted-average period of 0.96 year.

**16. Net Income Attributable to Canon Inc. Stockholders per Share**

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

|   | Years ended December 31 |               |               |
|---|-------------------------|---------------|---------------|
|   | 2009                    | 2008          | 2007          |
|   | (Millions of yen)       |               |               |
| Net income attributable to Canon Inc.               | ¥ 131,647               | ¥ 309,148     | ¥ 488,332     |
| Effect of dilutive securities:                      |                         |               |               |
| 1.30% Japanese yen convertible debentures, due 2008 |                         | 2             | 4             |
| Diluted net income attributable to Canon Inc.       | ¥ 131,647               | ¥ 309,150     | ¥ 488,336     |
|   | (Number of shares)      |               |               |
| Average common shares outstanding                   | 1,234,481,836           | 1,255,626,490 | 1,293,295,680 |
| Effect of dilutive securities:                      |                         |               |               |
| 1.30% Japanese yen convertible debentures, due 2008 |                         | 79,929        | 221,751       |
| Diluted common shares outstanding                   | 1,234,481,836           | 1,255,706,419 | 1,293,517,431 |
|   | (Yen)                   |               |               |

Net income attributable to Canon Inc. stockholders per share:

|         |                |         |         |
|---------|----------------|---------|---------|
| Basic   | <b>¥106.64</b> | ¥246.21 | ¥377.59 |
| Diluted | <b>106.64</b>  | 246.20  | 377.53  |

The computation of diluted net income attributable to Canon Inc. stockholders per share for the years ended December 31, 2009 and 2008 exclude outstanding stock options because the effect would be anti-dilutive.



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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**17. Derivatives and Hedging Activities*****Risk management policy***

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

***Foreign currency exchange rate risk management***

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

***Cash flow hedge***

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign exchange contracts associated with forecasted intercompany sales, are reported in accumulated other comprehensive income (loss). These amounts are subsequently reclassified into earnings through other income (deductions) in the same period as the hedged items affect earnings. Substantially all amounts recorded in accumulated other comprehensive income (loss) at year-end are expected to be recognized in earnings over the next 12 months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

***Derivatives not designated as hedges***

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

Contract amounts of foreign exchange contracts as of December 31, 2009 and 2008 are set forth below:

|                            | <b>December 31</b>       |             |
|----------------------------|--------------------------|-------------|
|                            | <b>2009</b>              | <b>2008</b> |
|                            | <b>(Millions of yen)</b> |             |
| To sell foreign currencies | <b>¥ 494,314</b>         | ¥ 350,959   |
| To buy foreign currencies  | <b>30,978</b>            | 35,247      |

***Fair value of derivative instruments in the consolidated balance sheet***

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheet as of December 31, 2009.

**Derivatives designated as hedging instruments**

**December 31, 2009**  
**Fair value**

|                            |    | <b>Balance<br/>sheet<br/>location</b> | <b>(Millions of<br/>yen)</b> |            |
|----------------------------|----|---------------------------------------|------------------------------|------------|
| Liabilities:               |    |                                       |                              |            |
| Foreign exchange contracts | 95 | Other<br>current<br>liabilities       | ¥                            | <b>644</b> |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**17. Derivatives and Hedging Activities (continued)**Derivatives not designated as hedging instruments

|                            | <b>December 31, 2009</b>                           |   |
|----------------------------|--|---|
|                            | <b>Balance sheet<br/>location</b>                  | <b>Fair value<br/>(Millions of<br/>yen)</b> |
| Assets:                    |  |   |
|                            | Prepaid<br>expenses and<br>other current<br>assets | ¥ <b>752</b>                                |
| Foreign exchange contracts |  |   |
| Liabilities:               |  |   |
|                            | Other current<br>liabilities                       | <b>6,566</b>                                |
| Foreign exchange contracts |  |   |

***Effect of derivative instruments on the consolidated statement of income***

The following tables present the effect of Canon's derivative instruments on the consolidated statement of income for the year ended December 31, 2009.

Derivatives in cash flow hedging relationships

|                            | Gain<br>(loss)<br>recognized<br>in OCI<br>(effective<br>portion)<br>Amount | Gain (loss) reclassified<br>from<br>accumulated OCI into<br>income<br>(effective portion)<br>Location | Amount         | Gain (loss) recognized<br>in<br>income (ineffective<br>portion and amount<br>excluded from<br>effectiveness testing)<br>Location | Amount         |
|----------------------------|--|---|----------------|--|----------------|
|                            | <b>(Millions of yen)</b>   |   |                |  |                |
| Foreign exchange contracts | ¥ <b>(2,372)</b>   | Other, net  | ¥ <b>2,670</b> | Other,<br>net  | ¥ <b>(462)</b> |

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2008 and 2007. The amount of net gains or losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was net losses of ¥3,701 million and ¥6,883 million for the years ended December 31, 2008 and 2007, respectively.

Derivatives not designated as hedging instruments

|                            | Gain (loss) recognized in income on<br>derivative<br>Location | Amount<br>(Millions of<br>yen) |
|----------------------------|---|--------------------------------|
| Foreign exchange contracts | Other, net  | ¥ <b>(8,638)</b>               |

## **18. Commitments and Contingent Liabilities**

### ***Commitments***

At December 31, 2009, commitments outstanding for the purchase of property, plant and equipment approximated ¥21,839 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥64,226 million.

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥14,210 million and ¥14,223 million at December 31, 2009 and 2008, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under the operating lease arrangements amounted to ¥36,474 million, ¥41,169 million and ¥36,900 million for the years ended December 31, 2009, 2008 and 2007, respectively.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**18. Commitments and Contingent Liabilities (continued)**

Future minimum lease payments required under noncancelable operating leases that have initial or remaining lease terms in excess of one year at December 31, 2009 are as follows:

|   | <b>(Millions of yen)</b> |
|---|--------------------------|
| <b>Year ending December 31:</b>         |                          |
| 2010                                    | ¥ 16,259                 |
| 2011                                    | 13,331                   |
| 2012                                    | 9,641                    |
| 2013                                    | 6,551                    |
| 2014                                    | 5,002                    |
| Thereafter                              | 8,180                    |
| <br>Total future minimum lease payments | <br>¥ 58,964             |

**Guarantees**

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

For each guarantee provided, Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years, in the case of employees with housing loans, and of 1 year to 10 years, in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥18,526 million at December 31, 2009. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2009 were not significant.

Canon also issues contractual product warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. Changes in accrued product warranty cost for the years ended December 31, 2009 and 2008 are summarized as follows:

|                              | <b>Years ended December 31</b> |              |
|------------------------------|--------------------------------|--------------|
|                              | <b>2009</b>                    | <b>2008</b>  |
|                              | <b>(Millions of yen)</b>       |              |
| Balance at beginning of year | ¥ 17,372                       | ¥ 20,138     |
| Addition                     | 21,670                         | 30,644       |
| Utilization                  | (22,050)                       | (26,846)     |
| Other                        | (3,048)                        | (6,564)      |
| <br>Balance at end of year   | <br>¥ 13,944                   | <br>¥ 17,372 |

**Legal proceedings**

In October 2003, a lawsuit was filed by a former employee against the Company at the Tokyo District Court in Japan. The lawsuit alleges that the former employee is entitled to ¥45,872 million as reasonable remuneration for an invention related to certain technology used by the Company, and the former employee has sued for a partial payment of ¥1,000 million and interest thereon. On January 30, 2007, the Tokyo District Court of Japan ordered the Company to pay the former employee approximately ¥33.5 million and interest thereon. On the same day, the Company

appealed the decision. On February 26, 2009, the Intellectual Property High Court of Japan issued a judgment in the appellate court review and ordered the Company to pay the former employee approximately ¥69.6 million, consisting of reasonable remuneration of approximately ¥56.3 million and interest thereon. On March 12, 2009, the Company appealed the decision to the Supreme Court.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**18. Commitments and Contingent Liabilities (continued)*****Legal proceedings (continued)***

In Germany, Verwertungsgesellschaft Wort ( VG Wort ), a collecting agency representing certain copyright holders, has filed a series of lawsuits seeking to impose copyright levies upon digital products such as PCs and printers, that allegedly enable the reproduction of copyrighted materials, against the companies importing and distributing these digital products. VG Wort filed a lawsuit in January 2006 against Canon seeking payment of copyright levies on single-function printers, and the court of first instance in Düsseldorf ruled in favor of the claim by VG Wort in November 2006. Canon lodged an appeal against such decision in December 2006 before the court of appeals in Düsseldorf. Following a decision by the same court of appeals in Düsseldorf on January 23, 2007 in relation to a similar court case seeking copyright levies on single-function printers of Epson Deutschland GmbH, Xerox GmbH and Kyocera Mita Deutschland GmbH, whereby the court rejected such alleged levies, in its judgment of November 13, 2007, the court of appeals rejected VG Wort's claim against Canon. VG Wort appealed further against said decision of the court of appeals before the Federal Supreme Court. In December 2007, for a similar Hewlett-Packard GmbH case relating to single-function printers, the Federal Supreme Court delivered its judgment in favor of Hewlett-Packard GmbH and dismissed VG Wort's claim. VG Wort has already filed a constitutional complaint with the Federal Constitutional Court against said judgment of the Federal Supreme Court. Likewise, after rejection by the Federal Supreme Court of an appeal by VG Wort in relation to Canon's single-function printers case in September 2008, VG Wort lodged a claim before the Federal Constitutional Court. Canon received a brief from the Federal Constitutional Court in September 2009 to enable the Court to decide on whether to accept the claim, and Canon responded to it in November 2009. In 2007, an amendment of German copyright law was carried out, and a new law has been effective from January 1, 2008 for both multi-function printers and single-function printers. The new law sets forth that the scope and tariff of copyright levies will be agreed between industry and the collecting society. Industry and the collecting society, based on the requirement under the new law, reached an agreement in December 2008. This agreement is applicable retroactively from January 1, 2008 and will remain effective through end of 2010. However, in Canon's assessment, the final outcome of the court case regarding the single-function printers sold in Germany before January 1, 2008 remains uncertain.

Canon is involved in various claims and legal actions, including those noted above, arising in the ordinary course of business. Canon has recorded provisions for liabilities when it is probable that liabilities have been incurred and the amount of loss can be reasonably estimated. Canon reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of the negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Based on its experience, Canon believes that any damage amounts claimed in the specific matters discussed above and other outstanding matters are not a meaningful indicator of Canon's potential liability. In the opinion of management, the ultimate disposition of outstanding matters would not have a material adverse effect on Canon's consolidated financial position, results of operations, or cash flows. However, litigation is inherently unpredictable. While Canon believes that it has valid defenses with respect to legal matters pending against it, it is possible that Canon's consolidated financial position, results of operations, or cash flows could be materially affected in any particular period by the unfavorable resolution of one or more of these matters.

**19. Disclosures about the Fair Value of Financial Instruments and Concentrations of Credit Risk*****Fair value of financial instruments***

The estimated fair values of Canon's financial instruments at December 31, 2009 and 2008 are set forth below. The following summary excludes cash and cash equivalents, trade receivables, finance receivables, noncurrent receivables, short-term loans, trade payables and accrued expenses for which fair values approximate their carrying amounts. The summary also excludes investments which are disclosed in Note 2.

| <b>December 31</b> |                  |                 |                  |
|--------------------|------------------|-----------------|------------------|
| <b>2009</b>        |                  | <b>2008</b>     |                  |
| <b>Carrying</b>    | <b>Estimated</b> | <b>Carrying</b> | <b>Estimated</b> |

|  | <b>amount</b> | <b>fair<br/>value</b>    | <b>amount</b> | <b>fair value</b> |
|--|---------------|--------------------------|---------------|-------------------|
|  |               | <b>(Millions of yen)</b> |               |                   |
| Long-term debt, including current installments | ¥(9,781)      | ¥(9,777)                 | ¥(13,743)     | ¥ (13,727)        |
| Foreign exchange contracts:                    |               |                          |               |                   |
| Assets   | 752           | 752                      | 10,516        | 10,516            |
| Liabilities                                    | (7,210)       | (7,210)                  | (678)         | (678)             |

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

Long-term debt

The fair values of Canon's long-term debt instruments are based on the present value of future cash flows associated with each instrument discounted using current market borrowing rates for similar debt instruments of comparable maturity.



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**19. Disclosures about the Fair Value of Financial Instruments and Concentrations of Credit Risk (continued)*****Fair value of financial instruments (continued)*****Foreign exchange contracts**

The fair values of foreign exchange contracts are measured based on the market price obtained from financial institutions.

**Limitations**

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

***Concentrations of credit risk***

At December 31, 2009 and 2008, one customer accounted for approximately 22% and 19% of consolidated trade receivables, respectively. Although Canon does not expect that the customer will fail to meet its obligations, Canon is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

**20. Fair Value Measurements**

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

|         |   |
|---------|---|
| Level 1 | Inputs are quoted prices in active markets for identical assets or liabilities.   |
| Level 2 | Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means. |
| Level 3 | Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.  |

***Assets and liabilities measured at fair value on a recurring basis***

The following table presents Canon's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2009 and 2008.

|   | Level 1           | December 31, 2009 |         | Total     |
|---|-------------------|-------------------|---------|-----------|
|   |                   | Level 2           | Level 3 |           |
|   | (Millions of yen) |                   |         |           |
| Assets:                                     |                   |                   |         |           |
| Cash and cash equivalents                   | ¥                 | ¥ 184,856         | ¥       | ¥ 184,856 |
| Available-for-sale securities (current):    |                   |                   |         |           |
| Government bonds                            |                   | 222               |         | 222       |
| Available-for-sale securities (noncurrent): |                   |                   |         |           |
| Government bonds                            |                   | 204               |         | 204       |
| Corporate bonds                             |                   |                   | 29      | 1,369     |
| Fund trusts                                 |                   | 1,589             | 979     | 2,568     |

|                   |                |                 |                |                 |
|-------------------|----------------|-----------------|----------------|-----------------|
| Equity securities | <b>17,726</b>  |                 |                | <b>17,726</b>   |
| Derivatives       |                | <b>752</b>      |                | <b>752</b>      |
| Total assets      | <b>¥19,741</b> | <b>¥186,616</b> | <b>¥ 1,340</b> | <b>¥207,697</b> |
| Liabilities:      |                |                 |                |                 |
| Derivatives       | <b>¥</b>       | <b>¥ 7,210</b>  | <b>¥</b>       | <b>¥ 7,210</b>  |
| Total liabilities | <b>¥</b>       | <b>¥ 7,210</b>  | <b>¥</b>       | <b>¥ 7,210</b>  |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**20. Fair Value Measurements (continued)***Assets and liabilities measured at fair value on a recurring basis (continued)*

|   | <b>Level 1</b>  | <b>December 31, 2008</b> |                | <b>Total</b>     |
|---|-----------------|--------------------------|----------------|------------------|
|   |                 | <b>Level 2</b>           | <b>Level 3</b> |                  |
|   |                 | <b>(Millions of yen)</b> |                |                  |
| Assets:                                     |                 |                          |                |                  |
| Cash and cash equivalents                   | ¥               | ¥ 194,030                | ¥              | ¥ 194,030        |
| Available-for-sale securities (current):    |                 |                          |                |                  |
| Government bonds                            | 1               |                          |                | 1                |
| Fund trusts                                 | 149             |                          |                | 149              |
| Available-for-sale securities (noncurrent): |                 |                          |                |                  |
| Government bonds                            | 413             |                          |                | 413              |
| Corporate bonds                             | 43              | 29                       | 1,516          | 1,588            |
| Fund trusts                                 | 1,284           | 952                      |                | 2,236            |
| Equity securities                           | 12,218          |                          |                | 12,218           |
| Derivatives                                 |                 | 10,516                   |                | 10,516           |
| <b>Total assets</b>                         | <b>¥ 14,108</b> | <b>¥ 205,527</b>         | <b>¥ 1,516</b> | <b>¥ 221,151</b> |
| Liabilities:                                |                 |                          |                |                  |
| Derivatives                                 | ¥               | ¥ 678                    | ¥              | ¥ 678            |
| <b>Total liabilities</b>                    | <b>¥</b>        | <b>¥ 678</b>             | <b>¥</b>       | <b>¥ 678</b>     |

Level 1 investments are comprised principally of equity securities, which are valued using an unadjusted quoted market price in active markets with sufficient volume and frequency of transactions. Level 2 cash and cash equivalents are valued using quoted prices for identical assets in markets that are not active. Level 3 investments are mainly comprised of corporate bonds, which are valued based on unobservable inputs as the market for the assets was not active at the measurement date.

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

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting of corporate bonds, for the years ended December 31, 2009 and 2008.

|   | <b>Years ended December</b> |                |
|---|-----------------------------|----------------|
|   | <b>31</b>                   |                |
|   | <b>2009</b>                 | <b>2008</b>    |
|   | <b>(Millions of yen)</b>    |                |
| Balance at beginning of year                    | ¥ 1,516                     | ¥ 1,889        |
| Total gains or losses (realized or unrealized): |                             |                |
| Included in earnings                            | (221)                       | (559)          |
| Included in other comprehensive income (loss)   | (1)                         | (8)            |
| Purchases, issuances, and settlements           | 46                          | 194            |
| <b>Balance at end of year</b>                   | <b>¥ 1,340</b>              | <b>¥ 1,516</b> |

Substantially all gains and losses included in earnings are related to corporate bonds still held at December 31, 2009 and 2008, respectively, and are reported in Other, net in the consolidated statements of income.

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**20. Fair Value Measurements (continued)***Assets and liabilities measured at fair value on a nonrecurring basis*

During the year ended December 31, 2009, long-lived assets held and used with a carrying amount of ¥15,390 million were written down to their fair value of zero and classified as Level 3 assets, resulting in an impairment charge of ¥15,390 million, which was included in earnings.

During the year ended December 31, 2009, non-marketable equity securities with a carrying amount of ¥1,468 million were written down to their fair value of ¥480 million and classified as Level 3 instruments, resulting in an other-than-temporary impairment charge of ¥988 million, which was included in earnings. During the year ended December 31, 2008, non-marketable equity securities with a carrying amount of ¥513 million were written down to their fair value of ¥112 million and classified as Level 3 instruments, resulting in an other-than-temporary impairment charge of ¥401 million, which was included in earnings.

**21. Segment Information**

Certain foreign private issuers, including Canon, have been exempted from the segment disclosure requirements of U.S. GAAP in filings with the SEC under the Securities Exchange Act of 1934.

However, in September 2008, the SEC issued its Foreign Issuer Reporting Enhancements ( FIRE ) rule. The FIRE rule eliminates an instruction to the Form 20-F that permitted certain foreign private issuers to omit segment disclosures required by U.S. GAAP, as well as other enhancements. This aspect of the FIRE rule regarding elimination of ability to omit segment disclosures is effective for fiscal years ended on or after December 15, 2009 and was adopted by Canon in the year ended December 31, 2009 for all periods presented.

***Segment information***

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

The primary products included in each segment are as follows:

Office Business Unit: Office network digital MFDs, Color network digital MFDs, Office copying machines, Personal-use copying machines, Full-color copying machines, Laser printers, and Large format inkjet printers

Consumer Business Unit: Digital SLR cameras, Compact digital cameras, Interchangeable lenses, Digital video camcorders, Inkjet multifunction peripherals, Single function inkjet printers, Image scanners, and Broadcasting equipment

Industry and Others Business Unit: Semiconductor production equipment, Mirror projection mask aligners for LCD panels, Medical equipment, Components, Computer information systems, Document scanners, and Personal information products

The accounting policies of the segments are substantially the same as those described in the significant accounting policies in Note 1. Canon evaluates performance of, and allocates resources to, each segment based on operating profit.

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**21. Segment Information (continued)***Segment information (continued)*

Information about operating results and assets for each segment as of and for the years ended December 31, 2009, 2008 and 2007 is as follows:

|                               | Office      | Consumer    | Industry<br>and<br>Others<br>(Millions of yen) | Corporate<br>and<br>eliminations | Consolidated |
|-------------------------------|-------------|-------------|--|----------------------------------|--------------|
| <b>2009:</b>                  |             |             |  |                                  |              |
| Net sales:                    |             |             |  |                                  |              |
| External customers            | ¥ 1,635,056 | ¥ 1,299,194 | ¥ 274,951                                      | ¥                                | ¥ 3,209,201  |
| Intersegment                  | 10,020      | 1,966       | 83,047   | (95,033)                         |              |
| Total                         | 1,645,076   | 1,301,160   | 357,998  | (95,033)                         | 3,209,201    |
| Operating cost and expenses   | 1,415,680   | 1,117,668   | 433,954  | 24,844                           | 2,992,146    |
| Operating profit (loss)       | ¥ 229,396   | ¥ 183,492   | ¥ (75,956)                                     | ¥ (119,877)                      | ¥ 217,055    |
|                               |             |             |  |                                  |              |
| Total assets                  | ¥ 745,646   | ¥ 437,160   | ¥ 359,635                                      | ¥ 2,305,116                      | ¥ 3,847,557  |
| Depreciation and amortization | 90,878      | 48,701      | 60,770   | 115,044                          | 315,393      |
| Capital expenditures          | 96,718      | 27,503      | 25,644   | 108,387                          | 258,252      |
| <b>2008:</b>                  |             |             |  |                                  |              |
| Net sales:                    |             |             |  |                                  |              |
| External customers            | ¥ 2,223,253 | ¥ 1,453,647 | ¥ 417,261                                      | ¥                                | ¥ 4,094,161  |
| Intersegment                  | 23,356      | 2,428       | 105,144  | (130,928)                        |              |
| Total                         | 2,246,609   | 1,456,075   | 522,405  | (130,928)                        | 4,094,161    |
| Operating cost and expenses   | 1,789,263   | 1,232,951   | 570,281  | 5,592                            | 3,598,087    |
| Operating profit (loss)       | ¥ 457,346   | ¥ 223,124   | ¥ (47,876)                                     | ¥ (136,520)                      | ¥ 496,074    |
|                               |             |             |  |                                  |              |
| Total assets                  | ¥ 822,660   | ¥ 502,927   | ¥ 453,581                                      | ¥ 2,190,766                      | ¥ 3,969,934  |
| Depreciation and amortization | 99,962      | 58,082      | 71,557   | 111,736                          | 341,337      |
| Capital expenditures          | 139,046     | 52,641      | 31,445   | 180,268                          | 403,400      |
| <b>2007:</b>                  |             |             |  |                                  |              |
| Net sales:                    |             |             |  |                                  |              |
| External customers            | ¥ 2,456,798 | ¥ 1,585,307 | ¥ 439,241                                      | ¥                                | ¥ 4,481,346  |
| Intersegment                  | 20,720      | 2,645       | 110,742  | (134,107)                        |              |
| Total                         | 2,477,518   | 1,587,952   | 549,983  | (134,107)                        | 4,481,346    |

|                               |           |           |           |             |             |
|-------------------------------|-----------|-----------|-----------|-------------|-------------|
| Operating cost and expenses   | 1,912,343 | 1,260,113 | 527,039   | 25,178      | 3,724,673   |
| Operating profit              | ¥ 565,175 | ¥ 327,839 | ¥ 22,944  | ¥ (159,285) | ¥ 756,673   |
| Total assets                  | ¥ 981,627 | ¥ 590,208 | ¥ 535,825 | ¥ 2,404,965 | ¥ 4,512,625 |
| Depreciation and amortization | 97,886    | 56,278    | 65,331    | 122,199     | 341,694     |
| Capital expenditures          | 126,857   | 35,548    | 113,178   | 194,081     | 469,664     |

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

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**21. Segment Information (continued)*****Geographic information***

Information by major geographic area as of and for the years ended December 31, 2009, 2008 and 2007 is as follows:

|                    | <b>2009</b>              | <b>2008</b> | <b>2007</b> |
|--------------------|--------------------------|-------------|-------------|
|                    | <b>(Millions of yen)</b> |             |             |
| Net sales:         |                          |             |             |
| Japan              | ¥ <b>702,344</b>         | ¥ 868,280   | ¥ 947,587   |
| Americas           | <b>894,154</b>           | 1,154,571   | 1,336,168   |
| Europe             | <b>995,150</b>           | 1,341,400   | 1,499,286   |
| Other areas        | <b>617,553</b>           | 729,910     | 698,305     |
| <b>Total</b>       | <b>¥ 3,209,201</b>       | ¥ 4,094,161 | ¥ 4,481,346 |
| Long-lived assets: |                          |             |             |
| Japan              | ¥ <b>1,205,887</b>       | ¥ 1,314,092 | ¥ 1,284,283 |
| Americas           | <b>59,273</b>            | 43,435      | 45,492      |
| Europe             | <b>44,875</b>            | 47,392      | 68,944      |
| Other areas        | <b>77,146</b>            | 71,407      | 78,499      |
| <b>Total</b>       | <b>¥ 1,387,181</b>       | ¥ 1,476,326 | ¥ 1,477,218 |

Net sales are attributed to areas based on the location where the product is shipped to the customers. Other than in Japan and the United States, Canon does not conduct business in any individual country in which its sales in that country exceed 10% of consolidated net sales. Net sales in the United States are ¥793,428 million, ¥1,043,333 million and ¥1,217,096 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Long-lived assets represent property, plant and equipment and intangible assets for each geographic area.



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**21. Segment Information (continued)***Geographic information (continued)*

The following information is based on the location of the Company and its subsidiaries as of and for the years ended December 31, 2009, 2008 and 2007. In addition to the disclosure requirements under U.S. GAAP, Canon discloses this information as supplemental information based on the disclosure requirements of the Japanese Financial Instruments and Exchange Law.

|                             | Japan       | Americas    | Europe      | Other<br>areas<br>(Millions of yen) | Corporate<br>and<br>eliminations | Consolidated |
|-----------------------------|-------------|-------------|-------------|-------------------------------------|----------------------------------|--------------|
| <b>2009:</b>                |             |             |             |                                     |                                  |              |
| Net sales:                  |             |             |             |                                     |                                  |              |
| External customers          | ¥ 827,762   | ¥ 871,633   | ¥ 991,336   | ¥ 518,470                           | ¥                                | ¥ 3,209,201  |
| Intersegment                | 1,714,375   | 1,263       | 919         | 534,147                             | (2,250,704)                      |              |
| Total                       | 2,542,137   | 872,896     | 992,255     | 1,052,617                           | (2,250,704)                      | 3,209,201    |
| Operating cost and expenses | 2,288,471   | 860,863     | 964,606     | 1,019,208                           | (2,141,002)                      | 2,992,146    |
| Operating profit            | ¥ 253,666   | ¥ 12,033    | ¥ 27,649    | ¥ 33,409                            | ¥ (109,702)                      | ¥ 217,055    |
| Total assets                | ¥1,386,511  | ¥ 198,094   | ¥ 378,477   | ¥ 384,795                           | ¥ 1,499,680                      | ¥ 3,847,557  |
| <b>2008:</b>                |             |             |             |                                     |                                  |              |
| Net sales:                  |             |             |             |                                     |                                  |              |
| External customers          | ¥ 998,676   | ¥ 1,141,560 | ¥ 1,337,147 | ¥ 616,778                           | ¥                                | ¥ 4,094,161  |
| Intersegment                | 2,318,521   | 3,758       | 4,329       | 670,678                             | (2,997,286)                      |              |
| Total                       | 3,317,197   | 1,145,318   | 1,341,476   | 1,287,456                           | (2,997,286)                      | 4,094,161    |
| Operating cost and expenses | 2,812,645   | 1,136,288   | 1,314,942   | 1,247,156                           | (2,912,944)                      | 3,598,087    |
| Operating profit            | ¥ 504,552   | ¥ 9,030     | ¥ 26,534    | ¥ 40,300                            | ¥ (84,342)                       | ¥ 496,074    |
| Total assets                | ¥ 1,607,653 | ¥ 203,255   | ¥ 417,562   | ¥ 344,638                           | ¥ 1,396,826                      | ¥ 3,969,934  |
| <b>2007:</b>                |             |             |             |                                     |                                  |              |
| Net sales:                  |             |             |             |                                     |                                  |              |
| External customers          | ¥ 1,048,310 | ¥ 1,329,479 | ¥ 1,499,821 | ¥ 603,736                           | ¥                                | ¥ 4,481,346  |
| Intersegment                | 2,494,251   | 4,608       | 3,496       | 824,844                             | (3,327,199)                      |              |

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|                             |             |           |           |           |             |             |
|-----------------------------|-------------|-----------|-----------|-----------|-------------|-------------|
| Total                       | 3,542,561   | 1,334,087 | 1,503,317 | 1,428,580 | (3,327,199) | 4,481,346   |
| Operating cost and expenses | 2,768,998   | 1,281,805 | 1,441,972 | 1,378,306 | (3,146,408) | 3,724,673   |
| Operating profit            | ¥ 773,563   | ¥ 52,282  | ¥ 61,345  | ¥ 50,274  | ¥ (180,791) | ¥ 756,673   |
| Total assets                | ¥ 1,899,452 | ¥ 280,458 | ¥ 591,104 | ¥ 424,244 | ¥ 1,317,367 | ¥ 4,512,625 |

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Canon Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**22. Subsequent Events*****Share exchange agreement to make Canon Finetech Inc. a wholly owned subsidiary of Canon Inc.***

On February 8, 2010, the Board of Directors of the Company approved a share exchange under which the Company would make Canon Finetech Inc. ( Canon Finetech ) its wholly owned subsidiary, and the Company has entered into a share exchange agreement with Canon Finetech on the same date. As of February 8, 2010, the Company owned 57.59% of Canon Finetech. The share exchange is expected to become effective on May 1, 2010. The share exchange ratio is one share of Canon Finetech for 0.38 share of the Company. The Company will issue no new shares of stock, as it plans to issue its treasury stock for this transaction.

In order to secure the fairness of the share exchange ratio, the Company and Canon Finetech determined that each company would separately request an independent third-party appraisal agency to calculate the share exchange ratio, and diligently examined the results of the professional analyses and advice on the calculation of the proposed share exchange ratios submitted by the third-party appraisal agencies. As a result, the Boards of Directors of the Company and Canon Finetech determined the share exchange ratio of 0.38 share of the Company's common stock for each share of Canon Finetech common stock at their meetings held on February 8, 2010.

As a result of the share exchange, the carrying amount of the Company's noncontrolling interest in Canon Finetech will be decreased from ¥31,675 million to zero. The difference between the fair value of the shares of the Company issued to the noncontrolling interest holders and the decrease in the carrying amount of the noncontrolling interests will be recognized as an adjustment to additional paid-in capital. Additionally, after the date of the exchange, all of the net income of Canon Finetech will be attributable to the Company.

The Company has decided that making Canon Finetech its wholly owned subsidiary would facilitate the organic integration of both companies' management resources, further enhance the synergy effect throughout the Canon Group, and further elevate the flexibility and speed of management.

***Acquisition of Océ N.V.***

On March 9, 2010, Canon acquired 34.8% of the total outstanding shares of Océ N.V. ( Océ ), which is listed on NYSE Euronext Amsterdam, through a fully self-funded public cash tender offer for consideration of ¥ 38,785 million, in addition to the 22.9% interest Canon held before the public cash tender offer. Subsequent to the acquisition date, Canon acquired an additional 9.8% of the total outstanding shares of Océ for consideration of ¥10,918 million during the post-acceptance period of the tender offer and also acquired 0.6% for consideration of ¥671 million through market purchases. In addition, Canon subsequently acquired Océ's convertible cumulative financing preference shares representing 19.1% of the total outstanding shares of Océ for consideration of ¥8,027 million. As a result, Canon's aggregate interest currently represents

87.2% of the total outstanding shares of Océ. Océ is engaged in research and development, manufacture and sale of document management systems, printing systems for professionals and high-speed, wide format digital printing systems. Canon and Océ have complementary technologies and products and would benefit from this strong business relationship. Amid the increasingly competitive printing industry, Canon is further strengthening its business foundation in order to solidify its position as one of the global leaders. Canon aims to provide diversified solutions to its customers in the printing industry by making Océ a consolidated subsidiary.

This acquisition will be accounted for using the acquisition method. Prior to the March 9, 2010 acquisition date, Canon accounted for its 22.9% interest in Océ using the equity method. The acquisition-date fair value of the previous equity interest of ¥ 25,508 million was remeasured using the quoted price of Océ's common stock on the acquisition date, and will be included in the measurement of the total acquisition consideration.

Further information related to the accounting for this business combination has not been disclosed, because none of the activities required to complete the initial accounting for this acquisition have been completed as of the issuance date of the consolidated financial statements.

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Canon Inc. and Subsidiaries  
Schedule II Valuation and Qualifying Accounts

|   | <b>Balance<br/>at<br/>beginning<br/>of<br/>period</b> | <b>Addition-<br/>charged<br/>to<br/>income</b> | <b>Deduction-<br/>bad debts<br/>written<br/>off<br/>(Millions of yen)</b> | <b>Translation<br/>adjustments</b> | <b>Balance<br/>at end of<br/>period</b> |
|---|---|--|---|------------------------------------|---|
| Year ended December 31, 2009:<br>Allowance for doubtful receivables | ¥ 9,318   | ¥ 3,054  | ¥ 1,474   | ¥ 445                              | ¥ 11,343                                |
| Year ended December 31, 2008:<br>Allowance for doubtful receivables | ¥ 14,547  | ¥ 1,304  | ¥ 3,618   | ¥ (2,915)                          | ¥ 9,318                                 |
| Year ended December 31, 2007:<br>Allowance for doubtful receivables | ¥ 13,849  | ¥ 3,527  | ¥ 2,978   | ¥ 149                              | ¥ 14,547                                |

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**Item 19. Exhibits**

List of exhibits

- 12 Certifications of Chairman and CEO and Executive Vice President and CFO pursuant to Section 302 of the Sarbanes-Oxley Act
- 13 Certification of Chairman and CEO and Executive Vice President and CFO pursuant to Section 906 of the Sarbanes-Oxley Act

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SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, as amended, the registrant certifies that it meets all of the requirements for filing on Form 20-F/A and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CANON INC.  
(Registrant)

By: /s/ Toshizo Tanaka  
Toshizo Tanaka  
Executive Vice President and CFO

Canon Inc.  
30-2, Shimomaruko 3-chome,  
Ohta-ku, Tokyo 146-8501, Japan

Date June 10, 2010

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**EXHIBIT INDEX**

| <b>Exhibit number</b> | <b>Title</b>  |
|-----------------------|---|
| Exhibit 12            | Certifications of Chairman and CEO and Executive Vice President and CFO pursuant to Section 302 of the Sarbanes-Oxley Act |
| Exhibit 13            | Certification of Chairman and CEO and Executive Vice President and CFO pursuant to Section 906 of the Sarbanes-Oxley Act  |