KPMG Enterprise

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Overview of SOC 1, SOC 2 and SOC 3 reports

By: ***Bing Lin****, Manager, IT Advisory*

In this issue

Organisations are increasingly outsourcing systems, business processes, and data processing to service providers in an effort to focus on core competencies, reduce costs, and more quickly deploy new application functionality. Many organisations have historically relied upon Statement on Auditing Standards (SAS) 70 reports to gain broad comfort over outsourced activities. SAS 70 was intended to focus specifically on risks related to internal control over financial reporting (ICOFR), and not broader objectives such as system availability and security. With the retirement of the SAS 70 report in 2011, Service Organisation Control (SOC) reports have been defined by the American Institute of Certified Public Accountants (AICPA) to replace SAS 70 reports and more clearly address the assurance needs of the users of outsourced services. Three types of SOC reports, SOC 1, SOC 2, and SOC 3 have been defined to address a broader set of specific user needs (summarised below).

	SOC 1	SOC 2	SOC 3
	• Internal control over financial reporting	• Operational controls	
Summary	• Detailed report for us users and their auditors	• Detailed report for users, their auditors, and specified parties	• Short report that can be more generally distributed
Defined scope of system	• Classes of transactions • Procedures for processing and reporting transactions • Accounting records of the system • Handling of significant events and conditions other than transactions • Report preparation for users • Other aspects relevant to processing and reporting users transactions	• Infrastructure • Software • Procedures • People • Data	
Control domain options	• Transaction processing controls • Supporting information technology general controls	• Security • Availability • Confidentiality • Processing integrity • Privacy • SOC 2+ additional criteria	
Level of standarisation	• Control objectives are defined by the service provider, and may vary depending on the type of service provided.	• Principles are selected by the service provider. • Specific predefined criteria are evaluated against rather than control objectives.	

SOC 1 reports require a service organisation to describe its system, and define its control objectives and controls that are relevant to users' internal control over financial reporting. A SOC 1 report generally should not cover services or control domains that are not relevant to users from an ICOFR perspective, and it specifically cannot cover topics such as disaster recovery and privacy.

In contrast, SOC 2 and SOC 3 reports use the Trust Services Principles, and Criteria, a set of specific requirements developed by the American Institute of Certified Public Accountants (AICPA), and the Chartered Professional Accountants of Canada (CPA Canada) to provide assurance beyond ICOFR. Principles, and Criteria are specifically defined for Security, Availability, Confidentiality, Processing Integrity, and Privacy. This has been done in a modular way so that a SOC 2 or SOC 3 report could cover one or more of the Principles depending on the needs of the service provider, and its users.

SOC 1 Financial Reporting Controls	⟷	**SOC 2 and SOC 3**
• Financial services • Asset management and custody services • Healthcare claims processing • Payroll processing • payment processing	• Cloud ERP service • Data center colocation • IT systems management	• Cloud-based services (Saas, PaaS, IaaS) • HR services • Security services • E-mail, collaboration, and communications • Any service where customers' primary concern is security, availability, or privacy

Financial/Business Process and Supporting System Controls

- Security
- Availability
- Confidentiality
- Processing Integrity
- Privacy

The table above has been developed to help determine what type of SOC report is most applicable regarding certain controls and services. Starting at the left end of the spectrum, there are services that are clearly financial reporting oriented, and where it is likely SOC 1 reports will be requested, and provided. These include financial services as well as processing for healthcare claims, payroll, and payment.

In addition, there may be some cases where users require more detail on security or availability. In these cases, the service provider might provide a SOC 1 report for ICOFR purposes, and a SOC 2 or SOC 3 report to address security/availability assurance needs if the demand for such reports or the burden of accommodating users' security audits is great enough.

In the middle of the table are services that don't neatly fit into one category or the other. Depending on the specific nature of services provided, and user needs, SOC 1, and/or SOC 2 may be most applicable. For example:

- A cloud-based ERP service historically would have provided a SAS 70 report because it provided a core financial reporting service to users. It is likely that it would continue to provide a SOC 1 report for that same reason. However, it may also have a need to provide a SOC 2 or SOC 3 security, and availability report to address user assurance needs specific to cloud services.
- Many data center colocation providers have historically completed SAS 70 examinations limited to physical and environmental security controls. However, most data center providers host much more than just customers' financial systems. As a result, leading providers are moving toward SOC 2 security reporting. Some service providers incorporate supporting environmental security controls within their SOC 2 security report, whereas others also address the Availability Criteria depending on the nature of their services.
- For IT systems management, which can include general IT services provided to a portfolio of users as well as customised services provided to specific users, SOC 1 or SOC 2 reporting could be applicable, depending on whether users' assurance needs are more focused on ICOFR or security/availability.

At the other end of the spectrum, there are services that are operational, and technology focused with very little, if any, direct connection to users' ICOFR.

For example, these types of outsourced services are unlikely to be included within a public company's Sarbanes-Oxley (SOX) 404 scope. Users of these services are typically most concerned about security of their data, and availability of these systems, which can be addressed by a SOC 2 or SOC 3 report covering Security, and Availability. Where applicable, SOC 2/ SOC 3 reports can cover Confidentiality, Processing Integrity, and/or Privacy as well. SOC 2 is also potentially applicable for any organisation that is storing, and processing sensitive third-party data.

Where there is a need to demonstrate to third parties that effective Security, and Confidentiality controls are in place to protect that information, SOC 2, and SOC 3 provide a mechanism for providing assurance. Through the system description in the report, the organisation clearly describes the boundary of the "system", and the examination is then performed based on the defined Trust Services Criteria.

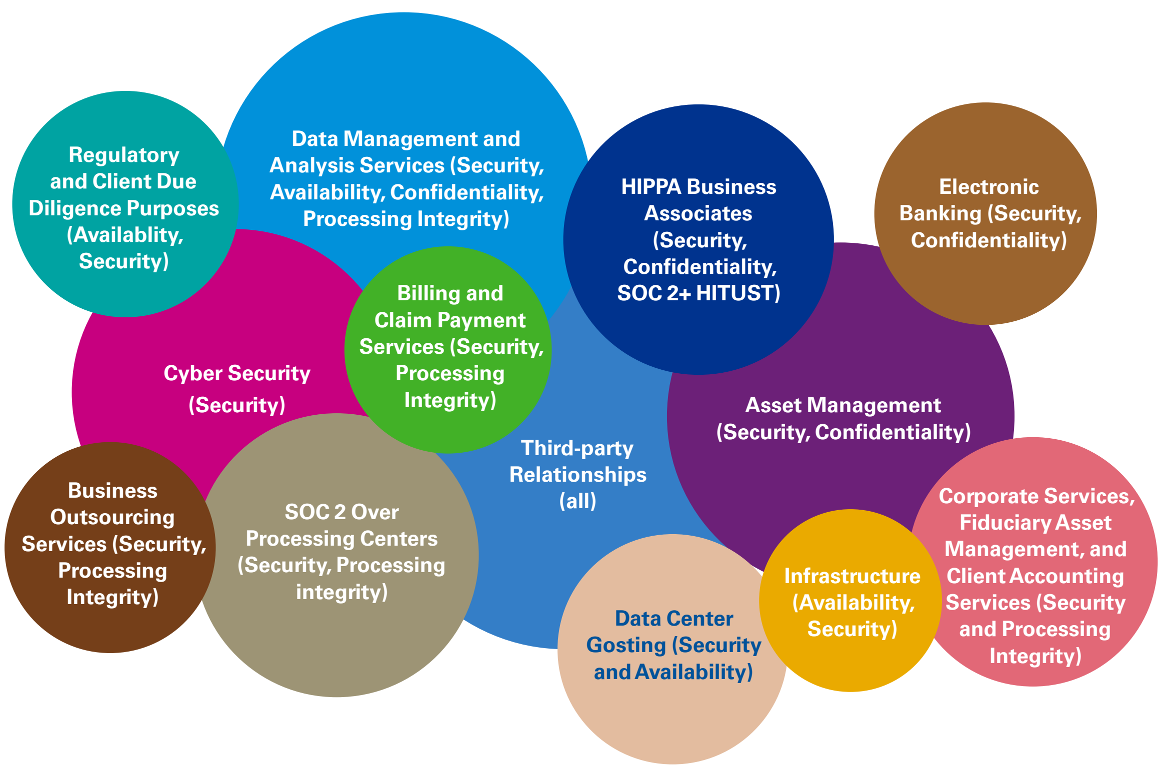
Contrasting the level of detail provided by SOC 2 and SOC 3 reports

As discussed earlier, SOC 2 and SOC 3 reporting both use the Trust Services Principles and Criteria, and the auditor's work is substantially the same. Having determined which Principles are most relevant to its users, a service provider will need to determine whether detailed SOC 2 reporting or summary level SOC 3 reporting will satisfy the needs of its users. In both cases, a detailed examination is performed based on the specific Criteria; however, the SOC 2 report includes detailed information on the service provider's controls, and the auditors' individual test procedures and results.

	SOC 2	SOC 3
Common benefits	• Detailed report based on defined criteria for Security, Availability, Confidentiality, Processing Integrity,and/or Privacy • Report includes a description of the system • Report includes a management's assertion regarding controls	• Where subservice providers are used, management may include its monitoring controls over those operations. • Report includes a description of the system • Report includes management's assertion regarding controls
Unique benefits	• SOC 2 is more flexible than SOC 3 for the service provider in that it permits carve-out of supporting services provided by subservice providers. • SOC 2 includes detail on the service provider's controls as well as the auditor's detailed test procedures and test results, enabling the reader of the report to assess the service provider at a more granular level.	• SOC 3 provides an overall conclusion on whether the service provider achieved the stated Trust Services Criteria, and the user does not need to digest pages of detailed control descriptions and test procedures. • May be distributed publicly; no limits to distribution
Potential drawbacks	• The user may need to obtain additional reports from applicable subservice providers to gain comfort over their activities. • The user may not want to review the detail of the report (controls, tests, etc.) rather than an overall conclusion • Distribution of the report is more limited than SOC 3	• SOC 3 does not permit carve-out of significant subservice provider activities. If it is not feasible to cover those activities as part of the service provider's audit, SOC 3 is not an available option.

How companies are considering SOC 2 and SOC 3 reports

Below is chart showing how companies are considering SOC 2 and SOC 3 reports. A company can select any combination of principles from Security, Availability, Confidentiality, Processing Integrity, and Privacy. Moreover, a company can consider a SOC 2 Enhanced Reporting, where the report includes mappings to demonstrate alignment of tested controls with the requirements of a specific standard or common vendor security questionnaire topics or consider a SOC 2 report plus additional criteria or additional subject matter based on other standards and specifically covered by opinion (i.e. Cloud Security Alliance Cloud Controls Matrix, COBIT, COSO 2013 Framework, HITRUST, ISO 27001, NIST 800-53 Framework).



Point of view on the use of SOC reports from both user and service organisations

From the user organisation point of view, a SOC report allows the user organisation to gain insights into the control environment at the service organisation, over which the user organisation does not have direct control, but is often required to demonstrate an effective monitoring mechanism is in place. With more and more processes being outsourced, SOC reports have become an integral component of user organisations' governance structure over various vendors.

From the service organisation point of view, a SOC report is a competitive advantage and can distinguish itself as a professional organisation and increase the customer's confidence. Going through a SOC report project offers an opportunity to further enhance the service organisation's internal control of the processes and increase transparency and standardisation of the processes; it enhances the 'control' mindedness within the organisation. Last but not least, a SOC report can result in fewer checks of the control environment at the service organisation by its customers.

In our Bermuda market, we have a wide variety of service organisations serving customers both locally and internationally. At the same time, the local user organisations could be using service organisations both on the island and overseas. With cyber security concern and regulatory compliance requirements on the rise, including the recently released Personal Information Protection Act (PIPA) effectively using SOC reports can help organisations achieve increased assurance over outsourced operations.

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On the horizon: ASPE's Update

By: **Felicia Govender** Senior Manager, KPMG Enterprise

Private Enterprises

When Canada's Accounting Standards Board (the "Board" or "AcSB") published Accounting Standards for Private Enterprises (ASPE) in 2009 for implementation in 2011, the AcSB committed to minimising the frequency of changes to the standards to enhance their cost effectiveness. In keeping with that commitment, the AcSB published two standards in 2014, Interests in Joint Arrangements and Subsidiaries, and amended Section 3051 Investments. The new and amended sections are effective for fiscal years beginning on or after January 1, 2016. As enumerated below, the Board also continued its annual improvements process with several minor improvements becoming effective in 2015.

Developments in Accounting Standards for Private Enterprises

Updates to ASPE are done in two ways:

- Through Major Improvements, and
- Through Annual Improvements for clarifications on guidance or wording, or to correct for relatively minor unintended consequences, conflicts or oversights.

New Guidance Issued/Guidance Effective in 2016

Joint Arrangements
The Board published the new *Section 3056 Interests in Joint Arrangements* in September 2014, replacing Section 3055 *Interests in Joint Ventures*. Significant changes are as follows:

Jointly Controlled Operations and Jointly Controlled Assets
Section 3056 requires an investor with an interest in jointly controlled operations or jointly controlled assets to recognise its interest in the individual assets, obligations, revenues and expenses of the joint arrangement. This accounting is similar to the proportionate consolidation method of accounting from Section 3055, but may produce different results depending on the details of the joint arrangement.

Jointly Controlled Enterprises
An investor in a jointly controlled enterprise may account for that interest using the equity method or cost method. If the investor has the rights to the individual assets and the obligations for the individual liabilities, the investor would have an accounting policy choice to recognise its share of assets controlled, liabilities incurred, revenues and expenses. To adopt this policy option, the investor would be required to undertake an analysis to demonstrate it has the rights to the individual assets and obligations for the individual liabilities, and not an interest in the net assets of the jointly controlled enterprise.

Contributions and Transactions
Section 3056 does not carry forward the requirement in Section 3055 for the investor to defer and amourtise the portion of a gain resulting from a transaction between an investor and a joint arrangement that does not relate to the amount of cash received or fair value of other assets.

The new standard is effective for fiscal periods beginning on or after January 1, 2016. Early adoption is permitted.

The Board has provided transitional provisions to minimise the cost of adopting the new standard as follows:

- When an investor must transition from proportionate consolidation to cost or equity, the investment in the net assets of the joint arrangement should be measured at the beginning of the earliest period presented at an amount equal to the aggregate of the carrying amount of the assets and liabilities that the investor had previously proportionately consolidated.
- When the investor must transition from the cost or equity method to directly accounting for interest in individual assets and obligations for the individual liabilities, the investor has the option to use either the carrying amounts of the assets and liabilities in the financial statements of the joint arrangement at the beginning of the fiscal year immediately preceding adoption or the fair value of the assets and liabilities of the joint arrangement on the same date.

Investments
In conjunction with the issuance of Section 3056 Interests in Joint Arrangements, the

Board amended Section 3051 Investments to provide clearer guidance on how to account for transactions, including contributions, between an entity and an equity-accounted investee to be consistent with Section 3056, such that any gain or loss is recognised in income only to the extent of the interests of the other non-related investors, except where the transaction provides evidence of reduction in net realisable value or carrying amount of the relevant assets.

Consolidations

The Board published the new Section 1591 Subsidiaries in September 2014. The new section provides amended guidance on circumstances in which an enterprise controls another entity through mechanisms other than voting rights associated with a majority shareholding. With the issuance of the new standard, the existing accounting guideline AcG-15 Consolidation of Variable Interest Entities was withdrawn, fulfilling a commitment made by the Board when ASPE were originally published. The following is a synopsis of key changes due to the new section:

- In assessing whether an entity has control through mechanisms other than voting rights, consideration would be given to:
  - Involvement of the entity in establishing the purpose and design of the other entity;
  - How decisions are made about strategic policies of the other entity that could affect the right and ability to obtain future economic benefits and related risks;
  - Risks to which the other entity was designed to be exposed;
  - Call rights and put rights, liquidation rights and rights to make decisions about activities that affect the entity's ability to obtain future benefits; and
  - Rights that are designed to protect the interest of the entity holding those rights without giving it control would need to be distinguished from rights that confer control.
- Contractual arrangements between entities under common control are excluded from the scope of Section 1591. Such arrangements are to be accounted for according to the nature of the contractual arrangement (e.g., as a lease). This relief from the application of the control concept is expected to provide significant cost savings for private companies.

The new standard is effective for fiscal periods beginning on or after January 1, 2016. Early adoption is permitted.

The Board has provided transitional provisions to minimise the cost of adopting the new standard as follows:

- The controlling entity has the option to measure the assets, liabilities and non-controlling interests of a subsidiary that was not previously consolidated using either the acquisition method or the carrying amounts of the assets and liabilities of the previously unconsolidated enterprise based on the information available. An enterprise would be permitted to measure any item of property, plant and equipment at fair value at the beginning of the comparative period.
- If information is lacking, the enterprise would measure the assets, liabilities and non-controlling interest of the previously unconsolidated enterprise by applying the acquisition method without recognising any goodwill or intangible assets, as at the beginning of the comparative period.

Annual Improvements

2014 Annual Improvements

In October 2014, the Board issued the following amendments to Section 3856 Financial Instruments, which are effective for annual periods beginning on or after January 1, 2015:

- Clarification that if a reporting period ends between the date a hedged transaction occurs and the date the hedging item matures, the hedging item is re-measured at the balance sheet date using the spot rate in effect at that date, with any gain or loss included in income.
- Clarification of the disclosure requirements for trade accounts receivable. Prior to the amendment, Section 3856 required an entity to disclose the carrying amount of impaired financial assets by type of asset, and the amount of any related impairment. The amendment recognises that for certain financial assets, such as accounts receivable, impairment may be assessed on a group basis and as result the disclosure requirement for the allowance for doubtful accounts for trade receivables should be the allowance in total.

2015 Annual Improvements

In October 2015, the Board issued the following amendments which are effective for annual periods beginning on or after January 1, 2016:

- Amendment to Section 1582 Business Combinations to make clear that where a business combination is achieved through the direct acquisition of assets and assumption of liabilities rather than an acquisition of a subsidiary, the requirement to disclose the amounts recognised for each major class of assets acquired and liabilities assumed applies.
- Amendment to Section 3051 Investments and Section 3065 Leases to require the disclosure of the amount of any impairment loss or reversal of a previously recognised impairment loss, similar to the requirement for financial instruments under Section 3856 Financial Instruments.
- Amendment to Section 3061 Property, Plant and Equipment to remove specific wording that could have implied that there is a requirement to disclose the amount amourtisation for each item of property, plant and equipment.
- Amendment and additions to Section 3462 Employee Future Benefits to provide clarification as to when a funding valuation can be used to measure the defined benefit obligation for a defined benefit plan.

Other Projects

Redeemable Preferred Shares Issued in a Tax Planning Arrangement – a Liability

The Board and the Private Enterprise Advisory Committee have discussed the suggestions received from stakeholders in response to the AcSB's Exposure Draft, Redeemable Preferred Shares Issued in a Tax Planning Arrangement, which was issued in October 2014. Those suggestions included:

- amending paragraph 3856.23 to remove references to specific sections of the Income Tax Act and instead restrict the use of the paragraph by describing the types of transactions to which it applies;
- providing application guidance to support the use of judgment in determining when the paragraph is applicable and to address application issues, such as the requirement to reclassify as a liability "when redemption is demanded";
- adding disclosure requirements to better inform users about the nature of the arrangement that gave rise to the issuance of the preferred shares and the characteristics of those shares; and
- allowing an accounting policy choice, as was previously permitted under pre-changeover GAAP.

At its May 2015 meeting, the Board decided that the effective date of any change will be no earlier than January 1, 2018.

Agriculture

The Board continues its work on a project for accounting for biological assets held by agricultural entities. The project is intended to address issues including whether biological assets are inventories or property, plant and equipment, initial and subsequent measurement of such assets and how to account for agricultural produce at the point of harvest. The Board expects to issue a discussion paper in December 2015 which will discuss the measurement of agricultural produce and animals held for sale and present the Board's preliminary view that these types of biological assets should be measured at current value, provided certain conditions are met, or cost, when those conditions are not met. The discussion paper will also include potential disclosures related to current value.

Subsidiaries and investments subject to significant influence accounted for using the cost method

The Board has issued an exposure draft proposing to amend Section 1591 Subsidiaries and Section 3051 Investments to address the accounting for a subsidiary and an investment subject to significant influence when the cost method is used. The Board recognises that there has been diversity in practice in the application of the cost method. The underlying principle of the exposure draft is that a consistent approach should be applied to investments and interests in subsidiaries that are accounted for using the cost method; the initial measurement of an interest in a subsidiary that is subsequently accounted for using the cost method should be on a basis similar to other business combinations, specifically as it relates to acquisition related costs, contingent consideration, pre-existing relationships and subsequent accounting for contingent consideration.

The key aspects of the Exposure Draft on Subsidiaries are as follows:

- Initial cost would be measured at the acquisition-date fair value of the consideration transferred, including contingent consideration. Contingent consideration is re-measured when the contingency is resolved.
- Acquisition-related costs are expensed as incurred.
- Pre-existing relationships would be required to be separately identified and settlement of such relationships are considered a separate transaction.
- No recognition of bargain purchase gains (i.e., "negative goodwill").
- For a step acquisition, no re-measurement of the previously held interest. This includes where acquisition related costs have been capitalised in accordance with Section 3856 Financial Instruments. It would however be required to consider whether the cost of the additional interest acquired indicates impairment.
- At a reporting date, where the initial accounting is incomplete as a result of working capital adjustment clauses or other reasons, the carrying amount of the interest in the subsidiary is based on provisional amounts. Such provisional amounts are adjusted in the period they are finalised, with the measurement period not to exceed one year from the acquisition date. Adjustments to provisional amounts are not retrospectively recognised in the prior period.

The key aspects of the Exposure Draft on Investments Subject to Significant Influence are as follows:

- Initial cost would be measured at the acquisition-date fair value of the consideration transferred.
- Acquisition-related costs are expensed as incurred.
- For acquisitions of additional interests there is no re-measurement of previously-held interest. This includes where acquisition related costs have been capitalised in accordance with Section 3856 Financial Instruments. It would, however, be required to consider whether the cost of the additional interest acquired indicates impairment.

Ways KPMG can help

KPMG professionals assist clients in understanding their financial reporting framework, be it IFRS, ASPE, or standards applicable to not-for-profit or public sector organisations or pension plans. Additionally, we have a range of publications and resources addressing developments in these areas and the implications for enterprises following Canadian private enterprise GAAP.

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Senior Moment

By: ***Steve Woodward,*** *Managing Director, KPMG Enterprise*

Focusing on the next generation does not remove the need for the older generation to play their part.

When families start to focus on their succession plans, there are many helpful options available for those who are interested in developing the next generation. However, this process inevitably raises the question of balance between the generations. This was clearly stated by a next generation member who asked: ‘Why is succession always about us?’ She continued: ‘Why are we always the problem when, let’s face it, no matter how well educated I am or how many next-gen courses I’ve attended, succession isn’t going to happen until the seniors let go of power? I cannot take what has not been offered. At worst, my generation is only half of the problem.’

She has a point. The seniors need to decide, for example, if they are financially secure independent of their stake in the family enterprise. If they are not, they are unlikely to let go. But, even if they feel they have enough in financial terms, they also need to decide what they will do after they stop devoting so much time to the family enterprise, including enjoying whatever reputation and status this bestows.

These challenges cannot be solved entirely by investing more time and money in preparing the next generation to take over. At least as much effort needs to be invested in helping the seniors face up to the emotional and financial challenges they will encounter in the next stage of their lives.

In reality, family members will often find that the answers they need in succession planning depend on what the other generation decide to do. Often:

- Seniors feel they cannot plan retirement until the next generation make up their minds about whether they want a career in the family enterprise.
- The next generation wants to settle down but can’t get an answer from seniors who are not yet ready to commit to succession and retirement planning.
- The next generation are too young to be bothered about making choices but feel under pressure to do so because this suits older parents who want to know what is happening.

Age and adult development trajectories add to the inter-generational dynamics of an enterprising family. Transitions tend to be smoother when both generations are in sync, meaning each generation is at the age and stage to make the personal changes in their lives that are at the heart of succession planning.

For example, the transition between seniors aged 60-70, who are looking to build a structure for retirement, and a next generation aged 35-45 is likely to be easier than if the next generation is 19-25. The 19-25 stage of life involves exploring options for the life you want (where to live, relationships, career options), so settling for a role in the family business may seem unattractive when there are still many other avenues to explore. However, as mid-life approaches (35-45), there is a stronger inclination to make choices and have a more established life structure.

Transitions in a family enterprise are easier if well timed and family members and advisers should pay heed to the demographic reality of a family when planning the succession conversation. If the family are not in sync it might be better to nudge the process along, rather than putting people under pressure to have discussions and make decisions prematurely.

It also helps both generations ease into the conversation if they understand the wishes of the other. On the basis that a problem shared is a problem halved, here is an agenda for the generations in a family enterprise to start the discussion — together:

1. What do you enjoy about your current stage of life?
2. What do you find tough or dislike?
3. What would you like to ask the other generation?
4. Is there any advice you would offer them?
5. What do you think the other generation are concerned about, given their age and stage?
6. How do you think they feel about the succession process?

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2016 Caribbean Hospitality Financing Survey

By: **Steve Woodward,** *Managing Director, KPMG Enterprise*

KPMG recently launched its 12th annual Caribbean Hospitality Financing Survey, highlighting financing trends in the region's hospitality and tourism industry and the outlook for the future of the industry.

The survey findings were presented by Steve Woodward, Managing Director and Head of KPMG Enterprise in Bermuda at the Caribbean Hotel and Resort. Investment Summit ("CHRIS") in Miami, Florida. This year's survey included contributions from three out of four of Bermuda's tasks.

This is the third year where we have expanded our survey beyond only banks to also include non-bank capital providers such as equity and mezzanine investors. It is becoming increasingly clear that "non-banks" provide a different perspective to the financing issue and they are proving to be a very welcome addition to our survey. Non-banks are consistently more confident than banks about the prospects for Caribbean tourism over the next 12 months. They also indicated a greater willingness than banks to contemplate a lending opportunity in the Caribbean.

Although banks' confidence levels were not as high as those of non-banks, it should be noted that they still continue to rise and are now at levels almost twice those experienced in 2009.

Industry Outlook

Confidence is higher than it has been for many years; liquidity is high and yet there is no readily available capital for tourism projects in the Caribbean.

This seemingly paradoxical state of affairs has been prevalent for several years now and appears to be strengthening and becoming more acute rather than resolving itself.

Banks are more confident than they have been in the last 10 years and their confidence levels have increased every year for the last seven years, as can be seen below.

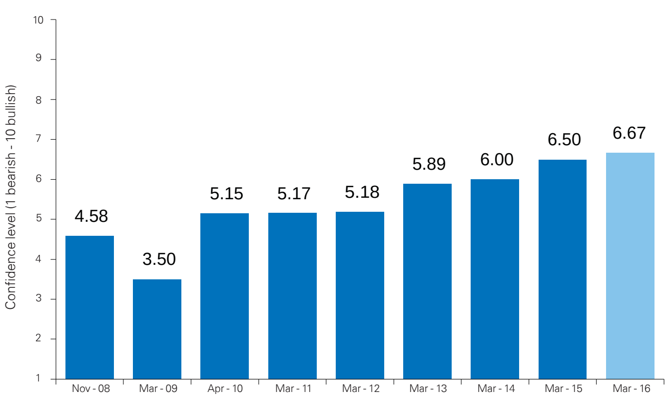
The differential in confidence between banks and non-banks is not as acute as last year because non-banks confidence levels have dropped slightly albeit remaining at very high levels.

When will meaningful growth in tourism return to the Caribbean?

Most (67%) of non-banks think meaningful growth has already returned to the Caribbean, whilst half of bank respondents feel the same way.

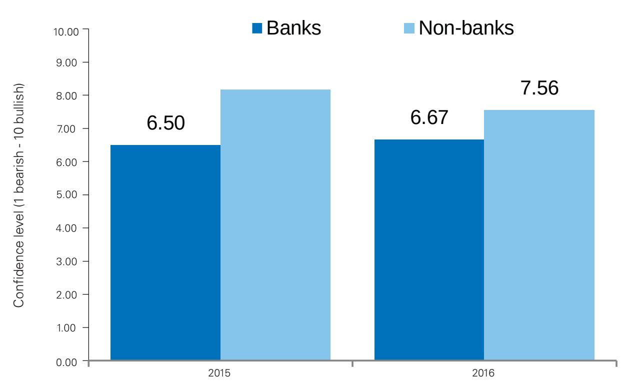
As we saw last year those respondents who do not think meaningful growth has already returned tend to think there is still a long way to go. For example, 33% of both banks and non-banks think it will be at least 2017 before meaningful growth returns.

Caribbean Financier Confident Barometer - Banks

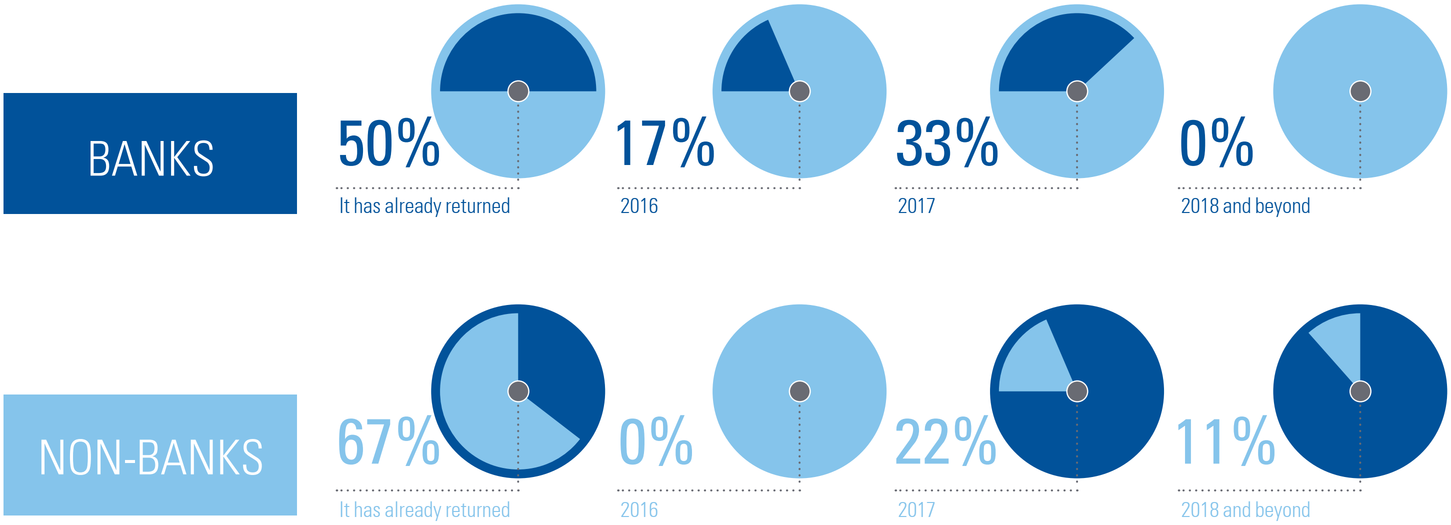


Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey

Caribbean Financier Confident Combined Barometer



Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey



Why so conservative?

Banks provided insight into why the more favourable economic environment is generally not translating into more available capital for tourism related projects.

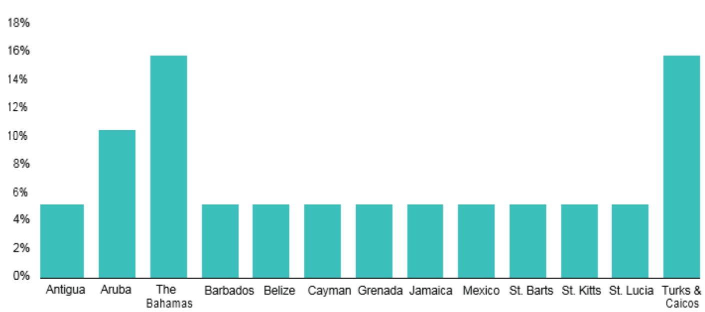
Non-banks provided an excellent explanation of what happens as soon as you move away from the preferred template comprising almost mandatory characteristics such as good airlift.

They also provided additional insight on the conservative financing environment.

When looking at which destinations in the Caribbean financiers are most bullish about in terms of financing opportunities, the responses were very informative. The large number of destinations nominated by respondents supports the argument that the financing landscape has indeed changed and increasingly there is evidence of financiers favoring certain jurisdictions rather than the region as a whole. Only six countries were nominated by both banks and non-banks and, for non-banks in particular, the countries nominated differed greatly from one respondent to another.

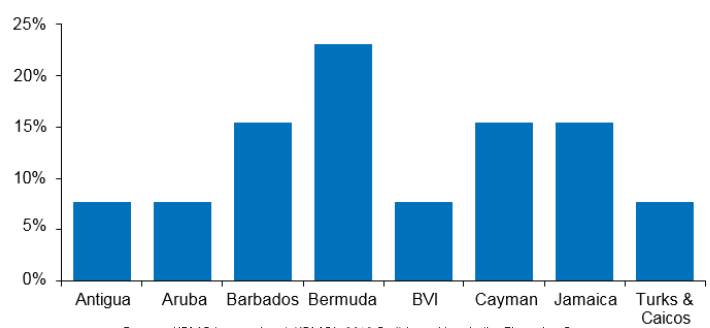
Regarding the terms of financing there have been no significant changes - if anything a slight "softening" of terms. The big issue is not the terms, rather it is whether or not financing can be secured. It is highly unlikely that there is anything in the average loan terms that will prevent an investor moving forward if they have reached the fortunate position of seriously negotiating such terms with a financier.

Non-banks' top countries for new financing



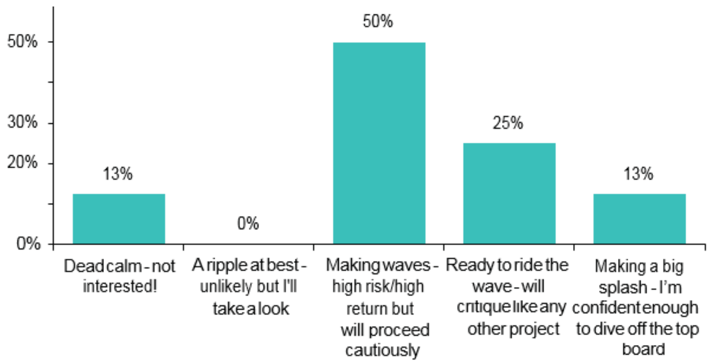
Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Bank's top countries for new financing

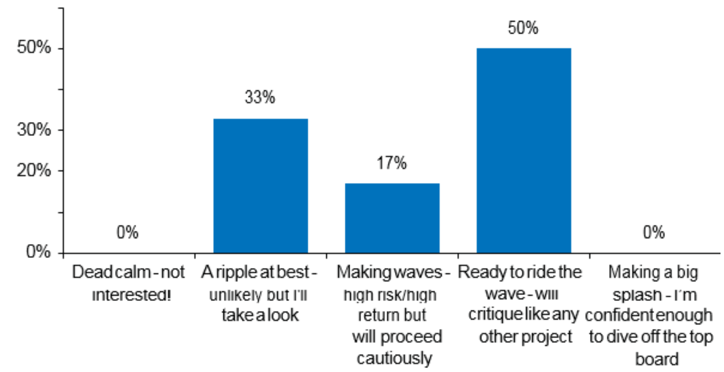


Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

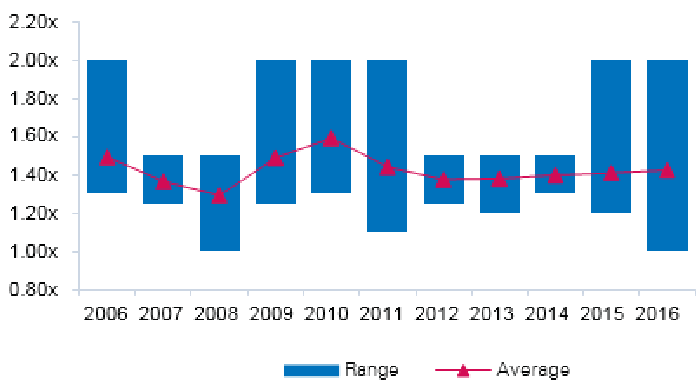
Non-banks' willingness to lend in the Caribbean



Banks' willingness to lend in the Caribbean

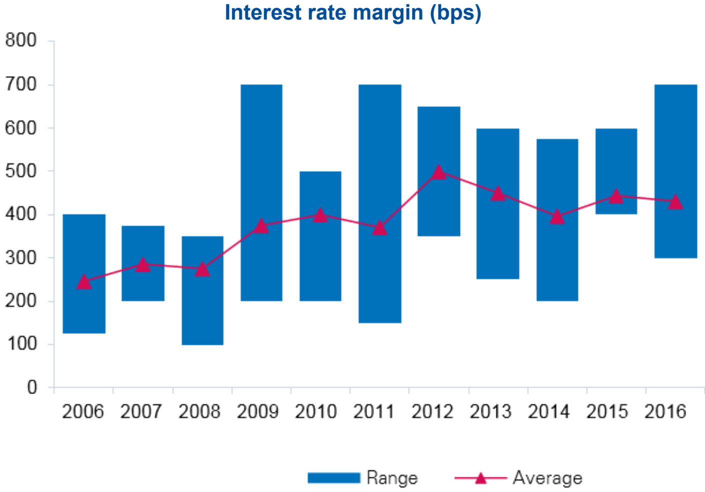


Debt service coverage ratio



Loan to value

Interest rate margin (bps)



Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Other Trends

No longer can anyone in the region claim not to understand the critical issues impacting financing activity in the region. For several years there has been remarkable consistency in the responses of the financial community. Once again airlift was identified as the most critical issue by all banks and non-banks. Again the ability to secure debt and equity financing was the second most critical issue for banks (83%) and non-banks (89%).

Emerging Opportunities

We asked survey participants what single new opportunity excited them most and filled them with optimism about the future of the tourism industry in the Caribbean. In terms of single events or projects, The Americas Cup in Bermuda in 2017 received an honourable mention.

However, most respondents preferred to concentrate on factors such as improvements in key performance indicators and the general financing environment.

In terms of new activities that could boost activity in the region, Economic Citizenship was raised again, as in prior years. On this subject responses were passionate and polarised.

We have already addressed the importance of the U.S. as the region's primary source market for capital and tourists. When asked which other markets have the most potential we received a wide variety of responses - China, Latin America, Canada, U.K and, less predictably, Turkey.

In closing, we return to the issue of the change in landscape. Almost without exception respondents indicated that there has been a change in the "major players" lending in the region and most believe this is a fundamental and sustainable change. With change comes opportunity and whilst easy to find negatives with the new landscape, we have strived to highlight some opportunities.

We found support for a sustainable alternative to traditional debt financing- expensive perhaps but satisfying a particular need.

We also found some evidence of the market adapting to the new landscape.

So what are we to make of these findings? It is not straightforward. However, when looking at the responses received, not only this year but in recent years, a clearer picture emerges. The financing environment appears to be very positive with high levels of confidence but this is not translating into readily available capital.

Most financing activity related to existing properties—renovations, refinancing, acquisitions—with virtually no greenfield development, so there are clearly obstacles that are holding back the flow of capital into the region.

Canadian banks have, for many years, been the primary financiers of developments in the region's tourism industry. It is now widely recognised that the landscape has changed, and that the long-term traditional lenders are not as dominant as they once were.

The traditional lenders are unquestionably more conservative than they once were and this is one of the factors holding back the flow of capital.

However, there are also other challenges. There are numerous structural issues that are considered critical by financiers. For example, good airlift is considered a must. This is consistent with the conservative nature of current financing - existing projects, strong management teams and good airlift all appear to be prerequisites if a project is to receive serious consideration from financiers. Projects that do not fit this template, for example, greenfield developments with no direct airlift, are finding it very difficult to find financing and will continue to do so.

For further information on this article, please do not hesitate to contact:

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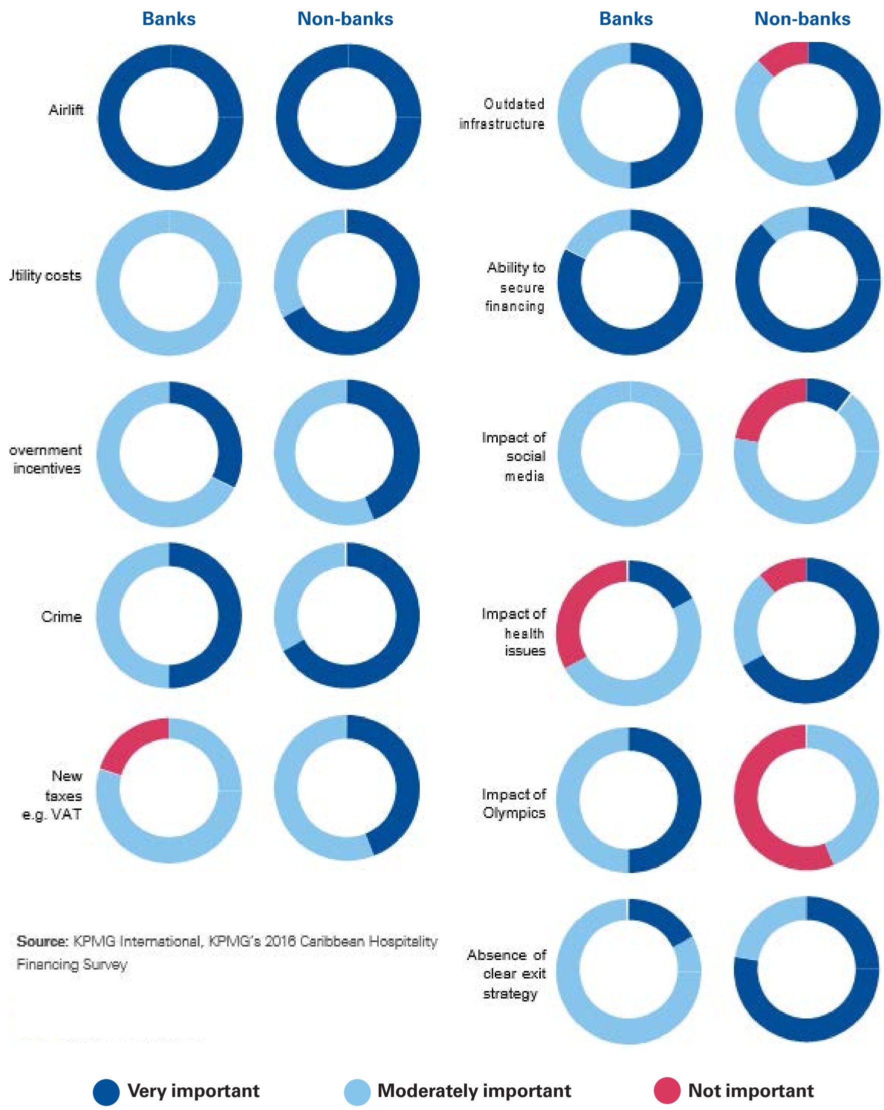

Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Future proofing

*By: **Chris Eaton,** Senior Manager, Advisory*

Protection from cyber-attacks is crucial and yet, not always as complex or expensive as you might think.

Barely a day goes by without a cyber-attack or other incident hitting the mainstream press. In recent times we have seen a number of high-profile cases with large companies such as TalkTalk and Sony Pictures. What is not reported with the same gusto is the impact of cyber-attacks, breaches or incidents on individuals or family offices — but that doesn't mean they aren't happening.

Most attacks stem from organised criminals simply looking to make money, whether by siphoning through payment systems or by targeting decision-makers through ever more sophisticated spear-phishing emails. Many assume that they will know if they have been hacked — not so. A successful hack may sit undetected, with unrestricted access to systems and data, for months and in some cases years.

When considering cyber-security in the family office context, the focus is often on expensive and sophisticated technology solutions, but the margin of vulnerability is often greater when it comes to people and process. What are they releasing online, particularly on social media, and could the aggregation of that data create a fuller picture which may be used to target family members or their interests?

This came to light recently when a well-known businessman spent millions of dollars on physical security only to have his daughter post photos on social media which held metadata, including time and location details, providing a target pack to any nefarious individuals.

Cyber-security can be seen as too expensive and complicated, but this need not be the case: improving your security does not need to be focused on advanced, hi-tech solutions. It incorporates how you communicate with your advisers, employees and family members. It is how you make payments or confirm your travel plans.

- Identify what is most valuable to you and the power that any personal or sensitive information could have if it fell into the wrong hands.
- Assess your degree of exposure. Do not forget to include social media and the 'internet of things'. Once you have highlighted your risks, the next stage is to look at ways to mediate these:
  - Ensure that fundamental security controls such as firewalls, anti-virus software, secure configurations, security logging and monitoring are all in place and updated.
  - Consider the email system you are using. Many family office employees simply use their personal email accounts for correspondence. Not only does this make it harder for you to manage security but also, as families have found out to their cost, should that employee leave they own and take away all the personal data, often including bank details and passport copies, that has been emailed to them over the years.
  - Make sure two-factor authentication is switched on where available, combining a password with a verification code. This simple step could have helped to prevent the many naked celebrity photos hitting the internet in 2014.
  - Review your processes and who actually needs access to what information. If your bank always telephones to voice authorise payments, consider replicating this within the family office.
  - Do not forget that people are key players in the effectiveness of cyber-security. Agree social media ground-rules with staff and family members.

It is impossible to be completely secure and safe from any potential attack. This should not stop you from trying, however, and could be a good way to involve the next generation and make the most of their skills and knowledge. By taking a positive and proactive approach to managing cyber-risk, you can get ahead of the risks and put yourself on a stronger footing to proceed with confidence.

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In the spotlight

Rachellin O'Connor
Executive Assistant,
KPMG Enterprise

Rachellin was born in Bermuda and raised in Mississauga, Ontario, Canada where she earned a diploma in Legal Office Assistant at Sheridan College. Shortly after, Rachellin moved to Bermuda in 1997 and has worked in the retail, software and legal industries before joining KPMG in 1998. Throughout the years, Rachellin has gained an abundance of experience working for KPMG's Accounting, Actuary, Insurance and Enterprise departments. Rachellin continues to enjoy the challenges of working at KPMG and in 2013, Rachellin completed her Associates in General Insurance with The Institutes in Philadelphia. Rachellin is a mother and enjoys volunteering on the PTA and helps to coach baseball at YAO Baseball Bermuda. In her spare time, Rachellin enjoys spending time with her family, running, playing softball, volleyball, socialising with friends and relaxing to with a glass of wine and a great book.

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