

Marion G. Wrobel
Vice-President
Policy and Operations
Tel: (416) 362-6093 Ext. 277
mwrobel@cba.ca

October 22, 2012

Office of the Secretary, PCAOB
1666 K Street, N.W.
Washington, D.C.
20006-2803

Dear Board Members:

**Re: Concept Release on Auditor independence and Audit Firm Rotation, PCAOB
Rulemaking Docket Matter No.37**

The Canadian Bankers Association (“CBA”) appreciates the opportunity to comment on the PCAOB’s Concept Release on Auditor Independence and Audit Firm Rotation (the “Concept Release”). The CBA is an industry association representing 54 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada, including 5 domestic bank members that are publically listed foreign private issuers registered with the Securities and Exchange Commission (“SEC”) with a combined market capitalization of almost \$300 billion. The CBA advocates for effective public policies that contribute to a sound and successful banking system that benefits Canadians and Canada's economy. The 5 banks that are publically listed as foreign private issuers that are directly impacted by the Concept Release represent about 87% of the assets of our members and accordingly are critically important to the Canadian economy. Further, our members are regulated by the Office of the Superintendent of Financial Institutions (“OSFI”), whose activities are centered around increasing public confidence in a safe and sound financial banking system.

Consistent with the objectives of a sound and successful banking system, our members are keenly interested in maintaining and improving the efficiency and effectiveness of the capital markets both domestically in Canada and in foreign jurisdictions where our members operate, including the United States. Also consistent with these objectives, we fully support the PCAOB’s vision to improve audit quality as a means to increase investor confidence and protect the interests of investors and we agree that auditor independence, objectivity and professional skepticism are critical to ensuring audit quality.

However, we believe that the possible approach raised by the PCAOB to improve auditor independence, objectivity and professional skepticism involving mandatory audit firm rotation would impede the efficiency and effectiveness of the Canadian banking sector and the Canadian capital markets, especially for our members that are foreign private issuers in the United States. Also, we are not aware of any evidence to support the notion that mandatory audit firm rotation would enhance auditor independence or increase audit quality. Instead we believe that

mandatory auditor rotation would:

- Be prohibitively challenging to implement in practice, especially for large and complex financial institutions such as the Canadian banks that are foreign private issuers. Mandatory audit firm rotation would also introduce an arbitrary rotation timeline that does not consider organizational challenges or the economic environment, in particular during times of significant organizational change or during a financial crisis.
- Be prohibitively costly, which increases the cost of capital for Canadian banks that are foreign private issuers.
- Reduce audit efficiency and effectiveness due to the complexities and significant learning curves associated with large bank audits, and as a result, the comfort that Audit Committees can place on the auditor.
- Dilute the mandate of the Audit Committee to independently appoint and oversee auditors which is not in the public's best interest as the Audit Committee is best suited for this role as part of the overall governance framework.

A more detailed discussion on the above noted ideas are set out in Appendix A. In addition, our view that auditor independence, objectivity and professional skepticism are to a large extent already supported by existing standards and practices are set out in the Appendix B.

However, as the CBA strongly believes that auditor independence, objectivity and professional skepticism are critical, we do support other means of improving these measures including: (i) some best practices followed by the Canadian banks; and (ii) other recommendations to enhance audit quality and promote auditor independence; each as set out below.

Best practices followed by the Canadian banks

There are a number of best practices followed by the Canadian banks (including those that are foreign private issuers in the United States) supporting auditor independence, objectivity and professional skepticism, many of which are established in accordance with the Corporate Governance Guideline issued by OSFI, for federally regulated financial institutions. The Corporate Governance Guideline reinforces the importance of the role of the Audit Committee in corporate governance and sets out the expected interactions between the Audit Committee and the auditor to ensure the effectiveness and quality of the audit. The Corporate Governance Guideline indicates that the Audit Committee should:

- Assure itself that the scope of the audit plan is appropriate, risk based, and addresses major areas of concern, and that the audit plan is reviewed with appropriate frequency.
- Assess the skills and resources of the auditor, taking into account the risks and complexity of the financial institution, and be satisfied with the content of the auditors engagement letter prior to it being signed.
- Obtain assurances regarding the independence of the auditor, and the audit firm's internal policies and practices for quality control.
- Establish criteria for the types of any non-audit services that the external auditor may provide, including rules stipulating when advance approval by the Audit Committee is required for new contracts.
- Ensure that the Audit Committee receives all material correspondence between the external auditor and management related to audit findings.
- Hold regular meetings with the external auditor, without management present, to understand all issues that may have arisen between the auditor and management in the course of the audit and how those issues have been resolved, and the extent to which

accounting practices being used by the institution are appropriate relative to the materiality of the item. In addition, these meetings should address any other matters that the external auditor believes that the Audit Committee should be aware of in order to exercise its responsibilities.

- Discuss In Camera, with senior management and the external auditor, the results of the audit, the annual and quarterly financial statements and related documents, the audit report, and any related concerns that the external auditor may have.
- Discuss In Camera, with the external auditor, the quality of the financial statements and related disclosures and satisfy itself that the financial statements present fairly the financial position, the results of operations and the cash flows of the financial institution.
- Regularly review the external auditor's performance.
- Make a recommendation concerning the appointment of the external auditor.

In addition, discussions are underway between the Canadian member banks and OSFI to further enhance some of these requirements.

Recommendations to enhance audit quality and promote auditor independence

We would also support the following recommendations to reinforce and enhance auditor independence, objectivity and professional skepticism:

- Implementing mandatory audit firm review as mentioned in the Canadian Public Accountability Board's ("CPAB") comment letter on the Concept Release in December 2011 and as more recently put forward in the joint discussion paper prepared by the Canadian Institute of Chartered Accountants ("CICA") and CPAB. This process would require the Audit Committee to formally evaluate the effectiveness of the auditor on a periodic basis (e.g. annually), and to report the results of the evaluation publicly to shareholders. This process would also require disclosure of the justification for either retaining or replacing the auditor, as well as the process the audit committee went through to reach that conclusion. As a result, transparency around the auditor evaluation and reappointment process would be improved.
- Enhanced education and training of auditing professionals at all staff levels should be instituted to help increase audit quality, especially in the areas that require judgment, professional skepticism, objectivity and independence. In addition, for areas that have been identified to have higher audit risk or audit quality issues during the PCAOB inspection process, more definitive guidance should be developed and communicated to all levels of auditing staff to ensure appropriate levels of "professional skepticism" are being exercised.
- Reporting of individual audit deficiencies, if any, from the PCAOB audit inspection should be issued to the Audit Committees of the respective companies to assist them in evaluating the performance of the auditor. We do support the guidance the PCAOB issued on August 1, 2012 to provide information to Audit Committees about the PCAOB's inspection process and the meaning of inspection results as well as suggested approaches that an Audit Committee might consider for initiating or enhancing inspection-related discussions with an audit firm.
- Enhanced disclosure concerning relationships with auditors, including the number of years that an audit relationship has been in place.

Conclusion:

The CBA fully supports the PCAOB's vision to improve audit quality as a means to increase investor confidence and protect the interests of investors, although we do not support mandatory

audit firm rotation. We believe the implementation of this requirement would not increase audit quality and would not serve as the most effective solution to increase auditor independence, objectivity and professional skepticism. Instead it could have the potential to decrease audit effectiveness and not serve the interests of investors and other stakeholders that rely on the safety and soundness of the Canadian banking system. We also believe that mandatory audit firm rotation would be prohibitively challenging and expensive to implement for our members, which unfairly increases the cost of capital for Canadian banks that are foreign private issuers in the United States.

Alternatively, we believe auditor independence, objectivity and professional skepticism are already largely supported by the requirements under existing standards and practices. However, we believe further enhancements as put forth in this letter should be considered to strengthen and promote auditor's independence, objectivity and professional skepticism. We believe that these alternatives would be more effective than the proposed mandatory audit firm rotation requirement.

We would be pleased to discuss any questions you may have and look forward to participating in further dialogue with the PCAOB on this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Grewal", is positioned below the word "Sincerely,". The signature is fluid and cursive, with a long horizontal stroke at the end.

cc: Mr. Brian A. Hunt, FCA, Chief Executive Officer, Canadian Public Accountability Board
Mr. Kam Grewal, CA, CPA, Vice President, Canadian Public Accountability Board
Ms. Julie Dickson, Superintendent, Office of the Superintendent of Financial Institutions

Mandatory audit firm rotation would be prohibitively challenging to implement in practice, especially for large and complex financial institutions such as the Canadian banks that are foreign private issuers:

- Mandatory audit firm rotation would introduce an arbitrary rotation timeline that does not consider organizational challenges or the economic environment. During times of significant organizational change or during a financial crisis, continued use of an audit firm that is familiar with the organization would be beneficial to shareholders. Conversely, rotating audit firms during these times would introduce significant distraction to internal resources, Boards and Audit Committees. This could potentially lower audit quality and effectiveness due to the significant gap in the level of institutional knowledge between the successor audit firm and the previous audit firm.
- Mandatory audit rotation would be logistically difficult to implement for a specialized industry that operates in global markets, such as banks in Canada, as there is a limited pool of qualified audit firms with global reach that have the deep technical audit partner and staffing resources to effectively deal with large and complex bank audits. These audits require specialized knowledge of complex products, regulations and technical accounting requirements across multiple jurisdictions. In Canada, it is our view that only the Big 4 audit firms have the capability of handling the audits of the 5 large Canadian banks that are foreign private issuers in the United States. In addition, significant start-up time would be required to gather sufficient experienced staff in Canada if an audit firm did not currently have the infrastructure to perform a large bank audit, which could further diminish the already thin pool of potential replacement audit firms.
- Auditor selection, as well as independence, could be further compromised as non-audit firms may be engaged in large multi-year non attest projects (e.g. tax, consulting etc.) that are not compatible with audit services under the existing independence rules, which effectively eliminates these firms from the already small pool of alternate firms in Canada. In addition, audit firms knowing that they would be required to roll off audit engagements might start contemplating relationships that would need to be cultivated or enhanced in order to win consulting work at their existing audit client after the completion of the audit cycle, which could further compromise independence.
- As a corollary, it would also become increasingly challenging and expensive for member banks to source high quality non-attest services from accounting firms that are currently not acting as the member bank's auditor because the pool of firms available to perform the work in Canada would be greatly reduced either because (i) the qualified firms would become increasingly distracted with the tender process for upcoming audits or the start-up process for new audits or; (ii) the qualified firms would be unwilling to take on the non-attest work because it may preclude them from participating in the tendering process on the next round of auditor rotation. The inability to source appropriate expertise for non-audit services will in many cases cause extensive disruption to the other activities, especially at the large Canadian banks that are continuously faced with a wide range of matters that require assistance from accounting firms that are not the member bank's auditor.
- Mandatory rotation of audit firms would create a distraction to the staff and management at member banks who interface with the auditors as they would have to spend a considerable amount of time managing the significant learning curve faced by a

successor audit firm on large bank audits. For example, the documentation and explanation of the relevant systems, processes and controls present in a large banking organization can be onerous on both the audit firm and the reporting entity. Efficiencies developed over time as the audit firm gains the institutional knowledge and experience of very large banking audits would be lost, while the learning curve for successor auditors would be immense in the first few years of the audit.

Mandatory auditor rotation would be prohibitively costly, which increases the cost of capital for Canadian banks that are foreign private issuers

- The cost of capital for Canadian banks that are foreign private issuers in the United States would increase, which reduces their competitiveness relative to other banks operating in the Canadian market that are not subject to mandatory audit firm rotation requirements. This could reduce the incentive for other members or other foreign companies in general to seek registration in the United States.
- Implementing mandatory audit firm rotation would be very costly as there would be both (i) an increase in audit fees to cover significant start-up and transition costs (i.e. we understand that studies suggest that this could be in the 20% range in the initial year of an audit rotation); and (ii) an increase in internal management and administration costs required to support a continuous rotation of audit firms. Furthermore, the cost of capital would indirectly increase because mandatory audit rotation would serve as a distraction to management from more pressing business and financial reporting issues due to the increase in management and staff time that would be required to continuously support a frequent change in audit firm and the associated regulatory filings.
- Costs of raising capital would further increase for Canadian banks registered in the United States as they would now require multiple audit firms to review documents to be filed with regulators during the transitional audit years.

Mandatory audit firm rotation could have a negative impact on audit quality thereby reducing the comfort that Audit Committees can place on the auditor:

- We are not aware of any evidence linking audit firm rotation with higher quality audits. We also understand that the PCAOB inspection process has not determined any systematic relationship between inspection deficiencies and audit firm tenure.
- Conversely, we believe that mandatory auditor rotation could hinder the ability of audit firms to develop and maintain essential industry expertise and institutional knowledge to consistently perform high quality audits, especially for large and complex Canadian bank audits that require specialized knowledge of complex products, regulations and accounting principles. Given that audit quality is highly dependent on an auditor's knowledge of the company and the industry, implementing mandatory auditor rotation could potentially reduce audit quality.
- Mandatory audit firm rotation could potentially lower audit quality and therefore increase the risk of undetected errors in the early years of the audit rotation due to the significant learning curve audit firms face on new engagements and the loss of accumulated audit knowledge and experience, which we believe are critical to audit quality and effectiveness. A significant amount of time would be spent by the successor firm in reviewing the audit working papers of the previous firm and on gaining a sufficient

understanding of complex banking systems, which we believe could be better spent on designing and implementing more effective audit and quality control procedures. The lack of appropriate understanding of complex systems and processes could potentially decrease audit quality and effectiveness.

- Mandatory audit firm rotation could also potentially reduce audit effectiveness during the later years of an audit rotation from auditors being increasingly focused on upcoming tenders rather than current year audits that they would nevertheless be required to walk away from.
- Furthermore, mandatory audit firm rotation may potentially reduce the incentive for some auditors to perform a quality audit if tenure is effectively no longer dependent on the Audit Committee's evaluation of the auditor.

Mandatory audit firm rotation would dilute the mandate of the Audit Committee to independently appoint and oversee auditors which is not in the public's best interest as the Audit Committee is best suited for this role

- The Audit Committee is already responsible for selecting the auditor and reviewing the auditor's effectiveness. We believe that Audit Committees are best suited to fulfill this mandate because (i) Audit Committee members are independent; and (ii) Audit Committees engage in significant due diligence to fulfill the mandate of evaluating the auditor. Mandatory audit firm rotation effectively dilutes the Audit Committee's mandate to effectively oversee the financial reporting process in the interest of shareholders.

Appendix B

Auditor firm independence, objectivity and professional skepticism are supported by the requirements of existing standards

We believe that mandatory audit firm rotation is not required because other corporate governance requirements are currently in place to further the PCAOB's objectives of ensuring independence, objectivity and professional skepticism, including:

- Mandatory audit partner rotation requirements that apply to both the lead and independent partners.
- Limitations on types of permitted non-attest services and a comprehensive review of all services performed and approved by the Audit Committee.
- Limitations of when auditors can accept employment at audit clients.
- Audit Committee review and approval of audit and non-audit fees.
- Limitations on the types of financial relationships between audit partners and audit staff with their bank audit clients (e.g. limitations on partners and staff holding deposits or taking out mortgages with the bank audit client).

The above noted existing partner rotation requirements combined with natural rotation and turnover of staff already ensure a fresh point of view is taken every 5 years on audit engagements, while also maintaining high quality standards. Furthermore, the benefit of a fresh point of view under the existing partner rotation requirement is not at the expense of the audit engagement team undertaking a significant learning curve in terms of understanding new systems and processes as part of a new audit engagement.

In addition, the forthcoming requirements in the PCAOB's new Auditing Standard 16, *Communications with Audit Committees*, establishes additional requirements that would enhance the relevance, quality, and timeliness of the communications between the auditor and the Audit Committee, and aims to ensure there is improved financial reporting oversight, improved financial reporting, and a more effective audit process.