Third Quarter Oil & Gas Update

Thursday October 4, 2018

Let's extract value for your business.
Let's do this.

Introduction

Murray Suey
Regional Managing Partner

New partners

Grant Brown
Corporate Finance

Les Der
Corporate Tax

Chris Marra
Enterprise Audit

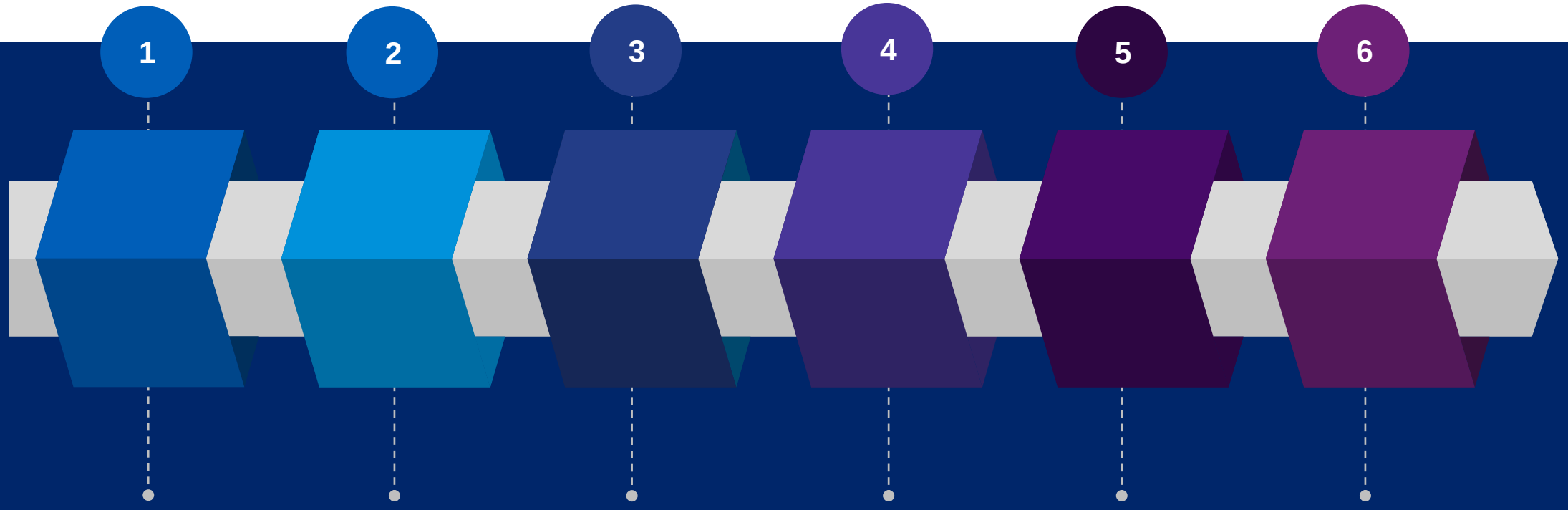
Grant McLarnon
KPMG Adoxio

Kathy Wang
U.S. Tax

Agenda

Michael McKerracher
Partner, National Energy Leader

Agenda



1. Impairment
2. IFRS 15/16
3. Regulatory
4. Innovation
5. Tariffs and U.S. Tax Reform
6. Capital Market Activity

Impairment

Michael McKerracher
Partner, National Energy Leader

Impairment - 3rd quarter?

Oil	Gas

IFRS 15/16

Sharlene Wilson
Partner

Let's do this.

IFRS 15 - A look back

Observations – South of the border (SEC Comment Letters areas of focus)

- **Quality of disclosures**
- **Disaggregated revenue disclosures**
  - Majority of disclosure comments
  - Significant judgments
  - Performance obligation descriptions and conclusions
- **When does control transfer:**
  - More specific about the point in time
  - Disclose measure of progress and why it depicts transfer
- **Licensing IP**
  - Conclusions on single vs. multiple performance obligations
  - Majority involving software license arrangements – how did you include maintenance support and warranty, license, hosting, etc. are one performance obligation or why are they separate performance obligations?
- **Determining the transaction price**
  - Variable consideration (cash based incentives, refunds, rebates, returns, credits, guarantees, etc.)
  - If material and significant judgment involved, disclose methods, assumptions and estimates used

IFRS 15 - A look back

Local observations

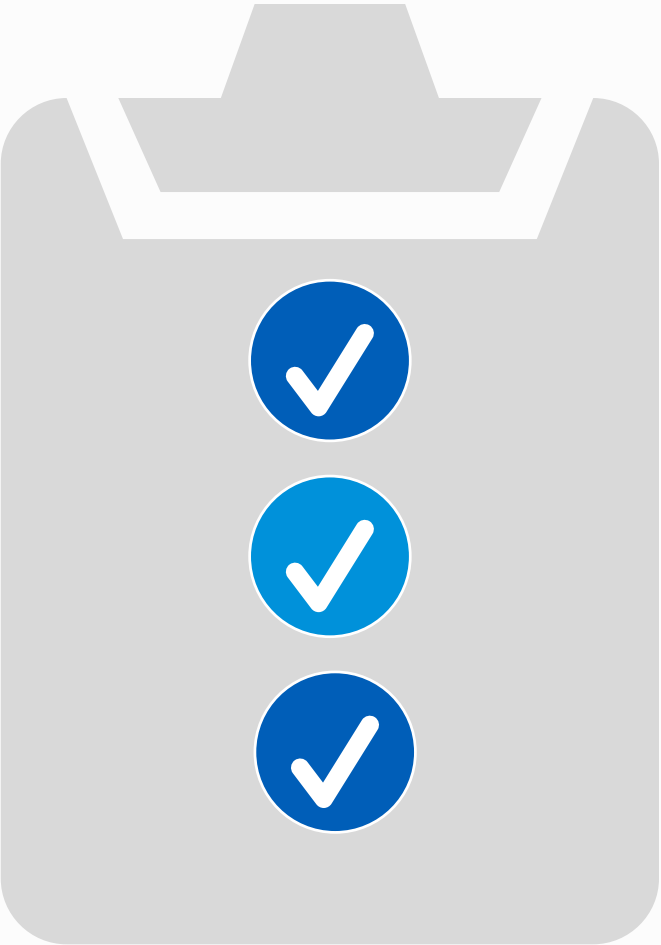
- **Modified retrospective approach**
- **Challenges:**
  - Principle vs. agent analysis (gross vs. net presentation for operator/non-op; purchase of commodities to fill existing sales contracts)
  - Change of control / performance obligations (ie. transportation, processing)
  - Long-term fixed price contracts
- **Impact:**
  - Few transition adjustments
  - Limited impact on timing or amount of revenue recognized
  - Presentation differences
  - Additional disclosures

Watch new transactions!

IFRS 16 - Observations

Project status

- **Recent KPMG survey results**
- **Locally:**
  - Taking longer than expected to determine inventory of contracts
  - Lease inventory (contract scoping) – in progress/near completion?
  - Gathering data, performing calculations – early stages
  - Disclosures – not started
  - Support for auditors - ?



IFRS 16 - Observations

Judgment areas

1

Renewal options (short term / lease term)

Lease term: Non-cancellable period, together with (a) periods covered by an option to extend if the lessee is **reasonably certain** to exercise, and (b) periods covered by an option to terminate if the lessee if **reasonably certain** not to exercise.

“Reasonably certain”: not defined; refer to following slide

IFRS 16 how to determine 'reasonably certain'?

Lessee considers all relevant facts and circumstances that create an economic incentive to conclude they are reasonably certain to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease.

Contractual/market	Asset
• Level of rentals in secondary period compared to market rates • Contingent payments • Renewal and purchase options • Costs relating to the termination of the lease and the signing of a new replacement lease • Costs to return the underlying asset	• Nature of item (specialized) • Location • Availability of suitable alternatives • Existence of significant leasehold improvements

New in IFRS 16 – consider past practice of renewing leases and the economic reasons for that practice.

IFRS 16 - Observations

Judgment areas

2

Discount rates: lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If it cannot, use the incremental borrowing rate.

"incremental borrowing rate": defined as "the rate of interest that a lessee would have to pay to borrow over a **similar term**, and with a **similar security**, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a **similar economic environment**."

- Judgment is required
- Please start conversations with your auditor now!

Note: if using modified retrospective, previous operating leases are discounted using incremental borrowing rate at the date of initial application

IFRS 16 - Discount rate (lessee perspective)

Is the rate implicit in the lease readily available?

No → **Use the lessee's incremental borrowing rate.**

Yes → **Are you sure?**

Some practical issues in determining the rate:

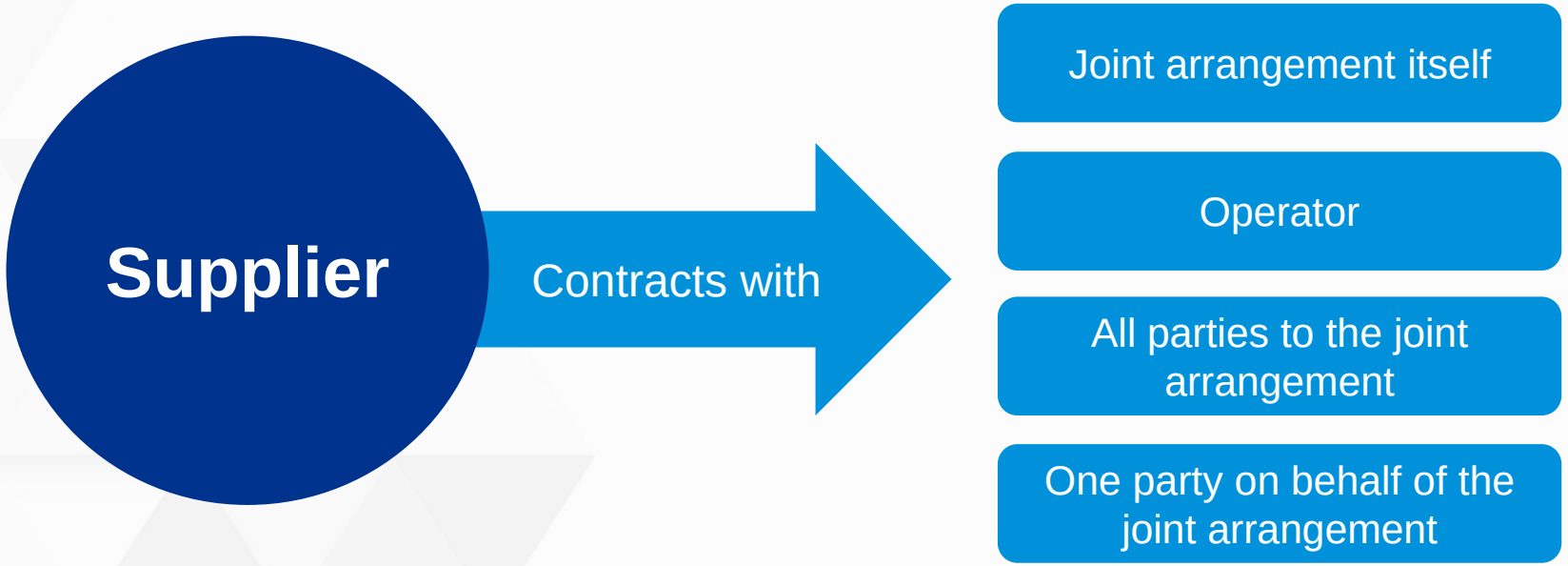
- How to determine a rate with a similar security?
- If starting point is unsecured rate, what are adjustments for security?
- Subsidiary vs. parent's borrowing rate

Refer to publication on discount rates.

IFRS 16 - Joint arrangements

A joint arrangement (operation or venture) is considered to be the customer when a contract is either:

- Entered into by the Joint Arrangement itself; or
- Signed by one or more of the parties on behalf of the joint arrangement



IFRS 16 - Joint arrangements

To consider:

- Applies to IFRS 11 (requires joint control – ie. unanimous consent about relevant activities)
- Which party signed the contract? in its own name or on behalf of the JOA?
- Who is named as the primary obligor (legally) in the contract?
- Is there legal recourse to the other parties in the event of default (or through a guarantee or indemnity?)

The JOA may, in effect, create a sublease between the operator and the other parties to the JOA.

Unlikely the existence of the JOA would relieve the Operator of its legal (primary) obligation.

Watch for tentative IFRIC Agenda Decision.

Refer to KPMG Publication "Joint arrangements in the oil and gas industry".

Regulatory

Gregory MacDonald
Partner

Non-GAAP measures

- CSA issued proposed National Instrument 52-112 in Sep, 2018
- Replaces the non-binding guidance of CSA SN 52-306
- Provides authoritative guidance and "… a stronger tool to take appropriate regulatory action when needed."
- Does not apply to certain financial measures required by securities legislation (e.g., earnings coverage ratio, NPV of future net revenue of oil and gas reserves)
- IASB project already underway on form and content of IFRS financial statements

Non-GAAP measures

- **Applies to Issuer's documents, websites and social media**
- **Incorporates the past definition of non-GAAP measures from SN 52-306**
- **Introduces specific reconciliation and disclosure requirements for:**
  - financial ratios
  - segment measures
  - capital management measures; and
  - supplementary financial measures (i.e,. same store sales)
  - FOFI
- **Requirements over labelling, prominence, consistency and usefulness**

Definition of a business – U.S. GAAP

- **U.S. GAAP required to adoption of ASU 2017-01 on Jan 1, 2018**
- **Phase 1 of 3, clarifying the definition of a business**
- **A transaction is not a business combination if:**
  - The fair value of gross assets acquired is concentrated in a single (or group of similar) identifiable assets
  - The assets in a group have similar risks and characteristics
- **<u>Fewer transactions will be a business combination due to screen</u>**
- **Change to definition of a business, outputs may not be necessary**
- **<u>IASB project underway</u>**

Who is impacted?

- Oil & Gas
- Midstream
- Utilities
- Biotech
- Real Estate

Definition of a business - U.S. GAAP

Description	Business combination	Asset acquisition
Transaction costs	• Expense as incurred	• Capitalize as part of the cost of the assets acquired
In-process research and development	• Record asset at fair value	• Expense if no alternative future use
Contingent consideration	• Record at fair value at the acquisition date • If a liability, mark to market through earnings	• Apply other GAAP such as ASC 815 or ASC 450-20 • Record changes to the cost basis of assets
Goodwill/bargain purchase	• Recognize goodwill as an asset • Recognize a bargain purchase gain	• Allocate excess consideration or bargain purchase amount on a relative FV basis • Recognize additional intangible assets as appropriate (e.g. assembled workforce)
Measurement period	• The acquirer may record provisional amounts and adjust them during the measurement period	• No concept of measurement period exists

Definition of a business - U.S GAAP

Asset acquisition under U.S. GAAP may be a business under SEC rules.

The SEC definition focuses on the continuity of the acquired entity's operations before and after the transactions – i.e., whether the revenue producing activities generally remain the same before and after acquisition

An acquisition or disposition of a significant business or asset must be reported on Form 8-K within four business days

A significant business acquisition may trigger a requirement to file separate audited financial statements as well as pro forma financial information

Talk to your advisors early!

Definition of a business – U.S. GAAP

Scenario

- Oil Company acquires a working interest in a single oil and gas property from a major petroleum company
- The oil and gas property is primarily proved and producing reserves
- The target is a producing property and there is a ready commodity market for the product
- Substantially all of the fair value is concentrated in a single asset

Evaluation

The property meets the screening test and therefore Oil Company accounts for its acquisition as an asset acquisition under US GAAP.

Oil Company considers the acquisition to be a business for SEC reporting because the target is a producing property and there is a ready commodity market for the product. Oil Company is required to comply with the SEC reporting requirements for a business combination.

Key/Critical audit matters

SEC registrants effective for year-ends of Dec 31, 2019

Reporting Issuers effective for year-ends of Dec 31, 2020

- **Reporting standards largely converged**
- **Combined Canada and U.S. opinions will not be available;**
- **SEC registrants may file the PCAOB report with Canadian regulators**
- **Auditors and companies should engage early:**
  - Audit committee
  - Investor relations
  - Legal
- **PCAOB guidance suggests there will usually be a CAM**

Consider a dry-run with your auditors

Innovation

Stephanie Terrill
Partner, Global Lead
Financial Management

Let's do this.

The impact of technology disruption, today and in the future

Disruptive technologies are transforming finance. Companies need to develop a long-term extreme automation strategy that is aligned with the enterprise strategic vision.

In response to disruption, leading CFOs are transforming their own operating models by addressing:

- How will disruptive technology impact our finance operating model in the next year? In the next five years? In the next 10 years?
- How will our current delivery model and locations be impacted? How can we effectively integrate disruptive technologies?
- What are the new skill sets required of our workforce and how will we hire and train the finance organization?
- How do we maintain, or improve, governance of financial processes and controls?

Technology disruptors are the largest drivers of change in business today. Finance must embrace the disruptors of today to transform their own operating models and unlock an environment of extreme automation.

70%

A well-architected use of disruptors will enable **extreme automation,** resulting in an operating model that achieves a **~70% reduction in labor**[1] while delivering on **business value** and **global risk management**

Source: KPMG International – CEO Outlook

The CFO agenda for disruption

Leading finance organizations have developed an agenda to deal with disruption

Leading strategy and capital allocation
Increasing role in innovation

- Trends and economics behind disruption
- Approaching disruption at the organizational level
- Maintaining an innovation portfolio
- Disciplined portfolio process and structure

Extreme automation

Integrating new technologies:
- Cloud ERPs
- Robotics
- Artificial intelligence
- Blockchain
- Mobile

Insights and analysis

New insights through:
- Automated *descriptive and diagnostic* analytics
- New *predictive and prescriptive* analytics
- Integrated business planning
- Local decision support

Organizational simplification

Changing work:
- Fewer people
- Less hierarchy
- Fewer offshore locations

Skills and talent

Changing requirements:
- Both strategy and finance skills
- Process and control leaders
- Relationship and collaboration

Risk management: Response to disruption impacts how risks and controls are managed in an organization and the need to continuously evolve.

Disruptor-enabled extreme automation

Eight disruptive technologies deliver extreme automation.

Data management
Progressive data management and mining of untapped data sources will create a springboard for elevated discovery agility and prescriptive insights.

Blockchain
Augmented information authenticity will enhance security, shorten transaction cycle times, and eliminate the need for reconciliations, for good.

Cloud ERP and EPM
Architect best-in-class application solutions and standardize end-to-end global processes, once and for all.

Robotic process automation
Rapidly scale and dramatically reduce finance work-effort through elimination of repetitive, rules-based processes that require human intervention today

Machine learning
Boost foundational automation by deploying adaptive technologies to make fact-based decisions that will eradicate manual segments of the process sequence.

Cognitive
Electronic brains will challenge the accounting opinion, perform the scorekeeping and provide deep analytics; humans will drive dynamic insight generation

Natural language processing
Unconstrained information accessibility from unconventional sources will allow finance to positively influence business outcomes in real-time.

Digital analytics and delivery
On-demand, customized insight delivery will enable finance to transcend the role of historical scorekeeper and become a strategic interpreter.

Source: KPMG International

Let's do this.

Disrupting the finance operating model

Disruptors will revolutionize the finance operating model resulting in never before seen heights in dimensional maturity.

Impact to finance operating model dimensions

Virtual service delivery	Extreme process automation	Technology agility	"Strategist" skill set	Dynamic insights	Digital governance
• Extreme automation is challenging traditional outsourcing delivery models • Reduced labor requirements • Centralized end-to-end process management	• Extreme process automation and accuracy performed digital labor technologies • Advanced process collaboration and business partnering	• Real-time, constant integration across systems requiring less human intervention • Instant scalability and agility enabled by "everything as a service" architectures	• Elevated insight and analytical skill sets augmented by digital capabilities	• Automated proactive data management without the need for harmonization or alignment • Increased information ingestion and insight extraction • Real-time, dynamic reporting anytime, anywhere	• Automated governance through built-in financial controls result in risk elimination and reduced governance costs • Enhanced visibility and governance of end-to-end processes

Source: KPMG International

Delivering with disruption

Virtual service delivery

Extreme automation will dramatically change the size, structure, and footprint of delivery model for finance.

Where work gets done:
Geography no longer matters

- Virtual delivery centers/“no shore”
- Local need highly reduced or eliminated
- Globally controlled

How work gets done:
Changing the service delivery model

- Robotics and artificial intelligence everywhere
- One-office combined (back, middle, front) to increase speed and agility
- Language neutralization removes barriers

What works gets done
Higher value services

- Sophisticated data modeling and virtual visualization
- Innovation and new capital allocation approaches
- Management of digital workforce (robots and AI)
- End-to-end process management

Who does the work:
Reshaped support structure

- Transactional layer is marginalized
- Innovation COEs
- Emphasis on partnerships, collaboration and reducing silos
- Strategic employees/digital skill set

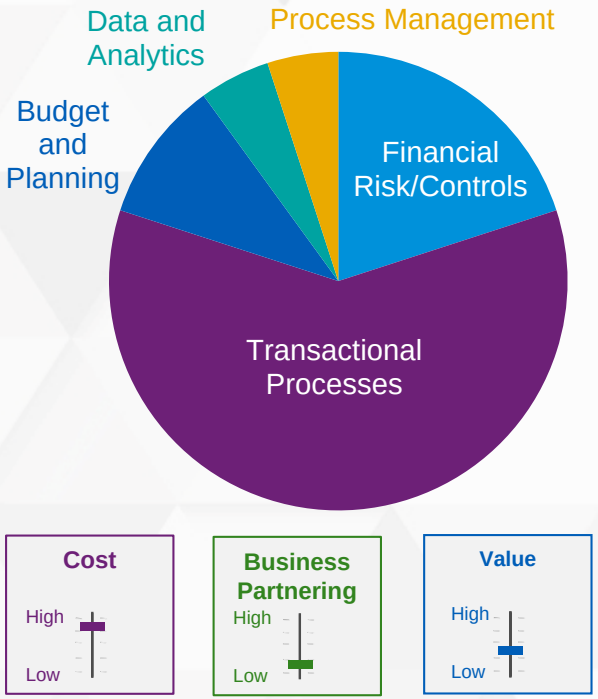
Let’s do this.

Extreme process automation

Extreme process automation

Extreme process automation will allow finance to transcend its transactional role, resulting in enhanced business partnering and value delivery through insight generation.

Traditional organization



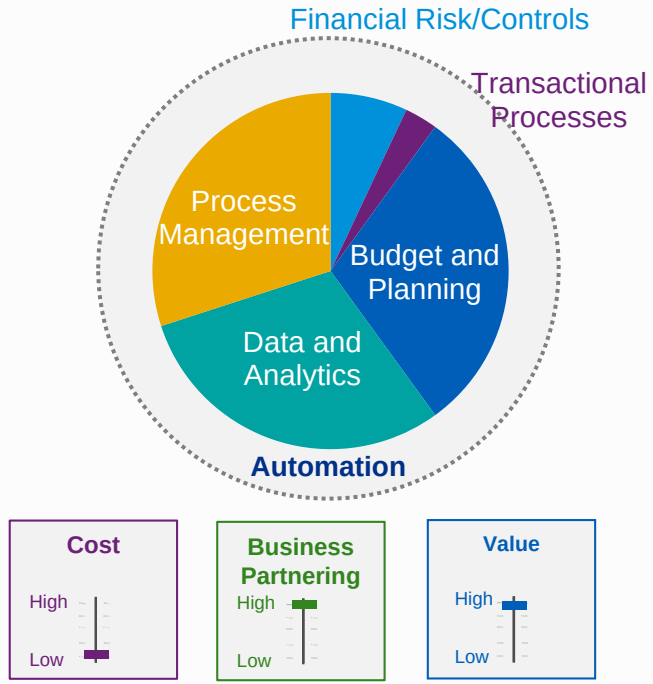
Additional value-add activities

+ Increased business partnering

- Transactional activities (automation)

Greater value, fewer people, lower cost

Future organization



Source: KPMG International

Let's do this.

Capability-driven finance architecture

Technology agility

The traditional finance architecture will be augmented by disruptors, resulting in a supercharged "capability framework."

Capability framework	New capabilities
User insight layer • Human digital engagement • Visualization technologies (dashboards, etc.) • Conversation bots, voice	**Empower human insight**
Cognitive and analytics layer • Content and external data analytics • Modeling, optimization analytics, and cognitive • collaborative business planning (SaaS)	**Answers before questions**
Data normalization layer • Digitized content • Unstructured data • Data repository • Internal process data	**Automatic data alignment**
Foundational layer • Systems of record (SaaS General Ledger, Accounts Payable, etc.) • Digital labor (customized automation) • Blockchain (real-time connectivity) • Automated process management	**Extreme automation**

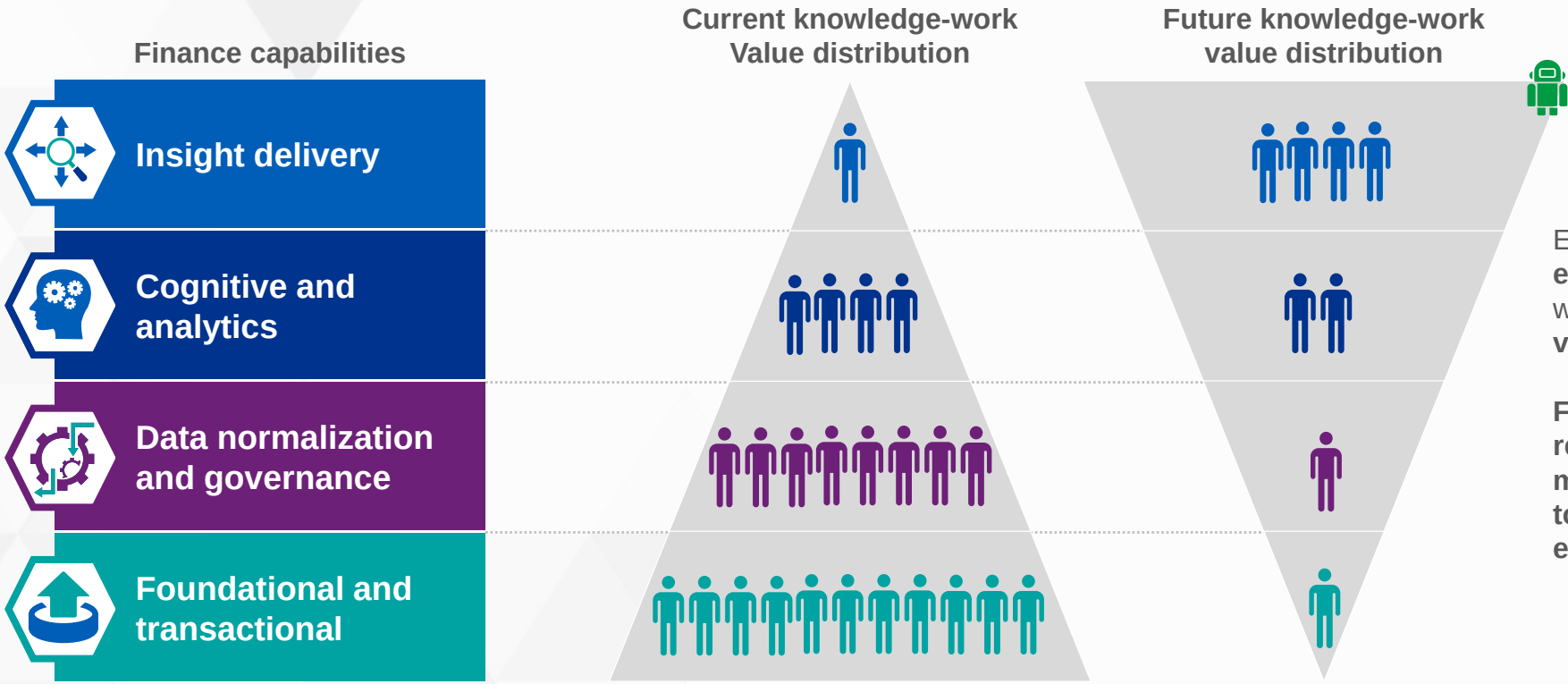
Cloud

Source: KPMG International

From "scorekeeper" to "strategist"

Strategist skill set

Extreme automation will invert the knowledge-work value distribution and challenge existing delivery models.



70% reduction in human labor driven by extreme automation

Extreme automation will **empower** the finance workforce to add more **value** at **rapid** speeds.

Finance must reimagine its operating model to position itself to meet constantly evolving requirements.

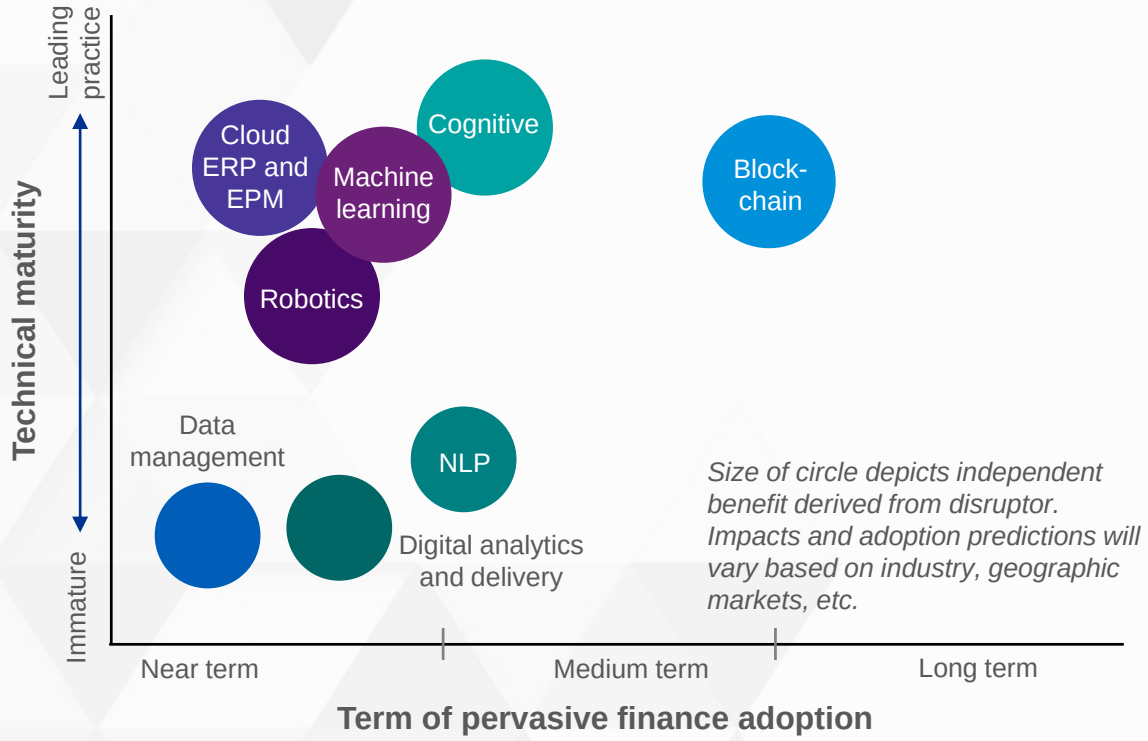
Source: KPMG International

Let's do this.

Every company's journey will be different, but the goal consistent

How each company architects its disruptive technology will be unique. What does your design look like?

Disruptor enabled maturity



What should you consider?

- Emerging technology selection should align to **enterprise strategy** and **target operating model maturity vision.**
- Adoption timing will play a critical role in **benefit realization**; **pervasive adoption** indicates the time horizon of fully developed technical viability and widespread market acceptance. Companies must define their **own** near-term and long-term adoption strategy.
- Independent disruptor deployment will have individual benefits, but **end-to-end integration** of disruptors will amplify finance benefit allowing finance to reach new heights in operating maturity.

What does your design look like?

Source: KPMG International

Source: KPMG International

Let's do this.

Extreme automation delivers benefits beyond cost savings

CFOs are embracing technology disruption to achieve innovation-fueled growth and accelerate short- and long-term value creation.

Reduced labor, more Insights

- Up to 70 percent reduction in human labor driven by extreme automation
- Reduce governance costs with built-in controls
- 50 percent reduction in manual reconciliations
- Reduced time for audit, resulting in lower audit costs
- Decoupled correlation between labor and revenue growth

Better use of capital

- 35 percent improvement in capital efficiency from shortened dispute resolution and process cycle times
- Improved business insights and dynamic reporting and analysis
- Redeploy resources to focus on higher value-added activities

Accelerated growth

- Harness the 80 percent of ”untapped” data with enhanced cognitive processing capabilities of unstructured data
- Dynamic, real-time data for elevated decision-making capabilities
- Unconstrained agility and scalability in response to changing business requirements

Risk reduction

- Automation enabled 100 percent transactional accuracy, eliminating the need for manual controls
- Increased security and governance without adding new human labor
- “No-labor” data integrity routines
- Real-time, secure data exchange supported by 100 percent verifiable and auditable transactions

Enhanced speed-to-value

- Up to 40 percent increase in labor productivity, enabling higher focus on value-add, business partnering activities
- Reduction of close to consolidation cycle time by 25 percent
- Improved visibility of business trends will enable better decision making and forecasting through driver based predictive analysis
- Enhanced digital delivery and visualization will augment insight generation

Let’s do this.

Tariffs

Angelos Xilinas
Partner

Trade & Customs

"May we live in Interesting Times"

- **Trade Agreements**
  - NAFTA (now USMCA)
  - CETA
  - Comprehensive and Progressive Agreement for Trans-Pacific Partnership
- **Retaliatory Tariffs**
- **Fundamental changes over the last couple of years to international tax rules, flowing from the OECD's Base Erosion and Profit Shifting (BEPS) initiative**
- **U.S. tax reform**

Continuous change in the world of cross border trade

Since 1989 to Present (Expected Change)

Developing Country Preferential Tariff

- Significant shift in income levels from developing countries led to a withdrawal of benefits for 72 countries as of January 2015
- Countries affected include China, India, Brazil, Russia, and South Korea

Free Trade Agreements

- CETA in force
- Comprehensive and Progressive Agreement for Trans-Pacific Partnership negotiation (revised TPP without the U.S.)
- Modernization of FTAs (e.g. Canada – Costa Rica)
- Exploratory Discussions and Negotiations (Qatar, Dominican Republic, China, and many more)

Since 2016 to Present (Uncertain Change)

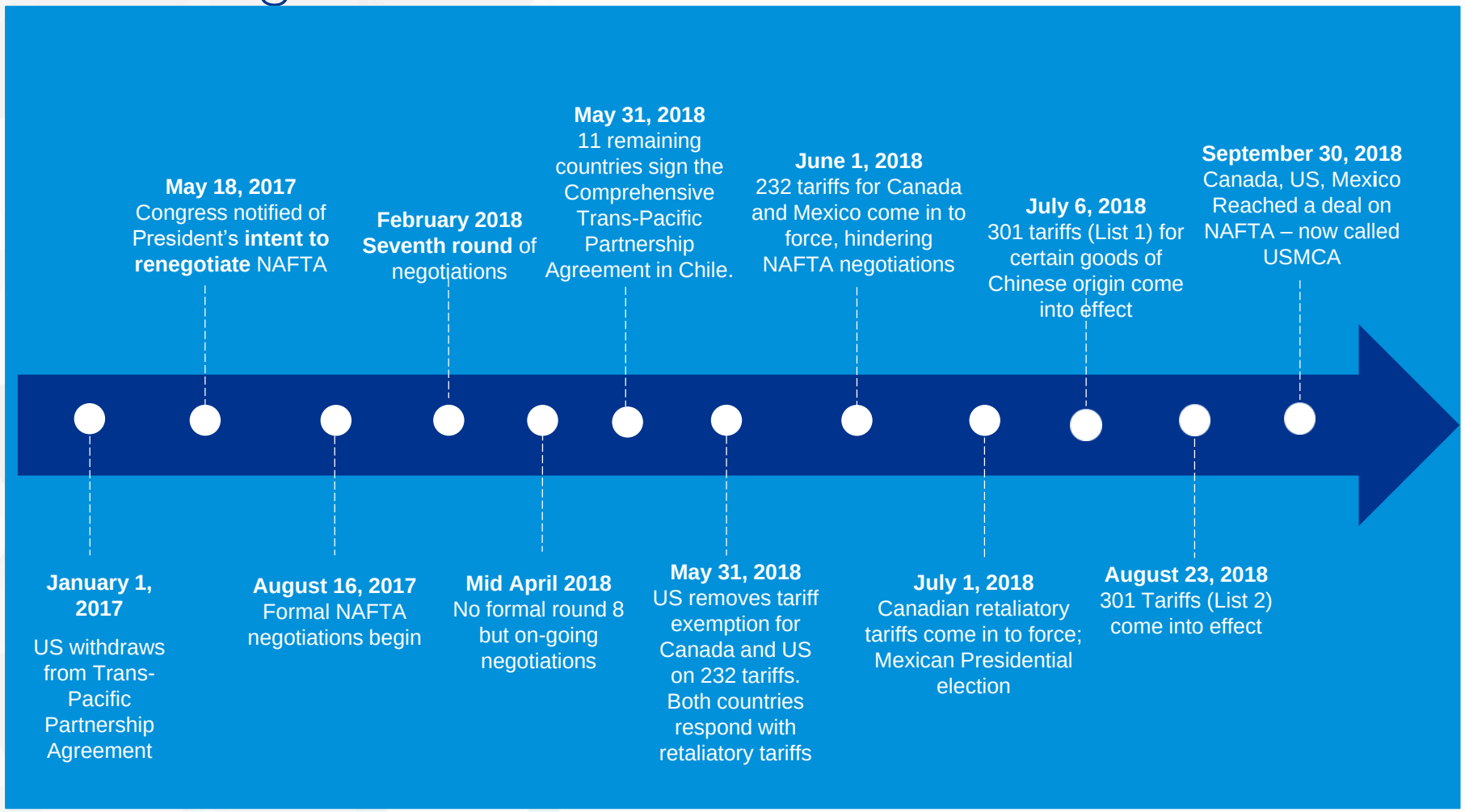
Free Trade Agreements

- Trans-Pacific Partnership termination
- NAFTA Negotiations
- U.S. – Mexico NAFTA Discussions

Retaliatory Tariffs

- U.S. Section 232 Tariffs of Aluminium and Steel
- U.S. Section 301 Tariffs (List 1, 2 and 3)
- Miscellaneous Trade Bill (making numerous products under Section 301 exempt)
- Canadian Retaliatory Tariffs on Goods of U.S. Origin
- Mexico Retaliatory Tariffs on Goods of U.S. Origin
- EU Retaliatory Tariffs on Goods of U.S.
- Chinese Retaliatory Tariffs on Goods of U.S. Origin
- Turkey Retaliatory Tariffs on Goods of U.S. Origin

Recent changes in N. American cross border trade timeline

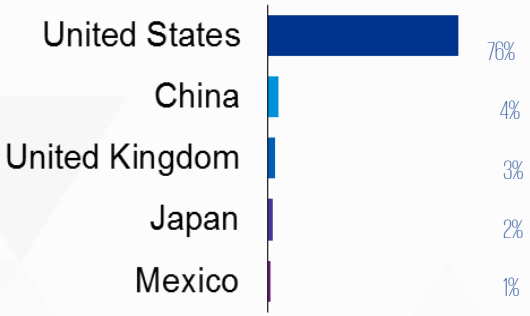


NAFTA Negotiations

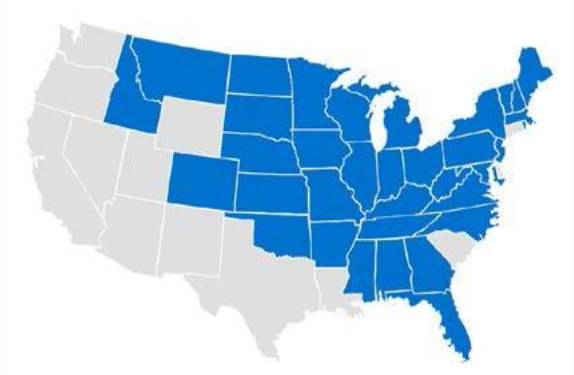
USMCA- New agreement to replace NAFTA reached

After extensive negotiations, Canada, Mexico and the US have reached an agreement to update NAFTA. The new agreement has been re-named USMCA.

2015 Canada's largest export destinations
(% of total merchandise export value)



Canada was the largest export market for 35 U.S. states in 2015



Canada is highly dependent on a healthy trade relationship with the U.S. but that relationship is reciprocal

Source: KPMG International

Let's do this.

Key points of USMCA

Sunset Clause

- US proposal to re-evaluate NAFTA every 5 years
- In the draft agreement, the deal will last 16 years and will be reviewed every 6 years.

Rules of Origin

- Update and strengthen rules of origin to ensure products are made in the U.S. or North America
- Establish origin procedures that streamline the certification and verification of rules of origin
- Under USMCA, the percentage of parts in cars that must be manufactured in North America in order to avoid import taxes will increase from 62.5% to 75%

Chapter 19 Dispute Settlement

- Chapter 19 remains part of USMCA.
- Chapter 19 (now Chapter 31) permits the appeal of the decision to impose anti-dumping and countervailing duties before a panel of officials from the disputing countries
- Dispute settlement mechanism prevents the US from fully enforcing its own trade laws (e.g., Canadian softwood lumber)

Supply Management

- The agreement will provide the US with access to Canada's market which is expected to be slightly greater than what Canada recently provided under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

Source: KPMG International

The positives

1. **The parties have reach a preliminary agreement within the deadline of October 1, 2018.**
   - Reaching an agreement avoided the imposition of potential punitive tariffs on auto parts by the US

2. **The supply management system remained intact, although concessions were made to give the US greater access to the Canadian domestic market.**

Observations

At first glance, it might look like only modest modifications were made to the original NAFTA. However, upon a closer look, the USMCA is much more complex. It's a brand new agreement and must be approached that way. Businesses will have to carefully review the intricate details included in the USMCA to understand and assess its potential impact, including identifying specific opportunities and risks.

Retaliatory Tariffs

U.S. section 232 – National security tariffs

Background

- On March 8, 2018, President Trump signed presidential proclamations 9704 and 9705 imposing a 10% tariff (on imported aluminum and a 25% tariff on imported steel products (HTS specific)
- These duties are in addition to current duties or fees
- No special rates of duty may be accorded to affected goods (no FTA preferential rates)
- Duty drawback is not permitted

Who is impacted?

- Generally, applies to imports from all countries, except Argentina, Australia, and Brazil
- South Korean steel exempt based on agreed upon quotas
- Although initially given temporary exemptions, these tariffs now also impact Canada, Mexico, and the EU
- Countries with a "security relationship" with the United States may seek an exemption
- U.S. parties may petition for exclusions

When?

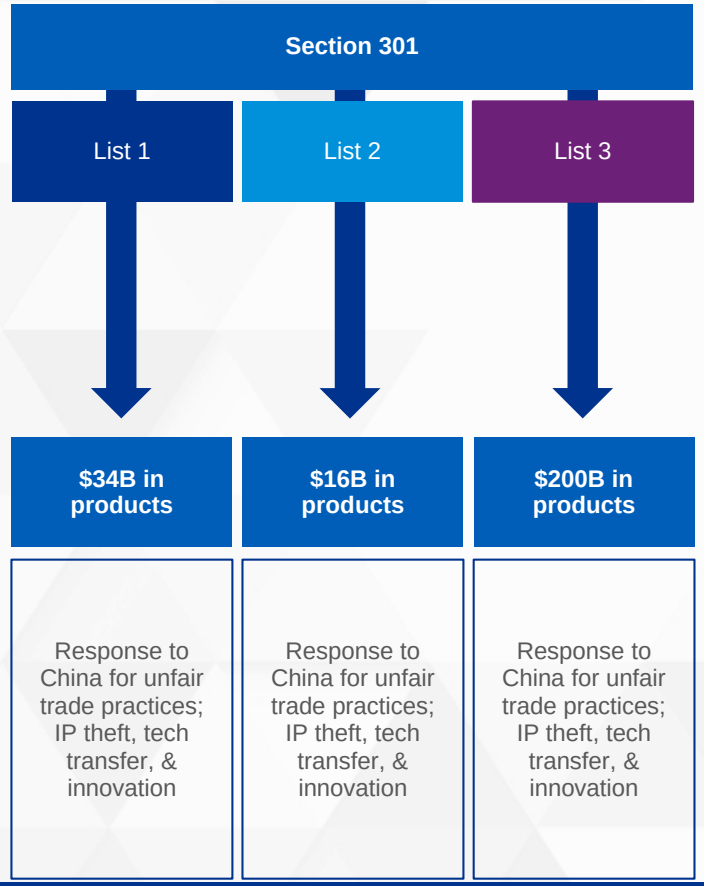
- For the majority of countries, tariffs came in to effect March 23, 2018
- For Canada, Mexico, and the EU, tariffs came into effect June 1, 2018

Retaliatory tariffs - Canada

- Canada, the US's biggest trading partner, also responded with retaliatory countermeasures (a 25% surtax on certain steel products and a 10% surtax on certain aluminum products as well as wide variety of other goods) after it was announced that Canada would no longer be exempt from steel and aluminum tariffs
- The proposed list includes steel, aluminum, as well as consumer products such as chocolate, licorice, whisky, pizza, cucumbers, jams, ketchup, and more
- A consultation period on retaliatory tariffs ended June 15, 2018. A final list was provided by Global Affairs Canada on June 29, 2018. The countermeasures came into effect on July 1, 2018

U.S. section 301 – Unfair trade practices

Authorizes the US Trade Representative to investigate and take action, subject to the direction of the President, for trade agreement violations or discriminatory trade practices



List 1

- Came into effect July 6, 2018
- Exclusion request process for importers is available through October 9, 2018

List 2

- Came into effect August 23, 2018

List 3

- The tariffs will be applied at a rate of 10% effective Monday, September 24th, increasing to 25% beginning January 1, 2019

The importance of impact modelling

How KPMG helps with impact modelling & mitigation strategies

Scenario Planning for Retaliatory Tariffs

Collecting Trade Data

Using our expertise and software such as our Tax Intelligence Solution (TIS), the data will be organized and reviewed to create a picture of trade activity, future risks, and opportunities.

Develop a Strategy

We review the data and help develop a strategy to identify and mitigate both short- and long-term risks/opportunities.

Assess Duty Planning Opportunities

Identify duty planning and savings opportunities to help mitigate the effects of the retaliatory tariffs. (Tariff Classification, Duty Drawback, etc.)

Execute Duty Savings Strategies

Once duty savings strategies are identified, execute them to help offset some of the impact of the retaliatory tariffs.

Source: KPMG International

U.S. tax reform

Jim Rowling
Partner

Let's do this.

Notices

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Corporate tax rate reduction

- Reduction of corporate tax rate to 21 percent
- Effective January 1, 2018 for calendar year end entities
- Blended rate for fiscal year end entities

Accounting for income taxes considerations

- **Current tax impact**
  - Reflected in the estimated annual effective tax rate beginning in the interim period which includes the latter of the date the legislation is enacted or effective
  - The impact on taxes payable or receivable for a prior year are recognized as of the date of enactment in income tax expense (benefit) from continuing operations
- **Deferred tax asset (liability) remeasurement**
  - Scheduling may be required for blended tax rate for fiscal year end entities
  - Estimation of temporary differences at enactment date
  - Reflected entirely in income tax expense (benefit) from continuing operations
  - Discrete event reflected in the interim period which includes the date of enactment

Interest expense limitation

- Disallows interest expense in excess of 30 percent of adjusted taxable income (generally without regard to activity not associated with a trade or business, interest income or expense, and net operating losses, amongst other adjustments)
- For taxable years beginning after December 31, 2017 and before January 1, 2022, adjusted taxable income also excludes deductions for depreciation, amortization, or depletion
- Disallowed interest may be carried forward indefinitely

Accounting for income taxes considerations

- **Current tax impact**
  - May result in an increase in taxable income and the effective tax rate
- **Valuation allowance judgment**
  - Consider amount and character limitations for utilization of disallowed interest carryforward, including ordering rules
  - Due to the expected increase in taxable income due to interest expense limitations, may result in a change in the overall valuation allowance judgment on the realizability of non-interest related U.S. federal deferred tax assets

Net operating losses

- Limits utilization to 80 percent of taxable income for losses arising in tax years beginning after December 31, 2017
- Repeals ability to carryback net operating losses, except for certain farming losses, for losses in years ending after December 31, 2017
- Permits indefinite carry forward losses in years ending after December 31, 2017
- Special rules for property and casualty insurance companies

Accounting for income taxes considerations

- **Requires tracking the net operating loss carryforwards arising in tax years beginning before December 31, 2017 separately from those subsequent to December 31, 2017**
- **Valuation allowance judgment**
  - Scheduling may be required for net operating loss limitation in determining the amount of deferred tax assets supported by reversing deferred tax liabilities
  - Support of indefinite life deferred tax assets with indefinite life deferred tax liabilities
  - We believe tax-planning strategies are required to be considered for carryforwards with an indefinite life

Alternative minimum tax repeal

- Permanently repeals alternative minimum tax (AMT) regime
- Existing minimum tax credit carryforwards are able to be utilized to the extent of regular tax liability
- 50 percent of excess carryforwards refundable in 2018-2020, with the remaining refunded in the following year

Accounting for income taxes considerations

- **Current and deferred tax impact**
  - We generally believe that it is appropriate to present assets for AMT carryforwards as receivables; however, we would also accept classification as a deferred tax asset if a company expects to use it to offset its income tax liability
  - Assets for AMT carryforwards presented as receivables should be classified as current or noncurrent based upon the expected timing of receipt
  - Assets for AMT carryforwards are not discounted
  - Companies should estimate the effect of sequestration, if any, when accounting for the AMT credit
- **Valuation allowance judgment**
  - Existing valuation allowances for AMT credit carryforwards may need to be reversed

Base erosion anti-abuse tax

- Imposes a base erosion minimum tax amount based on the taxpayer's modified taxable income (taxable income excluding base erosion payments) for the year, over an amount equal to the pre-credit regular income tax liability reduced by certain tax credits
- The tax rate is 5% (2018), 10% (2019-2025) and 12.5% (after 2025) except for banks and registered securities dealers that have rates of 6% (2018), 11% (2019-2025) and 13.5% (after 2025)

Accounting for income taxes considerations

- **Deferred tax impact**
  - Measure deferred taxes based upon the regular tax rate
    - Amounts payable in excess of the regular tax liability will be treated as a periodic cost in such period incurred
    - Companies would not need to consider whether they expect to pay BEAT when assessing the realizability of deferred tax assets under the regular tax system
    - Companies may elect to consider whether they expect to pay BEAT when assessing the realizability of deferred tax assets as an accounting policy election that should be consistently applied

Foreign derived intangible income

- Provides for a reduced effective tax rate on excess returns from foreign sales or services earned directly by a U.S. corporation
- Permits a U.S. corporation a deduction for 2018-2025 tax years equal to 37.5 percent (21.875 percent after 2025) of the lesser of foreign derived intangible income (deemed intangible income attributable to income received from a foreign person for sales of property or services for ultimate use outside the U.S.) or its taxable income, determined without regard to the deduction

Accounting for income taxes considerations

- **We believe the foreign derived intangible income (FDII) deduction is akin to a special deduction because it is limited to taxable income**

State and local income taxes

Potential state and local income tax considerations

- **State conformity to federal**
  - Certain states may automatically conform entirely to the federal tax code upon enactment of the federal legislation, some may conform as of a particular date, whereas others may adopt certain provisions of the code through future legislation
- **Reduction in the corporate tax rate will reduce the federal benefit of state income taxes**
- **Full expensing of property other than real property**
  - Consider states that decouple from federal bonus depreciation
- **Net operating loss limitation**
  - Consider specific state operating loss limitations as well as whether state taxable income begins with federal taxable income before or subsequent to net operating loss utilization
- **Interest expense limitation may also apply to states accepting the federal limitation**
- **Timing and forthcoming law changes**
  - States may have a variety of different enactment dates as state legislatures contemplate conformity

Disclosures

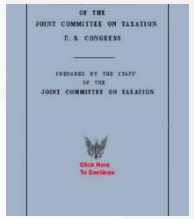
Potential state and local income tax considerations

- **Footnotes to the Financial Statements**
  - Income tax expense (benefit) arising from adjustments of deferred tax assets (liabilities) and income taxes receivable (payable) for enacted changes in laws or rates
  - Significant judgments made as a result of tax reform (valuation allowance, investments in subsidiaries, and unrecognized tax benefits)
  - Clearly disclose policy on GILTI (recognition of deferred taxes or periodic cost)
- **Management Discussion and Analysis**
  - Consider disclosing expected future effective tax rates and cash tax rates
    - Refer to the SEC Compliance and Disclosure Interpretations
  - Consider mandatory repatriation in disclosures around contractual obligations
- **Risk Factors**
  - To the extent future regulatory, administrative or legislative actions could have a materially adverse affect, consider providing disclosure

What's next: Clarifications and changes

Legislative History

- Additional explanation and clarification could be included in a "Bluebook" published by Joint Tax
- The bluebook could be used to clarify Congressional intent in drafting the legislation



Treasury Regulations

- H.R. 1 is likely to require many new regulations to implement the law
- Generally Treasury has 18 months to issue regs retroactive to enactment
- In the interim, notices could be issued
- Treasury's reg authority is limited

Other Legislation

- Some areas will require enactment of additional law
- Technical corrections may be needed to clarify the law where Treasury does not have adequate authority
- Substantive changes may also be made to the law to clarify, correct, or modify

Let's do this.

TCJA regulatory guidance projects

TCJA Provision	Issued/Expected
Repatriations – §965	8.3.18
Depreciation – §168(k)	8.3.18
Passthrough deduction – §199A	8.10.18
Interest limits – §163(j)	Fall 2018
Foreign tax credit – §§960, 902	Fall 2018
GILTI – §951A	9.14.18
BEAT – §59A	Fall 2018
FDII – §250	Late 2019

Capital market activity

Grant Brown
Partner

Today's topics

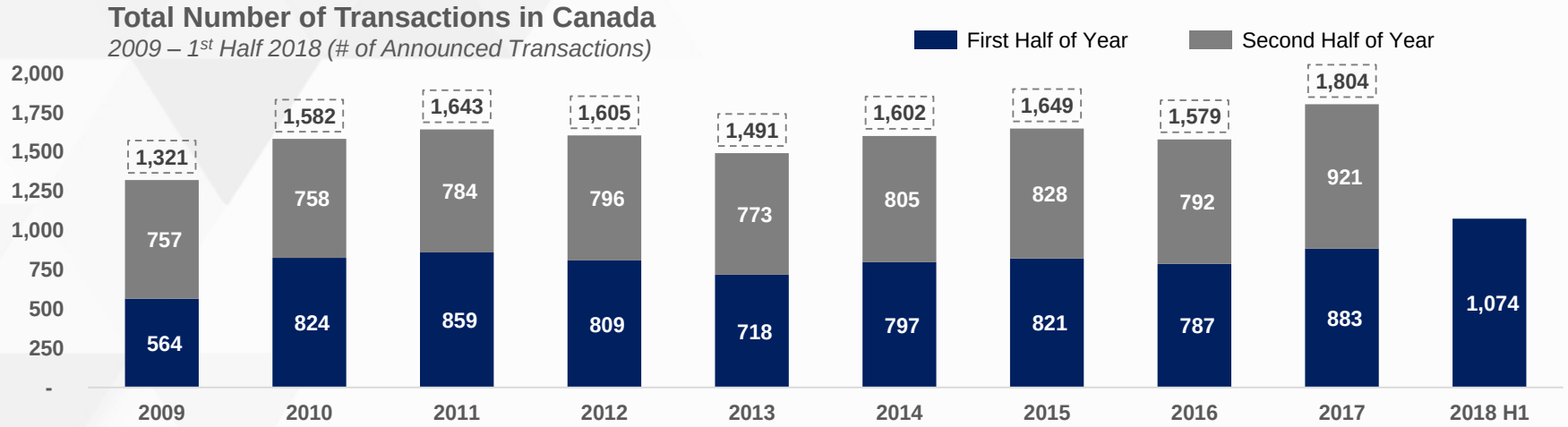
Canadian M&A Market Activity

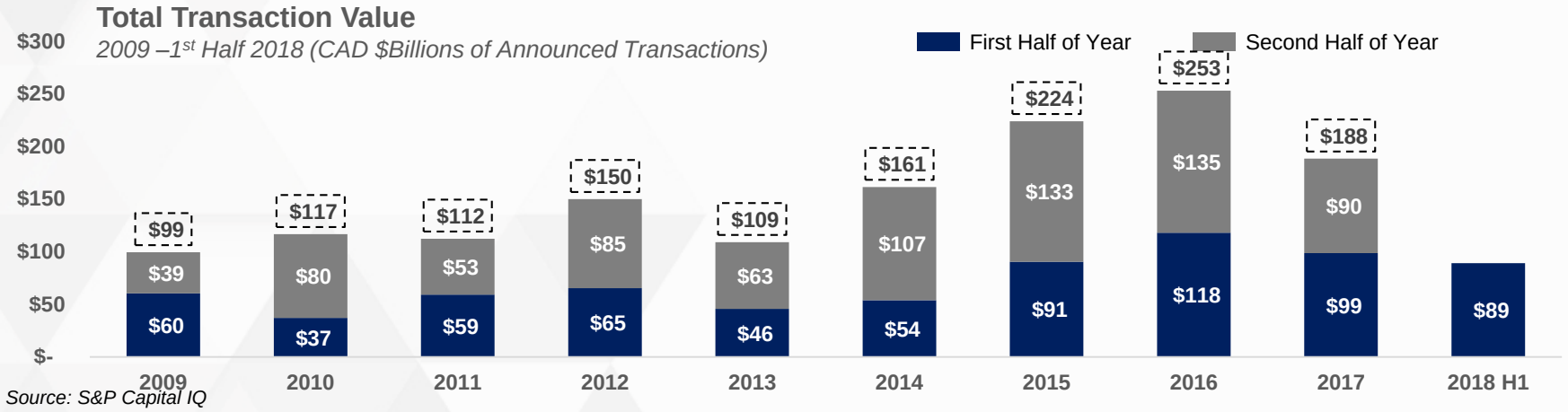
- Deal Value & Volume
- Cross-border Transactions
- Market Activity by Sector
- Market Activity by Province
- Market Activity – Deal Volume by City
- Alberta GDP by Sector
- Oil & Gas Deal Value and Volume
- Oil & Gas Equity Issuance in Canada
- Oil & Gas Trading Multiples
- Mid-Market Transactions Valuations

Oil and Gas industry in Canada

The Canadian M&A market is robust with deal activity remaining high despite rising interest rates and trade uncertainty

Deal Value and Volume





Source: S&P Capital IQ

Let's do this.

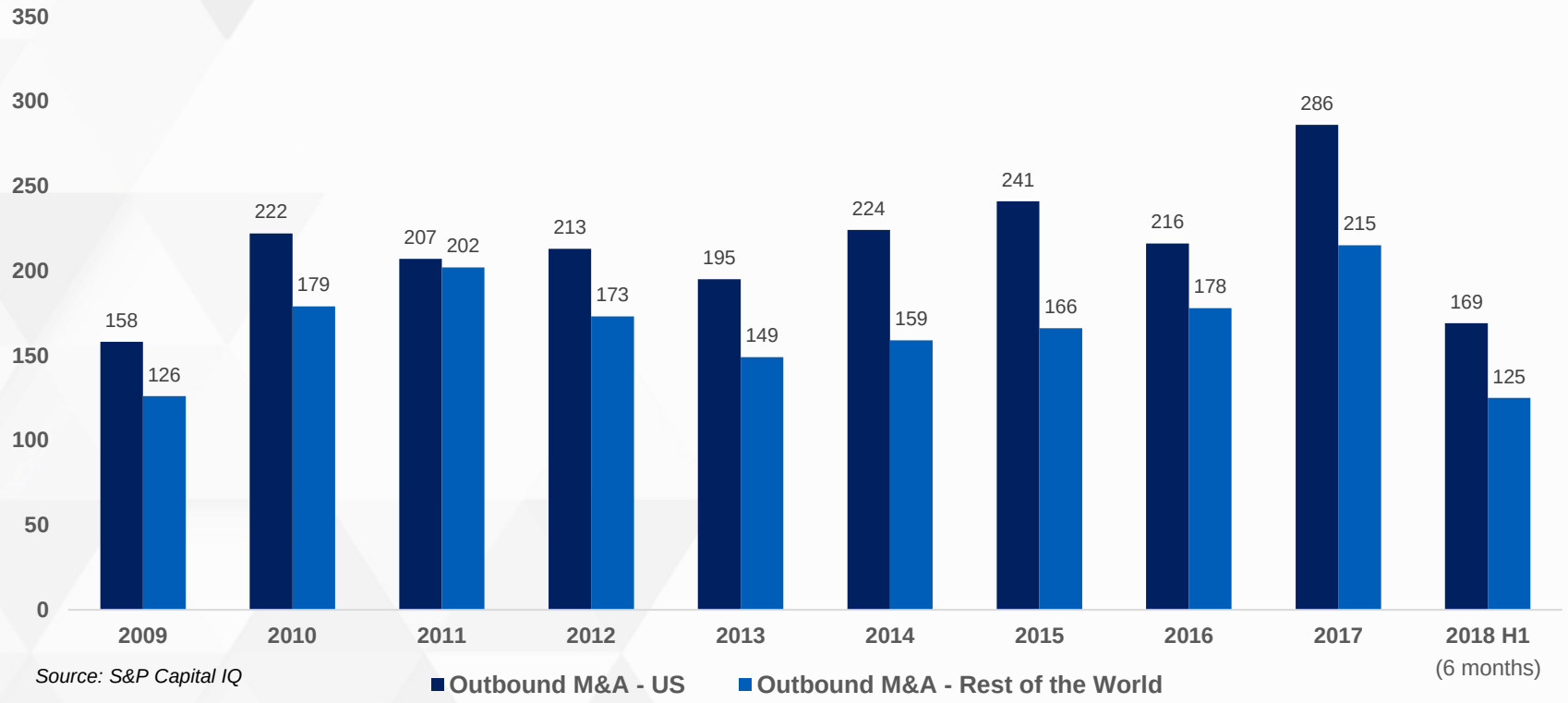
Oil and Gas industry in Canada

26% of Canadian M&A transactions in 2017 involved Canadian entities acquiring a foreign target

Cross-border Transactions

Outbound M&A Activity

2009 - 1st Half 2018 (# of Announced Transactions)



Source: S&P Capital IQ

Let's do this.

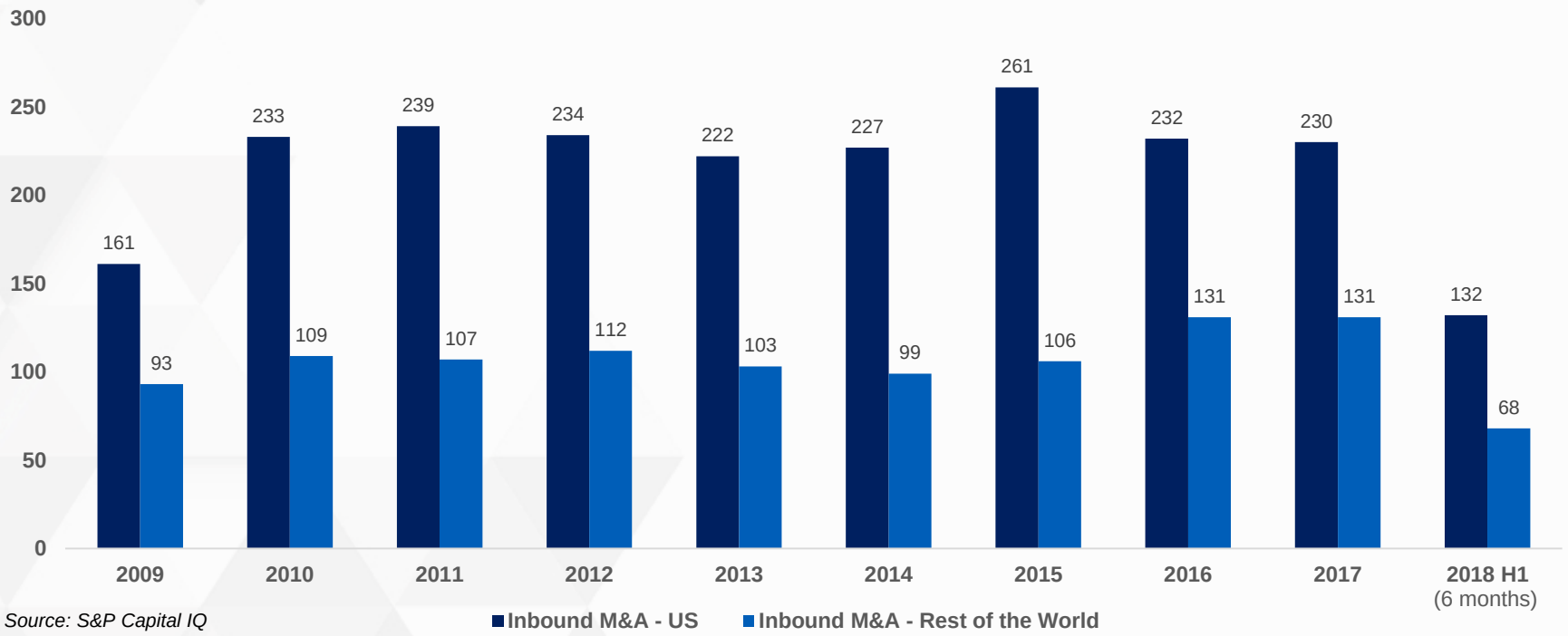
Oil and Gas industry in Canada

Canada remains an attractive destinations for foreign acquirers – 20% of 2017 deal volume involved a foreign purchaser

Cross-border Transactions

Inbound M&A Activity

2009 - 1st Half 2018 (# of Announced Transactions)



Source: S&P Capital IQ

Let's do this.

Oil and Gas industry in Canada

The United States remains the largest acquirer of Canadian businesses

Cross-border Transactions

Top 10 Inbound M&A Source

2013-2017 (# of Announced Transactions)

Rank	Country	2013	2014	2015	2016	2017	5 Year Total
1	United States	222	227	261	232	230	1,172
2	United Kingdom	27	13	16	24	19	99
3	France	7	14	11	16	8	56
4	China	5	10	11	18	11	55
5	Australia	9	5	9	6	9	38
6	Germany	4	1	4	8	9	26
7	Ireland	7	4	3	7	5	26
8	Switzerland	4	5	6	3	7	25
9	Japan	3	2	4	5	10	24
10	Netherlands	3	2	6	4	6	21
Other	Other	34	43	36	40	47	200
Total		**325**	**326**	**367**	**363**	**361**	**1,742**

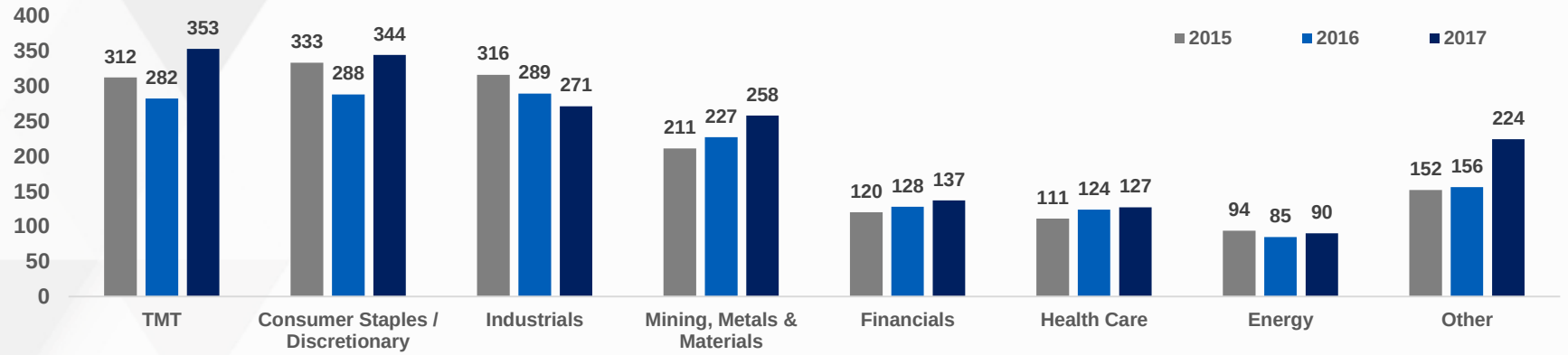
Source: S&P Capital IQ

Oil and Gas industry in Canada

Canadian Deal Volume By Target Sector

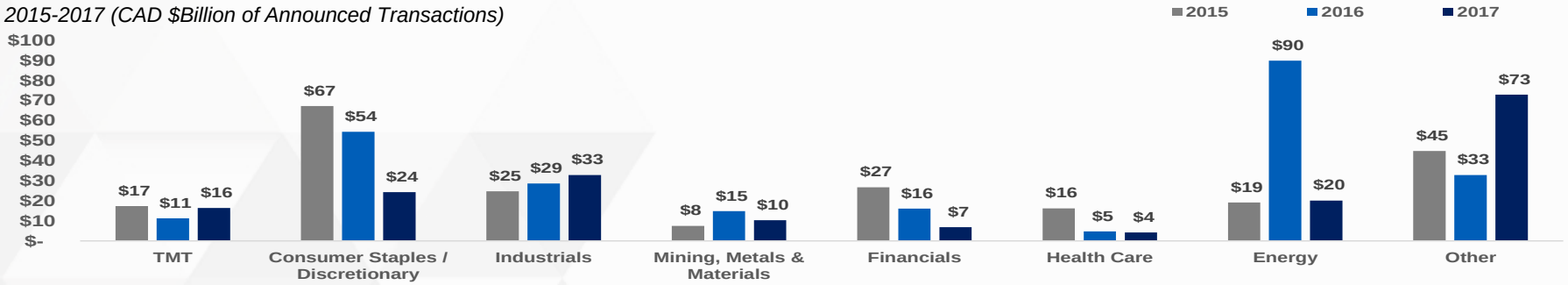
2015-2017 (# of Announced Transactions)

Market Activity by Sector



Canadian Transaction Value By Target Sector

2015-2017 (CAD $Billion of Announced Transactions)



Other includes Real Estate, Utilities and transactions with targets without sector disclosures

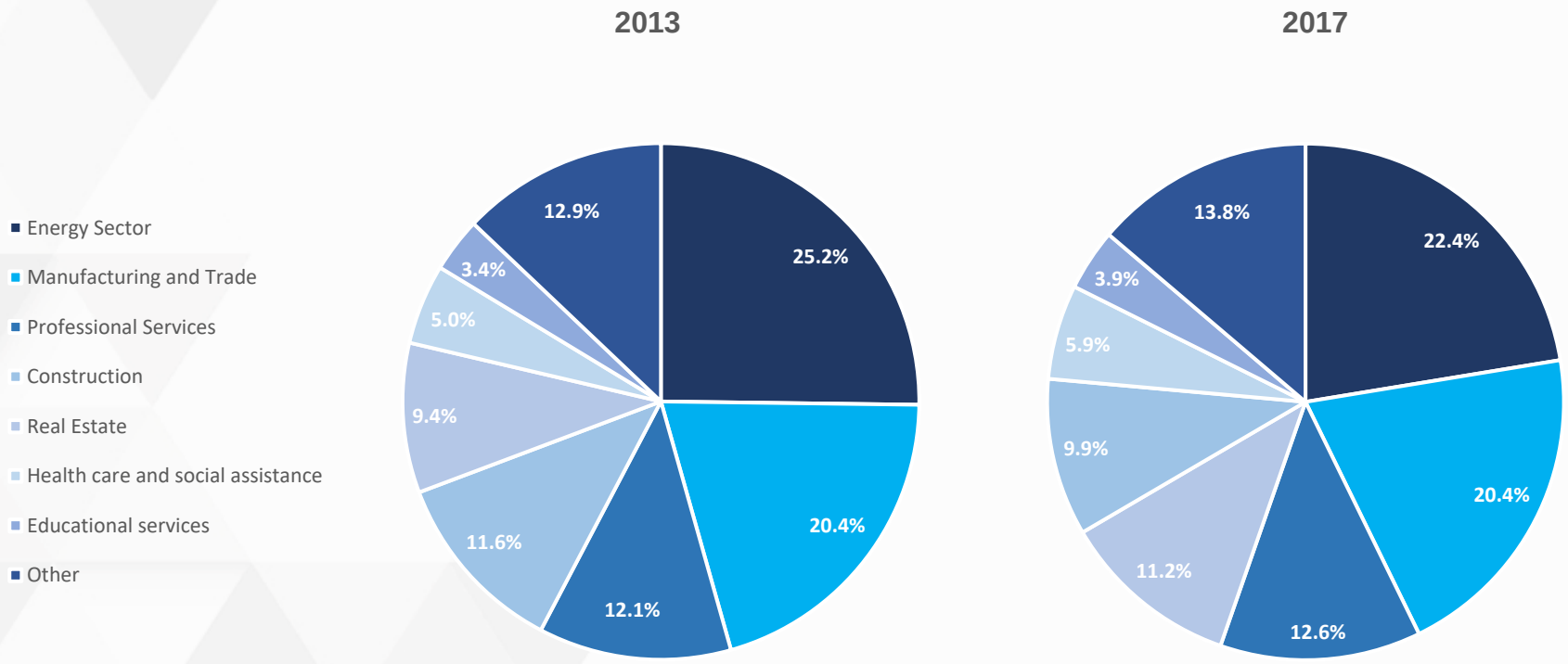
[1] Source: S&P Capital IQ..

Let's do this.

Oil and Gas industry in Canada

Energy sector contribution to Alberta GDP has decreased since 2013, though remains the largest contributor.

Alberta GDP by Sector – 2013 vs. 2017



Source: Statistics Canada. Table 36-10-0400-01 Gross domestic product (GDP) at basic prices, by industry, provinces and territories, percentage share

Let's do this.

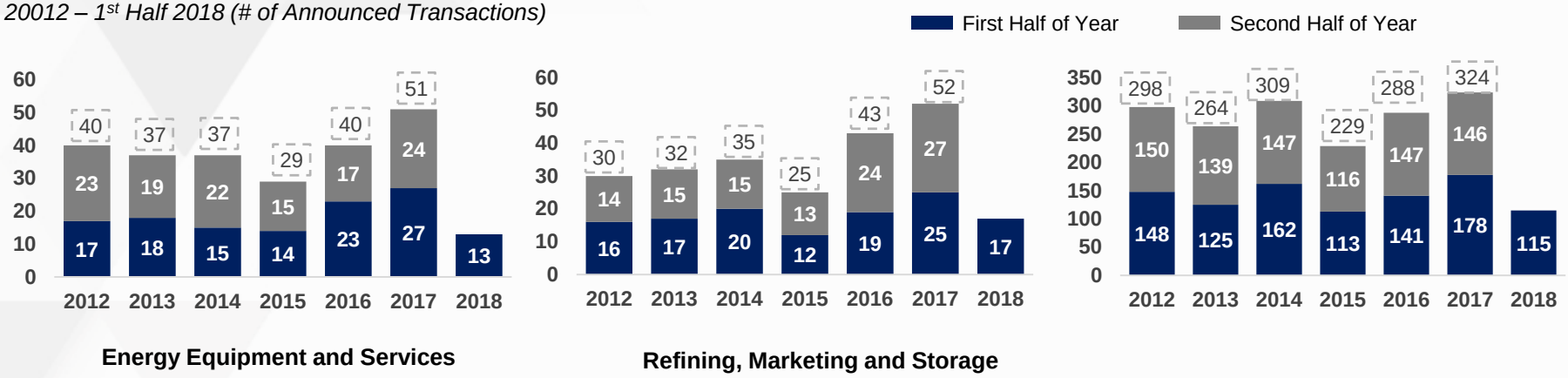
Oil and Gas industry in Canada

The Canadian M&A market is robust with deal activity remaining high despite rising interest rates and trade uncertainty

Total Number of Transactions in Canada

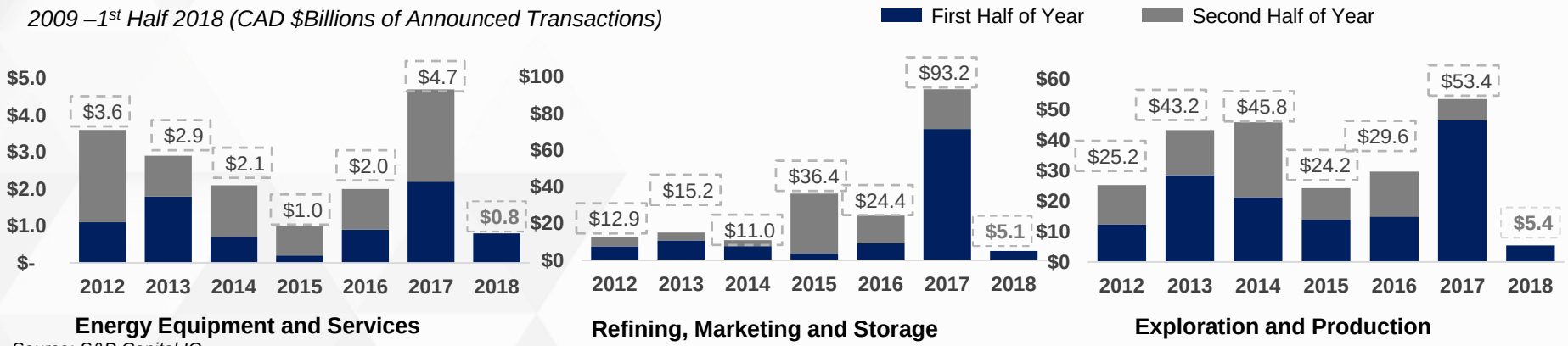
20012 – 1st Half 2018 (# of Announced Transactions)

Deal Value and Volume



Total Transaction Value

2009 –1st Half 2018 (CAD $Billions of Announced Transactions)



Source: S&P Capital IQ

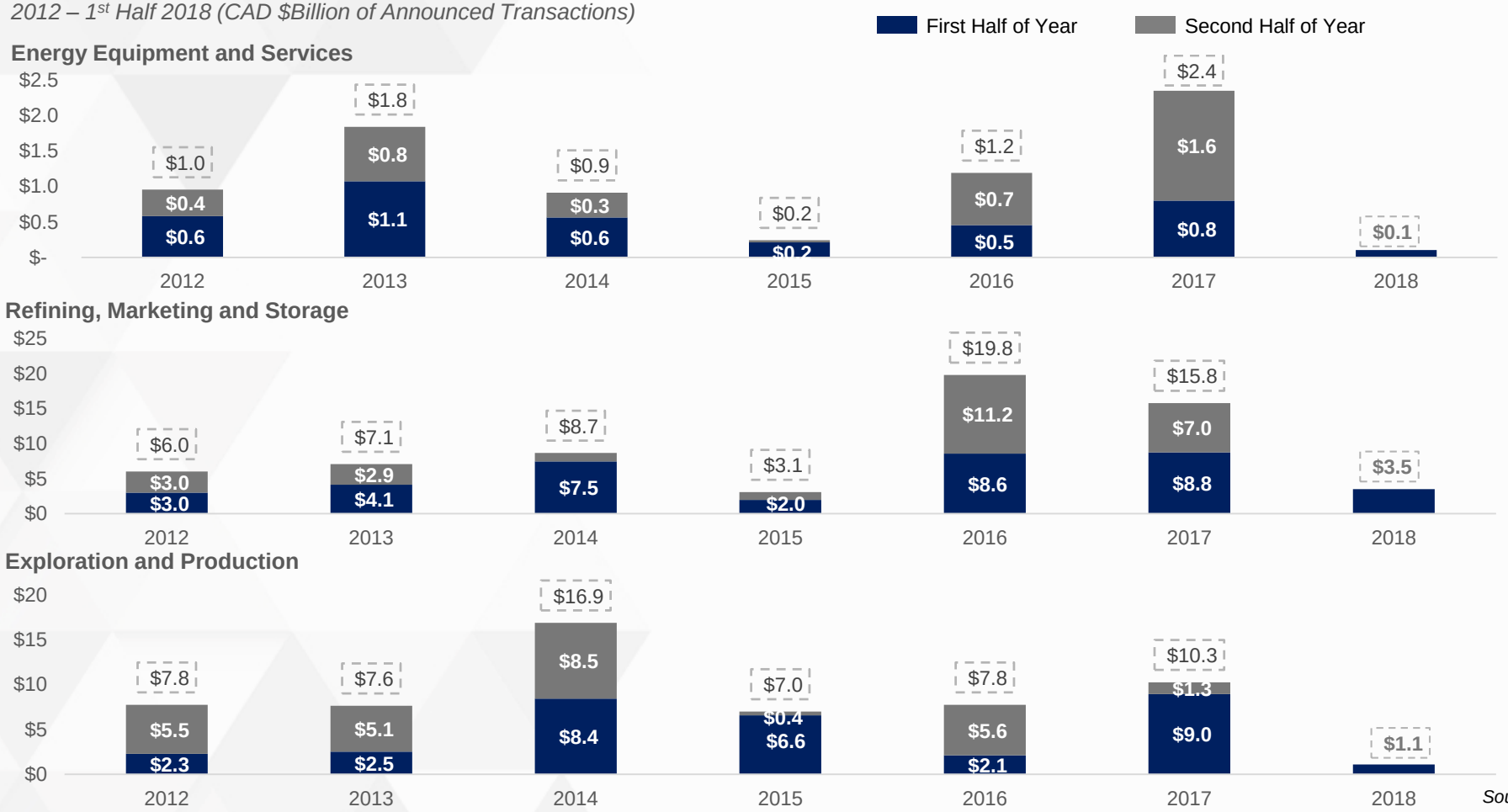
Let's do this.

Oil and Gas industry in Canada

Equity Issuance for Canadian Listed Oil and Gas Companies

Total Equity Issuance Value

2012 – 1st Half 2018 (CAD $Billion of Announced Transactions)



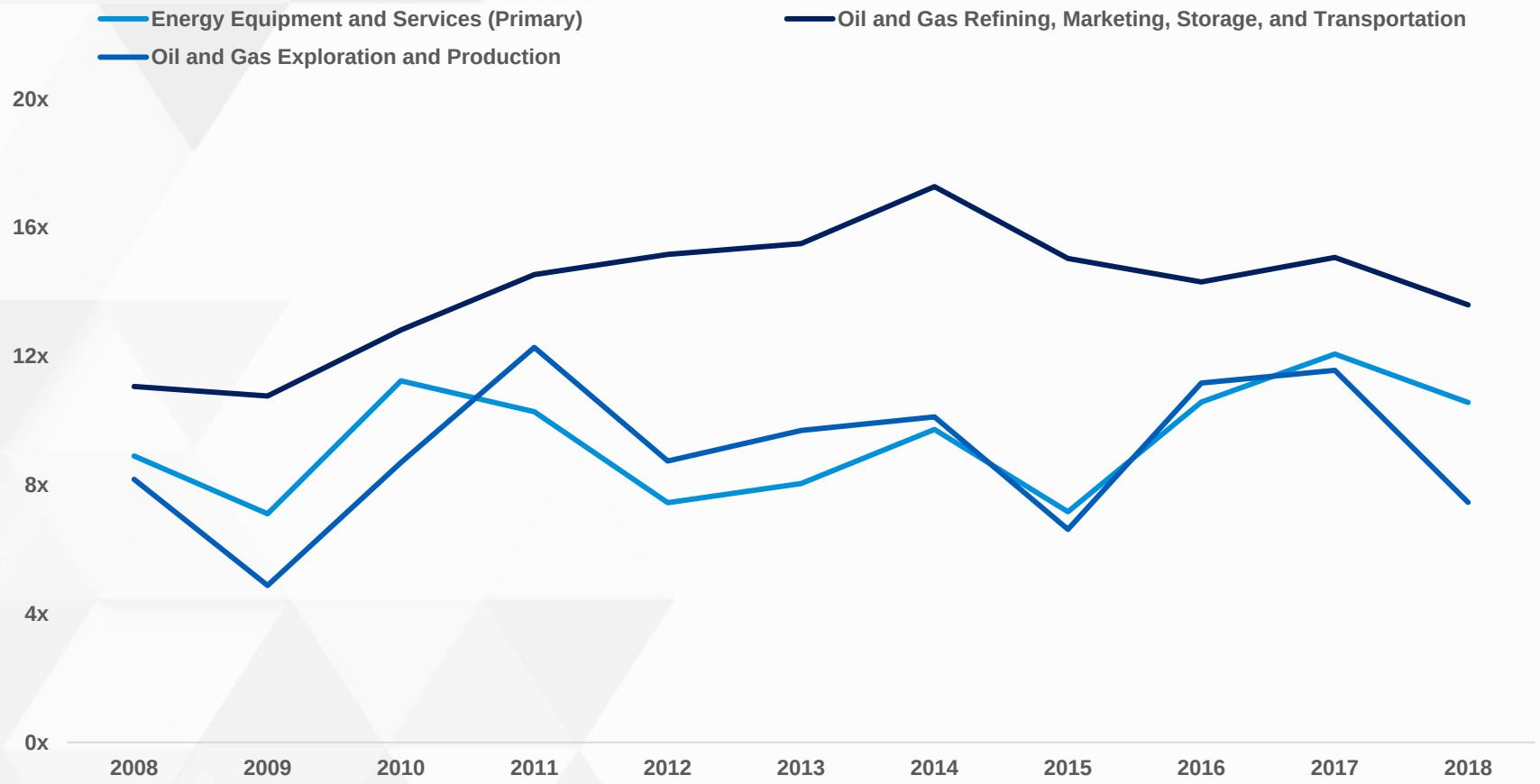
Source: S&P Capital IQ

Let's do this.

Oil and Gas industry in Canada

10 year Trading Multiples Average
Enterprise Value / EBITDA

Trading Multiples - 10 year EV/EBITDA Average



Source: S&P Capital IQ

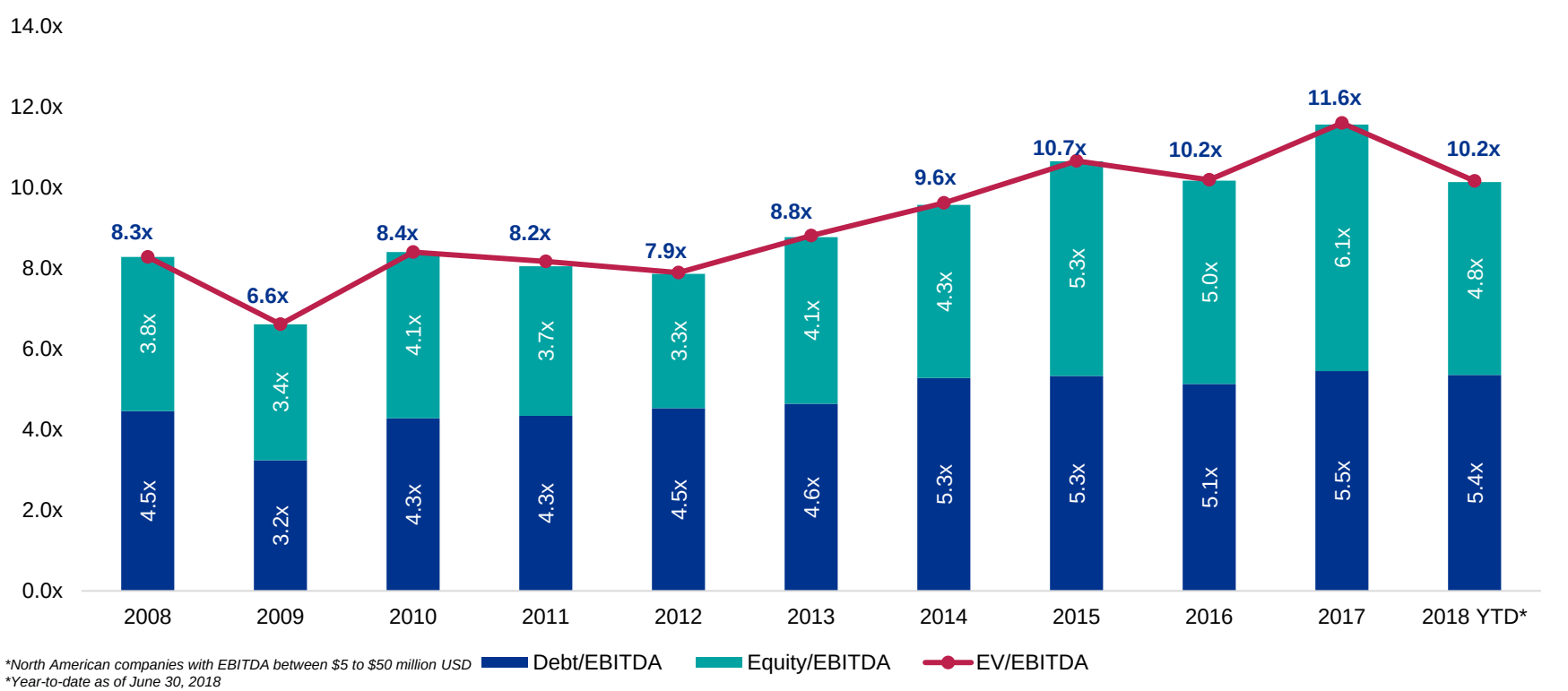
Oil and Gas industry in Canada

Transaction values remain at around the five-year average of 10.5x in 2018 YTD with debt contributions near historic peaks

Mid-Market Transaction Valuations (North America)

North-American Middle Market* – Leveraged Buy Out Purchase Price Multiples

2008 – 2018 H1



**North American companies with EBITDA between $5 to $50 million USD*
**Year-to-date as of June 30, 2018*
Source: S&P LCD Stats

Let's do this.

Oil and Gas industry in Canada

The Canadian M&A market remains a seller's market with strong valuation and decreasing buyer demands

Market Observations

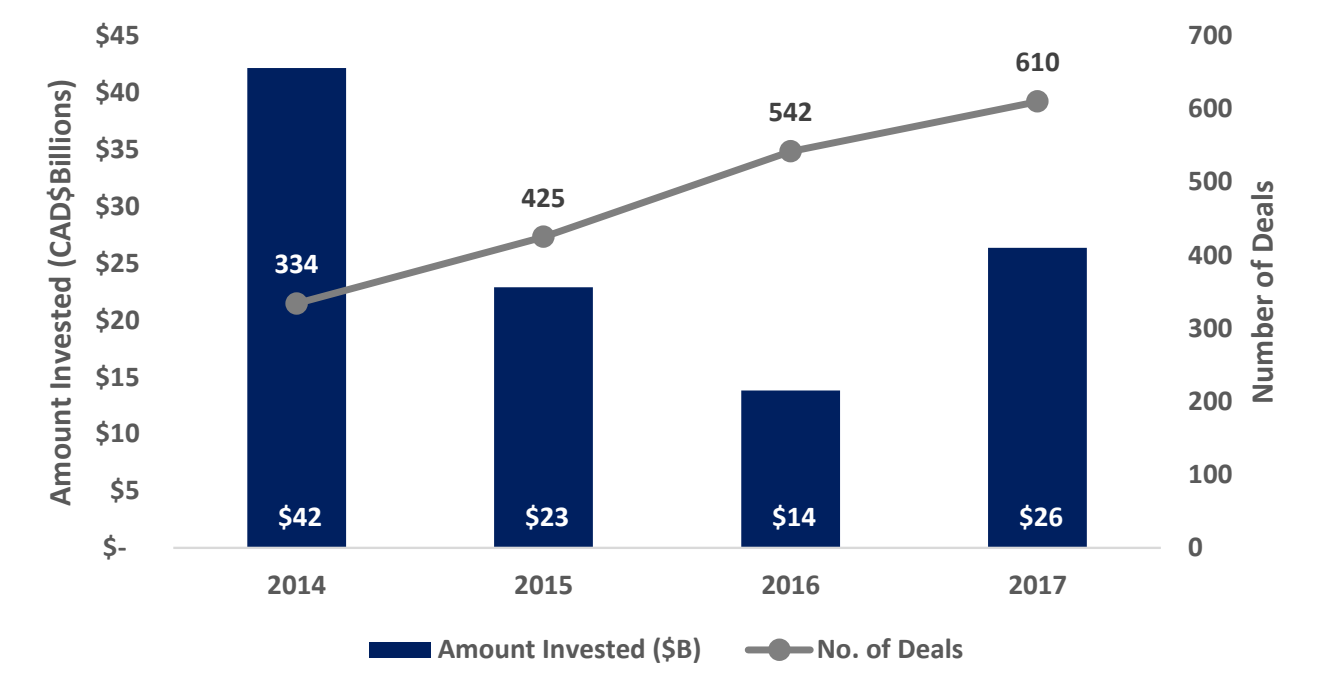
1. **Representation and Warranty Insurance**
2. **Quality of Earnings**
3. **Representation and Warranties**
4. **Deal Timeline**
5. **Contract Races**
6. **Staple Debt**

M&A activity drivers

M&A activity drivers

Private equity funds continue to be flush with cash – pressure from investors will continue to drive M&A activity

Canadian Private Equity Capital Deployed (CAD $Billions) and Deal Volume
2014 - 2017



Private Equity firms worldwide are sitting on $1 trillion USD of capital waiting to be deployed in the short-term

Source: Canadian Venture Capital & Private Equity Association Q1 2018 Report; The Globe and Mail

Let's do this.

M&A activity drivers

As $3.7 trillion in business assets are poised to change hands in five years — the biggest transfer of Canadian business control on record – experts predict a highly competitive buyer's market into 2022 and beyond

SME Trends

Key Statistics

98% *There are 1.2 million businesses employing people in Canada, of which ~98% are SME's.*

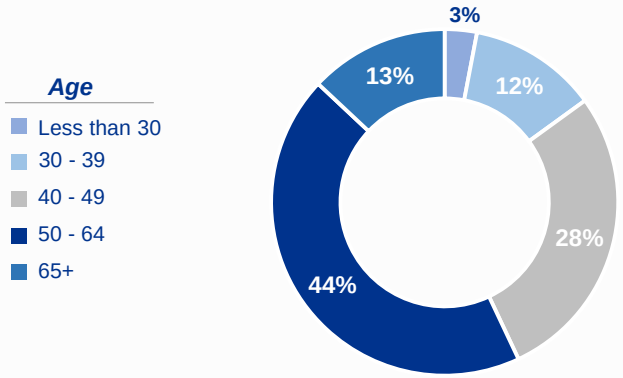
57% *57% of small business owners are over the age of 50.*

550k *550,000 Canadian business owners are forecasted to exit their businesses by 2022 – representing ~$3.7 trillion of business assets changing hands.*

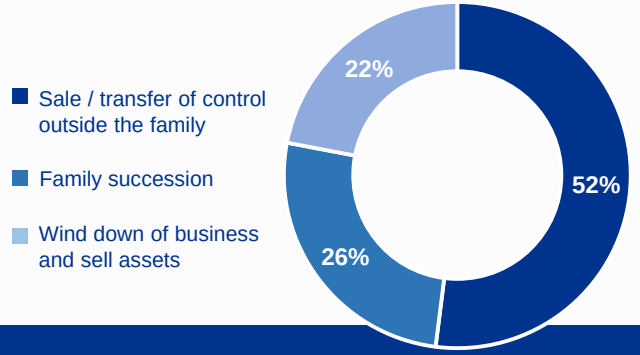
52% *52% of business owners don't have a formal succession plan in place and are considering a sale to a strategic buyer, financial investor, or new management team.*

17% *17% of Canadians are over the age of 65. Canada currently has more citizens aged 65 and older, than under the age of 15.*

Distribution of SMEs By Owner Age



SME Future Plans Survey



Source: Statistics Canada, Equicapita, BDO, BDC (Sept 2017 Survey), Atlantic Business Magazine

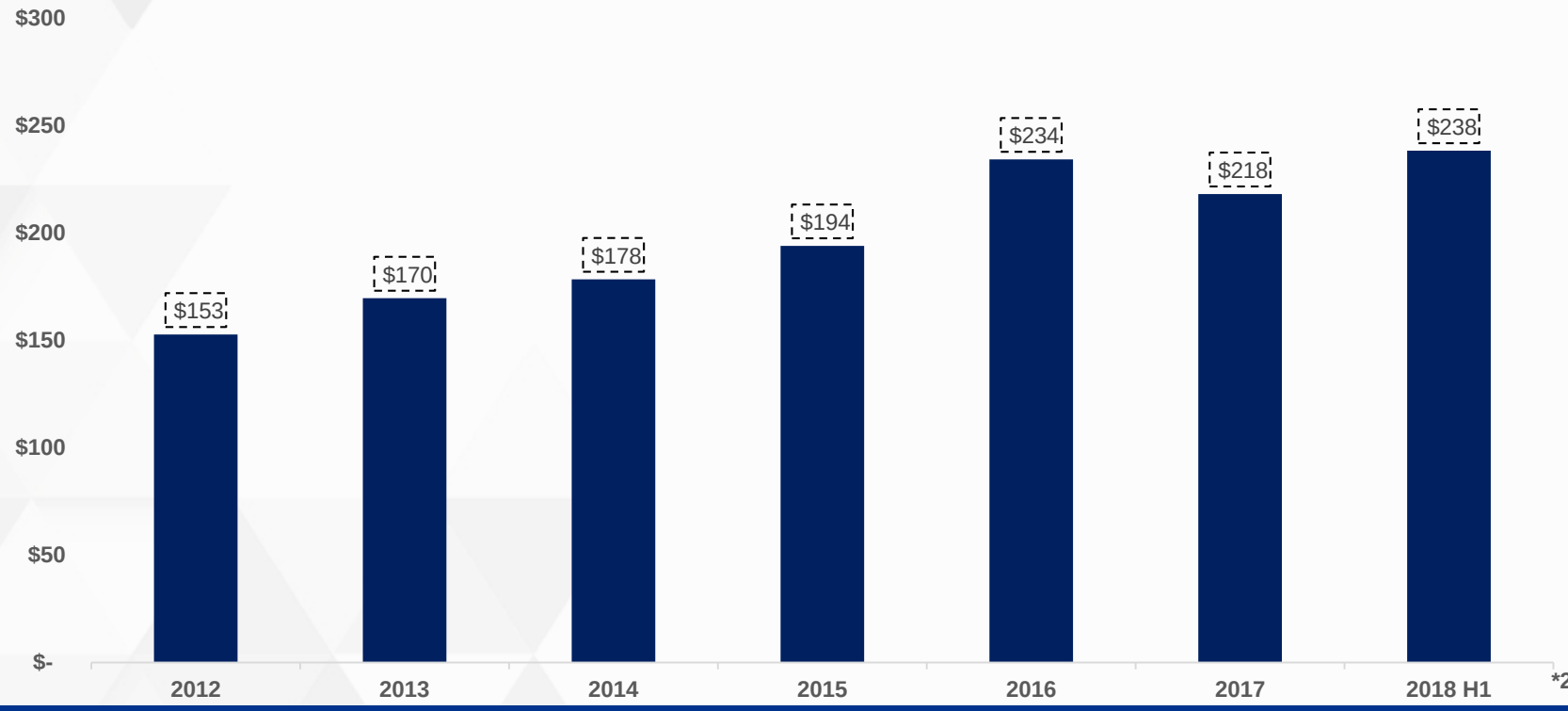
Let's do this.

M&A activity drivers

Canadian corporations are holding an increasing amount of cash on the balance sheet, providing potential capital for further M&A activities

Corporate Balance Sheets

Cash and Cash Equivalent Balances (CAD $Billions)
Public Companies Headquartered in Canada



Source: S&P Capital IQ

***2018 H1 As of June 30, 2018**

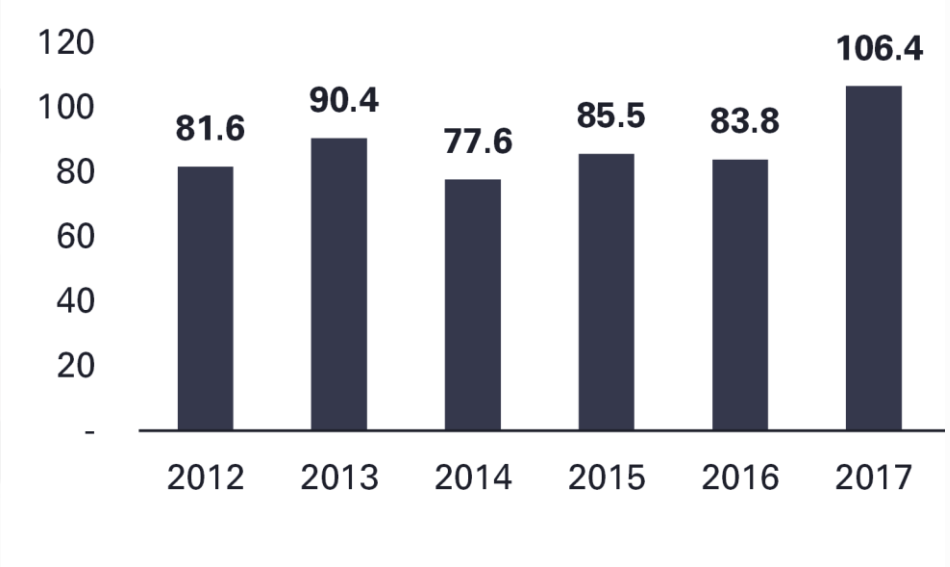
Let's do this.

M&A activity drivers

Debt Capital Markets have grown significantly since 2012

Debt Markets

Corporate Bond Issuances ($Billions)
2012 – 2017



- Debt Capital Markets reached a peak of $106.8 Billion of Corporate Issuances in 2017
- Issuances have been concentrated in the bank, industrial and Real Estate sectors

Source: Financial Post, Bloomberg

M&A activity drivers

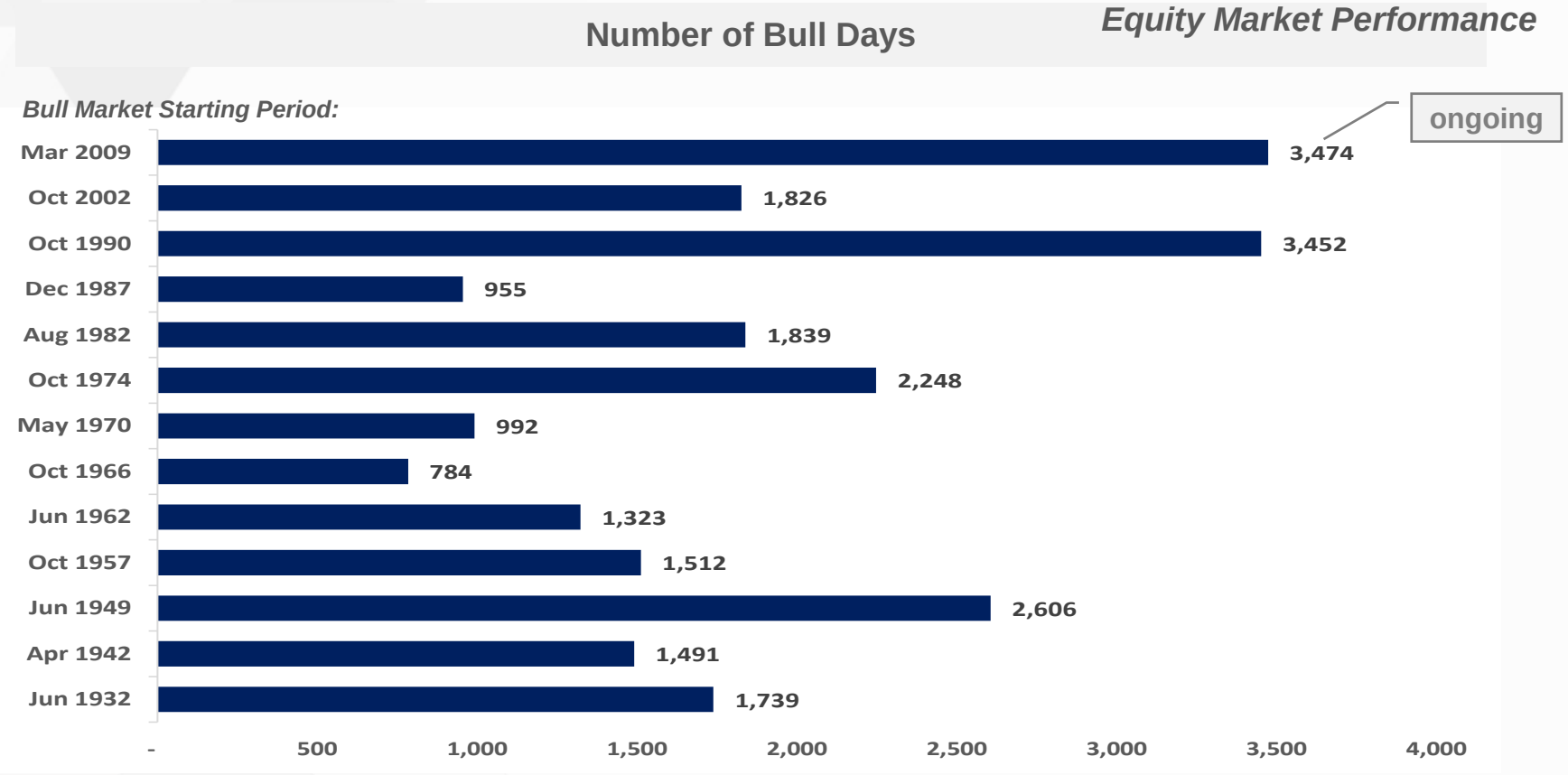
Protectionist actions taken by president Trump may impact the bilateral relations between the U.S. and Canada

Political Environment

- **NAFTA Discussions**
  - Automotive sector
  - Dairy sector / Supply management
  - Raw Materials / Natural resources
- **US Mid-term Election**
  - November 6, 2018
- **Canadian Federal Election 2019**

M&A activity drivers

Strong M&A activity is supported by the longest bull market on record, at 3,474 days – benchmark S&P 500 has surged 323% over this period



Source: S&P Dow Jones Indices, as at August 22, 2018

M&A activity drivers

The yield curve, once it inverts, has a track record of signaling that a recession is coming – it currently is at 0.34 pct. pts.

Yield Curve

Yield Curve

Delta between short-term (2 year) and long-term (10 year) US government bonds

1984 – 2018 (as at June 21)

Source: New York Times as at June 25, 2018

Q&A

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Appendix

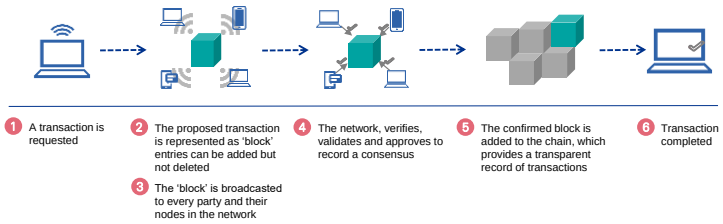
Blockchain

Augmented information authenticity will reduce risks and eliminate the need for reconciliations.

Through a distributed ledger database, blockchain maintains a continuously growing list of permanent transaction records, which are shared and synchronized across networks. Applying blockchain technologies in finance amplifies efficiencies and security through:

- Automation and streamlining of back-office operations
  - Enhanced peer-to-peer solution enablement
  - Elimination of intermediary services
  - Reduction in posttransaction latency and counterparty exposure
- Simplified infrastructure and enhanced system integration
- Increased security through cryptography and transaction documentation

Example transaction decomposition



Source: KPMG International

Use case examples within finance

- Source to pay: Accounts payable and invoice payables
- Order to Cash: Dispute management, trade promotions, cash application
- Acquire to Retire: Fixed assets accounting and intercompany reconciliation

Disruptor profile

	Virtual service delivery
✓	Process automation
✓	Technology agility
✓	"Strategist" skill set
✓	Dynamic insights
✓	Digital governance

Key impacts on finance

- Reduced manual execution of complex processes
- Authorizations ensure transparency and support verifiable and auditable transactions
- Seamless transaction integration with complete authenticity minimizes value leakage caused by reconciliations

Cloud ERP and EPM

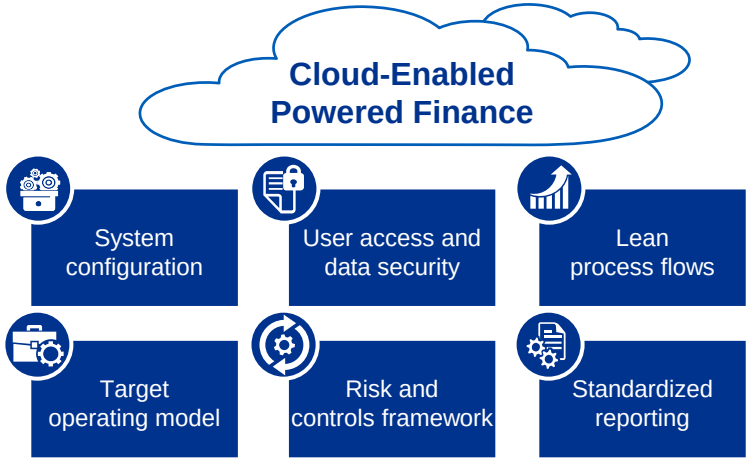
Agile foundational solutions should enable global finance process standardization, unconstrained scalability, and exceptional cost efficiencies.

Cloud-based infrastructure and SaaS applications provide a cost-efficient, scalable way to optimize and streamline the finance function via:

— "Pay-per-usage" model: untethering the finance function from a complex, inflexible ERP infrastructure

— Prebuilt functionality: supporting the standardization of financial processes across the organization

— Centralized platform: enabling seamless consolidation and enhanced data governance



Source: KPMG International

Use case examples within finance

— Budgeting and planning
— Financial reporting and consolidation
— Order to cash
— Management reporting
— Procure to pay
— Acquire to retire
— Payroll processing
— Reconciliations management

Disruptor profile

✓	Virtual service delivery
	Process automation
✓	Technology agility
✓	"Strategist" skill set
✓	Dynamic insights
✓	Digital governance

Key impacts on finance

— Breaking down barriers; global deployment of cloud-based services offers a cost-efficient solution that bypasses complex IT infrastructure builds

— Finance as a business partner; streamlined processes through a collaborative platform promote greater cross-functional integration

— Resilience and agility; accessible, real-time data enables quicker response times to changes in business requirements

Robotic process automation

Transformative advancements in robotic process automation will mechanize human labor and build the foundation for "digital labor" in the finance back office.

Rules

Automation based on documented process rules

Macro Based	Unstructured data	Natural language processing	Knowledge base	Adaptive alteration
✓	✓			

Predictive analytics	Machine learning	Reasoning	Large scale processing	Big data analytics
✓			✓	✓

Source: KPMG International

Finance can identify labor/FTE-intensive and time-consuming activities ripe for robotics process automation by considering certain criteria, such as:

- Low complexity
- Highly repetitive tasks
- Transactional in nature
- Consistent inputs/outputs
- Manual data entry activities between multiple systems
- Able to be broken down into structured steps and decisions

Use case examples within finance

- Close and reconcile subsidiary ledgers
- Process journal entries
- Master data maintenance
- Cash applications
- Purchase order creation
- Prepare and distribute management reporting

Disruptor profile

✓	Virtual service delivery
✓	Process automation
✓	Technology agility
✓	"Strategist" skill set
✓	Dynamic insights
✓	Digital governance

Key impacts on finance

- Greater cost efficiencies through labor automation are challenging traditional service delivery and offshoring assumptions
- Finance is no longer "9 to 5"; digital labor is executing processes at supercharged speeds, 24 hours a day
- Increased scalability; RPA is designed to scale instantaneously at digital speeds to respond to fluctuating workloads

Machine learning

Adaptive technologies use logic from computational learning to make real-time, fact-based decisions to accomplish advanced finance tasks.

Learning

Deep level of analytics of structured and unstructured data. Able to complete tasks better through learning.

Macro Based	Unstructured data	Natural language processing	Knowledge base	Adaptive alteration
✓	✓	✓	✓	✓

Predictive analytics	Machine learning	Reasoning	Large scale processing	Big data analytics
✓	✓		✓	✓

Source: KPMG International

Machine learning builds on traditional "rules-based" RPA with the ability to automatically "rewrite" the rules based on past learning or trends. This capability caters to finance processes that require a user to:

- Interpret data in nonstandard formats (e.g., PDF, verbal)
- Draw conclusions from high volumes of complex data
- Interpret or make comparisons based on historical data and trends
- Apply feedback/results for process improvement.

Use case examples within finance

- Manage payment exceptions
- Supplier and contract management
- P-card reconciliation and analysis
- Perform issues tracking and resolution
- Prepare statutory filings and shareholder reports
- Evaluate actual versus plan performance

Disruptor profile

✓	Virtual service delivery
✓	Process automation
✓	Technology agility
✓	"Strategist" skill set
✓	Dynamic insights
✓	Digital governance

Key impacts on finance

- Leverage digitized process data to increase visibility and continuous process improvement
- Leverage automation to deploy new "no-labor" data integrity routines
- Expected reduction in mistakes, accidents, regulatory violations and fraud; increased controls capability

Cognitive technologies

Cognitive technologies will challenge the finance and accounting opinion; electronic brains will do the scorekeeping and analytics; humans will drive insight discovery.

Reasoning

Hypothesis-based reasoning; mimics human activities such as perceiving, inferring, hypothesizing, and reasoning

Macro Based	Unstructured data	Natural language processing	Knowledge base	Adaptive alteration
✓	✓	✓	✓	✓

Predictive analytics	Machine learning	Reasoning	Large scale processing	Big data analytics
✓	✓	✓	✓	✓

Source: KPMG International

Certain finance processes require judgment that can not be clearly defined using a "rules-based" approach. Cognitive technologies can replace traditional human interventions, such as:

- Draw conclusions based on structured and unstructured data (e.g., chat, speech)
- Extract sentiment from complex and disparate data
- Apply specialized and/or undocumented knowledge
- Use perception and/or judgment to perform tasks.

Use case examples within finance

- Perform financial close analysis
- Forecast performance (P&L, BS, cash)
- Manage customer contracts
- Perform accounting issue identification and monitoring
- Develop strategic plan
- Perform strategic scenario analysis

Disruptor profile

✓	Virtual service delivery
✓	Process automation
✓	Technology agility
✓	"Strategist" skill set
✓	Dynamic insights
✓	Digital governance

Key impacts on finance

- Automation of knowledge work: Cognitive technologies can be "trained" to perform complex tasks, historically dependent on human intelligence and situational analysis
- Shift of talent skill sets to decision support; automation of complex processes will enable finance to focus on insight delivery
- Increase security, controls, and governance with no corresponding work increase

Natural language processing

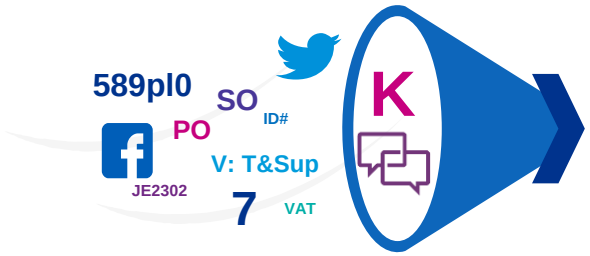
NLP will provide finance with unconstrained, real-time information accessibility, beyond just the numbers.

NLP technologies process large quantities of textual data to efficiently provide enhanced insights and analysis. Its applications span many layers of the capability framework, and it is a key enabler to information extraction and optimization, such as:

— Digitize and produce analysis from “unconventional” data sources

— Assess large volumes of data in a timely manner to increase productivity and operational efficiency

— Drive actionable insights based on past trends and patterns



Use case examples within finance

— “Alexa, what were comparable store sales in February?”

— Real-time language recognition and processing

— Back-office customer support

— Procurement requirement fulfillment

— Spend categorization and organization data engine

— Statutory interpretation and assurance

Source: KPMG International

Disruptor profile

✓	Virtual service delivery
✓	Process automation
✓	Technology agility
✓	“Strategist” skill set
	Dynamic insights
✓	Digital governance

Key impacts on finance

— Enhanced processing capabilities increase data accessibility and visibility, enabling a new level of analytical precision

— Exceptional finance operational efficiencies; automatic information processing of textual data previously performed by humans

— Amplified automation and cognitive enabler; integration of NLP technologies with other disruptors among the capability framework to accelerate extreme automation

Digital analytics and delivery

Dynamic insights in real time will enable finance to transcend its role as the historical scorekeeper to become a real-time, strategic interpreter.

The mobile, connected digital world is not just impacting the daily lives of humans, but the finance back-office. Finance must leverage innovative, interactive digital insights and analytics mechanisms to enable:

— Dynamic, customized reporting and elevated business partnering capabilities and decision support

— Enhanced operational effectiveness through connectivity, flexibility, and functionality

— Increased agility and responsiveness to constantly changing market needs and requirements.

Real-time collaboration and analysis across multiple users and channels

Use case examples within finance

— Management reporting and analysis and customizable content prioritization for data focus

— Live close process monitoring/reporting with threshold-driven notifications of key updates

— Strategic scenario analysis

— Performance and metrics reporting with built-in insight generation features

— Real-time business partnering and driver-based analysis (i.e., sales decision support)

— Operational and financial target setting

Source: KPMG International

Disruptor profile

✓	Virtual service delivery
✓	Process automation
✓	Technology agility
	“Strategist” skill set
✓	Dynamic insights
	Digital governance

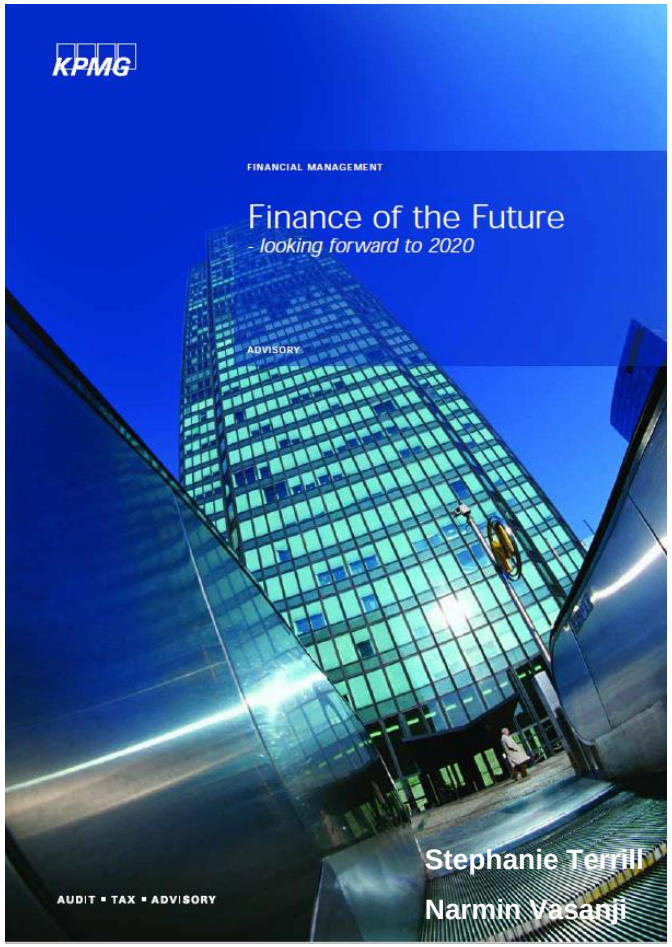
Key impacts on finance

— Increased cross-functional executive team alignment; dynamic insights to drive more frequent and informed strategic business decisions

— Real-time operational excellence; digital application integration will deliver higher-quality, on-demand information on every device

— Upgraded capabilities and value proposition for finance professionals; reporting aligned to strategy and performance objectives

Finance of the future



Source: KPMG International