



Ontario  
Securities  
Commission

Commission des  
valeurs mobilières  
de l'Ontario

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## IN THE MATTER OF ROYAL BANK OF CANADA

### SETTLEMENT AGREEMENT

#### PART I – INTRODUCTION

1. Accurate financial disclosure is a cornerstone principle of Ontario securities law identified in the *Securities Act* and is fundamental to achieving the purposes of the *Act*. The proper recording of business transactions and financial affairs is an important obligation of reporting issuers. The maintenance of appropriate books and records requires that reporting issuers prepare and maintain those books and records in compliance with applicable accounting standards and their related internal accounting policies. It is essential that reporting issuers remediate identified non-compliance with their internal accounting policies to ensure compliance with Ontario securities law.

2. This matter concerns the books and records of Royal Bank of Canada (**RBC** or the **Respondent**) as they relate to costs incurred by RBC to develop software applications internally as opposed to purchasing software from third-party vendors. Under accounting rules, certain costs associated with creating such internally developed software (**IDS**)<sup>1</sup> may be eligible for capitalization and recorded as intangible assets on RBC's balance sheet rather than being recorded as expenses. However, such costs must meet certain criteria including that they relate to the

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<sup>1</sup> IDS includes all software applications developed using RBC staff and other internal resources as opposed to the purchase of an “off the shelf” application from a third-party vendor. To take an example not specifically arising in this case, a corporation could choose to develop its own internal time keeping software as opposed to purchasing such software from an established provider. The costs associated with developing new IDS largely relate to work effort and include employee salaries and benefits, and fees paid to third-party contractors.

development of assets which, among other things, are expected to generate future economic benefits.

3. RBC's books and records and internal accounting controls and processes relating to the capitalization of IDS were deficient because they failed to provide support for RBC's capitalized IDS costs.

4. For many years, RBC applied a practical expedient whereby it aggregated the costs of its smaller IDS projects into a single pool and capitalized a percentage of those costs by applying a single capitalization rate to all projects in the pool (the **Pool Method**). The Pool Method had a number of control and process deficiencies. From 2008 through 2020, RBC included projects in the pool that were ineligible for capitalization. Also, during this period, the Pool Method suffered from additional shortcomings:

- (a) From 2008 to 2016, RBC estimated the capitalization rate to be 78% with limited supporting analysis; and
- (b) Starting in 2017, RBC instituted a "rate study" to determine whether its continued use of the 78% capitalization rate remained appropriate. The rate studies were intended to be a key control in support of RBC's IDS cost capitalization estimation process, but the studies were unreliable and did not provide sufficient support for the 78% capitalization rate due to a number of deficiencies with respect to key inputs into the study and the lack of documentation to support project costs.

5. Finally, RBC also lacked effective impairment assessment and amortization controls and procedures, which resulted in RBC carrying capitalized IDS assets in the large programs (defined below) on its balance sheet at full book value when those assets should have been amortized over time commencing when they became available for use or written off, if they were impaired.

6. Consequently, RBC failed to keep such books and records as are necessary to properly record the business transactions and financial affairs of RBC as they relate to IDS contrary to section 19(1) of the Act.

7. The parties will jointly file a request for a public hearing (the **Settlement Hearing**) in accordance with Rule 33, to consider whether, pursuant to subsection 127(1) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the **Act**), it is in the public interest for the Capital Markets Tribunal (the **Tribunal**) to make certain orders in respect of the RBC.

## **PART II - JOINT SETTLEMENT RECOMMENDATION**

8. RBC agrees to this settlement and consents to the making of an order (the **Order**) substantially in the form attached as Schedule “A” to this Settlement Agreement.

9. RBC neither admits nor denies the accuracy of the facts or the conclusions of the OSC set out in Parts I and III of this Settlement Agreement. It is the OSC’s position that the statement of facts set out by Commission Staff in Parts I and III, which is based on an investigation carried out by the OSC, is supported by the evidence reviewed by the OSC and the conclusions contained in Parts I and III are reasonable.

## **PART III – STATEMENT OF FACTS AND CONCLUSIONS OF THE ONTARIO SECURITIES COMMISSION**

### **A - Background**

10. RBC is a Schedule 1 Bank under the *Bank Act (Canada)* incorporated and domiciled in Canada. Its corporate headquarters are located in Toronto, Ontario and its head office is located in Montreal, Quebec. RBC is a reporting issuer in all provinces and territories of Canada, and its principal regulator is the *Autorité des Marchés Financiers* (the **AMF**). RBC's common shares are listed on the Toronto Stock Exchange and New York Stock Exchange with the ticker symbol RY.

11. RBC is Canada's largest bank whether on the basis of assets, revenue, net income or market capitalization. At October 31, 2022, RBC reported total assets of \$1.9 trillion. RBC’s total revenue in fiscal 2022 was \$49.0 billion, with \$15.8 billion of net income. Its market capitalization at the end of fiscal 2022 was approximately \$174.3 billion.

12. RBC's consolidated financial statements filed with the Ontario Securities Commission are prepared in accordance with International Financial Reporting Standards (**IFRS**).

### ***Applicable Accounting Standards***

13. Under applicable accounting standards, in order to qualify as an intangible asset, the expenditure must, among other things, provide future economic benefits and its cost must be subject to reliable measurement. Costs incurred during the development phase of an IDS project are eligible for capitalization provided other applicable criteria are met. Costs incurred for the investigation and planning for potential new IDS projects during the initial research phase and costs associated with maintaining or decommissioning existing IDS must be expensed.

14. Applicable accounting standards also require an entity to assess, at the end of each reporting period, whether there is any indication that an asset, including internally developed intangible assets, may be impaired. 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 instance, if an entity no longer uses an IDS application, the asset is likely impaired and its carrying amount should be written down to the amount to be recovered through its use, which is typically zero. The applicable accounting standards also require an annual assessment of impairment of intangible assets not yet available for use.

### **B - RBC's Internally Developed Software Accounting**

#### ***Growth in IDS at RBC***

15. RBC's spending on IDS, and capitalization of associated costs, has grown over the years. RBC capitalized approximately \$658 million of IDS assets in 2011.<sup>2</sup> That amount grew to \$1.3 billion by 2022. Likewise, the amount spent on pooled projects has grown from approximately \$100 million at the inception of the pool to approximately \$600-700 million.

#### ***Accounting for IDS at RBC***

16. Generally, RBC's process for capitalizing IDS project costs has depended on the dollar-value of the project. Projects estimated to cost more than \$5 million (increased to more than \$10 million in 2020) are designated as "large program" projects and individually reviewed to determine the

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<sup>2</sup> Prior to 2011, RBC did not separately disclose IDS balances.

amount of costs eligible for capitalization. Projects that have an expected cost of \$5 million or less (later increased to \$10 million or less) are subjected to the Pool Method developed by RBC.

17. The Pool Method, a component of RBC's internal accounting policy, aggregates the costs of RBC's smaller IDS projects into a single pool and capitalizes a percentage of those costs by applying a single capitalization rate. RBC implemented the Pool Method for administrative ease due to the time and expense it would take to assess each small project for capitalization. In later years, the IDS pool has included in excess of 1,200 projects.

18. In theory, the capitalization rate represents the estimated amount of development work eligible for capitalization relative to the total amount of work completed on each IDS project in the pool. The capitalized costs under the Pool Method are then amortized over three years starting one year from the date the costs were incurred.

19. RBC's internal accounting policy required that the capitalization rate be assessed on an annual basis and adjusted if necessary to reflect the nature of the actual expenditures.

### ***Control Deficiencies in RBC's Pool Method***

#### ***i. RBC Used the Same Unsupported Capitalization Rate***

20. From 2008 through 2020, RBC used a capitalization rate of 78%, meaning 78% of its IDS pool costs were recorded as intangible assets on its balance sheet.

21. From 2008 to 2016, RBC's purported process for calculating this capitalization rate was to:

- (a) add up salary, benefits, and professional fees for its IDS pool projects; and
- (b) divide that number by the total costs incurred (salary, benefits, and professional fees plus rent, utilities, training, and management salaries).

22. Consequently, and as an expedient, RBC treated staffing costs and professional fees on IDS pool projects as capitalizable even when certain of these tasks were not truly capitalizable under applicable accounting standards (such as planning and maintenance expenses). This resulted in RBC overcapitalizing costs associated with its IDS pool projects and understating period expenses.

ii. RBC Instituted Rate Studies That Were Unreliable

23. In 2017, RBC began conducting studies as a key internal control to validate its estimated capitalization rate of 78%. RBC conducted additional studies in 2019, 2020, and 2021, but did not conduct a study in 2018.

24. The basic methodology used for the studies involved surveying employees working on IDS as to their activities to determine how much time, on average, various roles spent on capitalizable activities (**Role Rate**). RBC also sampled IDS pool projects to determine how much time was spent in the research and development stages of projects and reviewed project documentation relating to third-party contracts (**Phase Rate**). The resulting Role Rate and Phase Rate were then averaged, providing RBC with two points on a range.

25. The rate studies completed prior to 2021 were unreliable and failed as an internal control and did not support the capitalization rate for the following reasons:

- (a) Starting in 2017, RBC received approximately 150 survey responses from employees. RBC did not in all cases accept the survey results. Instead, if the results of the survey did not match internal notions of a particular role's contributions to IDS project work (and thus what the capitalization rate should be) RBC disregarded the survey result and substituted a different value that more closely aligned with those internal notions;
- (b) For the Phase Rate portion of the studies, RBC sampled 27 to 45 projects in any given year. RBC eventually determined that the relatively small sample sizes resulted in unreliable survey results;
- (c) The sampled projects sometimes included projects that were ineligible for capitalization and should not have been in the IDS pool, such as maintenance and decommissioning projects, and canceled projects that should have been written off. These projects were in the IDS pool because RBC lacked an effective controls process to identify and exclude them. Maintenance and decommissioning projects

were incorrectly coded as "development" and accounted for using the Pool Method, resulting in a percentage of associated costs being improperly capitalized as assets;

- (d) Upon identifying ineligible projects during the study processes, RBC removed the projects from the sample as “outliers” but did not review the pool to ensure that it did not include other projects that were similarly ineligible for capitalization. The removal of “outliers” effectively undermined the representativeness of the project sample and further added to the unreliable nature of the studies;
- (e) 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.

26. Starting in 2021, RBC instituted additional controls governing the maintenance/development designation, including additional education on the topic and requiring project managers to answer a questionnaire about each project at the time the designation is made to help determine whether projects should be coded as maintenance. RBC also enhanced its rate study methodology by increasing the sample size, making the sampling more representative of the overall project pool and conducting the studies more frequently.

#### ***Lack of Documentation for Professional Fees***

27. From at least 2017 through 2020, RBC did not have an effective system in place to track and document contracts or the associated statements of work for professional fees paid to third-party contractors in respect of IDS pool projects and large programs. The lack of documentation meant that RBC often had to rely on unverifiable information from project managers as to the content of a contract, the type of work being undertaken, and whether any or all of the activities performed by contractors on a project were capitalizable.

### ***Control Deficiencies in RBC's Large Programs***

#### **i. Lack of Impairment Analysis**

28. From at least 2017 through 2020, RBC did not have an effective process to identify and report impaired IDS assets, resulting in impaired assets that should have been written off remaining on RBC's balance sheet.

29. In 2021, RBC improved its impairment review process, including by assigning two employees to assess each month whether any software applications are no longer in use and require a write-down.

#### **ii. Lack of Effective Amortization Start Date**

30. From at least 2017 through 2020, RBC did not have an effective process for determining and recording the start date for amortizing capitalized costs arising out of large programs because it did not have an effective method to determine when an IDS application was available for use.

### **C - Conclusions**

31. RBC failed to keep such books and records as are necessary to properly record the business transactions and financial affairs of RBC as they relate to IDS contrary to section 19(1) of the Act. RBC's books and records and internal accounting controls and processes relating to the capitalization of IDS were deficient because they failed to adequately support the accuracy of the IDS costs capitalized by RBC or whether the IDS costs were eligible to be treated as such.

### **D - Mitigating Factors**

32. Dishonest or abusive conduct has not been alleged and no evidence of such conduct was uncovered.

33. RBC provided prompt, detailed and candid cooperation during the investigation.

34. No evidence of harm or loss to investors was uncovered during the investigation and there was no material impact to RBC's financial statements.



35. The control deficiencies identified did not result in a material weakness in RBC's internal control over financial reporting, or impact the evaluation of RBC's disclosure control and procedures, within the meaning of National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings*.

36. RBC has agreed to make the voluntary payment set out in Part IV below.

37. RBC has also agreed to pay US \$6,000,000 (\$8,000,000 at a fixed CAD to USD exchange rate of 1 CAD = .75 USD) to the Securities and Exchange Commission (the SEC) and \$2,000,000 under a settlement reached with the AMF. RBC shall receive an offset credit against the amount payable to the SEC for amounts paid to the Commission and the AMF. Payments to the SEC and AMF also arise out of the conduct described in this Settlement Agreement.

38. RBC has taken corrective measures to address the books and records and control deficiencies relating to IDS cost capitalization including the following:

- (a) centralizing the IDS capitalization rate assessment process;
- (b) implementing an automated solution to improve the overall control environment respecting the IDS capitalization rate process;
- (c) undertaking an initiative to improve inputs into the project management system;
- (d) enhancing training for project managers on differences between development (capitalizable) and maintenance (non-capitalizable) expenditures;
- (e) conducting capitalization rate studies on a quarterly rather than annual basis; and
- (f) formalizing the impairment review process.

39. The above-noted corrective measures were taken prior to RBC being notified about the commencement of the investigation by the Commission, the AMF and the SEC.

#### **PART IV - TERMS OF SETTLEMENT**

40. RBC agrees to the terms of settlement set forth below.

41. RBC agrees to make a voluntary payment in the amount of \$2,000,000 by wire transfer to the Commission before the commencement of the Settlement Hearing.

42. RBC consents to the Order substantially in the form attached to this Settlement Agreement as Schedule “A”, pursuant to which it is ordered that:

(a) this Settlement Agreement is approved.

#### **PART V - FURTHER PROCEEDINGS**

43. If the Tribunal approves this Settlement Agreement, no enforcement proceeding will be commenced or continued against the Respondent under Ontario securities law based on the misconduct described in Part III of this Settlement Agreement, unless the Respondent fails to comply with any term in this Settlement Agreement.

44. If the Respondent fails to comply with any term in this Settlement Agreement, enforcement proceedings under Ontario securities law may be brought against the Respondent.

45. The Respondent waives any defences to a proceeding referenced in paragraph 44 that are based on the limitation period in the Act, provided that no such proceeding shall be commenced later than six years from the date of the occurrence of the last failure to comply with this Settlement Agreement.

#### **PART VI - PROCEDURE FOR APPROVAL OF SETTLEMENT**

46. The parties will seek approval of this Settlement Agreement at the Settlement Hearing before the Tribunal, which shall be held on a date determined by Registrar, Governance & Tribunal Secretariat of the Commission in accordance with this Agreement and the Tribunal’s *Rules of Procedure and Forms*.

47. Representative(s) of the Respondent will attend the Settlement Hearing by video conference or in person as required.

48. The parties confirm that this Settlement Agreement sets forth all facts that will be submitted at the Settlement Hearing, unless the parties agree that additional facts should be submitted at the Settlement Hearing.

49. If the Tribunal approves this Settlement Agreement:

1. the Respondent irrevocably waives all rights to a full hearing, judicial review or appeal of this matter under the Act; and
2. neither party will make any public statement that is inconsistent with this Settlement Agreement or with any additional agreed facts submitted at the Settlement Hearing. Nothing in this paragraph affects the Respondent's testimonial obligations or the right to take legal or factual positions in other investigations or legal proceedings in which the Commission and/or Commission Staff is not a party or in which any provincial or territorial securities regulatory authority in Canada and/or its staff is not a party (**Other Proceedings**) or to make public statements in connection with Other Proceedings.

50. Whether or not the Tribunal approves this Settlement Agreement, the Respondent will not use, in any proceeding, this Settlement Agreement or the negotiation or process of approval of this Settlement Agreement as the basis for any attack on the Commission or the Tribunal's jurisdiction, alleged bias, alleged unfairness or any other remedies or challenges that may be available.

## **PART VII - DISCLOSURE OF SETTLEMENT AGREEMENT**

51. If the Tribunal does not make the Order:

1. this Settlement Agreement and all discussions and negotiations between the parties before the Settlement Hearing will be without prejudice to either party; and
2. the parties will each be entitled to all available proceedings, remedies and challenges, including proceeding to a hearing on the merits of the allegations contained in the Statement of Allegations in respect of the Proceeding. Any such proceedings, remedies and challenges will not be affected by this Settlement Agreement, or by any discussions or negotiations relating to this Settlement Agreement.

52. The parties will keep the terms of this Settlement Agreement confidential until the Tribunal approves the Settlement Agreement, except as is necessary to make submissions at the settlement

hearing. If, for whatever reason, the Tribunal does not approve the Settlement Agreement, the terms of the Settlement Agreement shall remain confidential indefinitely, unless the parties otherwise agree in writing or if required by law.

**PART VIII - EXECUTION OF SETTLEMENT AGREEMENT**

53. This Settlement Agreement may be signed in one or more counterparts which together constitute a binding agreement.

54. An electronic copy of any signature will be as effective as an original signature.

**DATED at Toronto, Ontario, this 18<sup>th</sup> day of October, 2023.**

**ROYAL BANK OF CANADA**

I have authority to bind the Bank.

**“Nick Tomovski”**

By: \_\_\_\_\_  
Name: Nick Tomovski

Title: Senior Vice President, Personal  
Commercial Banking, Technology &  
Operations and Corporate Support  
Finance

**DATED at Toronto, Ontario, this 25 day of October, 2023.**

**ONTARIO SECURITIES COMMISSION**

By: **“Jeff Kehoe”**

\_\_\_\_\_  
Name: Jeff Kehoe

Title: Director, Enforcement Branch

**SCHEDULE "A"**  
**FORM OF ORDER**



Capital Markets Tribunal	Tribunal des des marches financiers	22nd Floor 20 Queen Street West Toronto ON M5H 3S8	22e étage 20, rue Queen oust Toronto ON M5H 3S8
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**IN THE MATTER OF  
ROYAL BANK OF CANADA**

File No.

*(Names of panelists comprising the panel)*

*(Day and date order made)*

**ORDER**

(Section 127 of the *Securities Act*, RSO 1990, c. S.5)

**WHEREAS** on [**date**] the Capital Markets Tribunal held a hearing by videoconference to consider the request for approval of settlement agreement dated [**date**] (the **Settlement Agreement**);

**ON READING** the Joint Application for Settlement Hearing, including the Statement of Allegations dated [**date**] and the Settlement Agreement, the written submissions, and on hearing the submissions of representatives of each of the parties, and on considering Royal Bank of Canada (**RBC**) having made payment of \$2,000,000 to the Commission in accordance with the terms of the Settlement Agreement,

**IT IS ORDERED** that:

1. the Settlement Agreement is approved.

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[Adjudicator]

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[Adjudicator]

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[Adjudicator]