Second Quarter Update

Thursday, June 23, 2016

kpmg.ca/quarterlyupdate

Welcome

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Agenda

- **Alberta Energy Regulator Bulletin 2016-16** – Trevor Hammond
- **U.S. GAAP update** – Trevor Hammond
- **Audit trends 2016: Targeting transformation** – Trevor Hammond
- **Carbon taxes and cap & trade** – Torran Jolly
- **Proposed changes to 55(2) tax standard** – Dennis Auger
- **Human capital management** – Mike Fedeyko
- **Questions & answers**

Accounting and audit matters

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Alberta Energy Regulator - Bulletin 2016-16

Effective June 21, 2016, there are three new interim regulatory requirements for the transfer of AER regulated assets in response to the Alberta Queens Bench Redwater decision.

- AER will require all transferees to demonstrate they will have a liability management ratio **(LMR) of 2.0 or higher** immediately following the transfer
- AER will consider and process all applications for license eligibility under Directive 067 as **"non-routine".**
- For holders of existing but previously unused license eligibility approvals, the AER may require evidence that there have been **no material changes since approving the license eligibility**.

U.S. GAAP amendments effective in 2017 and beyond

Topic	Effective Public	Effective Private
Simplifying the Measurement of Inventory	Fiscal years, and interim periods within those years, beginning after 15 December 2016	Fiscal years beginning after 15 December 2016, and interim periods within fiscal years beginning after 15 December 2017
Presentation of Deferred Taxes as Non-current	Fiscal years, and interim periods within those years, beginning after 15 December 2016	Fiscal years beginning after 15 December 2017, and interim periods within fiscal years beginning after 15 December 2018
Simplifying the Transition to the Equity Method of Accounting	Fiscal years, and interim periods within those years, beginning after 15 December 2016	N/A
Recognition and Measurement of Financial Assets and Financial Liabilities	Fiscal years and interim periods within those years, beginning after 15 December 2017	Fiscal years beginning after 15 December 2018, and interim periods within fiscal years beginning after 15 December 2019
Revenue Recognition	Fiscal years, and interim periods within those years, beginning after 15 December 2017	Fiscal years beginning after 15 December 2018, and interim periods within fiscal years beginning after 15 December 2019
Leases	Fiscal years, and interim periods within those years, beginning after 15 December 2018	Fiscal years beginning after 15 December 2019, and interim periods within fiscal years beginning after 15 December 2020
Credit Losses	Fiscal years, and interim periods within those years, beginning after 15 December 2019	Annual and interim periods in fiscal years beginning after 15 December 2020

Audit Trends - Targeting transformation

Changing risks are demanding substantive change to the global role of the audit committee.

Technological risks:

- Cyber security risk
- Business model risk
- Data and analytics privacy risk
- Technology project risk

Political and economic risks:

- Economic volatility
- Emerging markets risks
- Geopolitics

Audit Trends - Targeting transformation

Evolution of corporate reporting

- Integrated and strategic reporting
- Expanded audit reports
- Disclosure of operating and other performance indicators

Increasing complexity of the regulatory landscape

- Emerging regulatory issues and standards
- Audit committee’s role in improving audit quality
- Impact of global regulations on Canadian audit committees

Audit Trends - Targeting transformation

Best practices – how to address today's most pressing challenges:

1. Discuss the impact of regulatory trends as early as possible
2. Revisit risk appetite and risk frameworks more frequently
3. Ensure your organization has the right skill sets
4. Conduct stress testing and scenario planning
5. Consider implementing education sessions
6. Rely more on risk functions
7. Engage third-party professionals
8. Focus more broadly on talent and human capital
9. Review internal controls focused on preventing and detecting fraud.

Download report at kpmg.ca/audittrends

Carbon taxes and cap & trade

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Introduction

Global economy moving towards carbon pricing

- World-wide cultural shift to a lower carbon economy
- 40 countries and 20 sub-national jurisdictions (Quebec) have or will adopt carbon pricing framework
- Carbon pricing programs cover 12% of global emissions
- Market-based programs used to reduce other pollutants in the past
  - US Cap & Trade component of Acid Rain Program reduced sulphur dioxide by 60%
- 2 general frameworks
  - Carbon tax
  - Cap & trade

Many political, technical and economic challenges still remain

Cap & trade and carbon tax

Cap & trade (C&T)

- Emission credits are allocated, purchased or given to emitters by governments
  - Emission credits are reduced over time
- Emitter can buy and sell emission credits if they need or have credits
  - Often bought/sold through an auction process or from the government
  - Encourages free-market principles
- Encourages technological improvements and the benefactor accrues the economic benefit

Carbon tax

- A tax or levy based upon some measure of emission output (i.e. CO2)
- Exceptions available to emitters facing international competition

Revenue neutral

- Most programs introduced have been represented as revenue neutral (i.e. not a tax grab)
- Anticipate decreases to personal and corporate taxes

Canadian regimes

Cap & trade (C&T)

1. Quebec – implemented in 2013
2. Ontario – proposed for 2017
3. Manitoba – proposed by former NDP gov't

Carbon tax / levy

1. Alberta – new regime effective in 2017
2. British Columbia – implemented in 2008

No system

1. Saskatchewan
2. NWT, Yukon & Nunavut
3. Nova Scotia, New Brunswick, PEI & NFLD

Quebec - Cap & trade

Background

- Introduced January 1, 2013 and in 2014, linked with the State of California
- Applies to businesses that emit 25,000 metric tons or more GHG/year

Emission allowance

- Government sets annual caps on allowances that decrease over time
- 3 types of emission allowance
    1. GHG Emission Units - Units distributed free or charge, auctioned off or sold by government
    2. Offset Credits - stemming from GHG emission reductions in sectors not subject to C&T
    3. Early Reduction Credits - credits for early reductions of GHG by emitter - historical
- Emitters subject to foreign competition receive most allowance free of charge to avoid “carbon leakage”
    - After 2014, these free allowances decrease 1% to 2% per year

Quebec - Cap & trade

Regulatory compliance

- Emitter must have enough allowances to cover their period's emissions
- Can obtain emission allowance from government auctions, buying from other participants or purchasing offset credits
- System sets holding limits to prevent market manipulation

Auctions

- Emission units not allocated in the year are auctioned 4 times/year
- Minimum price is $10.75 CDN (2013); increase at 5% plus inflation to 2020
- Minimum price with Californian joint auction is the higher of the 2 systems minimum price at prevailing exchange rates
- Lowest price bid accepted by the government is the price for all units sold

British Columbia

Introduced carbon tax July 1, 2008

- Originally $10 / ton CO_2e increased to $30 in 2012
- Rates frozen for 5 years by current BC government in 2012
- Effect of revenue neutrality results in an effective cap on rates

Carbon tax review announced in 2012

- Review ongoing as part of holistic climate policy review
- Climate leadership team recommendations released November 2015
  - Decrease PST to 6%
  - Increase Carbon Tax by $10 / ton CO_2e per year beginning 2018
- No indication yet that BC will act on any of these recommendations

Carbon tax levied on fuel purchased, imported, combusted or used in BC

- Some exemptions
  - Fuel that is exported
  - Fuel used as feedstock
  - Fuel used down-hole at well site, certain uses in natural gas pipelines, etc.
  - Fuel for use in farming

Carbon tax rates from 2012

Item	Type of Fuel	July 1, 2012
1	Aviation Fuel	7.38 ¢/L
2	Gasoline	6.67 ¢/L
3	Heavy Fuel Oil	9.45 ¢/L
4	Jet Fuel	7.83 ¢/L
5	Kerosene	7.83 ¢/L
6	Light Fuel Oil	7.67 ¢/L
7	Methanol	3.27 ¢/L
8	Naphtha	7.65 ¢/L
9	Butane	5.28 ¢/L
10	Coke Oven Gas	4.83 ¢/m^3
11	Ethane	2.94 ¢/L
12	Propane	4.62 ¢/L
13	Natural Gas	5.70 ¢/m^3
14	Refinery Gas	5.28 ¢/m^3
15	High Heat Value Coal	62.31 $/ton
16	Low Heat Value Coal	53.31 $/ton
17	Coke	74.61 $/ton
18	Petroleum Coke	11.01 ¢/L
19	Gas Liquids	4.95 ¢/L
20	Pentanes Plus	5.28 ¢/L

Source: British Columbia Ministry of Finance, Carbon Tax Rates

Alberta

Did you know…?

- **Alberta has implemented carbon pricing since July 2007**
  - Large final emitters (LFEs) required to meet emissions targets pursuant to Specified Gas Emitters Regulation (SGER)
  - Reporting is by facility where facility exceeds 100,000 tons CO2e/year
  - Four compliance options:
    - Facility Improvements
    - Emission Performance Credits
    - Offset Credits
    - Climate Change and Emissions Management Fund Credits
  - Covers 45% of all emissions in Alberta
- **Economy-wide carbon pricing announced November 22, 2015**
  - Introduces additional layers to existing carbon pricing which will cover 90% of all emissions in the province

Alberta

Climate Leadership Plan

Framework for LFEs

- SGER to be replaced with Climate Competitiveness Regulation (CCR) in 2018
- $15 per ton increased to $20 and then $30
- Rebates – low-income
- Exemptions – similar to BC

Framework for conventional drilling

- Required retrofitting of pneumatic pumps
- Exemptions until 2023
- Purchased vs. produced gas
- Methane emission reduction - 45%

Framework for distribution of fuels

- $ per liter
- Collection mechanism – security vs. tax
- Upstream/midstream vs. downstream
- Exemptions

Framework for power generation

- Phase out of coal
- Collection on retail sales
- Exemptions for inputs

Source: KPMG

Alberta - Carbon levy rates by type of fuel

Type of Fuel	January 1, 2017 Rate ($20/ton)	January 1, 2018 Rate ($30/ton)
Aviation Jet Fuel	5.17 ¢/L	7.75 ¢/L
Aviation Gas	4.98 ¢/L	7.47 ¢/L
Bunker Fuel	6.36 ¢/L	9.55 ¢/L
Butane	3.56 ¢/L	5.34 ¢/L
Coal Coke	$63.59 /ton	$95.39 /ton
Coke Oven Gas	1.40 ¢/m3	2.10 ¢/m3
Diesel	5.35 ¢/L	8.03 ¢/L
Ethane	2.04 ¢/L	3.06 ¢/L
Gas Liquids	3.33 ¢/L	4.99 ¢/L
Gasoline	4.49 ¢/L	6.73 ¢/L
Heating Distillate Oil	5.51 ¢/L	8.27 ¢/L
Heavy Fuel Oil	6.35 ¢/L	9.53 ¢/L
High Heat Value Coal	$44.37 /ton	$66.56 /ton
Kerosene	5.14 ¢/L	7.71 ¢/L
Locomotive Diesel	5.94 ¢/L	8.90 ¢/L
Low Heat Value Coal	$35.39 /ton	$53.09 /ton
Methanol	2.18 ¢/L	3.26 ¢/L
Naphtha	4.49 ¢/L	6.73 ¢/L
Natural Gas	$1.011 /GJ	$1.517 /GJ
Non-Marketable or Raw Gas	$1.150 /GJ	$1.720 /GJ
Pentanes Plus	3.82 ¢/L	5.73 ¢/L
Propane	3.08 ¢/L	4.62 ¢/L
Refinery Gas	3.77 ¢/m3	5.65 ¢/m3
Refinery Petroleum Coke	$63.86 $/ton	$95.79 $/ton
Upgrader Petroleum Coke	$58.50 $/ton	$87.75 $/ton

Source: Alberta Finance, 2016 Tax Plan

Changes to 55(2) tax standard

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55(2) Before the 2015 budget

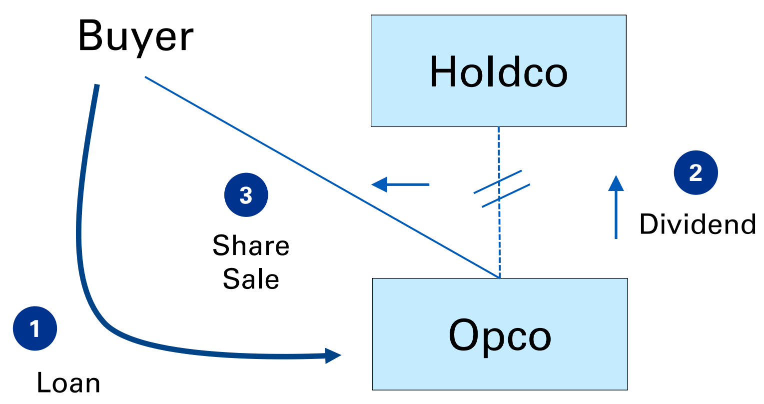
- Was there a dividend deductible under 112(1), (2) or 138(6)?
- Was purpose of dividend to reduce a *capital gain*; or
- Was result of 84(3) deemed dividend to reduce a *capital gain*?
- Was the gain attributable to anything other than safe income?
- Was dividend subject to Part IV tax that was not refunded on *payment* of dividend *to a corporation*?
- Subsection 55(2) did not apply if, as part of the series, there were no events described in paragraph 55(3)(a) [generally no disposition to or increased interest of an unrelated person]

Old 55(2) - Consequences

Where 55(2) applies, the dividend

- Is deemed not to be a dividend
- Where a corporation disposed of the share, is deemed to be proceeds of disposition of the share; or
- Where a corporation has not disposed of the share, is deemed to be a gain of the corporation for the year in which the dividend was received.

“Classic” capital gains strip



The new purpose tests

One of the purposes of the payment or receipt of the dividend is to effect:

- A significant reduction in the capital gain on any share
  - Results test for 84(3)
- A significant reduction in the fair market value of any share
  - Certain 84(2), (3) dividends excluded
- A significant increase in the cost amounts of property of the dividend recipient
  - Certain 84(2), (3) dividends excluded

Overview of new rules

Three conditions must be met for 55(2) to apply

55(2.1) – three conditions:

1. The dividend is deductible under 112(1), (2) or 138(6)

2. One of the three purpose tests or the results test is met

3. The dividend exceeds the Safe Income contributing to the capital gain that would have been realized

Overview of new rules

- 55(3)(a) exception
  - Applicable only to deemed dividends received under 84(2) and (3) on the redemption, acquisition or cancellation of shares

- Exception for Part IV taxes narrowed
  - Exception no longer applies if any dividend refund received

- New rules for stock dividends received by corporations

- The new regime applies to dividends received after April 20, 2015

CRA round table November 2015 - Purpose tests

Questions:

- Can the CRA provide guidance on the application of the purpose test?
- In particular, what factors will the CRA consider when deciding whether the factual reduction of value was the purpose for declaring the dividend?
- Can the CRA describe the factors or tests they would consider in deciding whether a reduction of value is significant?

CRA round table November 2015 - Purpose tests

CRA response

- Although a dividend on a share would normally result in a reduction of value of the share, it's not the result that determines the application of proposed subsection 55(2.1)

- It's the purpose and the motivation behind the purpose that could be established by finding the answer to questions such as:

  - What does the taxpayer intend to accomplish with a reduction in value?

  - How would such reduction in value be beneficial to the taxpayer?

  - What actions did the taxpayer take in connection with the reduction in value?

CRA round table November 2015 - Purpose tests

CRA response *(continued)*

- Without limiting the application of the purpose test, a dividend that is directly or indirectly instrumental in the creation of an accrued loss on any share that may be used, or has the potential to be used, to shelter a gain on some other property provides an indication that the FMV reduction purpose exists (for example, one might consider transferring a property with an accrued income or capital gain to the corporation that issued shares that have an accrued loss).

- Furthermore, it is also necessary to ascertain that the purpose of the dividend is not to increase the cost of property. For example, and without limiting the application of the purpose test, the use or possibility of using an increased cost amount of properties to shelter a gain is an indication that the purpose of the dividend is to increase cost.

- Whether a reduction of value is significant is a question of fact and could be measured in terms of an absolute dollar amount or on a percentage basis.

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CRA round table November 2015 – Purpose tests

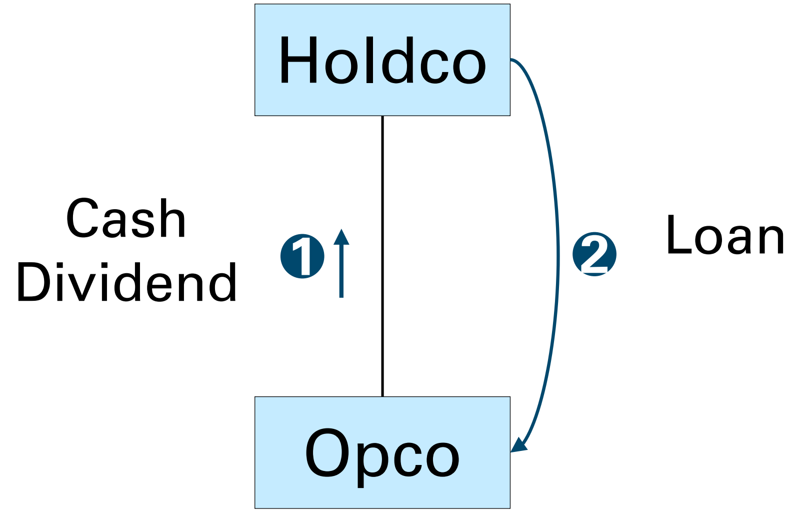
CRA response ***(continued)***

- The CRA said that where a dividend is paid pursuant to a well-established dividend policy and the amount of the dividend does not exceed a reasonable dividend return on equity on a listed share issued by a comparable corporation in the same or similar industry, the purpose of the dividend would not be described in proposed paragraph 55(2.1)(b)
- In response to a panel question as to whether the CRA would consider the payment of an annual dividend to distribute cash flow to fall under a well-established dividend policy, the CRA said that from a tax policy perspective a normal course dividend should not be subject to subsection 55(2)
- However, the CRA acknowledged that there is no definition of what constitutes a “normal course” dividend

Cash dividends - Asset protection

Scenario:

1. Opco pays cash dividend to Holdco
2. Holdco lends cash to Opco



Round table question: As there has factually been a significant reduction of value of Opco’s shares, can the CRA comment on whether proposed subsection 55(2) will apply? Will the securitization dividend and loan back have to be limited to safe income even if there is an apparent lack of intention to sell Opco from Holdco?

CRA round table - Nov 2015 - Creditor proofing

CRA response

The CRA said that they understand that a creditor-proofing transaction could be achieved by having Holdco lend money to Opco either before or after the payment of the dividend. When Opco pays a "lumpy" dividend such as in this creditor-proofing transaction in order to significantly reduce the value on the Opco shares, ***the apparent purpose of the payment of the dividend for the application of subsection 55(2) is to reduce the value on the Opco shares***. When such purpose is present, subsection 55(2) applies to the dividend. The CRA further elaborated on their response as follows:

The payment of a dividend that is in excess of the amount of the after-tax income of a corporation for the purpose of significantly reducing the value of the shares by essentially converting a significant amount of accrued value on a share of a corporation into full ACB debt that could be sold or repaid without any tax implication should be subject to tax under the scheme of the Act, as supported by proposed subsection 55(2).

The fact that the purpose of the dividend is also to achieve creditor proofing would not alter that conclusion.

55(2) and Creditor proofing

CRA document no.: 2015-0617731e5

In this technical interpretation, the CRA was asked whether one of the purpose tests would apply in the situation described below.

Scenario:

Holdco holds all the shares of Opco. The FMV of the shares is $1M and the ACB is $100. Opco has no safe income. In order to creditor-proof the assets, Opco pays a dividend of $1M to Holdco. Holdco then loans $1M to Opco.

The CRA indicates that it appears that one of the purposes of the payment of the dividend would be to effect a significant reduction in the fair market value of the shares. Subsection 55(2) would apply and the amount would be deemed not to be a dividend but a gain from the disposition pursuant to paragraph 55(2)(c).

CRA indicated that it appears that one of the purposes of the dividend would be the reduction in FMV of the share where the purpose of the transactions would be to shelter the assets from creditors or to secure the assets by reducing the total value of the operating company.

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Section 55 amendments - Summary

- New broader purpose tests
- 55(3)(a) related party exception no longer available except for share redemptions
- High-low stock dividends received by corporations now subject to 55(2) rules
- Part IV tax exception has been narrowed
- 55(5)(f) is no longer a designation

Section 55 amendments - Next steps

- **Check with KPMG Advisor on impact of large dividends within corporate group**
  - Cash dividends
  - Stock dividends
  - 84(2) deemed dividends on distributions of corporate funds or property
  - 84(3) deemed dividend on redemption, acquisition or cancellation of shares
  - Deemed dividends on paid-up capital increase

- **Keep safe-income calculations up-to-date on an ongoing basis**
  - Increased reliance on safe income (including foreign affiliate surpluses)

Human capital management

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The current situation…

Price of Oil	2014 Jun ~ $105	2016 Jun ~ $47	**$-55%**
Alberta Unemployment	2015 Jan 4.6%	2016 May 7.8%	**+3.2%**
Alberta Cap Ex	2014 Jan $97.8 B	2015 Jan $74.9 B	**-23.4%**

Source: Alberta Economic Dashboard, 2016

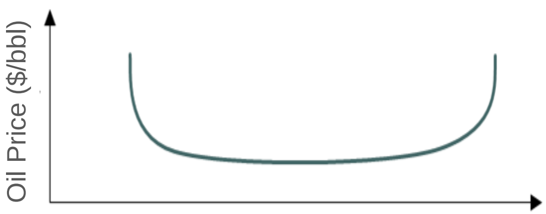
Refocus, reassess and reposition

The time is now…

Refocus

Consensus is shifting toward a "u-shaped" price recovery. This means we are in for a 'new normal'

'U-shaped' or 'Bathtub' (i.e. 1986)



Reassess

8-20 year time horizon

3-10 year time horizon

Immediate – 2 year time horizon

Reposition

To prepare for the 'new normal', companies need to take a data driven approach to people decisions, even as they react to changes in the external environment.

Source: KPMG, Evidence-based HR: The bridge between your people and delivering business strategy, 2015

Defining evidence-based HR

Evidence-based HR uses data, analysis and research to understand the connection between people management practices and business outcomes, such as profitability, customer satisfaction and quality.

Source: KPMG, Evidence-based HR: The bridge between your people and delivering business strategy, 2015

Top 5 benefits of evidence-based HR

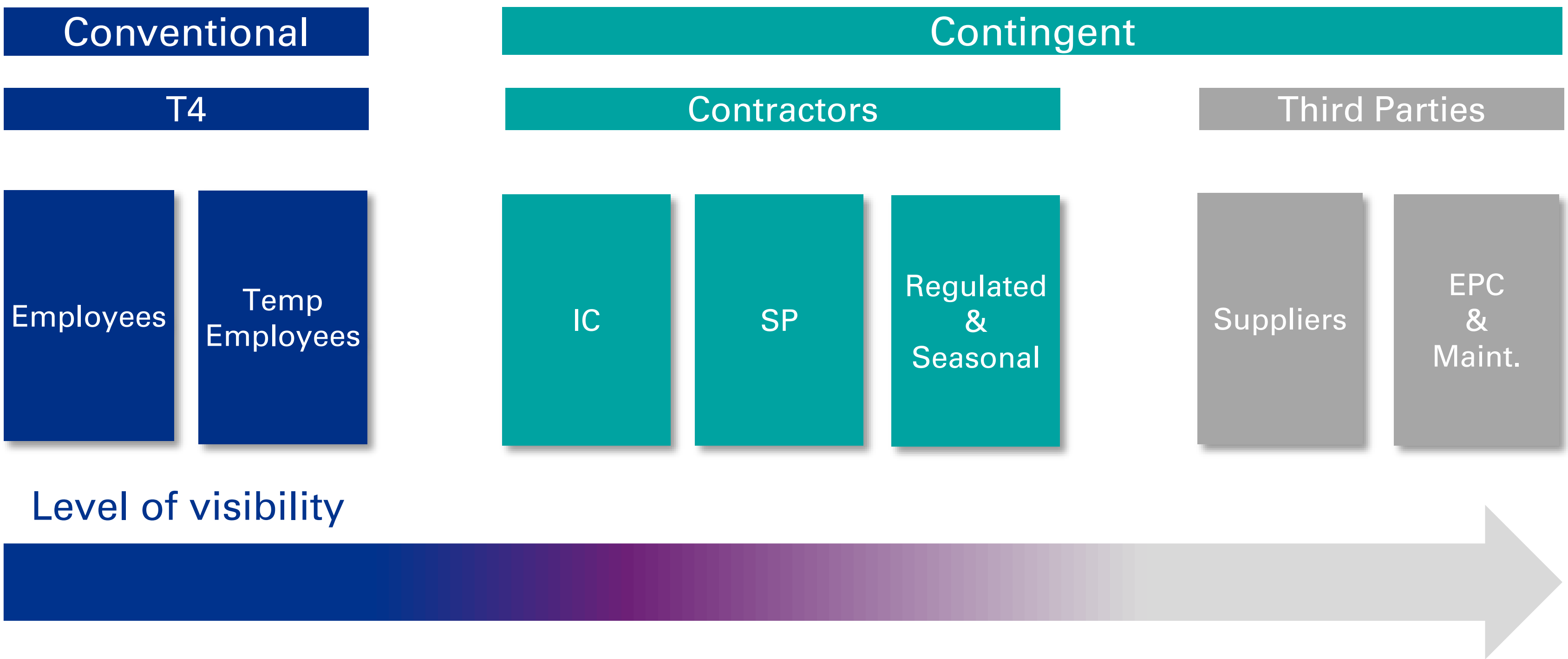
1	2	3	4	5
59%	43%	32%	29%	29%
Make HR more strategic	Enable HR to pinpoint which people practices drive the most business value	Enable HR to become more proactive in critiquing talent	Enable a fact-based assessment of the value of HR	Change talent management practices to align with evidence

% of respondents who indicated each choice as a benefit (top 3 picks)

Source: KPMG International's HR Advisory 2015 Global Pulse Survey

Contingent workforce analysis

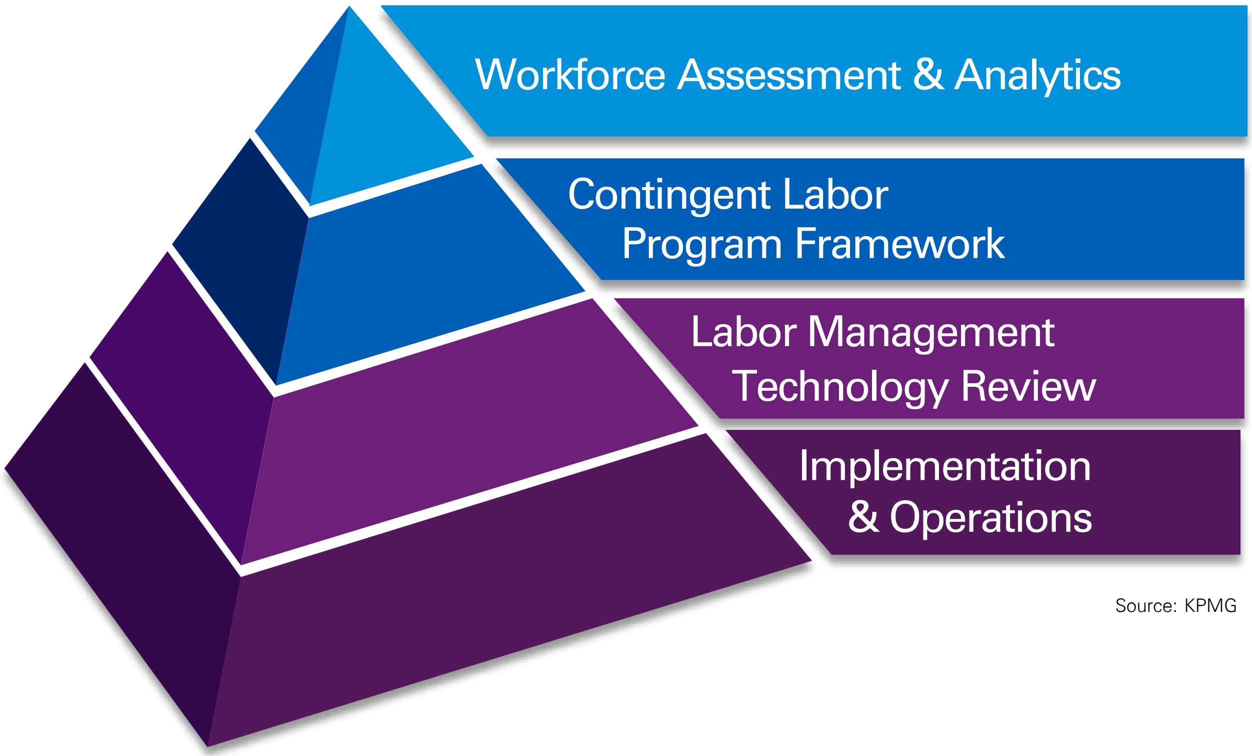
Evidence-based practice



Source: KPMG

The need to understand and manage the total workforce requirements, costs and demands is distressing our clients in the Energy sector.

Assessing your contingent workforce strategy



Source: KPMG

Contingent workforce can represent a significant spend category, in some companies ranging from 30-50%

Workforce assessment and analytics

Do you know **who** all of your workers are, **where** they are all located, and **what** they're all doing?

Do you know the **costs** and **risks** associated with them?

High Visibility

Low Visibility

Your workforce

Conventional T4
Employees
Temporary Employees

Contractors
I/C, S/P, Regulated, Seasonal

Third Parties
Suppliers, EPC Maintenance

Demographics
- *Headcount*
- *Location*
- *Categories*

Spend
- *Total cost*
- *Rate Analysis*
- *Variable Pay Assessment*

Vendor Landscape
- *IC*
- *Sourced*
- *Services*

Contract Assessment
- *MSA vs SOW*
- *Standardization*
- *Compliance*

Management Practices
- *Invoice Auditing*
- *Billing Practices*
- *AP Processes*

Value Realization Categories

Cost Savings

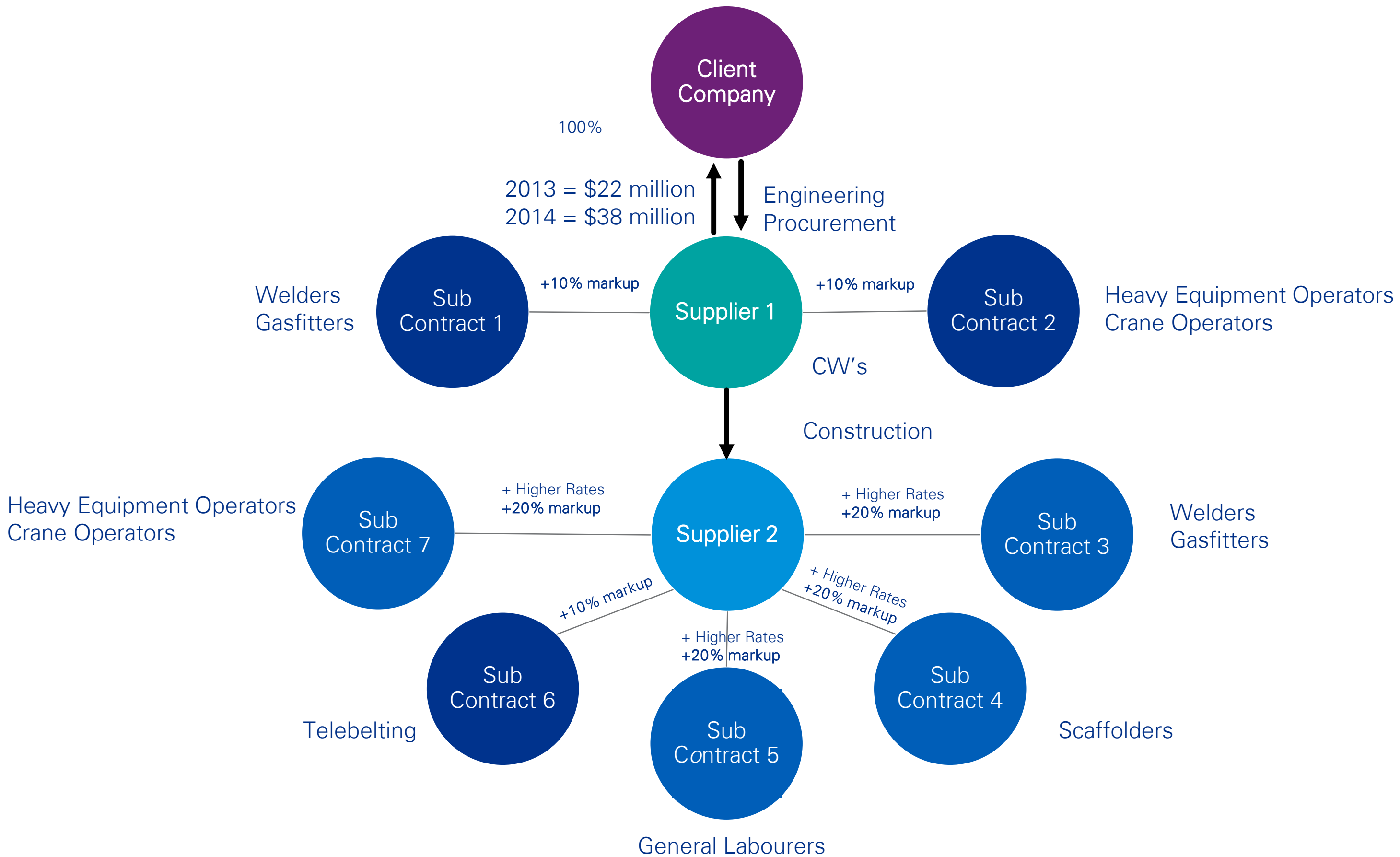
Risk Mitigation

Legal Compliance

Process Efficiencies

Source: KPMG

Hidden relationships



Source: KPMG

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Value Realization Categories

Cost Savings

Risk Mitigation

Legal Compliance

Process Efficiencies

Source: KPMG

Areas of savings

Determined for an organization with 400-500 contingent workforce

Areas of Focus	Category	Item	Workers	Impact per Year
Cost Savings	**Rate Inconsistencies**	$7.00 per hour reduction	34 workers	~$450,000 ($13,440 per worker)
	Overtime Management	$30.00 per hour removal	17 workers	~$650,000 ($38,000 per worker)
	Over Specification	$20.00 per hour reduction	10 workers	~$380,000 ($38,000 per worker)
	Bill Rate Analysis	$5.00 per hour	20 workers	~190,000
	Bill for Incorrect Rate	$5.00 per hour	15 workers	~145,000
	Leased Car Removal	$7,000 per vehicle	20 vehicles	~$140,000
	Avoidance of Markup's	Savings of 10% per CW	25 workers	~300,000 ($11,000 per worker)
	WCB Overpayments	$2,000 per worker	50 workers	~$100,000
Risk Mitigation	CRA Reclassification	$21,000 per worker	15 workers	~$320,000 + soft costs + costs to CW
	Employment Standards Obligations	$23,000 per worker	15 workers	~$360,000
Legal Compliance	AIT Act & Regulations	$15,000 per worker	20 workers	$300,000 + stop work orders
	Employment Standards	Exposure to fines & penalties	-	-
Process Efficiency	Savings through process improvements and increased efficiencies in workforce management			

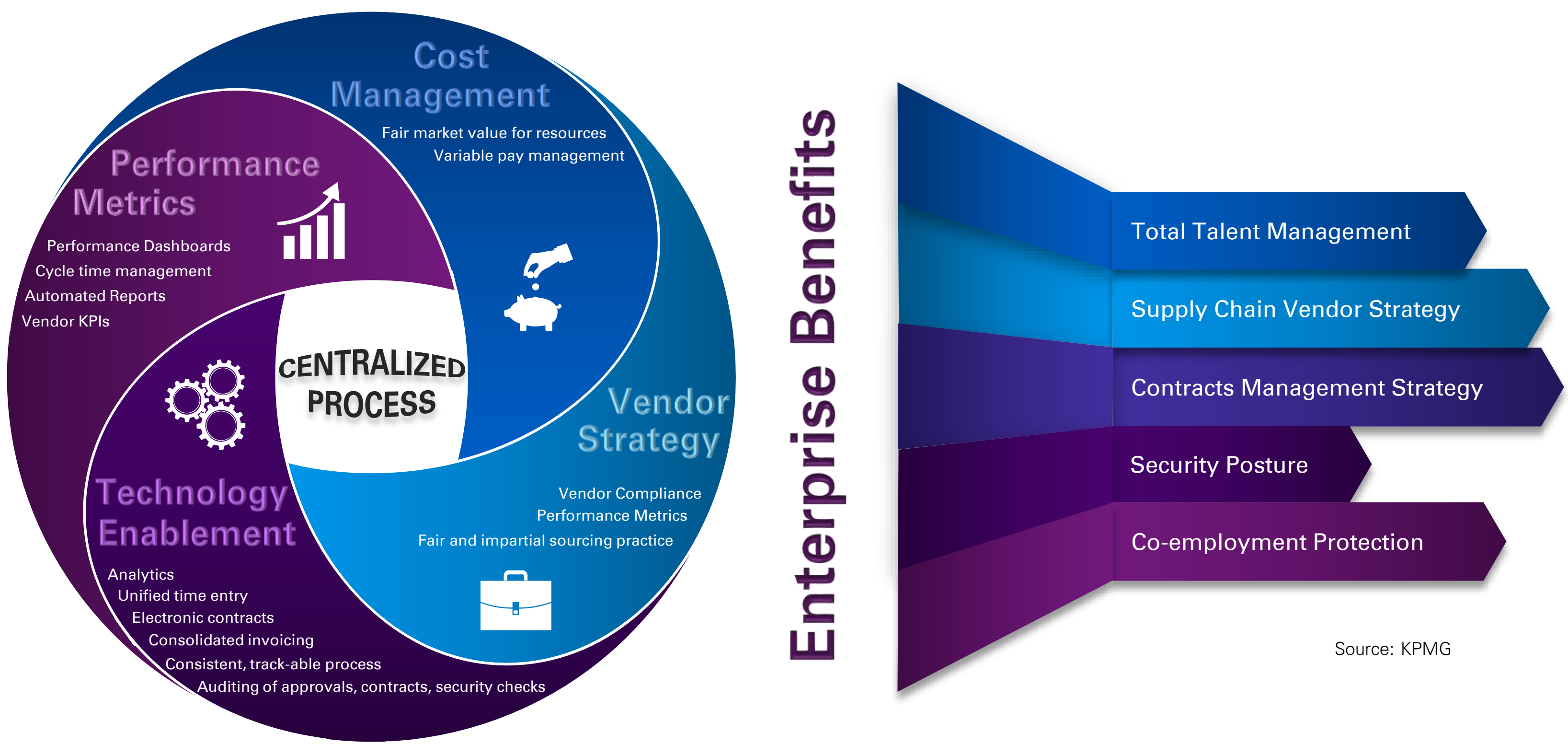
Overall Annual Savings Identified ~ $2M+

Source: KPMG

Assumptions:

- CW's base rate = $60/hour and $115,200 per annum
- 48 weeks of work per year

Contingent labor program framework



Source: KPMG

Analytics to drive workforce strategy

In conclusion an evidence based approach can help you…

1. Align business strategy with HR
2. Determine ROI on your people practices
3. Find hidden costs and act to eliminate them
4. Business case for management program

Questions?

Download today's presentation
kpmg.ca/quarterlyupdate

Thank you

kpmg.ca