UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 98849 / November 2, 2023

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 4473 / November 2, 2023

ADMINISTRATIVE PROCEEDING
File No. 3-21792

In the Matter of **ROYAL BANK OF CANADA,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act"), against Royal Bank of Canada (the "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (the "Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. This matter concerns internal accounting control deficiencies relating to accounting for internally developed software ("IDS") costs by Respondent Royal Bank of Canada. From 2008 through 2020, Respondent experienced a growth in IDS spending to support the growth of the organization. However, development of its control environment did not keep pace and internal accounting control deficiencies affected Respondent's cost capitalization accounting for IDS projects. Respondent applied a single capitalization rate to certain of its IDS project costs but lacked a reliable mechanism for determining the appropriate capitalization rate to apply. Among other issues, Respondent's deficient internal accounting controls resulted in Respondent capitalizing certain costs that were ineligible for capitalization under the appropriate accounting methodology. Respondent also lacked sufficient internal accounting controls to assess for indicators of impairment and to recognize amortization when assets were available for use, which resulted in Respondent carrying certain capitalized IDS assets on its balance sheet when those assets should have been impaired or amortized over their useful life.

2. As a result of these issues, Respondent violated Section 13(b)(2)(A) and Section 13(b)(2)(B) of the Exchange Act.

Respondent

3. Royal Bank of Canada is a Canadian chartered bank with its corporate headquarters located in Toronto, Ontario, Canada and its head office located in Montreal, Quebec, Canada. Respondent's common shares are registered pursuant to Section 12(b) of the Exchange Act and listed on the New York Stock Exchange and the Toronto Stock Exchange under the ticker "RY." Respondent's consolidated financial statements filed with the Commission are prepared in accordance with International Financial Reporting Standards.

Background

A. Internally Developed Software and International Accounting Standard 38

4. IDS is software that a firm develops internally rather than purchasing from a third-party provider. Under International Accounting Standard 38 ("IAS 38"), certain project costs incurred by an entity in creating an IDS application may be capitalized as an intangible asset on the entity's balance sheet. The capitalized costs are then amortized over the course of the estimated useful life of the application. In order to qualify as an internally developed intangible asset, IAS 38 requires, among other things, that the application being worked on provide probable future economic benefit to the firm and that its cost to develop be reliably measured. According to IAS

---

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

38, costs outside of the development phase, including those associated with maintaining or decommissioning in-use IDS applications, must be expensed.

5. In general, the costs associated with developing IDS largely consist of employee salaries and benefits, and fees paid to third-party contractors. Not all of these costs may qualify for capitalization under IAS 38. Costs incurred in the "research phase"—the investigation and planning for development of an IDS project—are ineligible for capitalization and must be expensed as incurred. After the "research phase" is complete, costs incurred in the "development phase" to design, create, and install the new IDS application may be capitalized.

B. International Accounting Standard 36

6. IAS 36 requires an entity to assess at the end of each reporting period whether there is any indication that certain assets, including internally developed intangible assets like IDS, may be impaired. IAS 36 provides a non-exhaustive list of indicators of impairment, including for example, whether evidence exists that the asset is at risk of obsolescence.

7. Any indicator of impairment requires the entity to then consider whether the carrying amount of the asset exceeds its recoverable amount and, if yes, to reduce the carrying amount to its recoverable amount. For example, when an entity no longer uses an IDS application, the asset is impaired and its carrying amount should be written down to the amount to be recovered through its use, which is typically zero.

C. Respondent's IDS Accounting

8. During the relevant period, Respondent's IDS accounting, including capitalization, was governed by its internal accounting policy, which was intended to align with IAS 38 and 36.

9. During that time, Respondent's process for capitalizing IDS project costs depended on the Canadian dollar-value of the project. Projects estimated to cost more than CAD $5 million (increased to more than CAD $10 million in 2020) were designated as "large program" projects and individually reviewed to determine the amount of costs eligible for capitalization. Projects that had an expected cost of CAD $5 million or less (later increased to CAD $10 million or less) were subjected to the "Pool Method."

10. The Pool Method aggregated the costs of Respondent's smaller IDS projects and capitalized a percentage of those costs by applying a single capitalization rate. Respondent implemented the Pool Method for administrative ease due to the time and expense it would have taken to assess each small project for capitalization. By 2020, the IDS pool grew to include in excess of 1,200 individual software projects.

11. Respondent employed the Pool Method as an accounting convention and treated the capitalization rate as an accounting estimate. Respondent's internal accounting policy required that the capitalization rate be assessed on an annual basis and adjusted if necessary to reflect the nature of Respondent's actual expenditures. Respondent amortized the costs capitalized under the Pool Method over the course of three years starting one year from the date the costs were incurred.

12. Respondent's spending on IDS, and capitalization of associated costs, has grown over the years. Respondent capitalized approximately CAD $658 million of IDS assets in 2011. That amount grew to CAD $1.1 billion by 2021. Likewise, the amount spent on pooled projects grew from approximately CAD $100 million at the inception of the pool to approximately CAD $600–700 million in 2020. By way of comparison, for fiscal year ended October 31, 2021 RBC reported non-interest expenses of approximately CAD $25.9 billion, with net income of approximately CAD $16 billion.

13. As Respondent's IDS spending increased to support the growth of the organization, development of its control environment did not keep pace and internal accounting control deficiencies affected Respondent's cost capitalization accounting for IDS projects.

D. Control Deficiencies in Respondent's Pool Method

i. Respondent's Internal Accounting Controls Over its IDS Capitalization Rate Were Insufficient.

14. From 2008 through 2016, the internal accounting systems relied upon by Respondent to develop and assess the ongoing reasonableness of its capitalization rate estimate were insufficient to comply with IAS 38. These systems constituted internal accounting controls for purposes of section 13(b)(2)(B) of the Exchange Act.

15. In or around 2008, Respondent set an initial capitalization rate of 78 percent. Thereafter and through 2016, Respondent used a simple calculation to determine whether that rate should remain in effect. Respondent (1) added up salary and benefits, for its employees and the fees paid to third-party contractors who worked on IDS pool projects and (2) divided that number by the total costs incurred (salary, benefits, and professional fees plus rent, utilities, and training) (the "Capitalization Rate Calculation"). If the result of the Capitalization Rate Calculation approximated the 78 percent rate Respondent was using, Respondent maintained the use of that rate. During the entirety of this period, Respondent did not alter the 78 percent capitalization rate.

16. The Capitalization Rate Calculation was an insufficient method of satisfying the requirements of IAS 38. The calculation did not adequately differentiate between capitalizable and noncapitalizable costs, including by treating some research-phase costs as capitalizable when IAS 38 requires they be expensed.

ii. Respondent's Internal Accounting Controls Over its IDS Capitalization Remained Insufficient.

17. In 2017, Respondent stopped doing the Capitalization Rate Calculation for pool projects and began conducting capitalization rate studies to validate the 78 percent capitalization rate. Respondent conducted the rate studies by sampling projects within the pool and surveying employee tasks to extrapolate an average capitalization rate for the pool. Respondent conducted studies in each of the following years except 2018.

18. Until 2021, when Respondent altered its study processes, these rate studies were insufficient support for the 78 percent capitalization rate and did not provide reasonable assurances that Respondent complied with IAS 38 in estimating the capitalization rate for pooled projects.

19. As Respondent developed the process for conducting capitalization rate studies during this period, it recognized that the rate studies lacked reliability for a number of reasons, including issues concerning methodology and the reliability of underlying data used in the studies.

20. The rate studies' insufficiencies derived from, among other things, unreliable sampling and response rates to surveys, incomplete information, lack of documentation for certain third-party contracts, and the inclusion in the project pool of projects that were ineligible for capitalization and obsolete projects that should have been impaired and written off. These projects were in the pool because Respondent lacked an appropriate system to identify and exclude these projects. Once a project made it into the pool, RBC also lacked an effective process for determining whether it should remain in the pool. This included projects that were started but then canceled (and thus impaired) and should have been written off prior to their complete amortization within three years of initial utilization.

21. Because of the overall lack of reliability of the rate studies, Respondent was unable to assess whether its estimated capitalization rate of 78 percent was reasonable and complied with IAS 38. Respondent maintained the 78 percent capitalization rate through 2020.

E. Accounting Controls Over Large Programs

22. From at least 2017 into 2020, the large program projects also lacked sufficient internal accounting controls over impairment and amortization of IDS assets.

23. Respondent's process for identifying impaired IDS assets for large program projects relied on the business units that used IDS applications (and the team that helped those business units stay on budget) to report to the accounting team that IDS applications were impaired, or that indicators of impairment existed that warranted an impairment assessment.

24. With regard to amortization, under IAS 38, capitalized costs should start to amortize once the project application is available for use. If an application is available for use but not amortized, the capitalized costs of that project remain as an unamortized asset on the balance sheet, resulting in an overstatement of assets and an understatement of period expenses.

25. Respondent did not have an effective process of identifying and reporting impaired IDS assets within its large program projects to provide reasonable assurance of compliance with IAS 36, including not properly segregating duties, or to identify the proper starting point for amortization under IAS 38.

Violations

26. As a result of the conduct described above, Respondent violated Section 13(b)(2)(A) of the Exchange Act, which requires public companies to "make and keep books,

records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."

27. As a result of the conduct described above, Respondent violated Section 13(b)(2)(B) of the Exchange Act, which requires, among other things, public companies to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that . . . (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements. . . ."

Respondent's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent, including instituting additional internal accounting controls over the makeup of the pool, and altering its rate study methodology to conduct the studies more frequently and make the sampling more representative of the overall project pool. These corrective measures included the following: centralizing the IDS capitalization rate assessment process, implementing an automated solution to improve the overall control environment respecting the IDS capitalization rate process; undertaking an initiative to improve inputs into the project management system; conducting enhanced training for project managers on differences between development (capitalizable) and maintenance (non-capitalizable) expenditures; conducting capitalization rate studies on a quarterly rather than annual basis; and formalizing the impairment review process.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Royal Bank of Canada's Offer.

Accordingly, it is hereby ORDERED that**:**

A. Pursuant to Section 21C of the Exchange Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

B. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $6,000,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Respondent shall receive an offset against the civil money penalty consisting of the United States dollar ("USD") value of amounts paid by Respondent to Canadian regulatory authorities concerning the matters set forth herein (the "Canadian Payments"). The USD value of the Canadian Payments shall be determined at the Canadian dollar ("CAD")-to-USD exchange rate of 1 CAD = .75 USD. Promptly upon making the Canadian Payments, Respondent shall provide the Commission staff with confirmation that such payments have been made and evidence of such payments in the form of copies of wire transfer records, checks, or money orders, or in a form otherwise acceptable to the Commission staff.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Scott A. Thompson, Division of Enforcement, Securities and Exchange Commission, 1617 J.F.K. Blvd., Suite 520, Philadelphia, PA 19103.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary