CANADIAN BANKERS ASSOCIATION

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Via email: comments@pcaobus.org

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Office of the Secretary,
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Dear Sir:

Re: PCAOB Rulemaking Docket Matter No. 008
Proposed Auditing Standard - An Audit of Internal Control Over Financial Reporting
Performed in Conjunction with an Audit of Financial Statements

The Canadian Bankers Association (CBA), appreciates the opportunity to provide comments on the Public Company Accounting Oversight Board's proposed auditing standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*.

The CBA is the main professional industry association, representing over 40 of Canada's domestic and foreign-owned chartered banks. Several of our member institutions are subject to the reporting requirements of the Securities Exchange Act of 1934. The CBA is also a principal contributor to the development of accounting standards that affect Canadian banks. Our member institutions make a significant contribution to the Canadian economy and six of our largest members represent, in aggregate, total assets under administration of approximately Canadian $2,863.4 billion dollars.

Our detailed comments appear in the attached Appendix. We would be pleased to answer any questions that you may have in respect of our comments.

Sincerely,

Original signed by Kelly Shaughnessy

RKS
Attachment

APPENDIX

Comments of the Canadian Bankers Association on the Proposed Auditing Standard - An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements

Questions Regarding Using the Work of Management and Others:

Question 12. To what extent should the auditor be permitted or required to use the work of management and others?

We are of the view that the auditor should be free to exercise his/her professional judgment, under the guidance of the existing generally accepted auditing standards, in determining whether and to what extent the auditor can reasonably place reliance on the work of management and others. Consequently, we do not believe that the extent to which the auditor may rely on the work of others needs to be prescribed.

Question 13. Are the three categories of controls and the extent to which the auditor may rely on the work of others appropriately defined?

We do not believe that the extent to which the auditor may rely on the work of others needs to be prescribed. It is our view that organizations should be encouraged to have robust documentation and assessment processes. To that end, our members have made efforts to supply quality evidence to their external auditors, which has been used to reduce the extent of the auditors' independent testing.

Question 14. Does the proposed standard give appropriate recognition to the work of internal auditors? If not, does the proposed standard place too much emphasis and preference on the work of internal auditors or not enough?

We do not believe the proposed standard places sufficient emphasis on the work of internal audit. It does not give adequate recognition to the depth of experience and business knowledge resident in our members' internal audit groups. It is our view that, to the extent that such groups are competent and objective, their work should be relied upon extensively by the external auditor and that such extent need not be prescribed.

In particular, we disagree with the proposal that the auditors should not rely on others for certain information technology controls and walkthroughs.

In our member banks' organizations, the effectiveness of pervasive controls over information technology is critical to the successful execution of their business strategy. As a result, our members make substantial investments in objective and competent specialized internal audit expertise to provide assurance that these controls are designed and operating effectively for both efficiency and effectiveness, as well as for the reliability of financial reporting. These resources require in-depth knowledge of our varied and complex technology systems. Our members' external auditors have traditionally placed a high level of reliance on these pervasive technology controls and have utilized internal audit testing to a large extent in reaching their conclusions about these controls.

The proposed standard is suggesting a full duplication of effort in this area for which there is no clear benefit to the issuers or investors. The requirement will necessitate substantial new investments in technology expertise by public accounting firms that will need to be financed in the first instance by issuers, and ultimately by investors.

Similarly, the requirement to have external auditors perform walkthroughs themselves does not give adequate recognition to the depth of experience and business knowledge resident in internal audit groups. While we agree that some reperformance would be appropriate in this area if reliance is placed on the work of management and others, we believe that efficiencies can be achieved if the external auditors are permitted to use this work to support their conclusions.

Question 16. Is the requirement for the auditor to obtain the principal evidence, on an overall basis, through his or her own work the appropriate benchmark for the amount of work that is required to be performed by the auditor?

We do not believe that the benchmark of principal evidence is appropriate. There is no doubt that the auditor must obtain evidence that management's assertion is reliable and that the internal controls are actually in place and effective. It is our view that existing auditing standards provide sufficient guidance as to the appropriate level of effort and involvement of the auditor in executing their work and determining whether or not, and to what extent, to rely on the work of others.

The introduction of this new term raises interpretive issues in respect of the role of auditors that are unnecessary and potentially costly and divisive. Inasmuch as the concept of *principal evidence* is open to interpretation, it may lead an auditor to perform more work than necessary in circumstances where substantial testing and documentation by management, internal audit and other third parties is already in place.

Questions Regarding Evaluating Results:

Question 17. Will the definitions in the proposed auditing standard of significant deficiency and material weakness provide for increased consistency in the valuation of deficiencies? How can this definition be improved?

Identification of significant deficiencies and material weaknesses is necessarily an area that involves the exercise of professional judgment. Consistency is always difficult to achieve in such an area. An important step to achieving consistency will be to ensure that the definitions used in the draft standard are compatible with the overall definition of internal control and how companies evaluate and seek to mitigate risk. We have serious concerns on these matters, as discussed below.

We have concerns that the definitions of significant deficiency and material weakness in internal control in the proposed standard are impractical and overly prescriptive, inasmuch as the definitions imply that an excessively high level of assurance must be obtained in order to conclude that internal control is effective. Both of these definitions refer to deficiencies that result in "a more than remote likelihood" that financial statement errors of a certain magnitude will occur. By way of example, human error remains a constant potential issue in respect of internal control and, as such, renders the possibility of more than a remote likelihood that a misstatement will occur, and as consequence, the standard of a "more than remote likelihood" can not be achieved. The business success of our members emanates from managing rather than avoiding risk. The manner in which our members assess their controls, likewise, should allow for some risk tolerance, including acknowledgement of cost/benefit considerations.

We note that existing auditing standard AT 501 provides additional useful guidance that does not appear in the proposed auditing standard. We suggest that these qualitative considerations be brought into the final attestation standard. In particular, the notion set out in paragraph .40 of AT 501 that the consideration of whether a deficiency represents a material weakness should include consideration of the overall control environment. In recent corporate failures, many of the problems were caused by weak overall control environments and inappropriate "tone at the top." The organizations represented by our members place a high importance on having strong overall control environments and ensuring that executives and employees live up to these high standards. The significance of deficiencies in internal control cannot be properly evaluated without consideration of these matters.

The definition of internal control contemplates providing reasonable assurance that transactions are reported as required by GAAP. The proposed definitions of significant deficiency and material weakness are incompatible with paragraph 16 of the proposed standard, which indicates that management's assessment of internal control effectiveness is at the level of reasonable assurance, as is the auditor's opinion. Paragraph 16 further states that "reasonable assurance includes the understanding that there is a relatively low risk that material misstatements will not be prevented or detected on a timely basis." We suggest that existing GAAS definitions of significant deficiency and material weakness should be used instead of those proposed in the draft.

Other Comments: Use of Service Auditors Report

The wording with respect to the operating effectiveness of outsourcing arrangements described in Appendix B, paragraphs B35 to B38, implies that an auditor should place reliance on a service auditor's report as the primary source of assurance. We are of the view that a determination in favour of stronger reliance can be made from an assessment of management's processes for controlling risk. Effective management of issuers' outsourcing arrangements is in the interest of both their shareholders and their customers. The processes for controlling risk is embedded in contract negotiations, service level agreements and monitoring, input and output controls, and in some cases through the contractual right of strong internal audit areas to monitor and report on these activities.

Within the Canadian context, a "Service Auditors Report" takes the form of a section 5900 report. These reports contain less detail than the more pervasive SAS 70 review, and are typically prepared at the outsourcers' fiscal year end, which may differ more or less significantly, from the fiscal year end of our members. The lack of clarity around a "significant period of time" as noted in paragraph B37, means that our members run the risk of incurring considerable incremental costs should the definition be for a period that is less than 12 months.