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CANADIAN BANKERS ASSOCIATION

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
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Re: Consultative Document on External Audits of Banks

The Canadian Bankers Association[1] ("CBA") appreciates the opportunity to respond to the Basel Committee on Banking Supervision's ("BCBS's") consultative document on external audits of banks. The CBA is an industry association representing 55 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. Furthermore, our members are regulated by the Office of the Superintendent of Financial Institutions ("OSFI"), whose activities are centered on increasing public confidence in a safe and sound 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. We believe that an effective external audit plays a key role in meeting our objectives.

CPA Canada has adopted International Standards on Auditing (ISA's) and must also comply with more stringent Canadian auditor independence regulations. In our view, the majority of the proposals set out within the 16 principles outlined in the consultative document are in line with existing ISA's or existing Canadian auditor independence regulations and are generally consistent with the proposals put forward by current Canadian audit quality initiatives which we support. The one main exception is the requirement to establish a formal policy on limiting the length of an external auditor's tenure as proposed in principle #8. In this area, we support the recommendations put forward by CPA Canada through their audit quality initiatives regarding mandatory audit firm reviews. We note that similar reviews are also proposed under BCBS principle #7. We believe this is a more effective alternative to address institutional familiarity risks on auditor independence as it increases transparency around auditor evaluation and the re-appointment process as compared to setting pre-determined timelines for audit-tendering or pre-set term limits on auditors.

[1] The Canadian Bankers Association works on behalf of 55 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness.

We also recommend that paragraph 66 of the BCBS consultative document include the notion of materiality when referring to the bank's internal control environment in all subsidiaries and branches of the banking group. Materiality must be considered to ensure that the audit addresses material risks, as opposed to all risks. The latter would likely have a substantial impact on audit costs without adding significant value, or enhancing audit quality. Additional work in non-material areas is unlikely to change reported financial results.

Our detailed analysis of the 16 proposed principles within the consultation paper, including the anticipated impact to our members, is included in Appendix A.

In conclusion, the CBA supports the BCBS's vision to improve audit quality and contribute to financial stability by establishing enhanced supervisory expectations of auditors and audit committees, and encouraging greater communication with supervisors. The principles will move us to a more consistent global standard. In our view, adhering to one global standard will result in more consistent application of audit standards across different jurisdictions.

Sincerely,

Implications of Principles to CBA Members

Principle 1: The external auditor of a bank should have banking industry knowledge and competence sufficient to respond appropriately to the risks of material misstatement in the bank's financial statements and to properly meet any additional regulatory requirements that may be part of the statutory audit.

CPA Canada has adopted International Standards on Auditing (ISA's) which requires the audit engagement partner to be satisfied that the team (including any experts) as a group have the competencies and expertise required to conduct the audit. In addition, the Bank Act (Canada) sets out a five year minimum experience requirement for the lead engagement partner. As a result, we believe these requirements are already in place.

However, we are supportive of the Canadian audit quality proposals put forward by CPA Canada regarding auditor independence and objectivity, which includes the same requirement to have a formal auditor evaluation as proposed within principle #7. We believe this would assist in ensuring that the required level of expertise matches the risks and complexity of the financial institution as monitored by the Audit Committee.

Principle 2: The external auditor of a bank should be objective and independent in fact and appearance with respect to the bank, consistent with the more stringent requirements applicable to public interest entities in internationally accepted ethical standards.

The 5 largest banks within our member base are listed with the US Securities and Exchange Commission. As a result, they currently comply with these restrictions and would not be impacted by this change. Due to the complexity of banking operations, most of the remaining members use one of the large Canadian public accounting firms which are also required to follow ISA's and as a result are currently adhering to this standard.

We are supportive of this proposal, largely because it further harmonizes regulations globally by encouraging adoption of the ISA's existing requirements.

Principle 3: The external auditor should exercise professional skepticism when planning and performing the audit of a bank, having due regard to the specific challenges in auditing a bank.

We believe that professional skepticism is critical to ensuring an independent review of the financial statements and, in particular, areas where significant judgment is applied. As CPA Canada has adopted ISA's, we believe that we are currently meeting this principle. We are supportive of the requirements within this principle, largely because it further harmonizes regulations globally for banks.

Principle 4: Audit firms undertaking bank audits should comply with the more stringent requirements on quality control applicable to listed entities in internationally accepted quality control standards, having due regard to the complexity of a bank audit.

The largest Canadian banks are all listed entities, and as a result their audit firms currently comply with the more stringent rules. For our remaining members, we are supportive of this change as it will enhance the quality control procedures for their respective audit firms which in turn will enhance overall audit quality. In our view, adhering to one global standard will result in more consistent application of standards across firms globally.

Principle 5: The external auditor of a bank should identify and assess the risks of material misstatement in the bank's financial statements, taking into consideration the complexities of banking activities and the need for banks to have a strong control environment.

For listed banks in Canada, specific risks impacting the bank are discussed within the Management Discussion and Analysis (MD&A), which is a public filing. The Auditors review the MD&A to ensure that

the disclosure is consistent with their understanding of risks and the bank's risk management practices. These would include all material risks in the Bank that have an impact on financial reporting. For the remaining Banks, we believe the requirements of this principle are covered under ISA's which have been adopted by CPA Canada. While specific risks are not included, the risks noted in the consultative document (credit risk, market risk, liquidity risk, operational risk, and regulatory risk) are understood to be material to banks and addressed by the audit. As a result, we believe this proposal will have a minimal impact on our members with the following exception.

Paragraph 66 does not include the notion of materiality when referring to the bank's internal control environment in all subsidiaries and branches of the banking group. Materiality must be considered to ensure the audit addresses material risks as opposed to all risks which would likely have a significant impact on audit costs without adding significant value or enhance the quality of the audit. Additional work in non-material areas is unlikely to change the reported financial results.

To ensure oversight bodies are satisfied that the internal control environment is in line with the complexity of the organization, we support the proposal that all matters of significance identified during the audit be disclosed to the Audit Committee as required under existing ISA's. For publically listed banks in Canada, investors also receive Management's certification on internal controls, and the auditors report thereon as part of the annual disclosure requirements. This provides banking supervisors, investors, and audit committees some assurance that the internal controls in place support the complexity of the bank's activities. If additional assurance is required for specific matters, specialized assurance reports are requested by supervisors. These specialized assurance reports should continue to be used as a mechanism for assurance on matters that do not impact the financial statements.

Principle 6: The external auditor of a bank should respond appropriately to the significant risks of material misstatement in the bank's financial statements.

Loan loss provisioning, going concern assessment and securitizations are examples where there is a significant risk of material misstatement for banks. We believe the audit requirements to appropriately address high risk areas are already addressed as part of an audit under ISA's and as a result this proposal would have no impact to our members.

Principle 7: The audit committee should have a robust process for approving, or recommending for approval, the appointment, reappointment, removal and remuneration of the external auditor.

The proposals are in line with recommendations put forward by Canadian audit quality initiatives, which maintains that the audit committee continues to be responsible for selecting the auditor and reviewing the auditor's effectiveness on an annual basis. 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 to determine if they should be re-appointed and set the remuneration level. In our view, the recommendation for reappointment of the auditor should be disclosed in a public document available to shareholders as per local securities regulators requirements instead of specifically within the annual report. This would provide the disclosure required, with flexibility to ensure that it is included in the most relevant location within a company's continuous disclosure documents. Mandating a specific location could result in duplicate disclosures in certain jurisdictions which may already have this requirement.

We are supportive of this proposed change, largely because it further harmonizes regulations globally with a minimal impact on our members.

Principle 8: The audit committee should monitor and assess the independence of the external auditor.

Most of the recommendations within principle #8 are in line with the conclusions in the CPA Canada audit quality initiatives with respect to auditor independence. The one exception is the requirement to establish a formal policy on the length of an external auditor's tenure.

We support CPA Canada's view that implementing mandatory audit firm review is a better alternative than pre-established time frames for tenure/tendering of the audit. We note that such reviews are also proposed under BCBS principle #7 discussed above. By contrast, we believe that pre-established timeframes for tenure/tendering would:

- Be prohibitively challenging to implement in practice, especially for large and complex global financial institutions which are already limited to a small pool of 4 audit firms with the global reach and infrastructure in place to complete the audit.
- Introduce an arbitrary rotation/tendering timeline that does not consider organizational challenges or the economic environment, in particular during times of significant organizational change or during a financial crisis.
- 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 we believe that the audit committee is best suited for this role as part of the overall governance framework.

Principle 9: The audit committee should monitor and assess the effectiveness of the external audit.

We believe that the role of the audit committee is to monitor and assess the effectiveness of the external auditor. We would further support increasing the audit committee's access to the findings of auditor oversight bodies on a global basis to increase the information available to the audit committee in completing their evaluation of the auditor.

In addition, we support communication to the audit committees on how the bank's choice on accounting and disclosure issues compares to their peers. This would only be possible where the information on peer entities is publically available. This presumes that confidential non-public information would remain confidential between an audited entity and its auditor.

Principles 10 & 11: The audit committee should have effective communication with the external auditor to enable the audit committee to carry out its oversight responsibilities and to enhance the quality of the audit. The audit committee should require the external auditor to report to it on all relevant matters to enable the audit committee to carry out its oversight responsibilities.

We believe that these requirements are currently in place under ISA's for required communications with audit committees. Areas of communication include:

i) the audit strategy and scope, including the timing of the audit, significant risks identified, information on specialist skills used in the audit, reliance on Internal Audit Services, planned audit strategy and risks identified, and any changes to the strategy or risks during the audit;
ii) significant accounting policies and unusual transactions;
iii) areas of judgment, and disagreements with management;
iv) evaluation of going concern;
v) deficiencies in internal control over financial reporting;
vi) confirmation of auditor independence, and other matters of significance.

Principles 12, 13 & 14: The supervisor and the external auditor should have an effective relationship that includes appropriate communication channels for the exchange of information relevant to carrying out their respective statutory responsibilities. The external auditor should report to the supervisor matters that are likely to be of material significance to the functions of the supervisor. There should be open, timely and regular communication between the banking supervisory authority, the audit firm and the accounting profession as a whole on key risks and systemic issues as well as a continuous exchange of views on appropriate accounting techniques and auditing issues.

We believe that the proposed communications are in place in Canada between OSFI and the external audit firms of the banks. For instance, the large bank audit firms in Canada are represented on an OSFI advisory committee which discusses issues relating to banking and bank audits. Additionally, bank auditors meet individually with OSFI on a quarterly basis. As a result, this will have a minimal impact to our members.

Principles 15 & 16: There should be regular and effective dialogue between the banking supervisory authority and the relevant audit oversight body. The banking supervisory authority and the audit oversight body should observe appropriate confidentiality requirements when sharing information.

We support this proposal to share information on a formal and informal basis between the banking supervisory authority and the audit oversight body provided that confidentiality requirements are adhered to. Currently, inspection findings from the Canadian Public Accountability Board and the U.S. Public Company Accounting Oversight Board are not shared with companies or their audit committees. The information should not be shared with bank supervisors until the information is available to a company's audit committee.

We believe this principle will support consistency in communication practices on a global basis and will lead to more cohesive implementation through new regulations which may also have an impact on audit work or lead to additional audit requirements.