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First Quarter Accounting & Tax Update

Tuesday, April 4, 2017

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Welcome

Trevor Hammond

Partner, Audit

Agenda

- **Q1 financial reporting reminders** – Jassie Kang
- **External reporting updates** – Reinier Deurwaarder
- **Highlights from Federal and Provincial budget releases** – Catherine Buhmiller
- **US tax reform** – James Rowling
- **Procurement & supply chain cost optimization** – Syed Ali

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Q1 financial reporting reminders

Jassie Kang

Senior Manager, Audit

Q1 financial reporting reminders

Considerations for March 31, 2017:

- Impairment considerations
  - How are you tracking relative to year end cash flow projections
- Banking arrangements and covenants (current and forecast)
  - Implications of timing of getting waivers for covenant failure
- Liquidity and going concern considerations

Accounting standards

Major project updates

- Lease accounting
- Revenue recognition
- Financial instruments
- Insurance contracts project

Other standards

- Amendments to IFRS 12 and IAS 28
- Amendments to IAS 7 – Disclosure on changes in Financial Liabilities
- Amendments to IAS 12 – Recognition of Deferred Tax Assets and Unrealized Losses

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External reporting updates

Reinier Deurwaarder

Partner, Audit

IFRS developments

2018

- IFRS 15 Revenue from Contracts with Customers
- IFRS 9 Financial Instruments

2019

- IFRS 16 Leases

Narrow scope

- Acc. Policies & Estimates (IAS 8)
- Operating Segments (IFRS 8)
- Liability classification (IAS 1)
- Definition of a Business (IFRS 3)

Standard setting

- Rate Regulated Industries
- Primary Financial Statements
- Materiality
- Principles of Disclosure

Source: KPMG

Climate-related disclosures

TCFD disclosure recommendations

In Dec 2016, the TCFD published 4 recommendations for disclosure of climate-related financial risks in mainstream financial reporting.

Physical risks

Disruption to companies' operations and value chain from extreme weather events or chronic changes in climate.

Liability risks

Increasing legislation to limit carbon emissions and potential to be held legally liable for contributing to climate change.

Transitional risks

Failing to make a successful commercial transition to the low carbon economy.

Climate-related financial risks

In 2015 the Financial Stability Board (FSB) Task Force on Climate-related Financial Disclosures (TCFD) was established to encourage more effective reporting on climate-related financial risks, including:

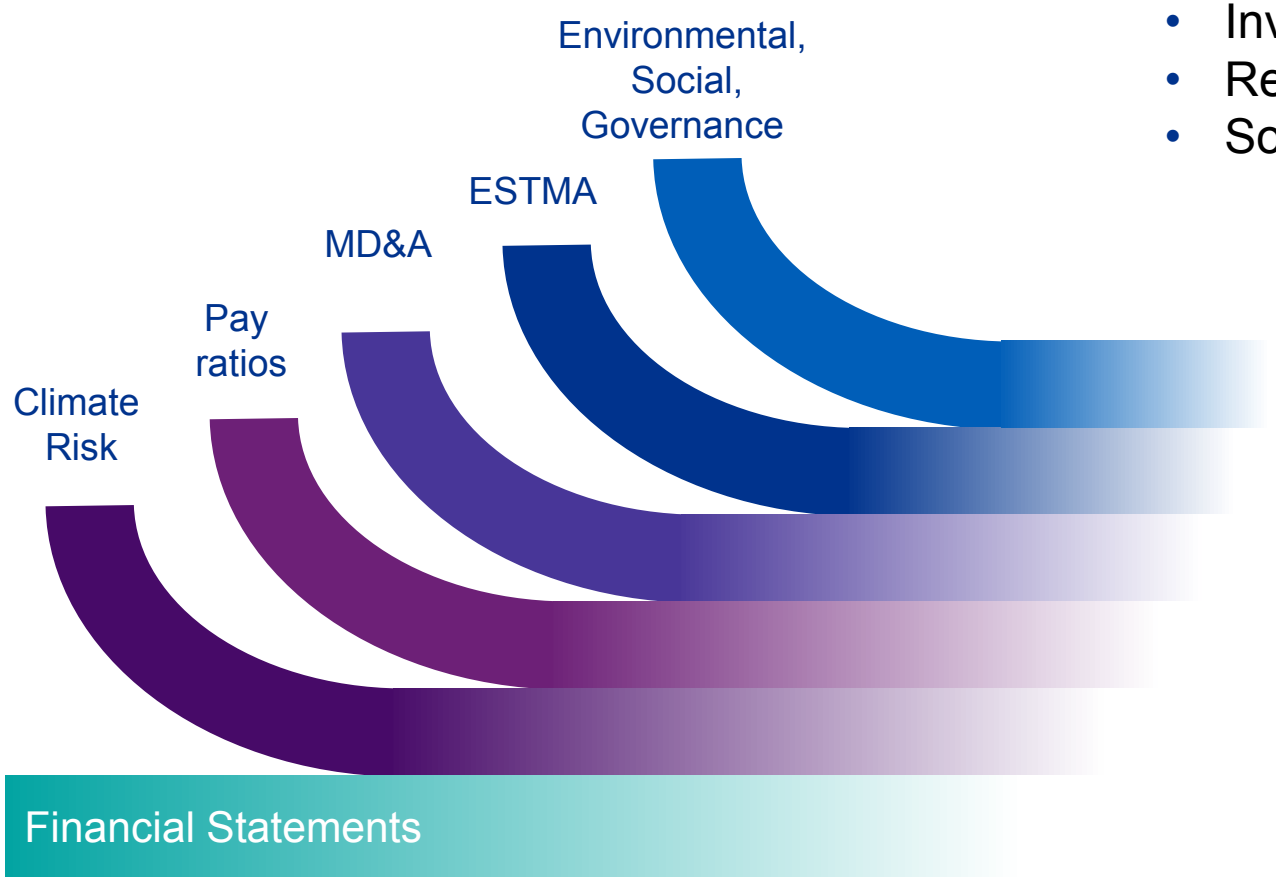
Governance	Disclose the organization's governance around climate-related risks and opportunities.
Strategy	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.
Risk Management	Disclose how the organization identifies, assesses, and manages climate-related risks.
Metrics and Targets	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities.

Source: KPMG

External reporting – Where are we going?

Impacted by:

- Investor demand
- Regulatory developments
- Social pressure



Integrated reporting?

Source: KPMG

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Federal and Provincial budgets

Catherine Buhmiller

Partner, Enterprise Tax

2017 Federal budget

What was not included

- Changes to corporate or personal income tax rates including capital gains inclusion rates
- Changes to taxation of stock options
- BEPS-related changes

2017 Federal budget – Corporate tax measures

Factual control of a corporation

- **Clarification of factors used in determination of factual control of a corporation**
  - Broadens the approach for determining whether factual control exists
  - Amendments to take into consideration all factors that are relevant and not to limit those factors to a legally enforceable right or ability to effect a change in the board of directors of the corporation, or the board's powers or to exercise influence over the shareholder(s) that may be taken into consideration in determining whether factual control exists
  - Applicable to taxation year beginning on or after March 22, 2017

2017 Federal budget – Corporate tax measures

Taxation of derivatives

- **New mark-to-market election**
  - Election can be made to mark to market eligible derivatives held on income account, aligns tax and accounting treatment
  - Once made, election applicable to all subsequent years until revoked with consent of CRA
  - Applicable to taxation year beginning on or after March 22, 2017

- **New anti-avoidance rule for straddle transactions**
  - Stop-loss rule will defer realization of loss if equivalent gain not yet realized
  - Includes transactions involving derivatives, commodities, debt obligations
  - Excludes
    - Transactions of financial institutions, mutual fund trusts and corporations
    - Hedging transactions undertaken in ordinary course of business
    - None of main purposes to defer or avoid tax
  - Applicable to losses realized on transactions undertaken on or after March 22, 2017

2017 Federal budget – Corporate tax measures

Billed-basis accounting

- **Elimination of work-in-progress (WIP) deferral for professionals**
  - Currently professionals can elect to defer WIP value from income, allows income to be recognized on a billed basis
  - Elimination of election for taxation years beginning on or after March 22, 2017
  - Transitional rules for two-year phase-in of current WIP balance

2017 Federal budget – Other tax measures

- **Miscellaneous CCA, CEE and CDE amendments**
  - Amendment to CCA class 43.1 and 43.2 to include certain geothermal equipment
  - Classification of discovery well expenditures as CDE instead of CEE after 2018
  - Removal of provision for eligible small oil and gas corporations to treat first $1million of CDE as CEE for expenditures incurred after 2018
- **Extension of mutual find merger rules to facilitate tax-deferred reorganizations of mutual fund corporations and segregated funds**
- **Elimination of requirement that employers must obtain express consent from employees before electronically issuing T4 slips to employees**
- **Elimination of childcare space investment tax credit**

2017 Federal budget – Other tax measures

- **Discussion paper to be released on tax planning strategies involving the use of private corporations and proposed policy responses**
  - Sprinkling income among family members
  - Holding investment portfolios
  - Converting ordinary income into dividends, capital gains

2017 Federal budget – International tax measures

BEPS update – Minimum standards

- **Agreed to by all participant countries**
  - Budget confirms Canada's focus on implementation of minimum standards
- **Country-by-country reporting**
  - Canadian legislation enacted and guidance recently released
- **Exchange of tax rulings**
  - Already in progress by Canada and many other jurisdictions
- **Resolution of treaty disputes**
  - Commitment to develop more effective and timely mutual agreement procedures
- **Multilateral Instrument (MLI)**
  - Canada is "pursuing" signing of MLI

2017 Federal budget – International tax measures

Life insurers carrying on business through a foreign branch

- **New FAPI-style rule for income earned on insurance of Canadian risks**
  - Currently income not subject to tax in Canada if earned in a foreign branch
  - Equivalent income earned in a controlled foreign subsidiary subject to FAPI rules, taxed in Canada annually
  - New rule will tax income earned in foreign branch if >10% of gross premium income related to insurance of Canadian risks
  - Current FAPI anti-avoidance rules extended to foreign branches
  - Applicable to taxation years beginning on or after March 22, 2017

Provincial budgets - 2017

British Columbia

- Small business corporate income tax rate decreased from 2.5% to 2.0% effective April 1, 2017
- Changes to interactive digital media tax credit
- Enhancement to mining exploration tax credit
- Adjustment to regional film tax credit
- Extension of existing tax credits for SR&ED, mining flow-through share, training and book publishing

Corporate Income Tax Rates – As of January 1, 2017		
	BC	Combined Federal and BC
General	11%	26%
M&P	11%	26%
Small business (on first $500K of active business income)	2.5%/2.0%	13%/12.5%

Provincial budgets – 2017 (cont'd)

Alberta

- No changes to corporate tax rates

Corporate Income Tax Rates – As of January 1, 2017		
	Alberta	Combined Federal and Alberta
General	12%	27%
M&P	12%	27%
Small business (on first $500K of active business income)	2%	12.5%

Provincial budgets - 2017 (cont'd)

Saskatchewan

- General corporate rate decrease by .5% effective July 1, 2017 and another .5% reduction effective July 1, 2019
- Refundable Research and Development Tax Credit introduced
- New "Patent Box" Incentive – Saskatchewan Commercial Innovation Incentive
- Increase M&P Investment Tax Credit from 5% to 6%

Corporate Income Tax Rates – 2017		
	Saskatchewan	Combined Federal and Saskatchewan
General	12% / 11.5%	27% / 26.5%
M&P	10% / 9.5%	25% / 24.5%
Small business (on first $500K of active business income)	2%	12.5%

Provincial budgets - 2017 (cont'd)

New Brunswick

- Small business corporate income tax rate decreased from 3.5% to 3.0% effective April 1, 2017
- Developing carbon pricing mechanism

Corporate Income Tax Rates – As of January 1, 2017		
	New Brunswick	Combined Federal and New Brunswick
General	14%	29%
M&P	14%	29%
Small business (on first $500K of active business income)	3.5%/3.0%	14%/13.5%

Provincial budgets – 2017 (cont'd)

Quebec

- Changes to qualification criteria for small business deduction
- Additional deductions for small and medium sized businesses
- Enhancement to “tax holiday” for large investment projects
- Additional Capital Cost Allowance for M&P and computer equipment acquired after March 28, 2017 and before April 1, 2019
- Enhancement to refundable tax credit to Quebec film or television production
- Amendments to refundable tax credits for various film and multimedia productions
- New refundable tax credits for:
  - Production of ethanol
  - Biodiesel fuel production
  - Creation of new financial services corporations

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US tax reform

James Rowling

Partner, Tax

US tax reform

The House Blueprint

- **Moving the Corporate Tax from an Income Tax to a Consumption Tax**

- **Economically equivalent to a credit method Value Added Tax (VAT) common in a number of jurisdictions, although there are important administrative differences**
  - No jurisdiction relies exclusively on a subtraction method consumption tax, such as the Blueprint

- **Tax reform elements**
  - 20% tax rate
  - Eliminate IRC Sec. 199 and other credits/deductions; retain R&D credit in some form
  - Wages still deductible
  - AMT eliminated

US tax reform

- **Consumption tax aspects**
  - Expensing
  - Interest expense deducted only against interest income
  - Cash method accounting
  - Net Operating Losses (NOLs)
    - Indefinitely carried forward and adjusted for inflation
    - Deduction capped at 90% of taxable income

- **Territorial tax regime**
  - 100% dividends received deduction for distributions from Controlled Foreign Corporations (CFCs)
  - Foreign tax credits largely eliminated
  - Only “passive income” subpart F rules likely to be maintained
  - Provides for “Repatriation Tax” on historical CFC earnings

Border adjustment mechanism

- Focus on consumption of U.S.-created goods and services in the U.S.
- Only take into account transactions with other U.S. taxpayers
  - Imports disfavored – no deductions/basis/expensing for imported goods/services
  - Exports favored – income from exports not taxed
- Essential elements
  - Necessary to achieve 20% rate; viewed as internationally competitive
  - Makes territorial taxation possible – parity between taxation of exports and CFCs
  - Is viewed as supporting the pro-growth/pro-jobs political narrative

US tax reform

- **Intended to be revenue neutral**
  - Creates winners and losers
  - If not revenue neutral, would likely sunset in 10 years under Senate "budget reconciliation" rules

- **Select industries and issues**
  - Financial institutions and insurance companies – Unclear how consumption tax and border adjustment apply
  - Treatment of financial transactions – interest, dividends, sales of financial instruments seem to be in the tax base (unlike most consumption taxes)
  - Services and royalties – effectively treated as a sale of good; determine if payor is U.S. taxpayer

- **Transition rules**
  - Will be essential but are unstated in the Blueprint

Procurement & supply chain cost optimization

Syed Ali

Senior Manager, Advisory

Landscape

In today's market, Supply Chain is being asked to do more with less…

Increasing Customer Demand:
Quickly react to increasing demand for **customization** while balancing **shortened product life cycles**

Risk Management:
Address risk associated with supplier failure, natural calamity, product/service quality, and commodity price volatility

Increasing value by using supply chain as competitive differentiator

Corporate, Environmental and Social Responsibility:
Invest in **greener and cleaner supply** chain while meeting expectations for **environmental responsibility** and **transparency**

Globalization:
Leverage **expanded supplier network** and options to optimize sourcing cost and quality

Source: KPMG

Where do we see opportunities?

Typical Supply chain challenges

Lack of strategic direction and focus	Disparate processes & tools	Exception based supplier management	Abundance of data little intelligence
Lack of spend visibility	Limited visibility to negotiated contracts	High degree of off-contract 'rogue' spend	Incomplete, incorrect, and inconsistent data
Low inventory accuracy and inventory turns	Lower customer service levels and fill rates	Inventory obsolescence	Spend data dispersed across multiple systems
Lack of supply chain skillset and/or organization	Inefficient processes	Lack of performance benchmarking	Lack of business buy-in

Generate the Value

Strategic Sourcing

Savings: 4% to 20%

Capture the Value

Materials Management, Logistics and Warehousing

Savings: 9% to 21%

Procure-to-Pay (P2P) Excellence

Savings: 4% to 7%

Protect the Value

Contract & Supplier Relationship Management

Savings: 5% to 10%

Supply Chain Management Enablers

Master Data Management & Supply Chain Analytics
Savings: 2% to 5%

Technology Enablement
The right systems and tools to support Supply Chain integration and efficiency

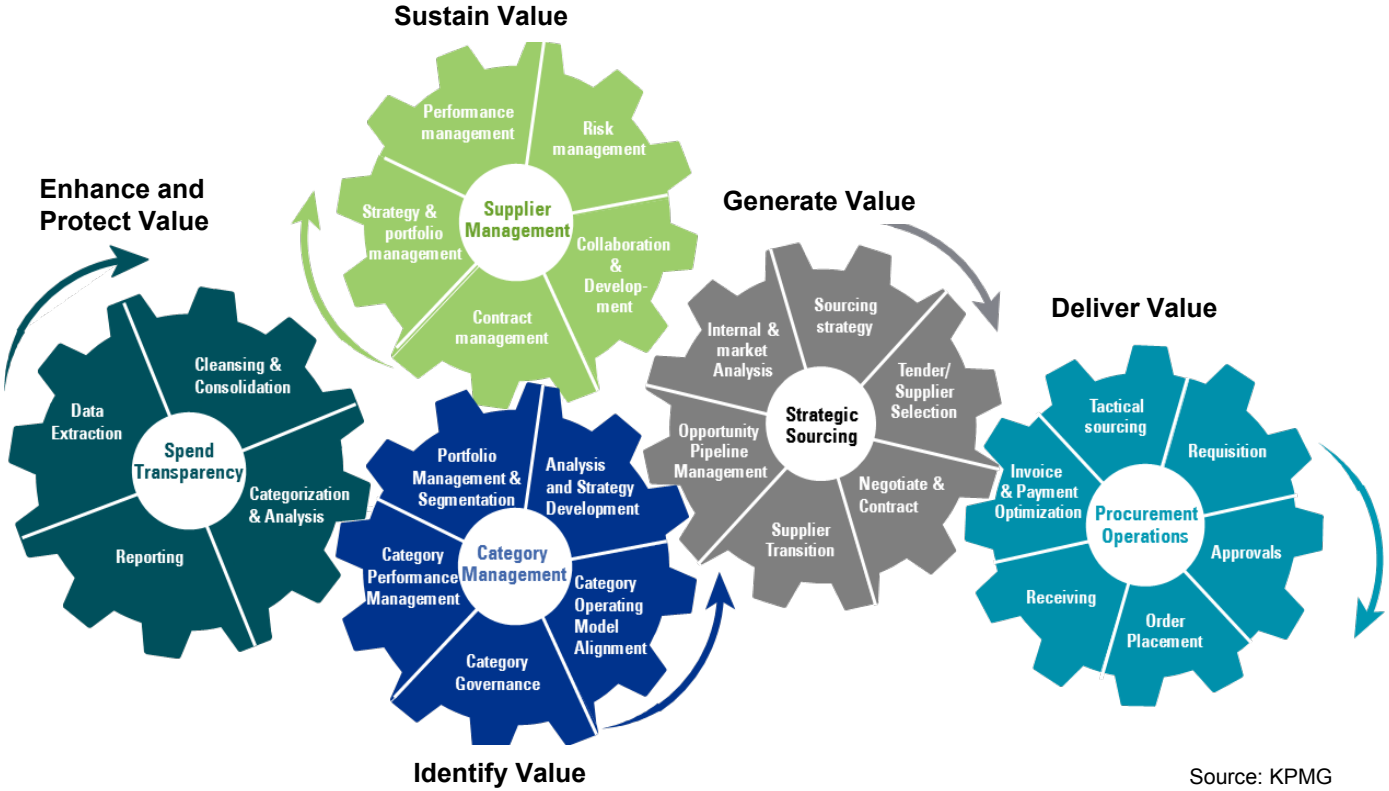
Source: KPMG

Source-to-pay transformation

… Leveraging *value* from the procurement spend has a significant direct impact on bottom line. Our approach drives efficiency and effectiveness of procurement transactions by optimizing processes and enabling tools

A leading procurement function drives value to the business:

- Value is **identified** through category management and value levers
- Value is **generated** in strategic sourcing through cost savings, risk management, and innovation
- Value is **delivered** by maximizing visibility and driving compliance to a preferred supplier contract
- Value is **sustained** through the supplier management process
- Value is **enhanced** and **protected** through advanced data & analytics and technology enablement



Source: KPMG

Our approach to Supply Chain Transformation

Our Transformation approach focuses on *Managing* the 'Value' and *Optimizing* the 'Cost-to-Serve'. We understand, procurement spend comprises a significant portion of Opex and Capex. Leveraging ***value*** from the procurement spend has a significant direct impact on bottom line. To remain competitive and profitable, the businesses must optimize their ***cost to serve*** customer. Our holistic approach to transformation addresses ***Strategy, People, Processes, and Technology:***

SUPPLY CHAIN DIAGONISTIC & MATURITY ASSESSMENT

STRATEGY DESIGN & TARGET OPERATING MODEL

PERFORMANCE IMPROVEMENT & COST OPTIMIZATION

TECHNOLOGY ENABLEMENT & MASTER DATA MANAGEMENT

Source: KPMG

Case study

The **Transformation** will change how employees will work in Supply Chain to deliver the right products and services across the business. Below are some of the changes that will improve how we provide reliable and timely supply chain information and fit-for-purpose solutions, considering all cost and market factors.

1. **e-Catalogue:** Self-serve ordering of inventory needs in a web-based environment.
2. **One Source of Truth:** All purchasing, inventory, supplier, and item information will reside in *One* system thereby providing a single source of trustworthy data.
3. **Master Data Management (MDM):** A single MDM group will ensure standardization of item and vendor set ups and maintenance.
4. **Data Cleanse:** Apply noun/modifier/ attribute logic to follow industry best practice and create short and long descriptions.
5. **Procure to Pay:** In line with leading practice, requisitions will reflect the validation of purchase need, and purchase orders will reflect the financial commitment.
6. **Inventory management:** Assuring timely and reliable data in an auditable system through count sheet creation for the cycle count process.
7. **Category Management:** New and detailed category structure will help drive spend transparency and allow for optimization of organizational spend.
8. **Contract Management:** Provides the ability to manage terms and conditions within a central repository, and for buyer to access appropriate terms during PO creation.

Source: KPMG

Other examples

Who	Size of spend	How	Savings
Heavy Equipment Dealer	Logistics spend: $100M	• Distribution network optimization • Renegotiation transportation and warehousing contracts • Process and organization realignment • Technology enablement	**$27M** in two years (sustainable savings)
Mid-sized Energy company (In progress)	Addressable spend: $200M	• Spend analysis and categorization • Category planning • Category management	Target Savings 10% - **$20M**

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Questions?

For more information

Publications
KPMG's Global IFRS Institute • KPMG's Global IFRS Institute provides information and resources to help Board and Audit Committee members, executives, management, stakeholders and government representatives gain insight and access thought leadership about the evolving global financial reporting framework.
Financial Stability Board: Task Force on Climate-related Financial Disclosures • KPMG's client briefing explains what the Task Force is, why it has been set up and what the implications are for KPMG member firm clients.
TaxNewsFlash - Canada • Keeping you in the know with all of the latest tax developments pertaining to Canada and its industry sectors.
U.S. Primed for Tax Reform Changes • With President Trump's inauguration, more details of expected U.S. tax changes should start to emerge. As a result, important tax legislation could be introduced this year, although the extent of any changes is still unclear, especially since there are a number of tax reform approaches currently circulating.

Thank you

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This presentation may contain a discussion or analysis of decided tax cases. Any discussion or description of the facts of the case or the positions argued by the parties is based solely on publicly available information. For greater certainty no confidential client or taxpayer information is disclosed.

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