



TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report

Volume 2: Inquiry Framework

Volume 3: Evidence

PWC

PWC: Core Book 55

January 2016

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This Board was established by the Institute of Chartered Accountants in Ireland to regulate its members, in accordance with the provisions of the Institute's bye-laws, independently, openly and in the public interest. The CARB is responsible for developing Standards of Professional Conduct and supervising the compliance of members, member firms, affiliates and students	PUB00415 [001-085]	57-141

C2: Role and effectiveness of the Policy appraisal regime before and during the crisis

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Description	Bates Number [Relevant Pages]	Page
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Independent Auditors' Report 2007	PWC00190 [001-002]	145-146

C3: Appropriateness and effectiveness of the Department of Finance actions during crisis

C3c: Effectiveness of reviews of banks' loan books and capital adequacy

Description	Bates Number [Relevant Pages]	Page
Project atlas II Volume 1 Overview Working Draft: Contents not for release – 17 November 2008 [Allied Irish Banks plc, Anglo Irish Bank Corporation plc, Bank of Ireland Group, Educational Building Society, Irish Life and Permanent plc and Irish Nationwide Building Society (collectively the "Banks" or the "Institutions")] (Extracts)	DOF02573 [006, 089-090, 102,116-118]	148-154

R2: Effectiveness of the Supervisory Practice (Central Bank, Regulator and Department of Finance)

R2c: Adequacy of the assessment and communication of both solvency and liquidity risks in the banking institutions and sector

Description	Bates Number [Relevant Pages]	Page
Statutory Duty Confirmation: Statement by the auditors for Bank of Ireland Group plc. to the Financial Regulator June 2008	PWC00256 [001-003]	156-158
Statutory Duty Confirmation: Statement by the auditors for Bank of Ireland Group plc. to the Financial Regulator June 2007	PWC00230 [001-003]	159-161



THEME: B1

Effectiveness of banks' board governance,
client relationships and business models

LINE OF INQUIRY: B1b

Integrity of financial reporting

OLIVER WYMAN

Bank of Ireland 

Financial Services

15 May 2009

Review of risk governance Recommendations and road map

CONFIDENTIAL | www.oliverwyman.com

LON-BIR03011-015

Five initiatives to implement recommendations

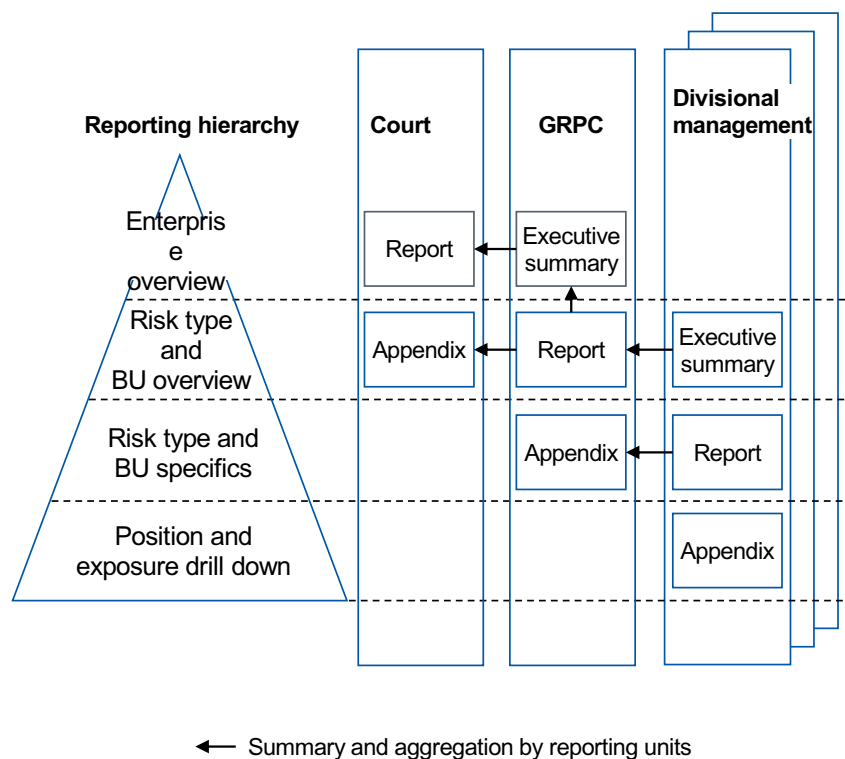
Risk governance	Recommendations	Initiatives
D. Risk measurement and reporting	11. Bring all risk reports into single hierarchical set of reports to the Court	I. Delivery of Court risk report
	9. Set up a uniform MI system across all credit businesses	II. Build-up of credit MI starting in business banking
	10. Embed portfolio and stress models in decision making at group and BU level	III. Deployment of risk modelling
B. Guidance	4. Make objective link between risk appetite and limits	IV. Enablement of Court to guard risk profile
A. Board level oversight	1. Increase the effectiveness of the Court in risk governance	V. Adjustments to risk committees
	2. Make risk appetite a boundary condition to strategy	
	3. Make executive remuneration risk-adjusted	
C. Risk Management and control	5. Differentiate GRPC from other governance committees	V. Adjustments to risk committees
	6. "Force" differentiated dissent	
	7. Enforce decisions more strictly (in particular limits)	
	8. Widen the GAC to cover risk governance and strengthen the risk function's position	

Initiative I – Delivery of Court risk report and introduction of hierarchical reporting

Approach: GRO is up-and-running to implement reporting changes

- Business owner
 - Head of Group Risk Office
- Objective
 - Bring all risk reports into single hierarchical set of reports
- Benefit
 - Enable the Court to form its own opinion on risk and to challenge Bol's risk profile and governance (e.g. by drilling-down through the reporting pack into specifics)
 - Ensure all material risks are appropriately monitored (and managed) from BU level up to Court level
- Priority
 - Provide Court with summary risk report
- Dependencies
 - Adequate resources
 - IT budgets

Framing of objectives: Recommended reporting hierarchy

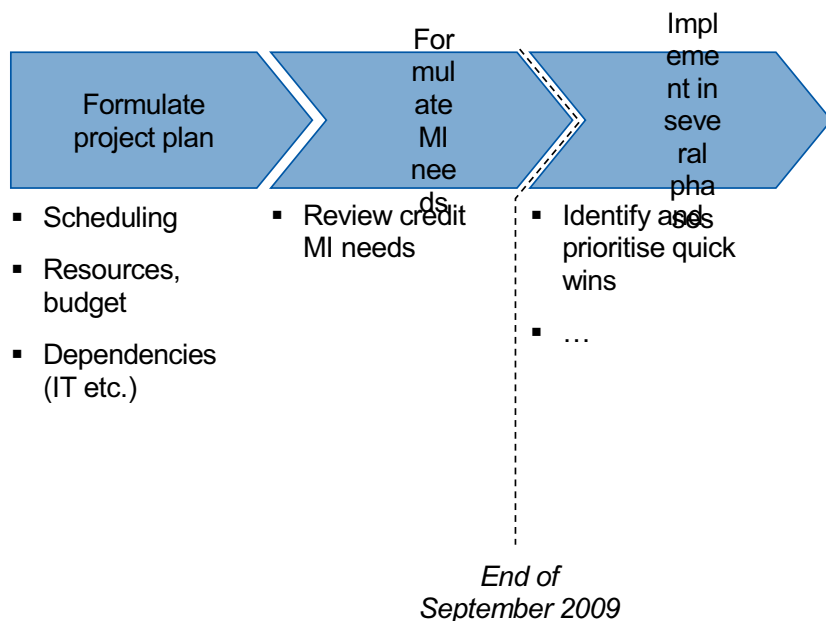


Initiative II – Build-up of credit MI (in particular in business banking)

Approach: Group MI Forum was established March 2009 to tackle the issue


- Business owners
 - Director of Group Finance and
 - Head of Group Credit
- Objective
 - Set up uniform credit MI across all businesses
- Benefit
 - BU: Enable more timely decision making – both at individual level (e.g. new lending) and overall portfolio level
 - Group: Enable better understanding of the aggregate risk position
 - Tactical: Assist in meeting Government/Regulatory requirements in a more consistent and efficient manner
- Dependencies
 - Competing priorities between tactical solutions to meet immediate demands (e.g. NAMA) and longer term solutions
 - Constrained IT budgets/competing demands (budget being scoped)
 - Access to required resources
 - Ownership and buy-in at BU/lender level (needs correct data input at the source)


Framing of objectives: First steps to be undertaken by Group MI forum



Observed limitations

Risk governance	Observed limitations	Significance
A. Board level oversight	<ul style="list-style-type: none"> ▪ Risk appetite statement is considered a derivative of the strategy, not an input/boundary condition to it ▪ Risks inherent in the core business and strategy may not have been fully appreciated 	
B. Top-down Guidance	<ul style="list-style-type: none"> ▪ Link between exposure limits and risk appetite is incomplete and heavily dependent on expert judgment 	
C. Risk management and control	<ul style="list-style-type: none"> ▪ Risk management and control was not geared towards understanding aggregate risk profile 	
D. Risk reporting	<ul style="list-style-type: none"> ▪ Business banking credit especially vulnerable <ul style="list-style-type: none"> – Oversight hampered by shortcomings in risk information – Risk modelling for stresses and portfolio still under development 	

 Could have materially influenced the past performance

 Valuable going forward

Directional recommendations – to be refined

Risk governance	Recommendations	Timing of impact		
A. Board level oversight	<ul style="list-style-type: none"> ▪ Increase effectiveness of Court in risk governance ▪ Make risk appetite boundary condition to strategy 	Coming half year	Within year	Next year
B. Guidance	<ul style="list-style-type: none"> ▪ Make objective link between risk appetite and limits 	Coming half year	Within year	Next year
C. Risk Management and control	<ul style="list-style-type: none"> ▪ Differentiate GRPC from other governance committees ▪ Adjust committee rules <ul style="list-style-type: none"> – Grant risk function a stronger position – Enforce decisions more strictly (in particular limits) – “Force” differentiated dissent 	Coming half year	Within year	Next year
D. Risk reporting	<ul style="list-style-type: none"> ▪ Set up uniform MI system across all credit businesses ▪ Prioritise further development and application of portfolio and stress modelling ▪ Bring all risk reports into single hierarchical set of reports 	Coming half year ¹⁾	Within year	Next year

1) Will be composed manually – only afterwards automated

Three initiatives to implement recommendations – to be refined

Risk governance	Recommendations	Initiatives	Key Success Factors
D. Risk reporting	<ul style="list-style-type: none"> Set up uniform MI system across all credit businesses Bring all risk reports into single hierarchical set of reports 	I. Build-up of MI and risk reporting	<ul style="list-style-type: none"> Align to existing IT roadmap Come to workable structure with risk function, business and IT participating Make benefits very clear to all stakeholders
B. Guidance	<ul style="list-style-type: none"> Prioritise further development and application of portfolio and stress modelling Make objective link between risk appetite and limits 	II. Development of risk modelling	<ul style="list-style-type: none"> Ensure models will be applied in decision making at BU level Build necessary skills in BU Allocate enough resources to implementation
A. Board level oversight	<ul style="list-style-type: none"> Increase effectiveness of Court in risk governance Make risk appetite boundary condition to strategy 	III. Adjustments to risk committees	<ul style="list-style-type: none"> Gain GEC support early on Strengthen position of risk function in committees Embed risk in GEC culture
C. Risk Management and control	<ul style="list-style-type: none"> Differentiate GRPC from other governance committees Adjust committee rules 		

Priorities in detailing initiatives

- Find leaders ASAP – if no suitable leader found, signal to the Court by 15 May
- Stepwise approach to ensure benefits are realised early on

Next steps

Topic	Details
Review of risk governance	<ul style="list-style-type: none">▪ Team will complete review<ul style="list-style-type: none">– Refine observation based on discussion today– Detail recommendations– Set-up implementation roadmap in close collaboration with candidate owners▪ Risk report will be further developed together with GRO (Group Risk Office) department
Communications	<ul style="list-style-type: none">▪ Report back to the working group on 6 and 11 May – discuss final report in 2 iterations▪ Present final report in Court on 15 May

Appendix

Supporting material

LON-BIR03011-006

Development of strategy 2012 was extensive, but under-emphasised downside risks

Clear strategy

- Significant out-performance growth in Ireland, particularly in business banking
- Growth in all three UK platforms but particularly business banking
- Accelerated expansion of the corporate banking niche skilled based areas

Extensive development

- Strategy 2012 put in place in July 2006 following a detailed nine month review process involving GEC, Court and external consultants
- External consultants presented to the Court on their view of
 - The shape of the financial services industry over the following 5/10 years
 - Potential options for the group
 - Major risk events
- Overall targeted earnings growth of 15%+ CAGR over a five year period
- Clear acceptance that strategy would result in 17% CAGR in RWA and of the increased risk profile inherent in the strategy

Regular monitoring

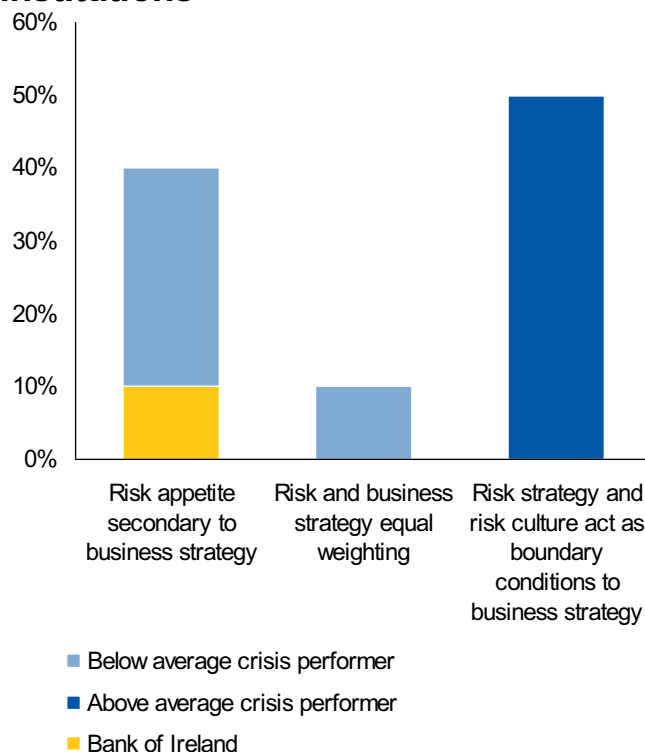
- From November 2006 semi-annual updates were provided to the Court outlining
 - Progress against strategy and key strategic metrics (EPS, TSR, geographic profile of earnings, cost/income ratio and level of non-interest income)
 - Updates on the central planning scenario
- Agreed in November 2007, recognising turmoil in financial markets, to re-visit assumptions underpinning strategy
- March 2008 agreed to look at alternative scenarios and options available to the group, recognising that strategic context too optimistic given market conditions

Source: Bol

Risk appetite statement was considered a derivative of the strategy, not an input/boundary condition to it

- Interviews with executive managers indicate that Bol's risk appetite was more a derivative of the strategy than vice-versa
- Benchmarking indicates that
 - Peers who have performed well during the crisis tend to have let bank culture and identity shape risk appetite, with strategy being conditional to this
 - Peers who have not performed well tend to develop strategy with little or no up-front consideration of risk appetite

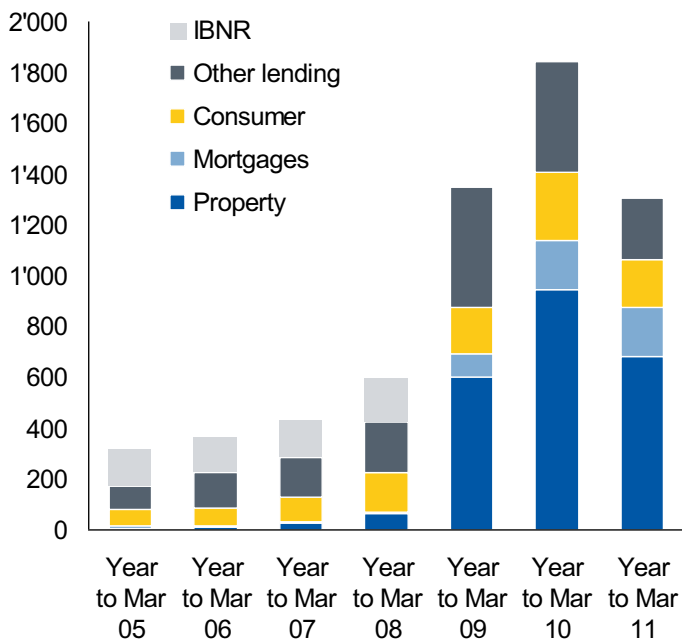
View/treatment of risk appetite by peer institutions



Source: Oliver Wyman analysis

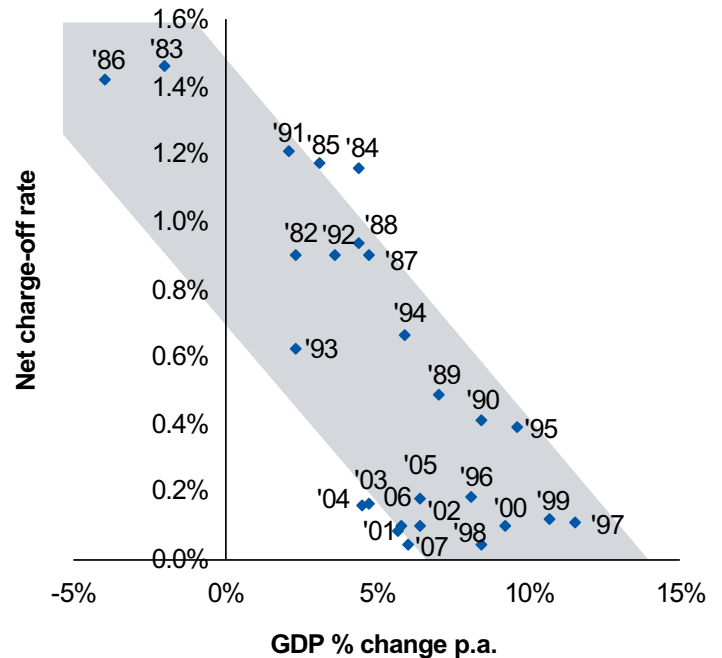
Increases in loan losses directly linked to dependence on Irish (and UK) economy

Loan losses per portfolio
€MM



Source: Bol data

Systemic Risk No. 1: Irish GDP
Bank of Ireland write-offs vs. the economic cycle



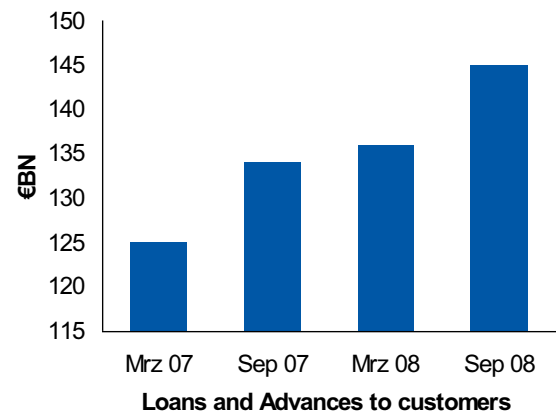
The start of the credit crisis did not automatically result in a revision of the core lending growth strategy

Court action

- November 2007 – acknowledged that Strategy 2012 had been predicated on a relatively benign economic environment with no major economic shocks and agreed that the Central Planning Scenario needed to be re-visited
- March 2008 – recognised changed market environment, funding challenges and Group's more selective approach to lending
- March 2008 – Consensus reached by the Court that alternative scenarios in Strategy 2012 needed to be assessed
- July 2008 – approach to new lending to be increasingly selective and available capacity to be rationed in favour of the core franchise business. Acknowledged that Strategy 2012 no longer appropriate

Business/credit action

- No significant slowdown in lending evident



Source: Bol

There is a relatively weak link between Bol's risk appetite and the derivation of exposure limits

Illustrative

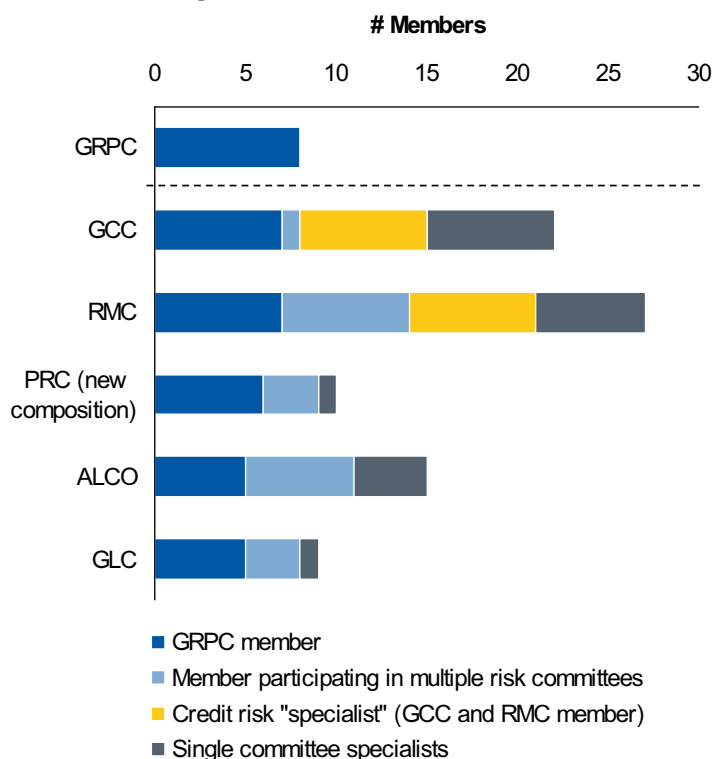
Portfolio	Limit
Landbank	ROI Limit €4.2 BN UK Limit £1.7 BN
Corp. Banking	
Global Project Finance	€4.5 BN
Maritime	\$2 BN
REIT	\$700 MM
Real Estate Oppty Funds	\$1.5 BN
Global Markets	
Trade Finance	€1 BN
Sub. Bank Debt Policy	€250 MM
BB ROI	€1.39 BN
BB UK	£300 MM

- Exposure limits are only weakly linked to risk appetite
 - Limits derived with view to portfolio exposure
 - Risk appetite mainly used as a restrictive condition (1in-10 limit exposure should not breach LTG)
 - No exposure limits for certain portfolio levels
 - Corporate banking (considered unnecessary)
 - BBROI sub-sectors (data not available)
- Portfolio/sector policies not explicitly considered from risk appetite perspective
 - There are few numerical links to risk appetite. Policies are driven by bank's market positioning
 - There is no view of overall exposure by exception type. Exceptions to policy are escalated/tracked as and when they occur

Source: Bol Risk Office

Fresh, top-down assessment of risk profile at GRPC difficult as members have already agreed to decisions in subordinate committees

Membership of risk committees



- Almost all GRPC members have a seat in all risk committees
- GCC and RMC are focussing on specific credit issues and therefore
 - Have wider membership and far less attendance of GRPC members
 - Very frequent meeting
- PRC has been restructured to gain seniority, however it is now close to a replica of the GRPC
- GRPC and GEC have large overlap in composition (five of eight GRPC members are GEC members)

Source: Bol

Bol's collaborative culture has reduced dissent in key risk committees

- Dissent in key risk management committees rare
 - Review of GRPC minutes from 2006 to date shows only two cases of clear disagreement among members (see right)
 - Interviews conducted during this review have confirmed the collaborative nature of the meetings and lack of open dissent
 - Possibly GCC is only exception where policy and limit exceptions were debated in detail
- A collaborative company culture and dissent in decision taking are not mutually exclusive
 - Bank of Ireland's culture is perceived to be collaborative avoiding confrontation and dissent
 - By formalising the roles in decision taking, one can augment the culture with more balanced decision taking (e.g. parties can "agree to disagree" – don't agree with decision, but will collaborate)

Source: Bol

Case 1 – August 2007 GRPC

- Proposal to increase Landbank limit from EUR 1.7 bn to EUR 2 bn
- Members agreed on a majority basis with two members expressing dissent

Case 2 – April 2008 GRPC

- Further request from Business Banking Ireland to increase their Landbank limit
- Limit increased by further €100 MM on a majority basis with clear dissent noted from one member

Risk mitigants were considered but rejected on cost grounds

Return considerations were used to come to conclusion on risk topics

- Opportunities to cap risk in certain portfolios were looked at on a number of occasions during the 2006 and 2007 period
- In all cases the decision was made not to do so for economic reasons

Example 1: Credit Default Swap

- In May 2007 consideration was given to purchasing a credit default swap for some exposures in the portfolio. Concluded against for economic reasons, no signs of stress in the portfolio and loan sales a more cost effective option
- By November 2007 the ability to dispose of stressed assets through sale on the secondary market/re-financing had either greatly reduced or disappeared

Example 2: Mortgage Indemnity Guarantee

- During 2006 and 2007 the issue of purchasing Mortgage Indemnity Guarantees was discussed a number of times for both the UK and Irish mortgage books – particularly for the high LTV mortgages
- Agreed not to proceed each time for economic reasons but to re-visit if necessary

Source: Oliver Wyman interviews

Policies were not adjusted to reflect changing business conditions

- Breaches of policy guidelines in transactions became frequent during the 2005-2008 period
- Majority of the policy breaches were in
 - Property transactions
 - Leveraged Acquisition Finance
- Property policy breaches were not unique to one area – all three divisions experienced an increase in the level and frequency of breaches over this period
- Exceptions all assessed on a case-by-case basis and approved if enhanced risks were considered sufficiently mitigated e.g. adequate security, track record, relationship, etc.
- Accepted by GRPC in March 2007 that *“policy exceptions were running at a relatively high rate but that this reflected the point in the property cycle and policy is designed to operate through the cyclical swings”*

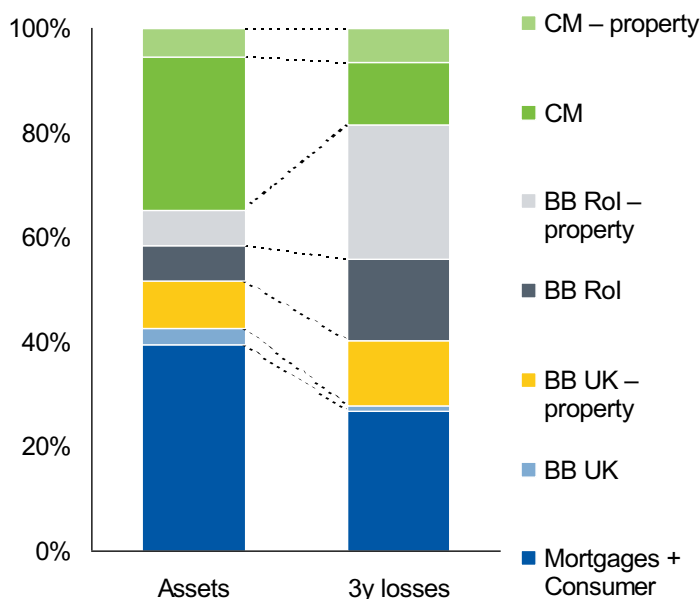
Examples of policy breaches include

- Breaches of leverage ratios (senior debt/EBITDA and total debt/EBITDA ratios)
- Property policy breaches included
 - Breaches of LTV limits
 - Element of speculative residential exposure,
 - non-recourse funding of Landbank
 - 3.25 years development time vs. 2 years max under Landbank policy
 - 100% site funding vs. 75% max.
- Breaches of total limits in a number of areas e.g. Landbank, project finance – approvals being sought for increased limits after they were exceeded

Source: Bol

Business banking has been hit disproportionately hard partly due to the difficulty in managing the risks there

Business banking disproportionately contributes to the 3 year losses



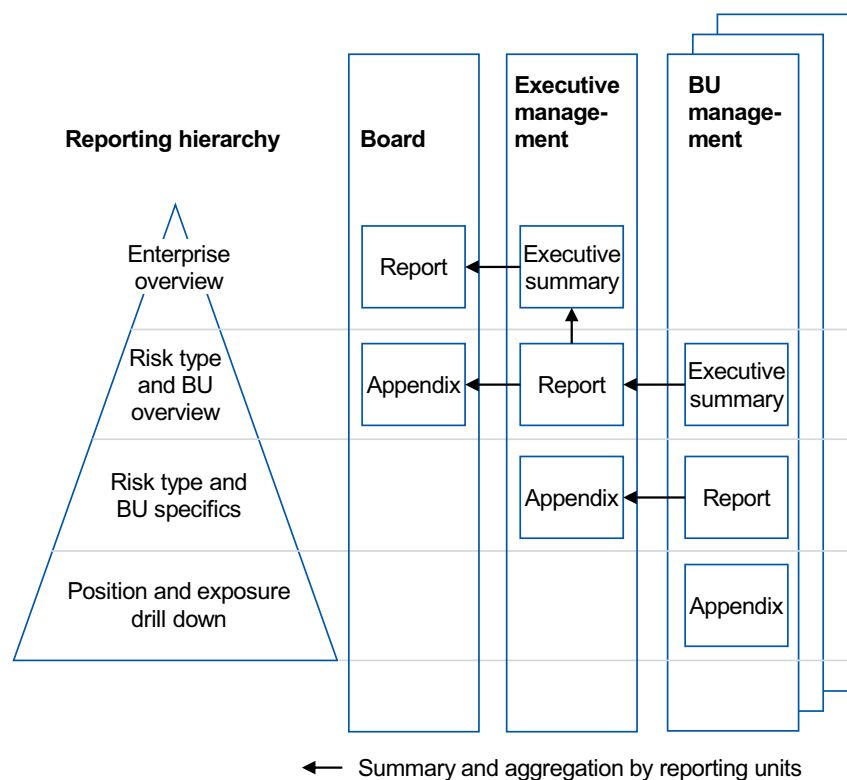
Source: Bol risk function

Business banking is most complex portfolio from risk management perspective

- It requires a combination of statistical and expert based approaches
 - Retail business can rely on statistical methods as products are standardised and large number of customers give good basis for statistical methods
 - Corporate banking should rely on expert judgments as deals are unique and large enough to assess individually
 - Business banking needs both as products are varied and number of customers is too large for expert based approach
- At Bol risk management for business banking could not rely on some of its key tools
 - Data: All stakeholders point out the weaknesses in Management Information and reporting
 - Modelling: In BBRoI the migration to BIPs rating system only complete in Q1 08
 - Oversight: Most deals too small to be assessed in GCC and lack of information hampered PRC to pick up the concentration risks in the portfolio

Reporting should allow executives to form their own opinions on risk profile

Recommended reporting hierarchy



Source: Oliver Wyman analysis

Reporting principles

- **Consistent set** of figures/charts allows trend tracking
- **Drill down** capability
 - Reports covering same broad themes but at different levels of detail
 - Short Court summary (e.g. 2-4 pages)
 - Longer risk type summaries enabling drill down into risk-type issues
 - More detailed line of business reports allowing further drill-down
- Traffic light risk triggers and **pro-active contingency plans**
 - Early warning system to identify capital and/or earning strains linked to a preventative actions e.g.
 - Green – everything on track
 - Yellow – consider contingency plans
 - Orange – put contingency plans into action and monitor
 - Red – Court/group risk intervene as last resort
- Value added **commentary plus ad-hoc analysis**
 - Comments added to put words to the graphs
 - Tailored analysis carried out to focus attention on key issues e.g. relevant trends/threat scenarios
- **Action point tracking** (e.g. limit breaches/major risks to the bank and follow-up actions)

BoI reporting template is being developed in parallel to review

Management Information: In the credit area the information is incomplete, heterogeneous and difficult to collate

Bol systems contain incomplete risk information, and not easily accessible

- Relevance
 - For portfolio/risk management a wide range of information is necessary to identify concentration, systemic risks, etc.
 - Paramount in an era of increased information requirements from the regulator and the NTMA.
 - Particular relevant for business banking as it needs to combine statistical approaches with expert assessments
- Issue: Not readily available
 - Incomplete (see illustration on the right)
 - Not uniform enough and
 - No central control on it
- Examples
 - Right hand side – providing information to external party requires substantial effort
 - In interviews almost all managers pointed out how this limited risk management

Illustration – February 2009 information request by external party covering non-retail

	# of requested items by theme		
	Risk	Rating	Other
Readily available	8	26	38
In system but ad-hoc query necessary	3	5	0
Combination of assumptions and ad-hoc query necessary	14	12	0
Not readily available (% total)	68%	40%	0%

Source: Bol risk function

To fully answer the question we have, below, separately addressed the effectiveness of underwriting, challenged loan management, reporting, and credit MI.

The **credit risk underwriting** process is effective and based on sound financial analysis. Our review of 112 credit risk files indicated that applications contain comprehensive analysis, including concise and informative company and industry profiles, and are well structured and easy to follow. Moreover, and as per section 3(c), the expert senior advisors who conducted our review agreed with 110 of 112 credit decisions. In our view the credit risk management team has extensive experience in the market and in-depth industry knowledge of the portfolio and clients.

While the overall process is strong, our analysis uncovered three areas for improvement:

1. BOI should further enhance its credit analysis by i) more frequent use of down side analysis, including all challenged loans; ii) adding a matrix summarising all group exposures in the credit file⁵;
2. Reduce the reliance on external ratings and improve the statistical nature of the internal rating model for banks over time; and
3. Review poorly performing models. Several rating models have seen significant deterioration in their ability to discriminate between good and bad obligors and to estimate the overall level of defaults. Some gradual downward drift in model performance is normal, but exceptionally severe macroeconomic conditions have created a discontinuity. Amendments to most of these models are currently under review and enhancements will be rolled out by the end of June 2011. Upon completion of these enhancements the models should once again perform to market standards. We recommend that remediating the remaining models also be prioritised.

We observe that in other countries with less “landlord friendly” leasing regimes, interest-only property loans are less common than in Ireland and UK, and loans tend to be more conservatively structured. As a result, there is greater attention paid to amortisation in general and the debt service coverage ratio in particular as a measure of borrower payment ability.

In order to adapt quickly during the period’s economic crisis, BOI set up dedicated units managing **challenged loans**, meaning previously performing loans that are progressively deteriorating. The Special Property Group (SPG) is a good example: most challenged loans which have real estate as the underlying security have been moved from the original business unit (e.g. Business Banking or Corporate Banking) to the SPG, which reports directly into Group Credit and Market Risk. In addition to the SPG, BOI decided to spread the management of challenged loans across nine separate units within the business divisions.

This may have potentially led to some inconsistencies in approach and to a lack of regular and consistent reporting at Group level. This issue is currently under review by Group Credit and Market Risk. Going forward we recommend that BOI complete its planned comprehensive review of the challenged loan operating model (organisational set up, policies, accountabilities and reporting) expeditiously. For example, the structure of the challenged loan organisation may benefit from a more unified centre of competency.

⁵ TGE is always presented in credit applications, and the detail of each individual exposure exists, but it is not as easy to follow as it could be

At the beginning of the period **credit risk reporting** was below industry standards. Information was not always consistent across different levels of the organisation, and reports to the Board had limited drill down. During the period, the Court Risk Report and Blue Book were overhauled and updated, with several overlapping reports merged into the Court Risk Report (CRR). As of today, these reports are now more action-oriented and user friendly, and cover all of the required credit risks in appropriate detail. The CRR can be considered an example of best practice compared to the reports of peer European banks.

Included in the CRR is an analysis of macroeconomic variables showing trends in GDP, unemployment, property prices, inflation, and interest rates. In addition to historical data, the report also includes a red, amber and green (RAG) assessment of the status of each macroeconomic indicator and short term forecasts for GDP and unemployment. This analysis sets the context for the remaining review and assessment of BOI's portfolio and risk profile.

Whilst we found the overall reporting quality to be high, it is our opinion that an additional report should be set up:

- ***A separate report (or section) for Challenged Loans.*** At present, BOI has ~€26B in challenged loans. With a portfolio this large, small changes could have significant impact to the overall loan book and P&L. We recommend a monthly report that provides detailed information solely on Challenged Loans. For example, it could report on loan volumes, loan loss provisions (LLP), inflows and outflows, etc. by portfolio (which business unit the loans originated from) and by managerial view (which challenged team the loan is currently with).

Credit Risk MI is currently adequate to produce the above mentioned reports but at the beginning of the period had deficiencies both in the underlying data (e.g. blank fields for some tenancy schedules) and the IT architecture (e.g. multiple data bases across different business units). This meant that there was difficulty answering key questions on BOI's lending book in a timely and accurate manner. BOI recognised these deficiencies and has materially progressed a €5m project to remedy the situation. BOI's proposed solutions to this issue are appropriate and the project management appears on track. However, we do have a concern with the timing.

- ***Timing.*** For the Credit MI Project to complete on schedule, ~370 relationship managers (and 10 central FTEs) in Business Banking need to correctly enter data for a large number of fields. It may be the case that these relationship managers will not view this data entry as a priority, which could cause schedule overruns and/or quality issues. Additionally, due to BIPS's IT architecture, data entry cannot commence until February 2011 when an updated version goes live. To ensure on-time roll-out, BOI senior management should monitor the project very closely to ensure that adequate resources and support are given to data entry and related quality assurance.

f) Balance of authority between risk and business

→ The balance of authority between risk management and the business lending in approving credit decisions

In our view the independence of BOI's risk function from its business function throughout the period is in line with best practice. BOI has:

- Independent lines of reporting for risk and business
- Group Credit Committee in line with applicable best practices guidelines
 - Balance of representation from risk and business
 - Healthy challenge and debate

4. Conclusions

Credit risk management at BOI has been robust during a period of extraordinary stress in the Irish banking sector and the Irish economy more generally. BOI is aligned with best practice with respect to the majority of the issues identified in the CBI letter, including:

- Board oversight of credit extension and risk management
- Executive management stewardship of credit risk
- Balance of authority between risk and business
- Role of Internal Audit
- Adequacy of credit risk management resources and skills to achieve lending targets
- Court risk report

There were four areas where there were gaps between BOI credit risk capabilities and peer best practice:

- Risk appetite framework
- Court Risk Committee
- Risk function organisation structure
- Credit MI

During the period there has been a considerable effort to address these issues, with material progress made.

The areas in the CBI letter aside, we have identified four broader areas for improvement:

1. **Review the challenged loans' operating model.** Currently, BOI has ten units managing challenged loans. A comprehensive review of the operating model is underway. For example, combining several restructuring units into one larger unit would create a centre of competency with a similar approach to restructuring. It would also optimise resource allocation and generate opportunities for career progression.
2. **Strengthen rating models.** BOI should continue to review and to recalibrate poorly performing rating models, and improve the statistical robustness of its bank rating model. While appropriate capital conservatism applied to poorly performing models, the overall level of model performance is a concern. In addition BOI should consider changing the reporting line of ICU out of Audit.
3. **Ensure credit MI improvements are delivered on time.** The credit MI improvements appear to be on track to be delivered during the second quarter of 2011. We do not expect any major delay; however, this is a challenge that needs to be managed tightly since thousands of data items will need to be entered manually into the system, and this cannot be started until a new version of Bank Ireland Pricing System (BIPS) goes live.
4. **Reconsider change membership of GCC to reflect deal flow.** Senior risk executives chaired all but one GCC. Attendance in GCC meetings amongst other senior executives is lower. Delegation of this responsibility is expected given the deal-specific scope of the GCC, and the focus on large tickets naturally emphasises capital markets. Retail risks are primarily dealt with through the risk dashboard and collections meetings. Consequently the membership of GCC could be reconsidered.

In addition, results from our credit file review were positive. We generally found the credit decisions to be based on strong company and industry analysis, and agreed with the vast majority of decisions (110 out of 112 reviews). However, we identified two specific areas of improvement for BOI, and two more general observations on the Irish and UK market for the CBI's consideration:

1. **Incorporate downside analysis more frequently.** When downside analysis was present, it was robust, well applied, and aided the final credit decision. However, BOI should incorporate downside analysis in all reviews for loans with low credit ratings and, in general, use this analysis more frequently. This would provide a more complete risk profile picture and a more accurate estimation of the high end of potential losses.
2. **Provide a summary sheet of all exposures for connected groups.** BOI should summarise total exposures to connected groups by listing each facility and the associated high-level financial indicators on a single sheet. While this information is already available in the bank, providing this summary view within each credit file for such groups would provide quick and easy access to a complete high-level view of group exposures.
3. **Add debt service coverage ratio as a main payment coverage ratio for property loans.** Many of the credit files use interest coverage and loan to value ratios as the key indicators of the borrower’s ability to meet payments. This is common in Ireland and similar markets such as the UK due to the high proportion of interest-only loans and the landlord-friendly leasing regime. In markets where principal amortisation is more common, such as the US, debt service coverage ratios are typically used as the main indicator of a customer’s ability to make payments. We feel that this focus would enhance property risk analysis, especially for borderline and speculative cases.
4. **Consider the use of general provisions.** While this will require a change in accounting standards, we believe it would be more useful for certain types of challenged loan than the generic IBNR calculation.

Exhibit 8

Improvements to credit process possible for BOI; other observations on market issues for Central Bank			
	Area of improvement	Case for change	
Scenario analysis	<p>Fewer than expected lower rated credit files containing downside case analyses</p> <ul style="list-style-type: none"> Expected for all 25 challenged and non-performing loans, but only present for five Present for 19 other well rated loans 	<p>Downside analysis on challenged loans would provide a more complete risk profile picture</p> <ul style="list-style-type: none"> Estimate high end of potential losses Some businesses and developments very sensitive to relatively small market declines 	BOI Issues
Summary information for groups	<p>TGE is provided but key financials for connected entities/groups not summarised in cover sheet</p> <ul style="list-style-type: none"> Best practice would be to provide a table of key metrics for all exposures in each file 	<p>Provides quick and easy access to complete high level view of group exposures</p> <ul style="list-style-type: none"> Require both total exposure and individual performance when making credit decision Easier/faster than looking up information in separate credit files 	
Debt servicing	<p>Many of the credit files use interest coverage and loan to value ratios as the key indicators of the borrower’s ability to meet payments</p> <ul style="list-style-type: none"> This is common in Ireland and similar markets such as the UK due to the high proportion of interest-only loans and the landlord-friendly leasing regime 	<p>In markets where principal amortisation is more common, such as the US, debt service coverage ratios are typically used as the main indicator of a customer’s ability to make payments</p> <ul style="list-style-type: none"> This focus would enhance property risk analysis 	Market Issues
Reserving	<p>While we find the overall level of provisions reasonable, we believe that total losses for a number of performing restructured property loans will likely exceed the reserves implicitly held against them through the IBNR reserves</p>	<p>In other geographies, general provisions are held against such potential losses</p> <ul style="list-style-type: none"> Since this is not permitted under current accounting rules, the CBI could consider adapting local regulations to allow for general provisions against pools of higher risk challenged loans 	

Source: BCG credit file review

THE BOSTON CONSULTING GROUP

In-flight initiatives address many of the points above. This effort should be sustained going forward to further improve credit risk management capabilities and bring them more in line with peer best practices.

One area of best practice is worth calling out: BOI senior management strongly encourages staff rotation between risk and the businesses. This has been effective at promoting business awareness in risk and risk awareness in the businesses. We applaud this practice and suggest formalising it as an official BOI policy going forward.

Bank of Ireland (BOI) worked with a wide range of property valuation firms across the Republic of Ireland (ROI) during the period 2001 to 2008 in relation to property valuation services on properties in ROI financed by BOI.

BOI has conducted a best efforts review of its available records (which we believe would cover the majority of payments) and can confirm, from the reviewed records, that BOI did not make aggregate payments which exceeded €25 million to any individual property valuation firm during the relevant period.

From the available records, a table is provided below of the aggregate fees paid by BOI to the 'Top 5' property valuation firms, whose aggregate fees could include payments for services such as searches, landlord services, etc, i.e. not only valuation services on properties in ROI financed by BOI.

This table demonstrates that the value of payments made by BOI to property valuation firms in ROI during the relevant period is significantly under the €25m threshold with the highest aggregate payment being c. €1.2m.

	Property Valuation Firm	€'m
1	Jones Lang LaSalle	c. 1.2
2	Lisney	c. 0.7
3	Sherry Fitzgerald	c. 0.2
4	Quirke Estate Agents	c. 0.2
5	Lambert Smith Hampton	c. 0.1

In most cases during the relevant period, the valuation fee was paid by the borrower and BOI does not have a record of the fees paid by the borrower in respect of such valuations.

Acquired Loan Assets

NAMA was established in December 2009 following the enactment of the National Asset Management Agency Act, 2009 in November of that year. Five institutions (and their subsidiaries) were designated as participating institutions by the Minister for Finance in February 2010: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Nationwide Building Society and EBS Building Society⁴.

LOAN ACQUISITION

The first loan transfers occurred in late March 2010.

Table 2 below summarises the major phases of the loan acquisition process:

TABLE 2: Phases of loan acquisition

	€bn	Date of transfer
Tranche 1	15.3	March – May 2010
Tranche 2	11.9	June – August 2010
Bulk transfer*	44.0	October – December 2010
Transfers in 2011	2.8	March and October 2011
TOTAL	74.0	

*At the request of the Minister for Finance, the transfer of the third and later loan tranches was accelerated as part of a bulk transfer in the last quarter of 2010.

96% of the portfolio (€71.2 billion) was acquired within a nine-month period between March and December 2010.

Transfers in 2011 took place in two phases: a transfer of €1.1 billion in March (loans which were deemed eligible by AIB in late 2010) and a transfer of €1.7 billion in October. After the Supreme Court judgements in the **Dellway** case, NAMA instituted a process of consultation in June 2011 with debtors whose loans had not, at that stage, yet been acquired. Debtors were invited to make written representations to NAMA in respect of the possible acquisition of their loans and, in particular, as to any adverse effect such acquisition was likely to have on their interests. Debtors were also provided with an opportunity to make representations as to the eligibility of the loans by reference to the criteria for eligibility set out in the Act and in the Regulations.

Following a review of submissions received from debtors, the NAMA Board exercised its discretion, under Section 84 of the Act, to acquire loans totalling €1.7 billion and this acquisition was completed in October 2011. In the

⁴ The business of Irish Nationwide Building Society transferred to Anglo Irish Bank on 1 July 2011 and the merged entity now trades as Irish Bank Resolution Corporation Ltd. (IBRC). EBS Building Society was acquired by Allied Irish Banks plc. on 1 July 2011 and now operates as a subsidiary of AIB.

case of another €400m, the Board exercised its discretion not to acquire the loans concerned. Loans totalling €260m were deemed to be ineligible following a review of additional information received in debtor representations.

ACQUISITIONS BY INSTITUTION

Table 3 below summarises the transfers by institution:

TABLE 3: Loan acquisitions by institution (€ billion)

	AIB	ANGLO	BOI	EBS	INBS	TOTAL
Loan balances transferred	20.4	34.1	9.9	0.9	8.7	74.0
Consideration paid	9.0	13.4	5.6	0.4	3.4	31.8
Discount	56%	61%	43%	57%	61%	57%

Table 4 below provides a breakdown of debtor connections⁵ by size of nominal debt acquired by NAMA (many of the debtors are also indebted to non-NAMA financial institutions).

TABLE 4: Distribution of NAMA debtor connections by size of nominal debt

Nominal Debt	Number of debtor connections	Average nominal debt per connection €m	Total nominal debt in this category €m
In excess of €2,000m	3	2,758	8,275
Between €1,000m and €2,000m	9	1,549	13,945
Between €500m and €999.9m	17	674	11,454
Between €250m and €499.9m	34	347	11,796
Between €100m and €249.9m	82	152	12,496
Between €50m and €99.9m	99	68	6,752
Between €20m and €49.9m	226	32	7,180
Less than €20m	302	7	2,117
TOTAL	772	96	74,015

⁵ Debtor connections may consist of one debtor or a number of closely-connected debtors whose aggregate debt is considered by NAMA to be best managed as one cohesive connection rather than managed through separate debtor entities.

**GROUP AUDIT COMMITTEE
MINUTES OF A MEETING HELD ON 14th May 2009**

PRESENT: Mr D Holt, Chairman
Mr T Considine, Director
Mr. P. Haran, Director
Ms R Hynes, Director
Mr J Kennedy, Director
Ms H A McSharry, Director

IN ATTENDANCE: Mr R Boucher, Group Chief Executive
Mr R Murphy, Group Chief Risk Officer
Mr J O'Donovan, Group Chief Financial Officer
Mr L McLoughlin, Director of Group Finance
Ms H Nolan, Group Chief Internal Auditor
Mr P Morris, Group Chief Internal Auditor Designate
Mr V Mulvey, Mr D Whelan, Group Credit (Item 2(b))
Mr S Crowe, Group Treasurer and Mr. T Joyce, Group Management Accountant (For Item 2 (c))

Mr Crumlish, Head of Group Accounting Policy (for Items 2(f), 3, 6)
Mr B Lonergan, Head of External Reporting (for Item 2(f), 3, 6)
Ms A Gallagher, Head of SEC Compliance (for Item 6)
Mr J G Murphy, Head of Group Regulatory and Operational Risk (for Item 8)
Mr C Kohli, Ms E Scott, Mr E Faughnan, PwC (for all except Items 1, 4 & 7)
Mr Paul Moran, Financial Regulator
Mr JB Clifford, Group Secretary
Mr J Crean, Deputy Group Secretary

1. Minutes of the Meeting & Matters Arising

The Chairman invited the Committee to provide any comments on the draft minutes of the 29th of April to the next meeting of the Committee. **Committee**

The Chairman commented that the Impairment paper had only been furnished to the Committee on the previous meeting, which gave the Committee very little time to review an important paper. He indicated that in future the Committee must receive such papers earlier.

2. Year-End Issues

a) Disclosure Committee Recommendations

The Committee considered the conclusions of the Disclosure Committee as set out in the letter from its Chairman to the Chairman of the Audit Committee and noted that no issues or concerns had been raised.

b) Review of Impairment Charge, Provisions and Impaired Loans

Mr Mulvey summarised the impairment charge and provisions, indicating that the overall charge of €1.44bn (102bps) (cf: 31 March 2008: €227m – 17bps) was broadly in line with the guidance given in the interim management statement of 12 February 2009 (losses of c. €1.4bn on loans and advances to customers). The impairment charge for the year on Available for Sale Financial Assets was 76m (March 2008: €5m) and on loans and advances to banks €2m (March 2008: nil).

The charge for IBNR had increased significantly from previous estimates as the effect of model re-builds and criteria-tightening took effect. Management viewed it as prudent in a rapidly deteriorating environment to further increase the charge by €0.17bn to bring the balance sheet IBNR provision closer to an overall three month emergence period.

Estimates for loan impairment losses for the 3 years to 31 March 2011 were included in the February IMS at c. €4.5bn, with further downside risk of €1.5bn; further deterioration in economic conditions since then suggested that the original assumptions required updating. Following a high level review, supported by Oliver Wyman for the non –property portfolios, a revised range of €6.1bn - €6.9bn had been developed. The lower end of the range was based on consensus macro economic forecasts available at April 2009 while the downside case used ESRI forecasts for ROI and a stress case for the UK.

Mr Kohli confirmed PwC's support for the provisions, including the increase in IBNR, noting that good progress had been made in redesigning the underlying models; while a range of views could be taken in regard to impairment, BoI had been consistent in its approach and the assumptions used were clearly justifiable.

In response to further probing from the Committee in relation to the assumptions and underlying models used in generating the new downside estimate of €6.1bn - €6.9bn, management acknowledged that the figure did not take any account of the emergence of NAMA, the likely outcome of which was unknown. Mr O'Donovan expressed the view that caution should be exercised with regard to predicting a downside figure, particularly in view of the fact that the outcome of the NAMA process had the potential to skew any prediction. He expressed the view that, in any event, the important factor was capitalisation of the Group, which was demonstrated to be adequate under the stress-testing work already carried out.

In response to a query from the Chairman, Mr O'Donovan confirmed that there were no material changes to the other key technical judgements as discussed in detail at the Committee meeting of 16 April.

The Committee approved the impairment charge and provisions and other key judgemental decisions.

c) Going Concern

Mr O'Donovan provided an overview of his paper on the going concern assessment, which had been circulated in advance and had been marked-up against the paper which the Committee had reviewed at the meeting of 29 April. It included a note on Emergency Liquidity Assistance (ELA) from the ECB. He noted that the most critical issue in the Going Concern assessment was liquidity/funding and whether the Group could meet its obligations as they fall due for the foreseeable future, i.e. up to 30 June 2010. In assessing Going Concern, the Group's liquidity position had been assessed under a range of scenarios and stresses. In the most stressed Scenario, the Group would require ELA from the ECB of circa €4bn., which the Central Bank had confirmed would be available if required. Norman corrective actions would include bidding up for deposits, reducing new lending and de-leveraging and disposing of non-core assets. He suggested that ELA provided significant comfort for material unexpected events where time did not permit normal corrective actions to produce results. In addition to normal corrective actions, NAMA would provide collateral amounting to c. €15bn, which had not been included in the stressed funding scenario. Mr O'Donovan indicated that even in Scenario 4 (most stressed scenario) described in the paper, the Group would pass the Going Concern test.

Mr Crowe outlined a number of factors which had led to improving funding conditions since the particularly stressed situation following the nationalisation of Anglo Irish Bank in January 2009. These included improving market sentiment generally leading to stabilisation in the Group's deposit balances and strengthening of confidence following the recently announced extension of the government guarantee for term debt. He commented that the degree to which Scenario 4 was a very stressed one should not be underestimated.

In response to an invitation to comment from the Chairman, Mr. Kohli indicated that since the last meeting, the external auditor had had the benefit of deeper insight into certain relevant issues, such as deposit stickiness and wholesale funding availability; a number of developments had made unlikely the possibility of deterioration in the wholesale funding renewal rate of 40%.

Mr Kohli commented that, while Scenario 4 was extreme, management should expressly confirm for the record its understanding that ELA would be forthcoming if required. In response, Mr. Crowe stated that at a recent meeting between management and the Central Bank, the latter had been asked directly whether ELA would be provided if required; the response from the Central Bank official concerned was decidedly in the affirmative.

Mr O'Donovan indicated that management had concluded there were no material uncertainties that would lead to significant doubts as to the

Group's ability to continue as a going concern for the foreseeable future, i.e. up to 30 June 2010.

In conclusion, the Committee confirmed its support for management's assessment of Going Concern.

d) Preliminary Announcement

Following a query from the Chairman as to whether there were points on which greater disclosure was required, Mr. Kohli responded that there had been strong focus this year on credit and liquidity risk. In that regards, management had made significant improvements in three relevant areas, i.e., by bringing together the quantitative and qualitative aspects of risk management into one section, adoption of the fair value hierarchy for assets and liabilities carried at fair value and by providing a break-down of credit risk as between property and non-property. He expressed the view that overall compliance was good in respect of the audited part of the Accounts; the Bank was not at the leading edge with respect to disclosure, but was ahead of other Irish banks.

In further discussion, the Committee queried whether guidance should be given to the market arising from the revised estimated downside figure of €6.9bn. In response, Mr. O'Donovan suggested that the Bank needed to resist the tendency to make predictions to the market which could not be verified and focus on the fact that the Group's capital position remained safe. The Committee queried whether, given the acknowledged movement in the base-case figure towards €6bn, it would be misleading not to restate the guidance already given to the market. Referring to the further deterioration in the Irish economy, management responded that there was an assumption that all of the Group's loan book was in Ireland when in fact it was diversified, 45% of the book was in the UK.

In conclusion, it was agreed that the disclosure should be re-written, for the Court meeting of the next morning, with a view to using one number in the disclosure with a reference to further downside. **JO'D**

e) Governor's Statement & (f) Reports & Accounts

The Committee agreed a number of amendments to be made to the text of the draft Governor's Statement and Reports & Accounts and, subject to finalisation of these, decided to recommend the amended draft to the Court on the following day.

3. PwC Internal Control / PwC Audit Findings Report

The Chairman invited Mr Kohli to draw the Committee's attention to the key audit findings as set out in the report of the external auditor. Mr Kohli indicated that the audit, including key risk areas of SOx work, was substantially complete and that PwC expected to issue an unqualified report on the

Consolidated IFRS Financial Statements once they had been approved by the Court. PwC also expected to be able to issue a positive opinion of its assessment of internal control over financial reporting to be included in the Bank's 20-F in late May.

In respect of overall audit conclusions, Mr Kohli indicated that in PwC's view:

- The dominant material and judgemental item in the Annual Report was the assessment of the quantum of the loan impairment provision; final findings were consistent with those reported to the Committee meeting of 29 April. Total booked impairment provisions were reasonable.
- As compared to the half year, assumptions for individual discounted cash flow provisions had been strengthened and significant progress made on the use of more relevant models, supplemented by management judgement in the current environment. Given the overall environment, there was more downside than upside risk in the overall level of provisions.
- There was significant increase in valuation risk around both financial and non-financial assets. Audit findings supported management's approach to valuation as outlined at the Committee meeting of 29 April.
- Management's assessment of Going Concern and liquidity risk was comprehensive and the conclusion was reasonable.

Mr Kohli reported that the adjusted and unadjusted differences which had come to PwC's attention during the course of the audit of the financial statements were not material. The Committee confirmed its satisfaction with these items.

In response to "Questions for the Group Audit Committee" set out in the PwC report, the Committee asked whether there should be disclosure of the fact that the Bank had spent a lot of money on a sizeable project, Alnova, which had not been successful. In response Messrs. Boucher and O'Donovan indicated that acknowledgement of fault on the Bank's part could impact negatively on the outcome of negotiations with Accenture. It was acknowledged that neither the Bank nor Accenture could deliver the desired outcome and both had decided to "call it quits". In addition, it was being treated as an operating expense. In response to a further query regarding the write-down of goodwill in Guggenheim and Iridian and whether the "external market" was an adequate explanation, Mr O'Donovan agreed to review the wording with a view to seeing that the Bank's responsibility was adequately reflected.

The Committee noted the PwC report.

4. Non Audit Fees

McLoughlin drew attention to the paper which was provided an update on fees paid to PwC to 31 March 2009. He reported that approximately €6m had been paid in Statutory Audit fees, including SOx, and €15.2m on Non-Audit work. Non-audit fees, which were pre-approved by the Chairman since the last update to the Committee on 23 February 2009, amounted to €1.2. The Committee ratified the Chairman's approvals.

5. Group Internal Audit Half Year Report to 31 March 2009

Referring to the Group Internal Audit Report 2008/09, Ms. Nolan indicated that the overall control environment in the Group during the period was satisfactory, with key performance indicators confirming negative audit results and outstanding unresolved issues to be at historically low levels. Nevertheless, controls, which in a normal scenario would be adequate, were under pressure in the current environment, resulting in the need for management to monitor and identify changes in risk profile and consequent need to strengthen controls.

Ms. Nolan indicated that a number of audits which were rated negatively raised concern as many were “repeat offenders”, e.g. Bray Branch and UKFS Finance Asset & Liability Management. In response to probing from the Committee as to whether management had put in place sufficient measures to ensure that repetition did not continue, Ms. Nolan described a range of management actions; these included, besides informal interaction, quarterly meetings with the relevant managers, network monitoring and meetings between Group Internal Audit and the Head of Retail. In the case of unsatisfactory ratings of the Limerick Cash Centre, management action included moving the overall management of Cash Centres into the Payments area, where better processes were in place, and change of management of the Cash Centres.

In response to a query regarding GIA’s investigation of Cahirciveen Branch (Assistant Manager acting as agent for external property company), Ms. Nolan advised that branch staff required written permission from management to engage in such activity. In this case verbal permission had been given in circumstances where it appeared that the manager did not correctly assess the potential conflict of interest. The Committee queried why such activity was not completely prohibited. In further discussion it was agreed that this policy should be reviewed, to include outside directorships. **RMM/HN**

The Committee noted the report

6. SOx S404 Update

Mr O’Donovan and Ms Gallagher reported on SOx S.404 Compliance, indicating that that testing was progressing well. Results from Management and PwC testing, completed to date, showed no Material Weakness or Significant Deficiencies identified as of 7 May. As of the date of the meeting, Control Deficiencies were at 9 for 2009, down from 19 in 2008 and 52 in 2007. A potential Significant Deficiency had come to light the previous evening (issue regarding a €13m error in the pension fund figures); this might need formal evaluation and would require monitoring by the Committee.

Mr. Kohli explained that because of the relevant materiality levels, the error would need to be in the order of €65m to be disclosable in the Report & Accounts. While PwC was still working with the issue with management, it was unlikely to be disclosable. As a Significant Deficiency, it would have to be reported to the Committee and monitored.

The Committee noted the Report.

7. External Auditor Effectiveness

The Chairman invited Ms. Nolan to provide an overview of the responses from the Committee and Senior Management, to the survey on external auditor effectiveness.

In summarising the results, Ms. Nolan reported that management's attitude was quite positive in general with responses being more qualified from those further from Group Centre. A number of responses from the Committee noted a desire for greater robustness from PwC on asset impairment & loan losses.

Further discussion focussed on whether there was sufficient robustness of discussion with, and clarity of opinion from, the external auditor. Mr. McLoughlin advised that management had engaged in much robust discussion with the external auditor, on range of judgemental issues, in a year in which these were particularly to the fore. While accepting that this was the case, a member observed that the Committee tended to see the outcome of such discussions; more "colour" with regard to the background debate which had take place was required. In conclusion, it was agreed that, while it was in general necessary for management and the external auditor to have reached conclusions in advance of Committee meetings, management should not hesitate to give the Committee a flavour of the debate leading to presentations at meetings. The Committee noted the responses and concluded that the external auditor continued to provide effective audit services to the Group.

In response to the Chairman's observation that the external auditor had been in place for a very long time, a member expressed the view that PwC seemed to have served the Bank and the Committee well. Mr O'Donovan pointed to limitations associated with potential alternative providers (KPMG Dublin being AIB's auditor, others based in London would involve dealing with cultural issues); nevertheless if the Committee wished to see a change that could be done. A member indicated that the arguments against alternatives, if accepted, would be a tantamount conclusion that no change could ever be made.

In conclusion, it was agreed that a formal review should be carried out with a view to exploring options. **JO'D**

8. Group Regulatory & Operational Risk – Half year review

Mr. John Murphy provided an overview of key elements of the Group Regulatory & Operational Risk Report. He noted that the regulatory agenda continued to be dominated by the compliance requirements arising from the Government Guarantee scheme, the Subscription Agreement and the increased reporting requirements from the Financial Regulator and the Department of Finance. A key risk regarding the new information requirements was that information was not necessarily readily available or not in the required format. Good progress was being made on Business Continuity and Data Protection

plans presented to the Committee at its February 2009 meeting. Money Laundering continued to have a high profile throughout the Group, the backlog of Suspicious Transactions Reports having been cleared. Operational risk losses amounted to €35m, down from €54m the previous year. In response to the Chairman's comment that every Euro written off should be resented, Mr Murphy outlined a series of measures being taken to reduce fraud losses. He noted, however, that certain credit card security features were lacking in some jurisdictions abroad (e.g. the US), making loss reduction there more challenging.

Pandemic planning: the Group's Pandemic Planning Working Group had been re-established and business units requested to update their plans. The pandemic had not materialised but the exercise had proven to be useful dry run.

UKFS Arrow Visit Risk Assessment: In response to a comment that the report on this assessment appeared complacent in view of the reality that the regulatory requirements had been raised, Mr. Murphy indicated that management was on top of the relevant issues. The Chairman requested that future reports contain a more judgemental as opposed to merely factual presentation. **JGM**

In response to the query from the Committee, Mr. Murphy confirmed that the 2 new reported (unprocessed refunds) were being dealt with. The Committee asked that it be closed as quickly as possible, noting that notwithstanding that there were relatively small amounts involved, significant negative publicity could ensue. **JGM**

The Committee noted the Report.

9. AOB

It was agreed that the draft 20-F would be reviewed at the meeting to be held on 29 May at 8:00a.m. – those passages which were completely new/ not previously seen by the Committee to be marked as such. **JO'D**

Chairman
2nd July 2009



THEME: B2

Effectiveness of banks' credit strategies and risk management

LINE OF INQUIRY: B2a

Appropriateness of property-related lending strategies and risk appetite

Bank of Ireland



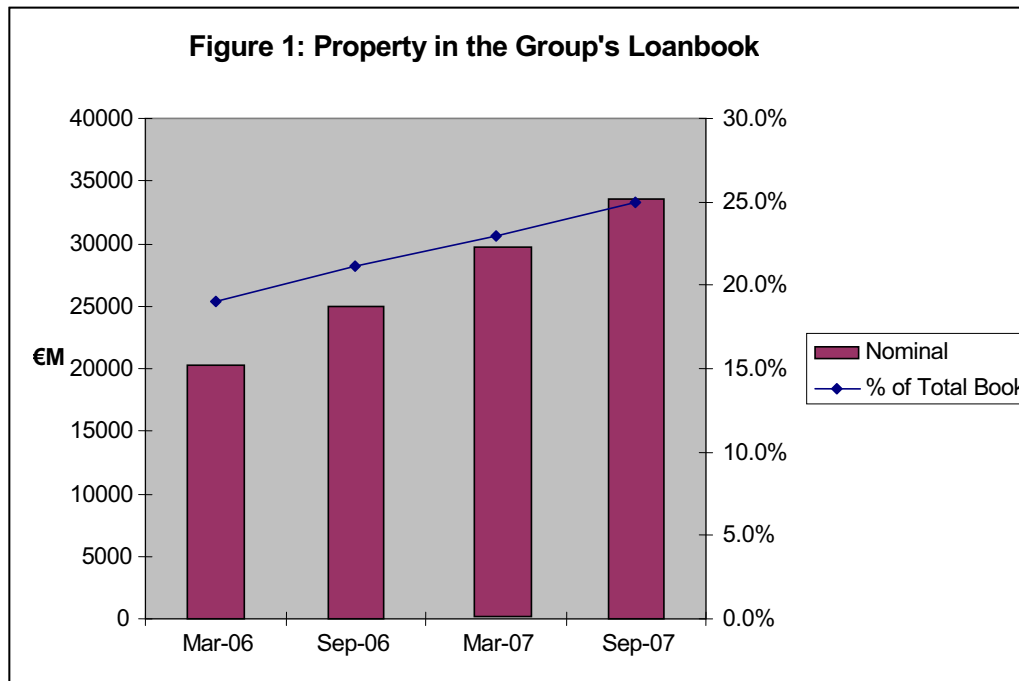
To: Group Risk Policy Committee
From: Group Risk Office
Date: 13 December 2007
Subject: Property Concentration in the Group's Loanbook

1. Purpose:

At its meeting of 28th November 2007, the Portfolio Review Committee considered a paper from the Group Risk Office that contained information on sectoral concentrations in the loan book. The PRC noted the increasing concentrations of exposures in the book. It was recommended that the content of the paper be brought to the attention of GRPC for its consideration and determination of any resulting action it deems appropriate. This paper also updates GRPC on the level of single name concentration in the book and the impact of both measures on our debt rating agency scores.

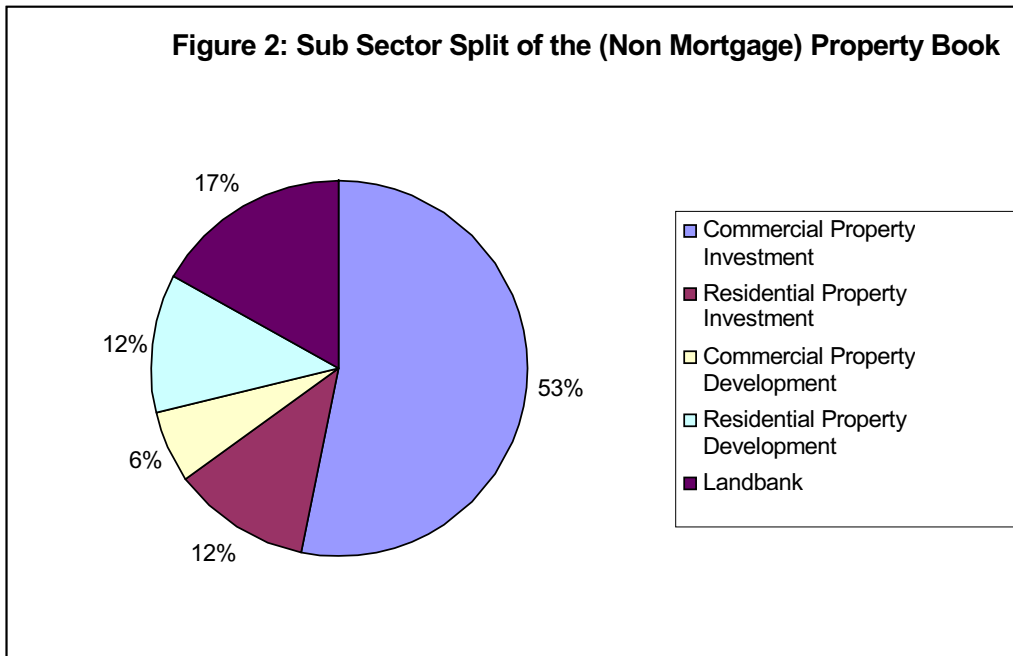
2. BoI Group Property Exposure:

Property now accounts for 44% of all non mortgage lending. The levels of property exposure (excluding mortgages booked in PLROI and PLUK) within our book are increasing at a faster rate than other sectors. Figure 1 below shows, our exposure has grown from €29.5Bn in March 07 to €33.5Bn in September 07 and from 23% of the book to 25%. The corresponding figures for March 06 were €20.2Bn and 19% respectively.



Source: Credit MI

Figure 2 shows the split among the different sub sectors of investment and development. It shows that the majority (65%) of the book is income producing investment assets.



Source BIPS extract May 2007 – relates to IRB books only – accounts for >70% of total Group loanbook.

3. Impact:

As an industry, the banking sector has not found a common approach to limit setting for sectoral exposure. As economic capital methodology and data improves, we could look to developing an internal Ecap related guidance measure. In August 2007, GRPC agreed that it was not yet an appropriate time to consider the imposition of Ecap based guidance or limits. There are, however, a couple of external benchmarks that we can look to.

3.1 Rating Agencies

We know that the rating agencies focus on concentrations in their analysis. Given the liquidity risk and funding risk facing the Group in current markets, we recognise the importance of addressing any issues with concentrations that the rating agencies may have in this regard.

When assigning Bank Financial Strength Ratings ('BFSR's), Moody's focus on 5 key rating factors which they believe are critical to understanding the business: 1) Franchise Value, 2) Risk Positioning, 3) Regulatory Environment, 4) Operating Environment and 5) Financial Fundamentals. A key component of factor 2 Risk Positioning is Credit Risk Concentration.

In February 2007 Moody's assigned a BFSR of B- to BOI and a C+ in the Risk Positioning sub-factor. In August 2007, GRPC was advised that the current concentration of borrower exposures within our book was impacting negatively on Moody's view of our "Risk Positioning". Two concentration measures, Borrower and Sector, are scored and the lower of the two scores is fed into our Risk Positioning score. As we scored a D in Borrower concentration and a C in Sector concentration, we received an overall D for concentration.

3.2.1 Borrower Concentration: In August 2007, GRPC focused on the lower of the two scores - Borrower concentration. Group Risk Office advised that if the Group could improve this score to a C it was likely that we could achieve a Risk Positioning score of B (up from C+) which in turn should lead to an overall uplift in our BFSR from B- to B.

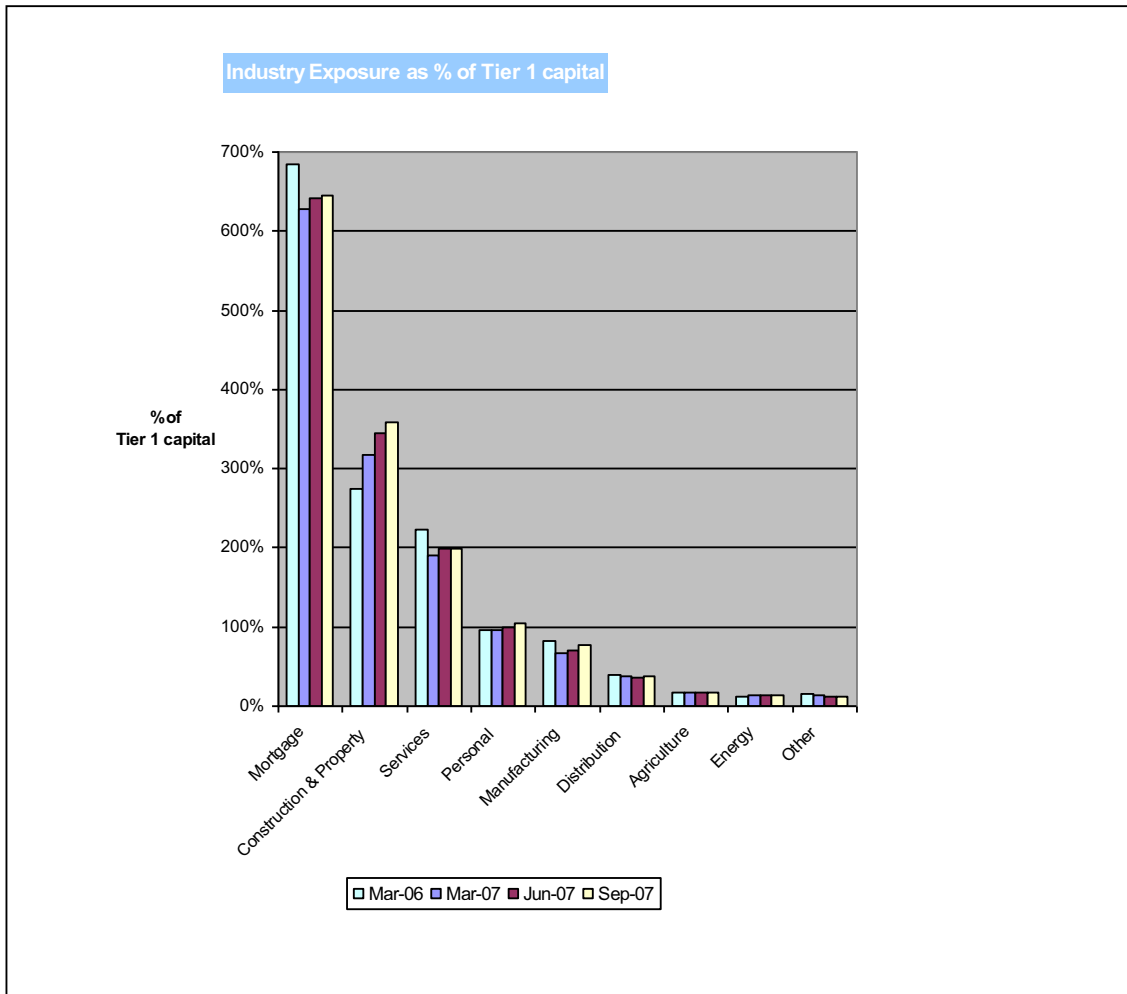
At the time GRPC agreed that it would be appropriate to position the Group to achieve a better concentration score from the rating agencies but only if it can be achieved without major upheaval within the businesses. The members also agreed that it is appropriate to seek

to hold, or opportunistically reduce, the individual exposures currently within the top 20. The most recent quarterly analysis of borrower concentration (as at end of September, just a month after the GRPC decision) showed that our score had deteriorated although it remains within the parameters for achieving a D.

3.2.2 Sectoral Concentration: We have looked at the Moody's sectoral concentration methodology. Moody's consider the percentage of our Tier 1 capital each main sector represents. Under this measure, property and construction is growing in significance more rapidly than other sectors. Based on current run rates, we will exceed a concentration threshold by March 2008 and we would slip into a D score under this measure also. As noted above, as we already score a D in Borrower Concentration, a D under Sectoral Concentration would not have an impact in overall score. However, deterioration in the score for sectoral concentration could prompt negative comment and would make any decision to seek an improvement in our overall risk management score more difficult to achieve.

Construction & Property (excluding mortgages) accounted for 359% of our Tier 1 Capital at end of September 2007, up from 345% three months earlier and 275% at March 06. Figure 3 below shows how this figure has trended since March 06 in Property and other sectors.

Fig 3 Sectoral Exposure as a % of Tier 1 Capital – March 05 to Sept 07



3.2 Peer Banks: AIB's 20-F indicates that their exposure to property and construction was c €34.8Bn at 12/06, which represented 344% of Tier 1, i.e. AIB's relative position was poorer than BoI's at last year end. AIB's construction and property lending represented 43% of all non mortgage lending, which is in line with our 44%.

4. Comment:

When discussing our property exposures in the past the Group has highlighted a number of factors that we view as mitigating the risk:

- The majority of our property exposure relates to income producing assets (65%). This compares favourably with AIB's ratio of 42%.
- Speculative commercial development is not permitted under policy except for speculative retail development (within strict parameters) for Corporate Banking.
- Landbank, which is arguably the more risky element of property lending, is subject to limits on aggregate exposure and is monitored at least half yearly by GRPC.
- Our book is spread evenly between Ireland and the UK giving an element of diversification.
- While property is a feature of most of our commercial portfolios, larger individual property exposures in Ireland are centrally managed by a specialist property team within Corporate Banking and within specialist teams in BBUK.
- The growth that has occurred in property lending in recent years has been planned and resourced for within the Group.

While the above statements remain valid, the level of concentration within the book is increasing and GRPC is asked to consider if the current level is acceptable. GRPC may also give consideration to what level of concentration the committee would not wish to exceed in the future so that this could be fed into the Group's and Business Units' strategic planning.

If the GRPC is of the view that the level of property exposure in the Group's balance sheet is too high, there are relatively few realistic options that could be considered:

- Significantly reduce our property lending and allow its relative significance to fall over time.
- Increase the Tier 1 capital base to improve the capital available to mitigate credit risk with additional benefit of an improved Moody's score.
- International or sectoral diversification. While this would have a risk management benefit it should be noted that this wouldn't necessarily improve our Moody's score as Moody's is not concerned with percentage of book in a particular sector, rather what percentage of Tier 1 Capital that it represents.
- Dispose of some of our property exposures either through CMBS (difficult or impossible in current markets) or targeted sell down of some of our property exposures in bi-lateral transactions with other banks. Approximately €3Bn would need to be sold down to ensure we remained within the Moody's score given current run rates. If some of the loans to be sold down were sourced from our top 20 exposures, we could also achieve an improvement in our Borrower concentration profile.

GRPC is asked to consider the content of this paper.

David Kiely/Alex Wolff
Group Risk Office



Purpose:

This paper represents the Bank of Ireland's ("the Group") response to the request for documents under Categories 16, 17 and 18 of the Direction submitted to the Bank of Ireland on 15 January 2015 by the Joint Committee of Inquiry into the Banking Crisis ("the Joint Committee"). The first part of the paper responds to Categories 16 & 17 and the second part addresses Category 18.

Part 1 – Categories 16 & 17

Category 16: Board approved exceptions to credit policy for commercial real estate and residential real estate loans - number and aggregate amount for the period 2001 to 2008. If necessary, and if not otherwise identified in existing documents, please create a document containing this information.

Category 17: Board approved exceptions to credit policy in respect of commercial real estate and residential real estate loans rejected by the board - number and aggregate amount for the period 2001 to 2008. If necessary, and if not otherwise identified in existing documents, please create a document containing this information.

The Court (board) of the Bank of Ireland did not have a role in the approval or rejection of applications in the period 2001 - 2008 unless such loans were an exception with regard to large exposure guidelines. In the period, there were no Court approved or declined exceptions to credit policy for commercial real estate and/or residential real estate loans which exceeded large exposure guidelines.

The remainder of this section outlines an overview of the policies and procedures applicable during the period 2001 - 2008 for:

- Credit Authority in the Bank of Ireland Group
- Approval of Policy Exceptions
- Authority to approve Policy Exceptions
- Reporting of Policy Exceptions

The policies and procedures set out in this memo related to all loans approved in the Group, including those that were ultimately acquired by the National Asset Management Agency.

Credit Authority in the Bank of Ireland Group:

The Group Credit Policy 1994 as approved by the Court in January 1994 which was refreshed annually from 2006 onwards stated that Credit authority had been delegated by the Court

of Directors to a Group level credit committee, i.e. the Group Credit Committee (“GCC”) and to named members thereto and was also sub-delegated to other individuals.

Personal lending discretions over €20m were subject to Court approval and were reserved for senior Group executives. These discretions were approved on a tiered basis depending on the credit grade of the borrower and were only exercisable on the positive recommendation of an independent credit unit. The maximum cash lending discretion (exercisable on the positive recommendation of an independent credit unit) was €65m in the period and this was reserved for the highest quality (Grade 1) loans. Property loans, in general, would have been subject to a lower discretion (typically max €20m to €40m, depending on the seniority of the discretion holder).

Papers detailing the Court approval of these discretions have been returned under Category 2.

Exposures in excess of individual senior executive lending discretions were subject to approval of the GCC. The GCC was the most senior credit transaction approval authority in the Group. It had authority to approve any credit transaction subject to the aggregate exposure (net of any cash collateral) not exceeding 15% of the Group’s Tier One Capital. It is to be noted that the Group adopted a conservative approach to the aggregation of exposures such that where individuals had exposures to joint ventures via 50% or greater shareholdings, the Group’s full exposure to that joint venture was included in calculating the Group’s exposure to an individual. This practice was also applied where two Group customers had a 50:50 joint venture, i.e. the joint venture debt would have been included in full in each of the calculations of the exposure for each individual.

The GCC comprised senior executive management of the Group, deemed to have relevant experience, with a minimum of three members required for a valid quorum. Listings of the membership of the Committee for the period 2001 to 2008 are attached at Appendix 1.

Approval of Policy Exceptions:

The Group Credit Policy stated that

“Allowance has been made for exceptions to Credit Policy. Any such exceptions must be reasonably justified and their extent monitored and controlled. Exceptions can only be approved in accordance with the procedures set out [in this policy]”

That policy document stated that the Group Credit Policy, together with the Credit Policy Statements of individual Business Units, was expected to accommodate the great majority of lending opportunities available to the Group. However, it was acknowledged there may have been occasions where there were exceptions to one or more of the policy criteria but appropriate mitigants supported approval of the transaction. The individual policies reflecting relevant business/product criteria were more granular in nature than the Group

Credit Policy. For commercial property investment lending, for example, the policy parameters included, inter alia, criteria relating to advance rate (Loan to Value), interest cover, residual risk, maximum term, and maximum interest only period. An exception to any one of these guideline criteria required consideration of mitigants to support approval. It is important to note that, irrespective of the mitigant (e.g. LTV at 77% vs 75% policy max for a high quality building with an investment grade tenant on a long lease), the transaction was recorded as a policy exception. In other words, no qualitative consideration influenced whether or not the overall transaction was recorded as a policy exception case or not. Such a transaction, as described above, would consequently contribute to an overall gross policy exception level that had no netting out of transactions with mitigants.

The Credit Functions of the Business Units were required to maintain adequate procedures and controls to monitor the level and quality of exceptions approved in respect of the relevant Business Unit and these were also monitored by the Group Credit Policy Unit.

Authority to approve policy exceptions:

In situations where a transaction was considered acceptable but where it represented an exception to Group, Business or Sectoral policy, it was a requirement to refer the credit proposal to, at least, the next higher level of credit authority for decision with the rationale for recommending the exception explained (a process known as “one up”). All individuals who held a lending discretion could approve such transactions on a “one up” basis. For example, if a proposed transaction had exposure of €1m and was considered by a credit underwriter with discretion of €2m, they could approve if compliant. If not compliant, the underwriter could recommend it to a more senior individual with a larger lending discretion (e.g. €5m) for approval on a “one up” basis.

Court approved lending discretion holders had discretion to approve cases with exceptions within their discretion but only on the positive recommendation of an independent Credit Unit. Certain approved independent credit personnel also had discretion to approve cases with exceptions. GCC, as the most senior transactional credit authority, also had discretion to approve cases with exceptions within its mandate.

Reporting of Policy Exceptions:

During the period 2001 to 2008, the Group Credit Policy Unit, prepared reports, based on credit underwriting unit returns, detailing the level of policy exceptions. These reports were submitted to Group Credit Committee in 2001 and from 2002 onwards to the Head of Credit Policy.

From 2004, exception data for ROI Mortgages was submitted to Group Risk Policy Committee for ROI mortgage lending on a monthly basis. These have been returned under Category 2 (f).

Quantification of exceptions:

To assist the Joint Committee, the Group carried out a review of listings of transactions considered by the GCC in the period to try to identify property loans in the relevant period that included cases with exceptions to credit policy. These listings were submitted to the Court (2001/02) and to the Group Risk Policy Committee thereafter and have been produced under Category 2 (f).

The review of the listings provided a basis for an estimation of the number and value of property related loans with policy exceptions approved in the period. There are a number of caveats attaching to this estimate:

- The listings show only net movements in exposures.
- Where multiple loans were approved as part of a single application for a connection and one loan had an exception, there is no way from the reports of distinguishing the number and value of the loans with and without policy exceptions attaching, i.e. an over estimation of exceptions may result.
- The report did not include a property/non-property indicator. While every effort has been made in the timeframe available to accurately identify connections that were property related, there is potential for over or under statement, particularly where connections had both property and non-property related loans.

The analysis indicates that in the period 2001 to 2008, the GCC approved 1,181 applications in respect of property related connections. The aggregate change in exposure approved in the period was €47.9bn. Of these applications, 70% by number and 64% by value had some level of exceptions to the granular policy guidelines when considered as previously outlined, i.e. calculated on a gross basis where there was an exception to any one individual lending guideline, however minor, and irrespective of mitigants and other considerations which supported the approval of the transaction.

As the GCC did not consider home mortgages, due to their size, Bank of Ireland has prepared analysis of the level and value of exceptions for Irish mortgages completions (which include mortgage loans booked in Governor & Company of the Bank of Ireland, Bank of Ireland Mortgages and the ICS Building Society) in the period 2001 to 2008. Data is available for owner occupied mortgages for the entire period. Data for Residential Investment Property/Buy to Let is available for the period 2004 to 2008. This analysis is based on a review of business unit data from the period and shows that:

Owner Occupier cases including policy exceptions (based on completions) ranged from 19% in 2002 to 5% in 2008 based on number of exceptions as a percentage of number of completions. The average exception rate over the period was 11% (See Table 1 below).

Table 1: Policy Exceptions for Owner Occupied Mortgages 2001 – 2008

Owner Occupied	2001	2002	2003	2004	2005	2006	2007	2008	Total
No. of Completions	17,608	19,386	23,366	25,777	27,925	27,106	19,913	14,676	175,757
No. of Exceptions	2,529	3,666	2,408	3,177	2,672	2,328	1,361	740	18,881
Exception rate by number	14%	19%	10%	12%	10%	9%	7%	5%	11%

Residential Investment Property/Buy to Let cases including policy exceptions (based on completions), for the period 2004 to 2008, ranged from 19% in 2004 to 13% in 2008 based on number of exceptions as a percentage of number of completions. The average exception rate in the period was 17% (see Table 2 below).

Table 2: Policy Exceptions for Buy to Let Mortgages 2004 – 2008

Buy to Let	2004	2005	2006	2007	2008	Total
No. of Completions	5,115	6,635	7,653	5,187	3,265	27,855
No. of Exceptions	970	1,243	1,273	842	411	4,739
Exception rate by number	19%	19%	17%	16%	13%	17%

Part 2 – Category 18

Category 18: Any other exceptions to credit policy in respect of any loan that was subsequently acquired by National Asset Management Agency, whether the exception required board approval or not – number and aggregate amount for the period 2001 to 2008. If this information is not readily available, please create a document setting out how credit policy exceptions could be approved, who was authorised to approve them and any related reports to the board on the matter of credit policy exceptions for the period 2001 to 2008. For clarity, this request applies solely to any loans that were subsequently acquired by the National Asset Management Agency.

This information was not available but in an effort to assist the Joint Committee, the Group carried out a review to estimate the level of loans including policy exceptions in this category.

Bank of Ireland transferred 191 connections to NAMA with aggregate nominal value of €9,760m. Cases including policy exceptions have been identified in 139 out of 191

connections (73%) with aggregated exposure of €8,782m of total €9,760m (90%). As noted above, exception levels are calculated on a gross basis to include connections where there was an exception to any one individual lending guideline and irrespective of mitigants and other considerations which supported the approval of the transaction.

As information on these loans is only available at connection level, rather than at loan level, the estimation is most likely overstated. For example, if a connection had five loans with aggregate value of €100m and one of the loans (value of €20m) was approved as an exception, it is not possible to segregate that loan. As a result the total exposure of the connection (€100m) would be classified as an exception in the analysis as opposed to the actual €20m exception. Similarly if a policy exception was approved on a loan that was repaid before a connection transferred to NAMA, the analysis includes it.

The process for the approval and reporting of policy exceptions is outlined in Part 1 of this document and did not differ between loans that were and were not subsequently acquired by NAMA.

Appendix 1

Group Credit Committee Membership 2001 to 2008¹

2001

M. Keane (Chairman)
B.J. Goggin (Chairman)
M. Murphy (Chairman)
P. M. D'Alton
D. Hanrahan
L. C. Madden

Alternate Member

J.G. Collins
J.B. Clifford

2002

B.J. Goggin (Chairman)
J.B. Clifford (Alternate Chairman)
M. Murphy (Alternate Chairman)
J.G. Collins (Alternate Chairman)
J. O'Donovan
D. Donovan
K. M. Holden
L. C. Madden
J.V. Mulvey
J.J. Ruane

Alternate Member

B.P. Lillis

2003

B.J. Goggin (Chairman)
M. Murphy (Chairman)
J.B. Clifford (Chairman)
J.G. Collins (Chairman)
J. O'Donovan
D. E. Crowley
D. Donovan
R. Keenan
M. King
J.V. Mulvey
J.J. Ruane
G. Stokes

¹ Membership lists reflects individuals who were members of the GCC during a stated year.

Alternate Members

T. Comerford
D. Flannery
B.P. Lillis
D. McGowan
P. Morris

2004

M. Murphy (Chairman)
J.B. Clifford (Chairman)
J.G. Collins (Chairman)
R. M. Murphy (Chairman)
B.J. Goggin (Chairman)
J. O'Donovan
D. E. Crowley
D. Donovan
R. Boucher
V. Fennelly
M.King
D. McGowan
P. Morris
J.V. Mulvey
J.J. Ruane
G. Stokes

Alternate Members

D. Flannery
T. Comerford
B.P. Lillis

2005

R. M. Murphy (Chairman)
J. V. Mulvey (Chairman)
J.B. Clifford (Chairman)
J. Collins (Chairman)
B.J. Goggin (Chairman)
J. O'Donovan
D. E. Crowley
D. Donovan
R. Boucher
M. Cunningham
J.E. Davidson
V. Fennelly
D. Flannery
S. Kirkpatrick
B.P. Lillis

H. McDaid
D. McGowan
P. Morris
D. Murray
G. Stokes
M.J. Woulfe

2006

R. M. Murphy (Chairman)
J. V. Mulvey (Chairman)
J.B. Clifford (Chairman)
B.J. Goggin (Chairman)
J. O'Donovan
D. E. Crowley
D. Donovan
R. Boucher
M. Cunningham
J.E. Davidson (Alternate Chairman)
V. Fennelly
D. Flannery
T. Hayes
S. Kirkpatrick
B.P. Lillis (Alternate Chairman)
H. McDaid (Alternate Chairman)
D. McGowan
P. Morris (Alternate Chairman)
D. Murray (Alternate Chairman)
G. Stokes
M.J. Woulfe

2007

R. M. Murphy (Chairman)
J. V. Mulvey (Chairman)
J.B. Clifford (Chairman)
B.J. Goggin (Chairman)
J. O'Donovan
D. E. Crowley
D. Donovan
R. Boucher
M. Cunningham
J.E. Davidson (Alternate Chairman)
V. Fennelly
D. Flannery
T. Hayes
S. Kirkpatrick
B.P. Lillis (Alternate Chairman)

H. McDaid (Alternate Chairman)
T. McGivney
D. McGowan
P. Morris (Alternate Chairman)
D. Murray (Alternate Chairman)
G. Stokes
M.J. Woulfe

2008

R. M. Murphy (Chairman)
J. V. Mulvey (Chairman)
J.B. Clifford (Chairman)
B.J. Goggin (Chairman)
J. O'Donovan
D. E. Crowley
D. Donovan
R. Boucher
M. Cunningham
J.E. Davidson (Alternate Chairman)
V. Fennelly (Alternate Chairman)
D. Flannery
P. Gaynor
T. Hayes
S. Kirkpatrick
H. McDaid (Alternate Chairman)
D. McGowan
T. McGivney (Alternate Chairman)
P. Morris (Alternate Chairman)
D. Murray (Alternate Chairman)
G. Stokes
K. Strecker
G. Younger



THEME: B3

Effectiveness of banks' funding, liquidity strategies and risk management

LINE OF INQUIRY: B3e

Capital structure and loss absorption capacity

2. Audit Findings - Significant audit risks and other areas of focus

In this section we have set out our findings in relation to areas we identified as significant risks in our 31 March 2008 Audit Plan and certain other areas of focus.

Significant risks identified at planning stage

- Credit & Liquidity Crunch
- Adequacy of Loan Loss provisions
- IFRS 7 (IFRS 7 is dealt with in Section 4 Financial Reporting Disclosure.)
- Life technical provisions & VIF asset
- Hedge accounting
- P&L geography

Other Areas of Focus

We had identified a range of other areas of focus in our audit plan. Our findings in relation to pensions and carrying value of goodwill and intangibles are set out in this section. The other items are set out in our Divisional Audit Findings Report



Assessment of Going Concern

The directors of a listed company are formally required to assess the company's going concern position annually. BOI has continued to trade very profitably. However, in common with other banks, there has been a significant increase in liquidity risk. Management's formal assessment of going concern and in particular liquidity risk has only just been finalised. Accordingly, we will update the Group Audit Committee on our review of this assessment at the meeting on 16 May 2008.

THEME: B7

Impact of the banks' external audit processes in supporting effective risk management

LINE OF INQUIRY: B7b

Effectiveness of the external audit process to identify and report to the board and management, any concerns related to significant risk exposures, including property, funding and liquidity

Messrs. Farrell and Hearn of KPMG, provided an overview of the scope and approach of the review and the summary of findings, which were gathered from interviews with the Committee, members of the Group Executive Committee (GEC) and a selection of senior management and GIA staff. A review of selected GIA documentation, including both GIA and Group Credit Review files was also carried out. The detailed report recommended best practice enhancements in a 32 point action plan.

Key findings of the report were that GIA is a very effective internal audit department which ranks highly against its peers and industry best practice, is respected within the organisation and staffed by well qualified and experienced auditors. GAC and GEC members value and derive considerable assurance from the work of GIA.

Mr. Hearn referred to the fact that the Bank is undergoing a period of significant change with a number of key strategic projects in progress, while operating in a highly volatile economy and sector and subject to an increasingly demanding and invasive regulatory regime. In this environment, KPMG highlighted a number of key themes as being critical to the internal audit function going forward:

- Greater focus on strategic risks in addition to focussing on control and assurance
- The need for elevated skill sets to address strategic and high level business reviews
- Continued focus on regulatory compliance
- Development of an integrated assurance model
- Improvement of the formality of the GCR methodology and review process.

Mr. Morris observed that while GIA performed its functions well, a key challenge was to ensure that GIA captured the important risks in the business on a dynamic basis.

Discussion of the top 8 key recommendations for improvement, as summarised in the presentation, focussed on:

- Item 1 (Move to a more integrated assurance model): the Committee observed that it would need to be assured that any functions providing assurance could be relied on. Mr. Farrell, KPMG, indicated that the internal audit function generally takes the lead in providing assurance in the combined assurance model, and this is the trend in the U.S.
- Item 6 (Staff rotation with the business): the recommendation that a formal staff rotation plan into and out of GIA be implemented to broaden the skill base in audit and across the business was noted.

Mr. Morris indicated that further work was required to understand how the combined assurance model would work and confirmed that an update on progress of the recommendations in the Report would be provided to the November 2010 meeting.

PM

6. PwC Effectiveness Survey

The Chairman referred to the survey paper setting out responses from the Committee and Senior Management on external auditor effectiveness, noting that responses from both were, overall, very positive.

Subsequent discussion focussed on the following:

- A comment, with regard to the external auditor's understanding of the significant business risks and issues, that, for impairment assessment, there is a need to give greater weight to a "through the cycle" view; the Committee queried how a repeat of the current experience could be avoided in future. It was acknowledged that if accounting rules remained unchanged, the same problems could recur unless capital levels were significantly increased; if increased capital could not be achieved, a more conservative dividend policy would be required. With regard to whether PwC could have done more to flag emerging

problems, it was acknowledged that while there is a global ongoing debate on the extent of the role of the external auditor, to date it has generally not been part of the terms of engagement of external auditors to look at a bank's risk model. It was agreed that the Committee should review accounting changes in prospect and developing practice regarding capital levels, recognising discomfort with prevailing accounting rules if necessary.

AK/JO'D

- A comment that issues were settled between management and PwC prior to Committee involvement, leaving the Committee in the dark as to the robustness of debate between the external auditor and management: Mr. O'Donovan observed that the Head of Group Accounting Policy and the Director of Group Finance would in the normal course flag and resolve issues with PwC well in advance, so that tensions did not arise between management and PwC at a late stage in the reporting process. It was agreed that the Committee would hold a short private session with the external auditor at year end in order to provide the Committee with a sense of the dynamics between management and PwC.

JK

The Group Audit Committee concluded that the external auditors were performing effectively.

7. AOB

None

Jerome Kennedy
Chairman

Actions Carried Forward

Item	Action	Responsible	Raised	Status/ Timing
External Auditor Effectiveness	Private discussion between Committee and External Auditor	JK	6 August 2010	Annually for Annual Report
External Auditor Effectiveness	Review accounting changes in prospect, developing practice re capital levels	AK/ JO'D	6 August 2010	Ongoing
GIA – KPMG Review	Provide update to Committee at November meeting	PM	6 August 2010	1 November 2010

Chartered Accountants Regulatory Board

A Report by

The Chartered Accountants Regulatory Board

On The Review of the Audit of the Provisions for Impairments for
the Irish Covered Institutions for financial year ends between 30
September 2008 and 31 March 2009

18 September 2015

The Chartered Accountants Regulatory Board is a body established by the Institute of Chartered Accountants in Ireland to regulate its members in accordance with the provisions of the Institute's Bye-laws independently, openly and in the public interest.

This is the Report on the Review of The Audit of Provisions for Impairments for the Irish Covered Institutions for financial year ends between 30 September 2008 and 31 March 2009.

The review was carried out in accordance with the Chartered Accountants Regulatory Board's Audit Regulations which implement the relevant provisions of the Companies Act 1990 as amended by Statutory Instrument (SI) 220 of 2010.

The Report forms part of the Chartered Accountants Regulatory Board Annual Report 2014.

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FOREWORD

The Audit of Provisions for Impairments for the Irish Covered Institutions for financial year ends between 30 September 2008 and 31 March 2009

Statement from the Chairman of Chartered Accountants Regulatory Board

As part of its response to the Irish banking crisis in 2008/9 the Chartered Accountants Regulatory Board decided in 2010 to commission an in-depth review of the audit processes and procedures of the auditors of certain Irish banks and building societies, whose liabilities had been guaranteed by the Irish Government in September 2008, for the financial years ending in 2008, or where relevant 2009. The review sought to determine whether in the performance of their audits, the auditors of the Institutions complied with appropriate legal, regulatory and professional standards in relation to the audits of the directors' valuation of loans and the provisions for impairment of these loans for the financial years ending in 2008, or where relevant 2009.

The review was carried out under the provisions of the CARB Audit Regulations by CARB staff under the supervision of an independent expert. The findings on the review of the individual audits were reported to the Quality Assurance Committee which was established by the Board of CARB to independently consider reports arising from audit inspections. The important role of the Quality Assurance Committee is discussed further in Chapters 2 and 3 of this report.

The Board further determined that, in order to fulfil its public interest objectives, a high-level report setting out the process, findings and recommendations of the review would be produced by an independent expert and published by the Board.

The involvement of an independent expert of high standing would enhance the independence and credibility of the review process. Mr D.L. Spence CA was appointed by the Board.

Chapters 1-5 of this Report constitute the high-level report produced by the independent expert and adopted by the Board.

The Board supports the findings and recommendations and looks forward to the implementation of those recommendations. CARB would welcome discussion on its recommendations with all relevant stakeholders including the standard setters, government and statutory audit bodies, the Institute and the wider audit community.

Don Thornhill
Chairman, Chartered Accountants Regulatory Board
18 September 2015

FOREWORD Continued

Statement from the Independent Expert to the CARB Board

In 2010 I accepted your appointment to:

- (i) Supervise the reviews of the individual audits of the banks and buildings societies to ensure they were carried out rigorously, fairly and independently; and
- (ii) Produce a 'high-level public report' for the Board.

In relation to (i) I can confirm that the auditors were subject to a thorough challenge by the review team and that the process followed was rigorous, fair and independent. The reports arising from the review of each individual audit have been considered by the Quality Assurance Committee, whose decisions are set out in Paragraph 32. The findings and conclusion on the review of the individual audits are set out in detail in Chapter 4.

In relation to (ii) I have produced a high-level report, as set out in Chapters 1 to 5, for the Board of CARB. This has been adopted by the Board to be published under its authority.

The overall conclusion, set out in more detail in this Report, is that the auditors were able to demonstrate that they had generally applied appropriate procedures and complied with relevant standards, practice notes and other legislative provisions in relation to the audits of the directors' valuation of loans and the provisions for impairment of these loans for the financial years ending in 2008, or where relevant 2009, but that a number of improvements were needed to clearly demonstrate the challenges and scepticism applied in reaching their conclusions.

It was important that the work of the auditors was measured against the standards applicable at the time and the knowledge then available.

One conclusion of the review is that the proper application of the then applicable accounting and auditing standards applied by the Institutions and auditors did not appear to meet the expectations of stakeholders. It is noteworthy that this has been widely recognised since 2009 and that many standards have since been amended by Standard Setters and Regulators. Some have been brought into effect while others remain work in progress.

The Report includes some important recommendations for ensuring that lessons have been learned and that further action is taken to build on the changes already made to improve future auditing and financial reporting and thereby to foster greater trust in and respect for audits.

David Spence, CA
18 September 2015

1 INTRODUCTION

The Structure of the Report

1. This Report (“the Report”) forms part of the CARB Annual Report 2014. It is structured as follows:

Chapter 1 is the Introduction, which sets out the role of CARB and the background and reasoning for the review.

Chapter 2 is the Executive Summary.

Chapter 3 sets out the Key Issues and Recommendations.

Chapter 4 sets out the details of the review in six sections.

- Section 1 is the Introduction;
- Section 2 includes details of the contemporary banking and market conditions in 2008 and early 2009 as a background to the audits undertaken in that period. This section is of particular significance as one of the great challenges in carrying out this review is to avoid the use of hindsight¹ and consider the audits in light of not only the standards applicable at the time but also the economic climate and expectations;
- Section 3 outlines the market positions and experience of the audit firms;
- Sections 4 and 5 summarise the principal relevant contemporary accounting and auditing standards respectively;
- Section 6 contains the Findings from the reviews of the individual audits.

Chapter 5 sets out relevant changes and improvements to audit and other relevant standards and requirements since 2008/9.

2. A Glossary of Terms used in this Report is set out in Appendix 1.

Chartered Accountants Regulatory Board

3. The Chartered Accountants Regulatory Board (CARB) is a body established by the Institute of Chartered Accountants in Ireland operating as Chartered Accountants Ireland, (the Institute) to regulate its members, member firms, affiliates and students independently, openly and in the public interest. The CARB Board comprises a majority of independently appointed persons who are not members of the Institute or the accountancy profession; this degree of regulatory independence sets the Institute apart from all other recognised accountancy bodies.

CARB’s objectives are set out in its Regulatory Strategy 2010-2015 and its goals are set out in its annual Regulatory Plan.

¹ Hindsight - bias or seeing an event as predictable only after it has occurred, which can seriously distort analysis and conclusions.

4. Chartered Accountants Ireland is a Recognised Accountancy Body under the provisions of the Irish Companies Act 1990, as amended by Statutory Instrument (SI) 220 of 2010, and a Recognised Supervisory Body under the provisions of the UK Companies Act 2006 (as amended). As a result of these recognitions CARB is responsible under the Bye-laws of the Institute for ensuring there is an appropriate licensing and supervision framework for statutory auditors/audit firms².
5. In furtherance of the above CARB has set Audit Regulations (the Regulations), which have been approved by IAASA. These Regulations govern the manner in which firms authorised to act as statutory auditors are regulated by CARB.
6. The CARB Board is responsible for setting the Regulations under which this review was conducted; these Regulations have been approved by IAASA. Members of the CARB Board, for reasons of fair procedure, do not carry out any of the functions set out in the Regulations. The responsibility for considering and making decisions on the reports produced under the Regulations is that of the Quality Assurance Committee (QAC)³, appointed by the Board of CARB. The role and functions of the QAC in relation to the review are set out in Chapter 4.
7. Any reports that identify confidential information about an audit client or audit firm which is obtained as part of a review conducted by CARB are subject to strict confidentiality rules and cannot be disclosed to any party other than those expressly provided for in the Regulations.
8. CARB is entitled under the provisions of SI 220 of 2010 to publish the overall results of its supervision of statutory auditors approved by it. It does this by way of an Annual Report. This Report forms part of the Annual Report 2014.

Irish Auditing and Accounting Supervisory Authority

9. IAASA is the statutory body established pursuant to the provisions of Part 2 of the Companies (Auditing and Accounting) Act, 2003 (“The 2003 Act”), to:
 - “(a) to supervise how the prescribed accountancy bodies regulate and monitor their members;
 - (b) to promote adherence to high professional standards in the auditing and accountancy profession;
 - (c) to monitor whether the accounts of certain classes of companies and other undertakings comply with the Companies Acts; and
 - (d) to act as a specialist source of advice to the Minister on auditing and accounting matters.” [Section 8 of the 2003 Act].
10. In addition SI 220 of 2010 designates IAASA as the Competent Authority responsible for oversight. In light of IAASA’s statutory powers and in particular its power to conduct investigations under the provisions of Section 24 of the 2003 Act, CARB agreed the scope of

² The detailed procedures implementing SI 220 of 2010 are set out in the Audit Regulations.

³ The Terms of Reference of the Quality Assurance Committee (abbreviated) are included in Appendix 2.

the review with IAASA. IAASA also approved the Regulations under which the review was conducted.

Government Response to Banking Crisis

11. In response to the banking crisis in Ireland, the Irish Government commissioned three principal reports into the sources of the crisis - all of which refer to the role of the auditors of the banks:
 - The Irish Banking Crisis. Regulatory and Financial Stability Policy 2003-2008, May 2010 (“Honohan”): *“the major responsibility lies with the directors and senior management of the banks that got into trouble...It may also be the case that auditors and accountants should have been more alert to weaknesses in the banks’ lending and financial position”*.⁴
 - A Preliminary Report on The Sources of Ireland’s Banking Crisis, May 2010 (“Regling and Watson”): *“There is a need to probe more widely the scope of governance failings in banks, whether they were of a rather general kind or (apparently in far fewer instances) connected with very serious specific lapses, and whether auditors were sufficiently vigilant in some episodes.”*⁵ This may refer only to specific ‘episodes’ not related specifically to impairment provisions.
 - The Report of the Commission of Investigation into the Banking Sector in Ireland, March 2011 (“Nyberg”). It states that *“A detailed review of the auditing of the banks’ loan loss provisions is beyond the scope of this Report. A review of the audits of the banks’ loan loss provisions for certain periods is currently being carried out by CARB”*.⁶

CARB Response to Banking Crisis

12. CARB made three major responses to matters within its remit raised by the banking crisis as follows.
13. Firstly, during 2009 Mr John Purcell, former Comptroller and Auditor General, was appointed as a Special Investigator by CARB’s Complaints Committee in relation to the conduct of four individual members of the Institute and the auditors of Anglo Irish Bank regarding certain matters relating to Anglo Irish Bank.
14. At the end of 2010 Mr Purcell presented his reports in relation to the individual members and in 2011 his report in relation to the auditors. It was planned by the Disciplinary Committee to hold hearings in 2011; however, following a request from the Office of the Director of Public Prosecution (DPP) the disciplinary hearings were stayed and continue to be so. Consequently no determinations have been made in this regard. The DPP expressed concern that the holding of public hearings and the publication of findings might prejudice future criminal proceedings arising from the investigations of An Garda Síochána and the Office of the Director of Corporate Enforcement.

⁴ Honohan Para 1.6

⁵ Regling and Watson Executive Summary, page 6

⁶ Nyberg, Footnote 79, page 55.

15. Secondly, CARB considered the Honohan and the Regling and Watson reports in the context of its own supervisory responsibilities and in 2010 wrote to the Irish Government, which was at the time developing the final terms of reference for the Commission of Investigation. CARB recommended that it should adopt a holistic approach to its investigation and include all parties, including the auditors, within scope.
16. CARB also carefully considered the response of the audit oversight bodies, IAASA and the Financial Reporting Council (FRC), to determine if they planned to undertake any statutory enquiry under their own statutory powers.
17. The Board noted from the final terms of reference of the Commission of Investigation (Nyberg) that the Irish Government had decided not to include the role of the auditors. Following discussions with the audit oversight bodies, and in particular with IAASA the Board decided that the following issue merited further consideration: *“Whether in the performance of their audits the auditors of the Institutions complied with appropriate legal, regulatory and professional standards in relation to the [audits of the directors’] valuation of loans and the provisions for impairment of these loans for the financial years ending in 2008, or where relevant 2009”*.
18. The Board therefore decided in 2010 to undertake an in-depth review of the audit processes and procedures of the auditors of the Institutions for the financial years ending in 2008 or, where relevant, 2009, with a view to determining whether those firms applied appropriate procedures and complied with relevant standards, practice notes and other legislative provisions when carrying out their audit of the loan impairment provision.⁷ The Board agreed the Terms of Reference and the appointment of the independent expert, Mr David Spence, with IAASA.
19. Thirdly, in June 2012, following consultation with all relevant stakeholders, CARB published the Irish Audit Firm Governance Code (the Code), establishing, for the first time in Ireland, a formal benchmark of good governance practice for firms auditing certain public interest entities.⁸ This has been recognised by the various stakeholders consulted as a very positive development that is intended to enhance transparency and accountability, thereby promoting greater confidence in audit and auditors. As adherence to the Code is voluntary, bolstered by a ‘comply or explain’ requirement, CARB is pleased to report that each of the affected firms has agreed to implement the Code, which applied to the financial years of the audit firms starting on or after 1 January 2013.
20. While the Code is primarily intended to benefit shareholders in public interest entities by bringing about greater transparency in relation to how audit firms operate, it should also be of use to other stakeholders including the directors of such entities, audit committee members, CARB and other regulators with an interest in maintaining confidence in audit quality and the partners and employees of the firms within its scope. Other audit firms may also decide to adopt the Code in full or in part.

⁷ CARB Bank Audit Review Terms of Reference, Appendix 3.

⁸ Public Interest Entities are defined in Article 2(13) of Directive 2006/43/EC and include listed, credit, insurance and other entities designated by Member States as of significant public interest.

The Review

21. The Board determined that major matters of public interest arising from the crisis centred on the Institutions covered by the Government Guarantee, referred to as the Covered Institutions.
22. The respective year ends, listed in Paragraph 20, were chosen because the Board noted that the Commission of Investigation's terms of reference expired in January 2009; the logical year ends to include were those ending between 30 September 2008 and 31 March 2009. (Referred to in this Report as "the 2008 audits or year ends".)
23. Details of the Institutions and the auditors are set out below. In this Report they are referred to collectively as 'banks', 'Institutions' or 'Covered Institutions' as the context permits.

<i>Institution</i>	<i>Financial Year End</i>	<i>Auditor</i>
Allied Irish Bank Plc	31.12.2008	KPMG
Anglo Irish Bank Corporation Plc	30.9.2008	EY
Bank of Ireland	31.3.2009	PwC
EBS Building Society	31.12.2008	EY
Irish Life and Permanent Plc	31.12.2008	KPMG
Irish Nationwide Building Society	31.12.2008	KPMG
Postbank Limited⁹	31.12.2008	KPMG

Review Focused on Most Significant Aspect of the Audits

24. To focus the resources available for the review, CARB decided that it would examine only the most significant aspect of the audit of the seven Irish Covered Institutions for years ended between 30 September 2008 and 31 March 2009. In the Board's opinion this concerned the audit procedures relating to the loan impairment provisions of the Institutions. The review does not, therefore, constitute a full review of every aspect of the audits. It also does not extend to the various Institutions' subsidiaries in other jurisdictions.

Conduct of the Review

25. The reviews of the audits of the seven Covered Institutions were carried out by CARB staff. The Board further determined that, in order to fulfil its public interest objectives, a 'high-level' report setting out the process, findings and recommendations of the review would be produced by an independent expert and published by the Board. The involvement of an independent expert of high standing was to enhance the independence and credibility of the review process. Mr D.L. Spence CA was appointed by the Board in December 2010 as the Independent Expert. Mr Spence's experience and credentials are set out in Appendix 4.

⁹ Postbank had no relevant loans or impairment provisions, and as a result no findings relating to its audit are included in this report.

26. Mr Spence's terms of reference, as set by the CARB Board, were to, on its behalf :
 - (i) Supervise the reviews of the individual audits to ensure they were carried out with rigour and fairly and independently; and
 - (ii) Produce a 'high level public report' for the Board.
27. To achieve this, Mr Spence has been closely involved in all aspects of the review including the meetings with the firms and the development of the individual reports issued to the firms and the Quality Assurance Committee (QAC) and this public report.
28. It is important to note that the CARB review has been carried out by reference to the working papers of the auditors concerned, and detailed discussions with relevant partners in the audit firms. Under the Bye-laws and Regulations within which it operates, CARB has power to require full co-operation from the audit firms and access to all relevant records, but it has no equivalent power of access to the officers or records of the banks and other institutions. CARB received the full co-operation of the relevant audit firms.
29. The review was carried out by the members of CARB's own staff who had the necessary competence to carry out the review of this complex accounting and auditing area. This small specialist team had to review the very substantial records of the audits which had been prepared by the large teams used by the auditors. One inevitable implication was that the teams could not review all seven audits at the same time, but had to complete each review before moving on to the next. Each review of an audit firm took many months.
30. The review team examined the firms' very extensive audit records to establish the facts upon which the judgements regarding impairment provisions had been based. The team then challenged the firms' judgments in detail by developing possible alternative judgements based on the recorded facts and an assessment of contemporary market conditions at the time of the audits. These alternative scenarios were then presented to the firms in detail and discussed thoroughly with the firms, both in writing and at a series of meetings. The ultimate outcome, after an inevitably extended process, designed to ensure that it was both thorough and fair, was that the review team were satisfied that the firms had exercised reasonable judgements based on appropriate audit evidence available at the time of the audits. The process revealed the areas where the recording of the firms' scepticism and challenge to management required improvement. The process extended over a period of time as it was carried out by the small team within CARB, it having not been possible to bring in additional competent resources not already conflicted by previous involvement in related matters. The procedure adopted was to review the relevant audit working papers and electronic records and then to issue to each firm a detailed document of the issues for consideration and discussion. The process included robust and detailed challenges to the audit procedures carried out on the impairment provisions. The firms responded, in equal detail, this again taking some months. This led to further review work by the review team and ultimately to detailed and rigorous discussions with the relevant partners and other senior staff of the firms.
31. Individual reports on each audit were issued to the QAC, after giving each firm the opportunity to comment on the draft reports, to ensure that a fair process was maintained. Following the

issue of the final reports to QAC, the firms were invited to make formal submissions. The submissions were then considered by QAC.

32. QACs overall conclusion was that the audit firms generally complied with the then current, relevant auditing standards. QAC noted the areas where the firms had not fully complied and where improvements were required and considered the detailed plans submitted by the firms demonstrating the considerable action taken to date and undertakings for the future aimed at improving audit quality. It determined that no further regulatory action was required, while noting that the effectiveness of the firms' actions in respect of certain areas requiring improvement would be assessed in future monitoring inspections.
33. The cost of the review, which was borne totally by the members of Chartered Accountants Ireland, was significant, at approximately €1.335million. This does not include the significant cost of the internal staff resources which CARB allocated to this project.

Confidentiality

34. Legal constraints limit the amount of information that can be publicly disclosed with respect to identifiable institutions.¹⁰ Similar restrictions apply to individual audit firms. However, such restrictions do not apply to published information such as the annual reports of the Institutions or information otherwise in the public domain. The same convention as that adopted by Honohan¹¹ has been adopted in this Report to maximise the amount of information that can be provided within the legal constraints. Thus, individual audit firms and Institutions may be referred to as Firm A and Bank A and so on. To further guard the confidentiality, these codes are scrambled. Thus Firm A in one context is not necessarily the same firm as Firm A in another context.

¹⁰ Honohan, pages 4/5

¹¹ Honohan, pages 4/5

2 EXECUTIVE SUMMARY

The Review

35. The CARB team that conducted the review of the audits (the review team) carried out a very thorough, detailed and challenging procedure with the objective of establishing whether the audits did comply with the relevant contemporary standards. Detailed discussions took place with the firms who responded in detail to the challenges made by the review team. The key findings are set out in Section 6 of Chapter 4.
36. The scope of the review was to review the processes and procedures of the audit firms in relation to the audit of the financial statements of the Covered Institutions for the years ended between 30 September 2008 and 31 March 2009, to determine whether the auditors applied appropriate audit procedures and complied with relevant standards, practice notes and other legislative provisions in the audit work carried out on the provisions for impairment as part of their audit of the financial statements as a whole.
37. It was not the role of CARB to re-perform the audit or determine the appropriateness or otherwise of the impairment provision, but rather to form a view as to whether the firms applied appropriate auditing procedures when carrying out the statutory audits.

Overall Conclusion

38. As set out in Chapter 1 the purpose of the review was, in short, to determine whether the auditors of the Covered Institutions complied with the relevant auditing standards when carrying out the audit of the loans and the associated provisions for 2008/9.
39. The overall conclusion arising from the review of the individual audits is that, in carrying out the audit on impairment provisions, the audit work was satisfactory with the audit firms generally applying appropriate procedures and complying with the relevant contemporary auditing standards. In the small number of instances where the audit firms did not fully comply and areas for improvement were identified, these were not material.
40. One related conclusion of the review is that the proper application of the then applicable accounting and auditing standards applied by the Institutions and auditors did not appear to meet the expectations or needs of stakeholders. It is noteworthy that this has been widely recognised since 2009 and that many standards have since been amended by standard setters and regulators. Some have been brought into effect while others remain work in progress.

Responsibilities of Directors' and Auditors'

41. In simple terms, it is the responsibility of the:
 - Directors of the Institution to prepare accounts in accordance with the provisions of the Companies Acts and the accounting framework set out in the International Accounting Standards (IAS/IFRS) (see Chapter 4 Section 4).

- Auditor to conduct an audit of the financial statements in order to make a report to the members on those financial statements. The form of the report is set out in the Companies Acts and the International Standards on Auditing (UK and Ireland) (ISA) (see Chapter 4 Section 5).

Accounting Standards and the “True and Fair View” Requirement

42. Directors of companies prepare the company’s financial statements in accordance with International Accounting Standards (IAS) and the relevant legislative framework. The accounting standard adopted by the Institutions, IAS 39, was applied in Ireland (and to the best of the review team’s knowledge virtually everywhere else in the world), as prohibiting provisions in respect of losses to be incurred in the future. It is noteworthy that a new accounting standard, IFRS 9, has recently been issued and introduces a new methodology for recognising loan loss provisions which is closer to an ‘expected loss’¹² model. The effective date of this standard is 2018.
43. IAS 39 is a complex standard and has been the subject of considerable debate and, in some quarters, criticism. The emerging banking crisis led to growing concerns that provisions were recognised too late as losses turned out to be greater than the financial statements had recognised or implied, because IAS 39 ensured that impairments could only be recognised in respect of circumstances existing at the balance sheet date.
44. However, IAS 39 had only been in force for three years when the December 2008 financial statements were prepared. The 2008 banking crisis was the first time that the provisions of IAS 39 were tested in such a combination of adverse factors.
45. There have also been comments in relation to the interaction between the concept of true and fair and compliance with individual accounting standards. Under EU law, an individual accounting standard can only be adopted by the European Union if, as a consequence of its application by companies, it will result in the financial statements giving a true and fair view.
46. Furthermore, IAS 1 states that *“in virtually all circumstances, a fair presentation is achieved by compliance with applicable [accounting standards]”*. The standard did provide for departures from a particular accounting standard but in only *“extremely rare circumstances in which management [of the entity] concludes that compliance with a requirement ... would be so misleading that it would conflict with the objective of financial statements set out in the Framework”*. It further states that *“If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity’s compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework”*.
47. There is no hierarchy of standards and no clear guidance as to when the principle of true and fair would override compliance with accounting standards generally; this is a matter of professional judgement. The evidence, certainly in UK and Ireland, suggests that the application of the true and fair override is rarely used. In fact, the FRC itself has stated that *“disagreement with a particular standard does not, on its own, provide grounds for departing*

¹² For ease we have referred to the new methodology as an ‘expected loss’ model throughout the rest of the Report.

from it. Where the accounting standards clearly address an issue, but the requirements are insufficient to fully explain the issue, the solution is normally additional disclosure". In the context of the 2008 audits the auditors, as required by Irish Law, concluded that the accounts of the Institutions gave a true and fair view in accordance with the relevant accounting framework. It would have been difficult for the Institutions and the firms to have adopted a different approach given the EU interpretation, the FRC position and the almost Europe wide acceptance and application of IAS 39.

48. CARB believes it unfortunate that compliance with an accounting standard is deemed of itself to result in a true and fair view of a company's financial position. Accordingly, CARB believes that in the future the first principle that should apply is true and fair; followed then by adherence to the individual standards. CARB appreciates that there may be difficulties in moving to what would essentially be a principles-based system rather than the more accepted rules-based system that has emerged over the last decade. However, notwithstanding this CARB believes that all interested stakeholders should discuss how a principles-based framework for the future could be developed to ensure that lessons are learned from the past and that current rules are not simply replaced by another set of rules.

The Application of Auditing Standards

49. The auditors conduct audits of the financial statements of a company in accordance with International Standards on Auditing (ISA) and the relevant legislative framework. In relation to the loan provisions the question became one of whether there was sufficient appropriate audit evidence as to the extent to which losses had actually been incurred at the balance sheet date. The audit firms were well aware of the audit risks around impairments for the 2008/9 audits and brought significantly increased levels of resources, including international resources, to bear on the audits.

Recommendations

50. As a result of the review a number of important themes have been identified and recommendations for future improvements made. These are set out in detail in Chapter 3.

3 KEY ISSUES AND RECOMMENDATIONS

51. As a result of the detailed review of the audits of the Covered Institutions, a number of important themes have been identified which lead to recommendations as to future actions to improve audit and financial reporting and foster greater trust in, and respect for, the audit process.
52. CARB has carefully considered the significant developments and improvements that have been introduced since the crisis commenced, and has sought to build on these when formulating its own recommendations.
53. CARB would welcome discussion on its recommendations with all relevant stakeholders including the standard setters, government and statutory audit bodies, the Institute and the wider audit community. A summary of the recommendations and relevant stakeholders is set out in Appendix 5.

Accounting Standards

[International Accounting Standard 39 Financial Instruments: Recognition and Measurement \(IAS 39\)](#)

54. The accounting standard required to be adopted by the Institutions, IAS 39, which prohibited making provisions for losses expected to be incurred in the future, was introduced by the International Accounting Standards Board (IASB) in response to concerns that the existing standard appeared to enable companies to use general provisions to smooth profits from one year to the next. To avoid this, the standard introduced certain rules regarding the point at which a loss could be recognised and how it should be measured. During the development of the standard there was considerable discussion as to its impact on the level of provisions.
55. This 'incurred loss' methodology which resulted from the debate, had a number of positive effects, not least the fact that it promoted consistency across companies and allowed for greater comparability of results.
56. It was, however, a relatively new standard. It had not been tested in a period of recession and certainly not to the extent of the global recession experienced from 2008 to 2013.
57. This standard was almost universally applied worldwide in 2008 and 2009. Whilst recognising the restrictive requirements of the standard, we are aware of few major claims or assertions made at the time that it was not fit for purpose. The Institutions in Ireland and auditors recognised that as an incurred loss model was in place they could not provide for expected future losses and to address this the Institutions included warnings about expected future provisions in, for example, the notes to the financial statements and in the Directors' or Chairman's Report. (See Appendix 6)
58. It is clear that subsequent commentators have identified the accounting standard IAS 39 as having not been fit for purpose when the financial statements for the 2008 year ends were prepared. This accusation relies upon the virtually universally accepted interpretation of the

standard, but others have suggested that an alternative interpretation could reasonably have been taken which would have allowed institutions who were so minded to make earlier and larger impairment provisions. This has been controversial, and the steps taken by IASB and the Financial Accounting Standards Board (FASB) to develop a replacement standard have not resulted in a common agreed approach. IASB has agreed a new standard, IFRS 9 (IFRS 9 Financial Instruments), which will require the impairment of financial instruments to be based explicitly on an expected loss model. This is likely to be effective in Ireland for financial periods starting on or after 1 January 2018. Impairment provisions will likely increase once this standard is adopted by Institutions. This is in accord with the principle of prudence which is, once more, being given prominence in the conceptual framework for financial reporting.

59. In light of the experience of the implementation of IAS 39, it is important that preparers and auditors of financial statements prepared under the new IFRS 9 ensure that sufficient details are included in the financial statements to clearly and fully explain the assumptions made, the range of judgements, and the subjectivity involved in arriving at the impairment provisions.
60. The new 'expected loss' model represents a fundamental change to current practice and will therefore have significant implications from an implementation perspective. In view of the magnitude of the change, IASB has established a discussion forum, the IFRS Transition Resource Group for Impairment of Financial Instruments, to provide support for stakeholders on implementation issues arising.

Recommendations

61. **CARB encourages preparers and auditors to submit potential IFRS 9 implementation issues to the IASB discussion forum, as they arise. This should assist IASB in determining what, if any, action is needed to address such issues.**
62. **Once effective (i.e. for financial periods beginning on or after 1 January 2018), CARB recommends that the Financial Reporting Supervision Unit of IAASA conducts an annual review of the implementation of IFRS 9 and its effectiveness and consistency of application, particularly for the first few years. As this is an international issue we encourage cooperation at EU level and with bank regulators.**

Interaction between International Accounting Standards and True and Fair View

63. As a result of the financial crisis many commentators have, in retrospect, questioned why the auditors did not qualify the 2008 audit reports on the basis that the level of impairment could have and should have been considerably higher if not for the apparent constraints imposed by complying with IAS 39. They query whether the auditors should have considered that, because of these apparent constraints the financial statements, did not show a true and fair view, and required a different standard to be adopted which did result in such a view.
64. IAS 39 was developed by IASB after considerable discussion and consultation with the financial markets and the statutory authorities. It was then adopted by the European Union in the form of regulations, which are directly applicable in all Member States. No IAS or IFRS can be adopted by the EU if it would be contrary to the financial statements giving a true and fair view. While subsequently it may have been felt that the standard was not fit for purpose, this

was not expressed at the time the 2008 financial statements were being prepared and then audited. Even if it had been it is questionable as to whether the auditors could have qualified their reports on the basis that they did not support IAS 39 given its legal status. Further, if the auditor did conclude that the IAS was not appropriate what standard would they have expected the Institutions to adopt? One effect of the legal environment in which the standards are issued and adopted by the EU is that it inhibits the auditor legitimately using a true and fair override in circumstances where the Institution has, in the auditor's opinion, complied with the provisions of the IAS. Further discussion on the role of the auditor in the application of accounting standards is included in Paragraph 192 and 193.

65. IAS 1 'Presentation of Financial Statements' which was in place in 2008/9 required that the financial statements "*present fairly*" the financial position, financial performance and cash flows of the entity. It further states that "*application of the accounting standards, with additional disclosure where necessary, is presumed to result in financial statements that achieve fair presentation*". IAS 1 also states that "*in virtually all circumstances, a fair presentation is achieved by compliance with applicable [accounting standards]*". The standard did provide for departures from a particular accounting standard but in only "*extremely rare circumstances in which management [of the entity] concludes that compliance with a requirement-... would be so misleading that it would conflict with the objective of financial statements set out in the Framework*".
66. Furthermore, IAS 1 states that "*If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework.*"
67. The review team is unaware of any financial institution in Ireland or the UK, or indeed in the rest of Europe, in 2008 and the first half of 2009, that formed a view that compliance with IAS 39 resulted in the financial statements not being fairly presented.
68. There is no hierarchy of standards and no clear guidance as to when the principle of true and fair would override compliance with accounting standards generally. This is a matter of professional judgement. The FRC has stated that "*disagreement with a particular standard does not, on its own, provide grounds for departing from it. Where the accounting standards clearly address an issue, but the requirements are insufficient to fully explain the issue, the solution is normally additional disclosure*". In the context of the 2008 audits the auditors, as required by Irish Law, concluded that the accounts of the Institutions' gave a true and fair view in accordance with the relevant accounting framework. It would have been difficult for the Institutions and the firms to have adopted a different approach given the EU interpretation, the FRC position and the almost Europe wide acceptance and application of IAS 39.
69. As accounting standards have become more prescriptive, the use of true and fair overrides have become less frequent with many more examples of the use of an override being disallowed after investigation by the FRC than were found to have been acceptable.

70. CARB believes it unfortunate that compliance with an accounting standard is deemed of itself to result in a true and fair view of a company's financial position. Accordingly, CARB believes that in the future the first principle that should apply is true and fair; followed then by adherence to the individual standards. CARB appreciates that there may be difficulties in moving to what would essentially be a principles-based system rather than the more accepted rules-based system that has emerged over the last decade. However, notwithstanding this, CARB believes that all interested stakeholders should discuss how a principles-based framework for the future could be developed to ensure that lessons are learned from the past and that current rules are not simply replaced by another set of rules.

Recommendation

71. **CARB believes that all interested stakeholders should discuss how a principles-based framework for the future could be developed to ensure that lessons are learned from the past and that current rules are not simply replaced by another set of rules.**

The Audits and Auditing Standards

72. At the planning stage of the audits, the firms clearly identified loan impairment provisions as an area of significant risk. In recognition of this the firms allocated additional experienced auditors to the audit team and increased the level of involvement of the audit engagement partners and quality review partners, often augmenting the audit team with partners from their international network. In a number of cases where the audit firm had concern about the controls in the Institution the firms increased (and in more than one case significantly increased) the level of substantive testing carried out. In all cases the planned approach to test impairment provisions was an acceptable approach under ISA 540 'Audit of Accounting Estimates' (see Section 5 of Chapter 4).
73. In carrying out their work, the firms carried out extensive testing with the volume of testing of individual loan files significantly increased, on average, from 15% to approximately 50-60% of the loan book.
74. In the carrying out of the audits the firms engaged extensively with management of the Institutions to obtain sufficient evidence in relation to the reasonableness of the assumptions of management when arriving at the loan provisions. In addition, the firms increased the number of meetings with the Audit Committees to ensure that considerations and conclusions were brought to the Audit Committees' attention to assist the Audit Committees in forming their opinions on the appropriateness of the impairment provisions. It is clear, from the review, that the firms challenged management and the Audit Committees.
75. In most instances it was clear that the challenge during the audit process contributed to or resulted in the Institutions increasing the provision, in most cases significantly. The review indicated that in overall terms the level of the provisions across the Institutions increased by at least €1.3bn (28%) from the commencement to the conclusion of the audit. This was a

result of the engagement of the auditors with the management and the Audit Committees and their reaching agreement as to the appropriate level of the provisions.

76. As a result of the Government Guarantee Scheme, the composition of the Boards and/or Audit Committees of the Institutions changed considerably before or shortly after the year ends under review. The review team found no evidence to conclude that the Institutions and auditors working together had any desire other than to arrive at the right conclusion.
77. The overall conclusion is that the auditors generally complied with the then current Auditing Standards. The review identified that the audits would have been improved by better recording of the challenges made of management and of the degree of scepticism adopted by the auditors. This conclusion has been mirrored in other recent reports¹³ and it is worrying that this issue is still the subject of concern.
78. The following are the areas where the firms agreed to improve audit procedures. These applied to one or more of the firms subject to the review:
- Planning: At the planning stage all firms identified the significant risk of material misstatement in relation to loan impairment provisions and tailored their audit procedures accordingly. In relation to planning documentation it was noted that a number of firms could have set out more clearly in the audit documentation the manner in which they intended to use available market information as a basis for challenging management assumption, particularly where more market information came to light during the course of the audit.
 - General Audit Procedures: In all cases, the planned audit approach complied with the relevant auditing standards. In one case it was noted that the firm should in future ensure that there is sufficient audit evidence on file of the firm critically assessing loan groupings.
 - Provisions: The firms generally complied with the relevant auditing standards and there were no material matters to note. The main area of improvement was that, for a number of loans, there could have been more extensive documentation on the audit file to demonstrate the firms' scepticism and challenge of management assumptions. Examples of improvements identified in audit documentation included- challenge on emergence periods; review of the quality of grading; challenge on application of loss rates; and overall assumptions as to the fall in property values.
79. CARB notes the various changes made since 2009, as discussed in Chapter 5, and agrees that significant improvements have been made as a result of these changes, including the adoption of replacement clarified ISAs. The International Audit and Assurance Standards Board (IAASB) conducted a post-implementation review of the clarified ISAs which was completed in 2013¹⁴. Many respondents expressed the general view that the ISAs need to more explicitly reinforce auditors' professional scepticism, in light of the increasing complexity of business and transactions and the increasing use of accounting estimates, with more emphasis needed on

¹³ For example 'The audit of loan loss provisions and related IT controls in banks and building societies' (December 2014). Paragraph 1.2.3. Financial Reporting Council

¹⁴ Clarified International Standards on Auditing – Findings from the Post- Implementation Review – IAASB - July 2013

the importance of auditors' challenging management's assumptions. During 2015-2019¹⁵, the IAASB will prioritise efforts to address the findings from their review. The FRC has recently reported that the requirement for extended auditors' reports¹⁶ has been successfully introduced¹⁷ and pointed to a number of areas where further improvement might be made, namely:

- *“Increasing the granularity of risk reporting (i.e. being as entity specific as possible);*
- *Improving the discussion of the auditor’s application of materiality and why a particular benchmark or level was chosen and addressing other aspects of materiality; and*
- *Making a clearer linkage between the discussions of risks and materiality and the description of how these influenced the scope of the audit”.*¹⁸

80. The FRC also noted the following: *“One of the more interesting innovations has been the reporting of findings by certain audit engagement partners. One firm has announced an intention to adopt this practice more widely. Although investors are generally supportive of this practice, we have heard that some Audit Committees are resistant to such a development and that some audit firms would like to see a safe harbour provision put in place for the protection of auditors.”*¹⁹

81. These changes and innovations relate very closely to the areas identified in this review and are of relevance to the impairment provisions to be made under IFRS 9, the disclosure of the assumptions made, the range of judgements and the subjectivity involved in arriving at the impairment provisions.

82. The role of the auditor is to provide an independent professional opinion on whether the company's financial statements give a 'true and fair' view in accordance with IFRS both as issued by the IASB and subsequently adopted by the EU. Although the concept has long been central to accounting and auditing practice, there is no statutory definition of 'true and fair'. The most authoritative statements as to the meaning of 'true and fair' have been legal opinions written by Lord Hoffmann and Dame Mary Arden in 1983 and 1984 and by Dame Mary Arden in 1993. The FRC commissioned a further legal opinion²⁰ from Martin Moore QC – 21 April 2008.

83. There is no equivalent legal opinion in Ireland. However, due to the dual applicability of the FRC standards in the UK and Ireland there has been a presumption that this opinion also applies in an Irish context. CARB would welcome clarity on this from DJEI and IAASA.

¹⁵ Strategy for 2015–2019: Fulfilling Our Public Interest Mandate in an Evolving World – IAASB - December 2014

¹⁶ ISA (UK and Ireland) 700 (Revised June 2013) “The Independent Auditor’s Report on Financial Statements”

¹⁷ Extended auditor’s reports: A review of experience in the first year. Financial Reporting Council 2015, Page 5.

¹⁸ Extended auditor’s reports: A review of experience in the first year. Financial Reporting Council 2015, page 5.

¹⁹ Extended auditor’s reports: A review of experience in the first year. Financial Reporting Council 2015, page 7.

²⁰ This legal opinion has been published on the FRC website: <https://www.frc.org.uk/FRC-Documents/FRC/True-and-Fair-Opinion,-Moore,-21-April-2008.pdf>

Recommendations

84. **CARB recommends that the audit firms take immediate steps to introduce the improvements, agreed with the Quality Assurance Committee as a result of the review of the individual audits, which have not yet been implemented. This should be followed up in subsequent reviews by IAASA following the introduction of their new statutory powers from June 2016.**
85. **CARB recommends that a survey on the application of Revised ISA 700 be carried out by IAASA in respect of the auditor's report on the financial statements of Irish Public Interest Entities as soon as practicable for the year ended on or around 31 December 2015 or 2016 as appropriate.**
86. **As the use of assumptions will be inherent in the application of IFRS 9, CARB recommends that IAASA and the prescribed accountancy bodies provide input into any proposed changes to auditing standards (or associated guidance) relating to auditors' challenge of management assumptions.**
87. **CARB recommends that Department of Jobs, Enterprise and Innovation (DJEI) and/or IAASA commission a legal opinion to provide an authoritative statement on the meaning of true and fair.**

Financial Statements

Disclosures in the Annual Report

88. The annual reports of the Institutions comprised the financial statements (including related notes) and other information (e.g. Chairman's Statement, Financial Review). The auditor is required to audit the financial statements and to read other information contained in the annual report to consider whether it is consistent with the audited financial statements
89. The financial statements of the Institutions (including related notes), are substantial documents with very detailed and lengthy disclosures. For the years under review the Institutions made significant disclosures regarding, amongst other things, the requirements of IAS 39, the loan provisioning methodology and the provisions made. These disclosures were included in a number of different areas of the financial statements and, while they conformed to the requirements of the accounting standards, they were not necessarily presented in a manner that enabled the reader to easily understand the most important assumptions. In addition, the disclosures were frequently at a high level or generic in nature.
90. The Institutions gave indications in their annual reports of likely impairment provisions to be booked in future years. These disclosures varied from narrative references on downside risk to more categorical statements that impairment charges would increase in future years. The annual report for one Institution included numerical disclosures of likely impairment charges over a three-year period (and also referenced indicative impairment charges disclosed in the

Institution's Interim Management Statement). Appendix 6 contains quotations of Institutions' disclosures. The majority of these statements were outside the scope of the audits. Nevertheless it was clear that the release of these statements was acknowledged by the auditors to improve the overall quality of information available as to the financial positions of the particular Institutions.

91. The review noted the disclosures in the financial statements prepared by the directors of the Institutions were generally compliant with the relevant accounting standards. However the review team concluded that matters relevant to impairments could have been more clearly and specifically disclosed in the financial statements of the Institutions. The review further concluded that, while areas for improvement had been identified, the firms generally complied with the relevant auditing standards.
92. To ensure that the ISAs appropriately acknowledge and address the auditor's expected effort in relation to disclosures in financial statements, the IAASB commenced a project in September 2012 to determine whether changes to the ISAs with respect to disclosures were needed. In July 2015, the IAASB issued revisions to certain ISAs, effective for audits of financial statements for periods ending on or after 15 December 2016. Auditing standards applicable in Ireland and the UK are issued by the FRC and based on the ISAs issued by the IAASB. These new standards have not, as yet, been brought into effect in the UK and Ireland.

Going Concern

93. In the circumstances in which certain of the Institutions found themselves when the 2008 financial statements were being finalised the Directors had to decide on the whether the going concern basis was appropriate. In making this decision the Directors considered the effectiveness of the various measures, including the Government Guarantee, refinancing and nationalisation, introduced by the Irish Government. In no case did the Institutions or the auditors obtain a formal written confirmation of the Government's on-going support. It was believed by the auditors that such written confirmation was not necessary or likely to be obtained, if requested, in the wholly unprecedented situation that existed.
94. It would have been more satisfactory if a clear protocol had been agreed to clarify that issue. In such critical situations it would be appropriate for Government support to be explicitly confirmed to the Institutions and the auditors.

Recommendations

95. **CARB recommends that the FRC revise its auditing standards in an equivalent manner to the revisions made by the IAASB in July 2015 in relation to disclosures.**
96. **CARB recommends that the FRC develop a framework for providing assurance on forward-looking statements (whether included in annual reports or other documents), drawing where relevant on existing standards issued by the IAASB, particularly in light of the subjectivity that will be involved in arriving at the impairment provisions under IFRS 9.**

97. **CARB recommends that, to ensure clarity in the situation where a financial institution is dependent on Government support to continue as a going concern, a clear protocol²¹ be agreed to enable the institution to seek and obtain clear and unambiguous confirmation from the Government of the terms and conditions attaching to such support and for such confirmation to be available to the auditor as part of the appropriate audit evidence.**

The Financial Regulator

98. In other public reports, most notably Nyberg²², there has been commentary on the role of the Financial Regulator.
99. It is not the function of this review to comment on that role. However, in the course of reviewing the work of the auditors and their engagement with the Financial Regulator, we have a number of observations.
100. During the course of the review it became apparent that the auditors made significant efforts to engage with the Financial Regulator with evidence to suggest that a number of meetings between the auditors and the Financial Regulator took place due to pressure from the auditor.
101. During the review it was noted that a number of written statutory reports were not made by the firms to the Financial Regulator within the timeframe required by the legislation. The auditors' records evidenced that the audit firms did engage with the Financial Regulator at various meetings and brought a number of significant matters to the attention of the Financial Regulator. In addition, following the introduction of the Government Guarantee, representatives of the Financial Regulator were present at Audit Committee meetings of the Institutions; certain audit firms relied on these representatives to bring matters to the attention of the Financial Regulator. It is, however, important that written statutory reports are made as required by the legislation.
102. Since the year ends under review, the Financial Regulator, with the support of the audit profession, has instigated a number of new procedures to increase interaction and communication between the Financial Regulator and the auditors. These include:
- The auditors and the Financial Regulator worked together to produce an Auditor Protocol in 2010 and updated in 2013; and
 - The auditors now have a right to report to the Financial Regulator, rather than a duty to report only on certain specified matters as existed in the period under review.

These are welcome steps that should improve the openness and transparency of communications between the auditors and the Financial Regulator in the future.

²¹ A protocol could be developed similar to the existing protocol between the Central Bank of Ireland and the Auditors of Regulated Financial Service Providers.

²² The Report of the Commission of Investigation into the Banking Sector in Ireland, March 2011 ('Nyberg')

Recommendations

103. **CARB recommends that the audit firms ensure that their internal procedures are sufficient to ensure that all reports due to be submitted to the Financial Regulator are produced in the format and within the timeframe set by the Financial Regulator.**
104. **CARB recommends that the Financial Regulator in conjunction with the audit firms continuously review and, if necessary, improve the operation of the Auditor Protocol to ensure that the transfer of information between the auditors and the Financial Regulator continues to be open and transparent.**

Future Reviews

105. The Institute is a Recognised Accountancy Body ('RAB') for the purpose of Section 191 of the Companies Act 1990, as amended by Regulation 10 of the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010 ('S.I. 220 of 2010'). An RAB is an accountancy body that is authorised to approve its members/member firms to practice as statutory auditors/audit firms in Ireland.
106. In accordance with the provisions of SI 220 of 2010, CARB, of behalf of the Institute, is required to monitor the audit work of firms registered by it to audit PIEs (as defined) every three years. The QAC has, in accordance with the provisions of the Audit Regulations, inspected each of the firms subject to this review since it commenced. The QAC has noted no material matters during the course of these inspections. A further inspection will be carried out in 2015.
107. In 2016 IAASA will be required by EU law to assume responsibility for the monitoring of the audits of PIEs. It is critical for the reputation of the audit profession in Ireland that IAASA is sufficiently resourced to fulfil its statutory obligations.
108. The FRC reported on an Audit Quality Thematic Review on the audit of loan loss provisions and related IT controls in banks and building societies in December 2014.

Recommendation

109. **CARB recommends that IAASA carry out an Audit Quality Thematic Review in respect of the audits of Irish banks and building societies for the year-ending on or after 31 December 2016. It is suggested that this review should conclude on whether the improvements recommended by CARB have been implemented by the firms.**

4 THE REVIEW

Section 1: Introduction

110. This Chapter has been written to stand alone and includes in detail the scope of the review, the findings of the review and conclusions of QAC. Certain issues discussed fully in this Chapter are included in summary in the Executive Summary (Chapter 2) and the Key Issues and Recommendations (Chapter 3).

Scope of the Review

111. The scope of the review was to review the processes and procedures of the audit firms in relation to the audit of the financial statements of the Covered Institutions for the years ended between 30 September 2008 and 31 March 2009, to determine whether the auditors applied appropriate audit procedures and complied with relevant standards, practice notes and other legislative provisions in the audit work carried out on the provisions for impairment as part of their audit of the financial statements as a whole.
112. It was not the role of CARB to re-perform the audit or determine the appropriateness or otherwise of the impairment provision but rather to form a view as to whether the firms applied appropriate auditing procedures when carrying out the statutory audits.
113. It is important to emphasise that the review focused on how a particular audit was performed and was not designed to assess whether the information being audited was correctly reported.

Respective Responsibilities of Directors and Auditors in relation to the Financial Statements

114. The directors are responsible for preparing the financial statements in accordance with applicable law and regulations. The Companies Acts require the directors to prepare financial statements for each financial year. Under the Acts, the directors are required to prepare the financial statements in accordance with International Financial Reporting Standards (“IFRS”) both as issued by the International Accounting Standards Board (“IASB”), and adopted from time to time by the European Union (“EU”). The financial statements are required by law and IFRS to present fairly the financial position and performance of the Institutions; the Companies Acts provide in relation to such financial statements that references to financial statements giving a true and fair view are references to their achieving a fair presentation. Further information on contemporary accounting standards is set out in Section 4 of this Chapter.
115. The responsibility of the auditor is to audit and express an opinion on the financial statements in accordance with applicable legal and regulatory requirements and International Standards on Auditing (ISAs) (UK and Ireland). An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are

appropriate to the entity's circumstances, consistently applied and adequately disclosed. The audit is planned and performed so as to obtain all the information and explanations which the auditor considers necessary in order to provide the auditor with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming an opinion on the financial statements, the auditor also evaluates the overall adequacy of the presentation of information in the financial statements. Further information on contemporary auditing standards is set out in Section 5 of this Chapter.

116. It is also important to be aware of what is outside the scope of an audit. The scope of the audit is very specifically restricted to the matters set out in Paragraph 116. The implication of this is clearly demonstrated by the following extract from the auditor's report for one of the Institutions, setting out in the section dealing with the responsibility of the auditor: *" We are not required to consider whether the Directors' statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures".*

Process of the Review

117. The review team's observations and conclusions have been formed on the basis of a detailed review of the audit files, robust challenges to the firms followed by detailed responses from and discussions with the firms, all of which co-operated fully with CARB.

Environment in which the Audits were Conducted

118. In late 2008 and early 2009 the Institutions faced very considerable challenges in finalising the year-end financial statements; this included the rapidly deteriorating environment in Ireland and globally following the collapse of Lehman Brothers, the loss of confidence in Ireland generally and the action of the Government, through the guarantee scheme and in the case of some Institutions recapitalisation, to secure the future of the Irish banking system. All this resulted in difficulties in developing accurate economic forecasts and in determining the values of property and construction assets and loans secured on those assets in the absence of an active market.

Findings of the Review

119. The findings of the review are set out in detail in Section 6 of this chapter of the Report. The CARB team that conducted the review of the audits carried out a thorough, detailed and challenging procedure with the objective of establishing whether the audits did comply with the relevant contemporary standards. Detailed discussions took place with the firms who responded in detail to the challenges made by the review team. The overall conclusion is that, in carrying out the audit on impairment provisions, the audit firms generally complied with the then current, relevant auditing standards. In a number of instances where the audit firms did not fully comply and areas for improvement were recommended these were not material. Where QAC made recommendations for improvement in relation to the individual audits these are set out in Section 6 of this Chapter.

Accounting Policy for Impairments

120. In all cases the Institutions' accounting policy on impairment disclosed in its financial statements complied with the accounting standard that specified how impairments of loans should be recognised and measured: IAS 39 Financial Instruments: Recognition and Measurement. Under IAS 39, only incurred losses as at the balance sheet date are recognised. Losses expected as a result of future events, no matter how likely, are not recognised.
121. The review noted that IAS 39 is a complex standard and has been the subject of considerable debate and, in some quarters, criticism. The emerging banking crisis at that time led to growing concerns that provisions were recognised too late as losses turned out to be greater than the financial statements had recognised or implied, because IAS 39 required that impairments could only be recognised in respect of circumstances existing at the balance sheet date. The implications for audits are examined in Section 4 of this Chapter of the Report, including the critical issue of matters to be considered which may lead to the recognition of an impairment provision. Changes to the standards for accounting for impairments made since 2008/9 and the review's recommendations relating to this matter are dealt with in Chapters 3 and 5.

Auditors Recognised the Risk Posed by Impairments

122. At the planning stage of the audits, the firms clearly identified loan impairment provisions as an area of significant risk. In recognition of this the firms allocated additional experienced auditors to the audit team and increased the level of involvement of the audit engagement partners and quality review partners. In a number of cases where the audit firm had concern about the controls in the Institution the firms increased (and in more than one case significantly increased) the level of substantive testing carried out. In all cases the planned approach to test impairment provisions was an acceptable approach under ISA 540 "Audit of Accounting Estimates".

Auditors Increased the Extent and Depth of Audit Work

123. The auditors clearly recognised the heightened risk of material misstatement in the financial statements in relation to the loan provisions. In response the firms allocated a higher volume of senior people to the audit of the loan provisions and the level of substantive testing of loans increased considerably. This is discussed in detail in Section 6 of this Chapter.
124. In addition, the firms engaged extensively with management of the Institutions to ensure the firms obtained the necessary level of assurance, as part of their overall audit procedures, in relation to the audit of the loan provisions. The firms also generally increased the number of meetings with the Audit Committees to ensure that considerations and conclusions were brought to the Audit Committees' attention to assist the Audit Committees in forming their opinion on the appropriateness of the impairment provisions. It is clear that the firms challenged management and the Audit Committees.

Impairment Provisions Increased

125. In most instances it was clear that the challenge during the audit process contributed to, or resulted in, the Institutions increasing the provision, in some cases significantly. The review indicated that in overall terms the level of the provisions across the Institutions increased by at least €1.3 billion (28%) from the commencement to the conclusion of the audit. This was a result of the engagement of the auditors with management and the Audit Committees and their reaching agreement as to the appropriate level of the provision.

Reporting to the Financial Regulator

126. In relation to reporting to the Financial Regulator, during the course of the review it became apparent that the auditors made significant efforts to engage with the Financial Regulator. There was even, on occasion, evidence to suggest that a number of meetings between the auditor and the Financial Regulator took place due to pressure from the auditor.

127. However, certain of the firms relied on the fact that representatives of the Financial Regulator were present at Audit Committee meetings. These firms in some measure relied on these representatives to bring matters to the attention of the Financial Regulator. As a result, the auditors in a number of instances did not make the statutory reports under Section 27 of the Central Bank Act 1997 (as amended by the Central Bank and Financial Services Authority of Ireland Act 2004) , in writing within the timeframe set in the legislation.

Disclosures in the Financial Statements

128. The review noted the disclosures in the financial statements prepared by the directors of the Institutions were generally compliant with the relevant accounting standards. However, the review team concluded that matters relevant to impairments could have been more clearly and specifically disclosed in the Financial Statements of the Institutions, and concluded that while areas for improvement have been identified the firms generally complied with the relevant auditing standards.

Changes and Improvements since 2008/9

129. A number of changes have been made or initiated in the last six years, some arising directly from the crisis. These changes are designed to improve the quality of audits and financial reporting in the future. These are described in Chapter 5 of this Report, and include changes to the key accounting standard relating to impairment provisions as well as to aspects of auditing standards dealing with scepticism, audit documentation, going concern and other matters. CARB notes that the firms welcome these changes, and that they have taken steps to implement these changes as they have been introduced.

Recommendations Arising from the Review

130. CARB has given its full support to a number of important themes that have been identified leading to recommendations as to actions to improve future audit and financial reporting. These are discussed in Chapter 3.

Section 2: The Irish Economy, Banking and Property Markets in 2008/9

Introduction

131. After a period of unprecedented expansion, the Irish economy experienced a severe setback in 2008, which continued for some years. This chapter describes the market context in which the Irish banks found themselves and which faced their auditors at the time of the audits of the various financial statements for the years ended between 30 September 2008 and 31 March 2009 (“the 2008 audits”), which were carried out between mid-2008 and May 2009.

The Wider Context of the Irish Economy

132. The Regling and Watson report provides a useful summary of the financial and economic context in which the 2008 audits were carried out:

“The financial climate in Europe and the global economy during the past decade, coupled with rapid financial integration, was an environment that truly put bank management and governance to the test. In many economies, there were strong incentives to fight for market share during prolonged credit and asset price booms, while cross-border funding markets provided ever more ample liquidity to do so.

Many of the sea-changes that were taking place in financial markets and the real economy seemed permanent, presenting bankers with a perceived “new paradigm” that combined low inflation, a cheaper global supply of goods, and a drop in the risk premia required by lenders, with risks perceived as more widely and efficiently spread.

In peripheral EU economies, moreover, there was an accelerated catching-up of income (and in some cases productivity) which seemed to validate higher levels of debt among banks’ corporate and household clients. Some of these changes in the banking environment, of course proved more durable than others. The banking market in Ireland was far from unique in these respects.

Faced with these changes, banks responded in three different ways, all of which involved expanding their balance sheet and on/off balance sheet activities, typically funded at the margin by a rise in wholesale market borrowing. Some favoured expansion in domestic market segments that were not yet highly competitive: lending on commercial and residential property was one candidate. Others found cross-border opportunities in neighbouring markets, often also in the form of plain vanilla property lending.... A third set of banks found no obvious outlet of these kinds; they bought large amounts of complex securities²³ based on (for example) US mortgages, and placed them in special vehicles where they could minimise the capital cover that regulation obliged them to set aside. It is not a coincidence that property lending was a recurring theme in these bank strategies. A perceived “permanent” downward shift in real interest rates and an upward shift in asset prices - accompanied in many cases by strong growth in household incomes - made mortgages an instrument of choice for balance sheet expansion. Credit and property prices in many markets then chased each others tails skywards

²³ The Irish banks had little or no significant exposure to such securities.

in one of those cycles that punctuate many periods of economic history and are not generally recognised for what they are.

The management of individual banks in such markets thus faced a genuine dilemma. They could compete strongly through ever more aggressively priced and structured products; or they could find themselves shrinking in terms of market share – which many believed would also imply falling relative share prices and thus the risk of being taken over by a more aggressive bank. With hindsight, of course, a prudent stance in lending and funding would have left institutions ultimately in a more, not less, competitive position.”²⁴

The Irish Banks

133. Nyberg summarised the financial outcome in Ireland of these influences, by identifying that the lending of the covered banks rose from about €120 billion in 2000 to almost €400 billion by 2007, remaining at that level in 2008. During that period Irish GDP rose from about €100 billion to €180 billion.²⁵ The Nyberg report examined the banks’ strategies: “...the covered banks pursued strategies which would lead to higher growth, higher reported profits and higher bank valuations. A primary reason appears to have been to prevent a predatory takeover by another bank (either domestic or foreign) and thus maintain independence. However, in a number of cases, professional pride and a desire to catch up or stay ahead of the competition (i.e. playing to win) also seem to have been important.”²⁶

The Growth in impairments

134. As Nyberg reported that lending in the covered banks increased significantly, reaching almost €400 billion by 2007. The impairment provision charges reported by the institutions in the years before the crisis were relatively small, reflecting the market conditions experienced in that period.
135. During 2008, the Irish property market deteriorated, leading to concerns about the recoverability of the banks’ loans made during the previous years. Such concerns were heightened to the extent that interbank markets and the equity markets began to suspect that the institutions might be experiencing liquidity and/or solvency problems. In official circles, the view up to late 2008 was that the problems were related to liquidity rather than solvency²⁷ as the global collapse in interbank markets during that year caused severe liquidity problems for Irish institutions, and share prices of the listed banks decreased significantly.
136. The provision charges reported in the 2008 audited financial statements were substantially higher than in previous years and increased dramatically in the succeeding years as the scale of the collapse in the markets became evident. The charges for each of the Covered Institutions for the years 2006 to 2013 are shown in Chart 1²⁸:

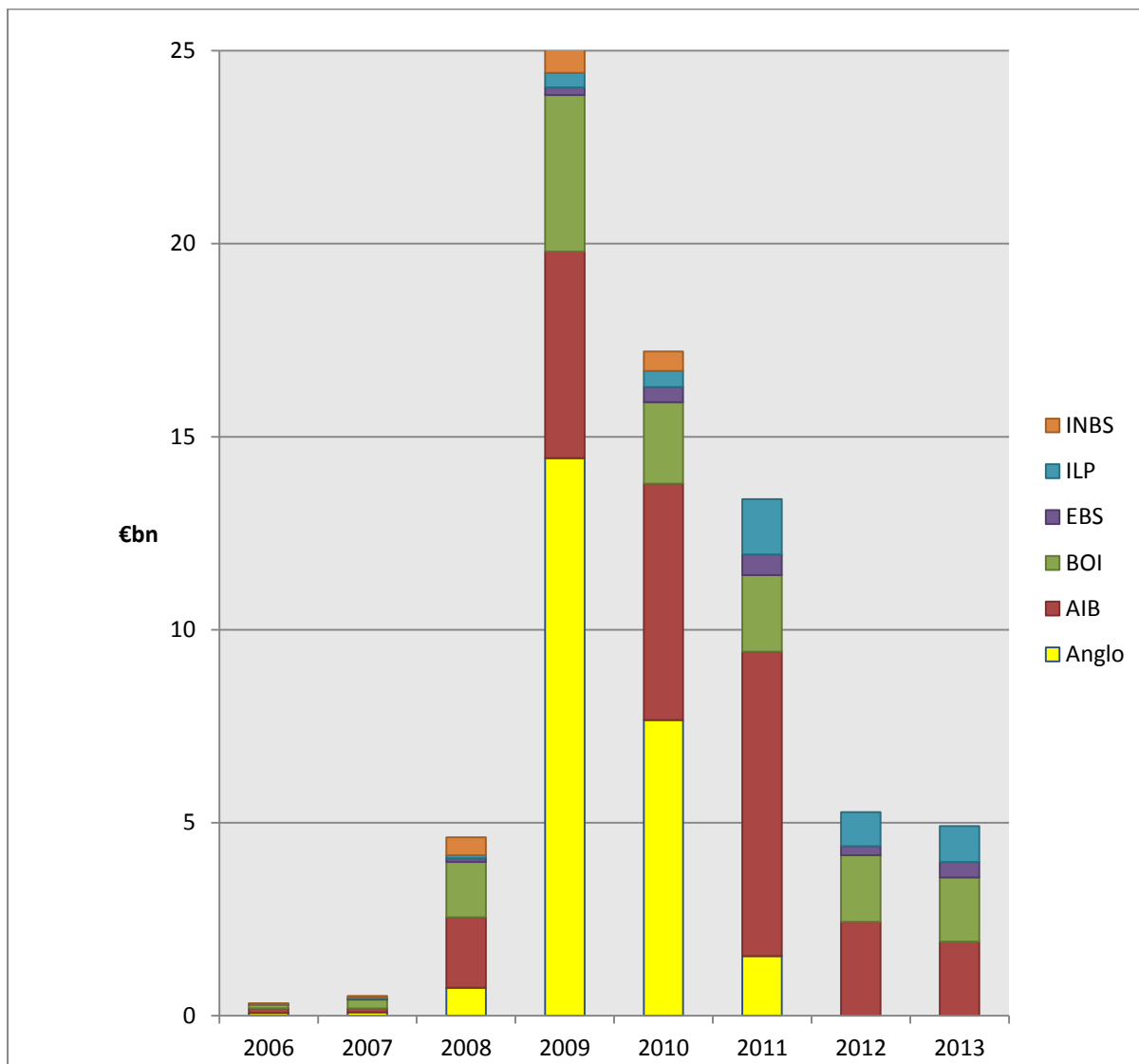
²⁴ Regling and Watson, page 15.

²⁵ Nyberg, paragraph 2.2.2 and Figure 2.1

²⁶ Nyberg, paragraph 2.3.3

²⁷ This was the basis on which the blanket guarantee of covered institutions’ liabilities was introduced on 30 September 2008.

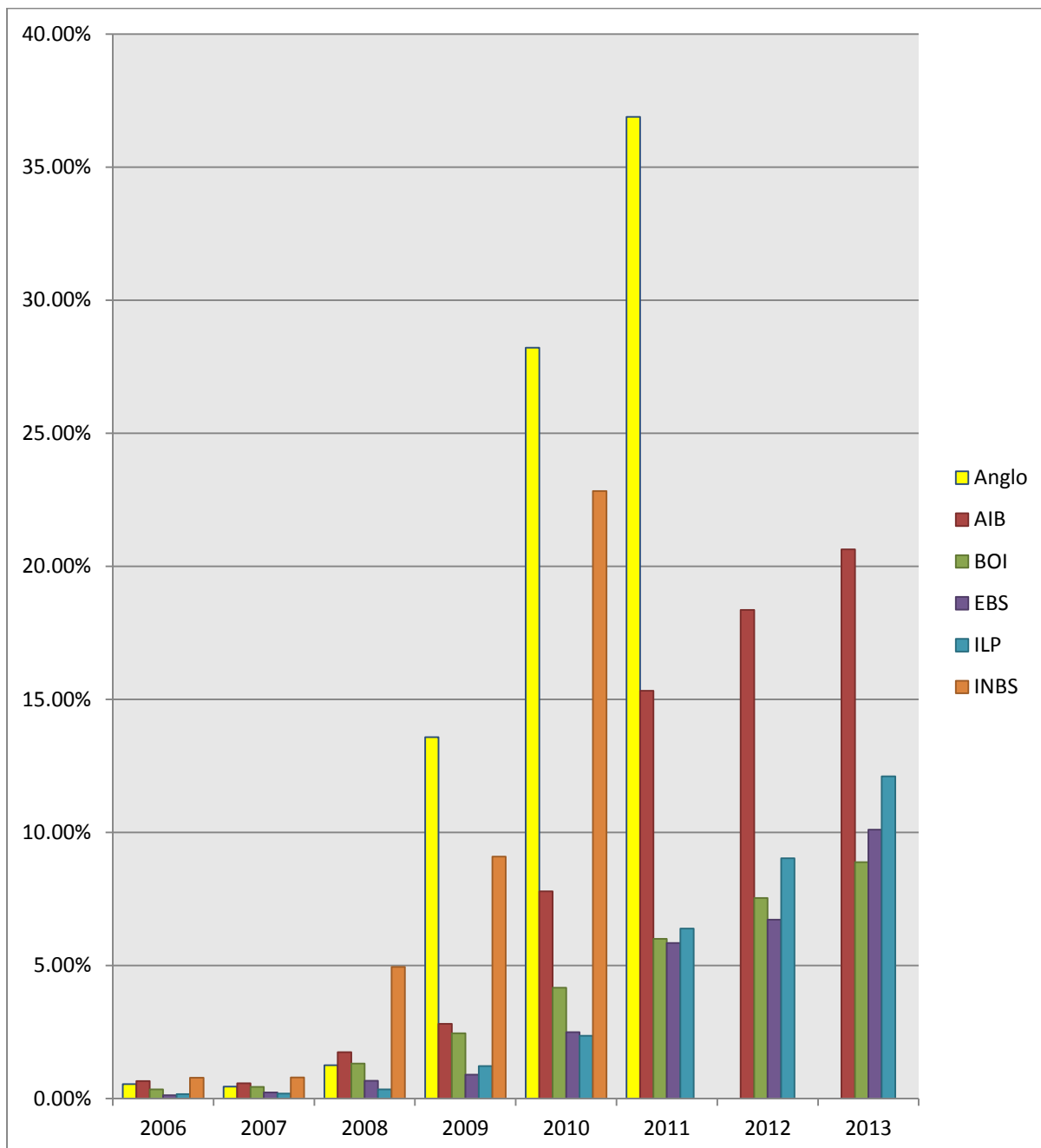
²⁸ The charges for 2010 exclude losses reported in the financial statements on sales/transfers to NAMA amounting to €11.5bn in the case of Anglo, €2.2bn in the case of BOI, €6.0bn in the case of AIB, €0.3bn in the case of EBS, and €2.7bn in the case of INBS. These covered institutions had no control over the valuations placed by NAMA on assets acquired. The above losses on sales/transfers to NAMA represent additional discounts over and above the carrying amount (which is net of impairment provisions) of the assets in the financial statements of the covered institutions.



137. These charges initially amounted to small proportions of the Institutions' loan books, but the proportions grew significantly during the period 2008 to 2013. Chart 2 shows the total year-end provisions as a proportion of the year-end loan books.

138. This has led to the question as to whether any of the provisions made in 2009 and later could or should have been made in the 2008 financial statements. The accounting standard IAS 39 requires that only incurred losses as at the balance sheet date are recognised. Losses expected as a result of future events, no matter how likely, are not recognised. The review noted that a number of the Institutions included warnings with regard to expected losses should the economic crisis deepen. Two Institutions included their best estimates of future loan losses in the financial statements or investor communications.²⁹

²⁹ For example, Bank of Ireland included figures for projected future loan provisions in the Group Chief Executives Review in the Annual Report 2009. AIB included figures for projected future loan provisions in the AIB 2008 Full Year Results Presentation to investors. See also Appendix 6.



139. The financial information on which Charts 1 and 2 are collated is included in Appendix 7³⁰.

The Irish Property Market in 2008

140. The Institutions had very considerable exposure to the Irish and UK property markets, principally through lending to developers and investors.

141. Irish property values had risen consistently between 1995 and 2007 (in the case of commercial property (combined Office, Retail & Manufacturing) by over 200%) , but had fallen sharply during 2008. New house prices had risen during the same period by about 185%, and had peaked in early 2007 following which a steady decline commenced.

³⁰ This excludes Postbank which had no relevant loans or impairment provisions

142. There was considerable uncertainty at the time as to how these trends would develop and as to whether or not they would continue and with what intensity.
143. There was even some confusion as to the extent of house price falls already experienced. While a number of different measures existed, based on different methods of assessing market prices, the best-known and most widely used was the Permanent TSB Index which was produced in conjunction with the ESRI. In broad terms, this showed house price falls to be of the order of 20% by 31 December 2008. While substantial house price falls had been recorded by December 2008, the bulk of the falls had yet to materialise with the troughs occurring in late 2012/early 2013. Subsequent official statistics show that house price falls between end-2008 and the eventual troughs some years later were of the order of 40 to 50%, depending on the location and type of residence.
144. The situation regarding commercial property prices was similar. According to the IPD statistics, prices had fallen by approximately 35% by December 2008; again, the bulk of the falls materialised after that date. In this case, the troughs did not occur until late 2013 and the full extent of the falls was clearly unknown in early 2009. Between end-2008 and the eventual price troughs in 2013, retail, office and industrial property prices fell by a further 43%, 35% and 31%, respectively.
145. Further property price falls were widely expected in early 2009 with forecasts for the peak to trough falls in house prices ranging up to 40- 50%. Forecasts for commercial property prices were much rarer. While IAS 39 precluded the Institutions and the auditors from using such estimates as a basis for provisions, there was nothing to stop the directors from providing guidance outside of the formal accounts and, in most cases, they did so in varying degrees of detail.
146. This level of uncertainty increased the pressure on the auditors to ensure that they planned and conducted the audits with sufficient rigour, scepticism and attention to up-to-date market indicators when considering the judgements made by the banks when assessing impairment provisions in the 2008 audits. Banks made their own interpretations of the characteristics that had to be taken into consideration and published these alongside the statutory financial statements.
147. One bank used very broad ranges of value reductions, including in an internal report to its Audit Committee these figures: "*Land 20-50%, Development assets 20-50% and Property Investment assets 10-25%*". Auditors had to assess such estimates in the light of their own knowledge and experience. Such a market and its range of disparate market indicators, which led to challenging judgements by banks and auditors, would inevitably give rise to ranges of potential impairments. Judgemental choices would have to be made and it must be recognised that, in these circumstances, there would not be a single 'right' number.

Major Events Relevant to the 2008 Audits

148. During the time in which the 2008 audits were being planned and carried out, a number of significant events occurred which affected the environment of the Institutions. These are set

out briefly below³¹. The auditors' reports were signed at dates between 2 December 2008 and 18 May 2009.

- 15 September 2008-Collapse of Lehman Brothers in USA
- 30 September 2008-Irish State guarantees liabilities of seven Irish banks
- 14 December 2008- Irish Government announces €10bn allocated to recapitalisation of domestic banks
- 18 December 2008- Anglo Irish Bank's Chairman and CEO resigns following disclosures over directors loans
- 21 December 2008- Irish Government announces €5.5bn to be invested in preference shares in AIB, Anglo Irish and Bank of Ireland
- 15 January 2009- Irish Government announces intention to nationalise Anglo Irish Bank due to weak funding position and "unacceptable practices"
- 10 February 2009- IL&P CEO and two directors resign over €7bn placed with Anglo in September 2008
- 11 February 2009- Recapitalisation plans amended to invest €7bn in AIB and Bank of Ireland from the National Pensions Reserve Fund
- 7 April 2009- National Asset Management Agency (NAMA) announced.

³¹ Extracted from Nyberg, pages 151 to 154

Section 3: The Auditors

149. The audits were carried out by three major audit firms, all of which were the Irish members of the “Big 4” worldwide audit networks, from which support was drawn when required. They had each carried out audits of banks and similar institutions for many years, and had dedicated specialist teams trained in the audits of such financial, regulated institutions. Their experience had of course been predominantly during a period of growth in the overall prosperity of Ireland and its banks.
150. Each firm cooperated fully with the review team, made their audit files and other audit records available. They also participated in detailed discussions about the issues raised during the review.
151. The audits were largely carried out between June 2008 and May 2009. During this period the Irish economy and its banking sector experienced a combination of severe disruptions which ended an extended period of exceptionally strong growth. This resulted in the need for rescue measures to be introduced by the Government due to the Institutions’ inability to secure adequate liquidity.
152. The auditors had to deal with an unprecedented set of circumstances while conducting the audit, during which the effects of the disruption to the markets, particularly the property market, were unclear.
153. The audit firms all recognised that the 2008/9 audits would be extremely challenging and the leadership of the firms responded by increasing the resources to undertake the audit both in terms of hours required and seniority. The audits were carried out under the close scrutiny of the audit engagement and quality control partners. The review team noted that the levels of resources and scrutiny were appropriate.
154. The time spent by the audit teams on testing of loan provisions increased significantly from the prior year, reflecting the changed economic circumstances. For example, for Firm A, the time spent testing loan provisions on the audit of Bank Y was estimated to have been in excess of 1,500 chargeable hours-15 to 20 times greater than the 2007 hours. However, this level of increase did not result in a proportionate increase in fees.

Section 4: The Contemporary Accounting Standards

Introduction

155. This section describes the key accounting standard relating to impairment provisions, and difficulties that have arisen as a result of its requirements.

The Setting of Accounting Standards

156. Since 2001, International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) have been issued by the International Accounting Standards Board³² (IASB). IASB is an independent group of 14 experts who are geographically diverse and have a mix of recent practical experience in setting accounting standards; in preparing, auditing, or using financial reports; and in accounting education. IASB members are appointed for terms of five years³³ by the Trustees of the IFRS Foundation (the oversight body of the IASB) after a well-publicised selection process³⁴. The Trustees are accountable to the Monitoring Board, a body of publically accountable markets authorities.

157. All Accounting Standards must go through a due process of endorsement before becoming law in the European Union (EU). All the standards and related interpretations are adopted by the EU in the form of regulations which are directly applicable in all member states. Furthermore, no IAS or IFRS can be endorsed if it would be contrary to the financial statements giving a true and fair view (i.e. a true and fair view of the financial position and performance of an entity).

158. Under EU law an individual accounting standard can only be adopted by the European Commission if as a consequence of its application by companies it will result in the financial statements giving a true and fair view.

159. Under Irish Company law applicable at the time, the statutory auditor's report was required to include an opinion as to whether the financial statements gave a true and fair view in accordance with the relevant financial reporting framework.

160. In 2005, the Covered Institutions adopted for the first time IFRS in their financial statements. IFRS differed in certain significant respects from the existing Irish generally accepted accounting principles (Irish GAAP).

IAS 39 *Financial Instruments: Recognition and Measurement*

161. At the time of the 2008 audits, IAS 39 "Financial Instruments: Recognition and Measurement" was the accounting standard which the Covered Institutions applied in their financial statements in determining:

- When impairment losses on loans should be booked (i.e. recognised), and
- How the amount of such losses should be calculated (i.e. measured).

³² For current IASB members, see <http://www.ifrs.org/About-us/IASB/Members/Pages/Members-of-the-IASB.aspx>.

³³ With a possible second term of three years.

³⁴ <http://www.ifrs.org/About-us/IASB/Members/Pages/Process-for-IASB-Member-Appointments.aspx>

162. IAS 39³⁵ was issued in March 1999 and has since been subject to a number of revisions and amendments. The Covered Institutions first applied IAS 39 in their 2005 financial statements as part of the transition from Irish GAAP to IFRS.
163. IAS 39 is a complex standard and has been the subject of considerable debate and, in some quarters, criticism. The emerging banking crisis led to growing concerns that provisions were recognised too late as losses turned out to be greater than the financial statements had recognised or implied, because IAS 39 ensured that impairments could only be recognised in respect of circumstances existing at the balance sheet date.
164. In simple terms the main objective of the relevant requirements of IAS 39 is to ensure that only losses that had been incurred at the balance sheet date are recognised in the financial statements. This was different from the requirements under Irish GAAP which applied up to 2005 when estimates of expected losses could be made. In the Basis for Conclusions (BC 109) which accompanies IAS 39, the IASB reasoned that *“it was inconsistent with an amortised cost model to recognise impairment on the basis of expected future transactions and events.”* The underlying reason for this approach was to disallow the build-up of general provisions which could then be used to smooth earnings and performance in a downturn. As part of the transition to IFRS in 2005, many financial institutions wrote back provisions which were no longer allowed under IAS 39. For example, in the case of one of the Covered Institutions, group provisions for impairment of loans and receivables amounted to €760 million as at 31 December 2004, with a reduction of €146 million on 1 January 2005 as part of the transition adjustment to IFRS. In another Institution the reduction was €123 million on a previous provision balance of €339 million.
165. IAS 39 had only been in force for three years when the December 2008 financial statements were prepared. The 2008 banking crisis was the first time when the provisions of IAS 39 were tested in such a combination of adverse factors.

Requirements of IAS 39

166. Loans are financial assets that are carried at amortised cost. In order to assist an understanding of the accounting requirements relevant to the recognition and measurement of impairment losses on loans, an outline of the relevant requirements of IAS 39 has been set out below. As previously noted, IAS 39 is a complex standard and this outline is not a substitute for a full reading of the Standard.

When Should Impairment Losses be Recognised?

167. Under IAS 39, only incurred losses as at the balance sheet date are recognised. Losses expected as a result of future events, no matter how likely, are not recognised.

³⁵ Disclosure requirements previously in IAS 39 were initially moved to IAS 32 *Financial instruments: Disclosure and Presentation*. Then, in August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*. IFRS 7 requires qualitative and quantitative disclosures about credit risk.

168. Paragraph 58 of IAS 39 states that *“An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired.”*
169. Losses are recognised when there is *“objective evidence of impairment”*, as described in IAS 39, as a result of one or more events that occurred since initial recognition of the asset (a ‘loss event’) and that loss event (or events) has an impact on estimated future cash flows that can be reliably estimated.
170. There is significant judgement and complexity involved in assessing whether there is any objective evidence that impairment has been incurred. This is an issue where different judgements can lead to very different provisions and require auditors to apply rigour and scepticism in examining these judgements.
171. Loss events to be considered include not only default by the borrower but other events such as:
- Significant financial difficulty or probable financial reorganisation of the borrower;
 - Concessions by the bank for reasons relating to the borrower’s financial difficulty;
 - Loss events that cannot be identified with an individual loan but which may impact the estimated future cash flows of a portfolio of loans (e.g. an increase in the unemployment rate in the geographical area of the borrowers or a decrease in property prices for mortgages in the relevant area).
172. Paragraph 59 of IAS 39 states that *“It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment.”*
173. Paragraph E4.1 of the Implementation Guidance, which accompanies but does not form part of IAS 39, notes that *“Other factors that an entity considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors’ or issuers’ liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.”*
174. It is important to note that the above are examples of loss events to be considered and the fact that one exists (e.g. a fall in property prices) may not constitute objective evidence of impairment. For example, a borrower may continue to meet the obligations on a residential mortgage (i.e. interest and principal payments) without needing to sell the property. Therefore the fall in property prices does not directly impact the estimated future cash flows of the loan.
175. The loan books of the Institutions comprise very large numbers of loans. It is impracticable for every loan to be individually assessed, so a procedure has been developed within IAS 39 to enable the assessment to be carried out in two or more stages. The Institution first assesses whether objective evidence of impairment exists individually for individually significant loans (e.g. large developer loans) and either individually or collectively for individually insignificant

loans (e.g. residential loans)³⁶. Any resulting provision is generally referred to as a 'specific provision'.

176. An additional assessment is performed where the Institution has determined that no objective evidence of impairment exists for an individually assessed loan. In such cases, the loan is included in a group of loans with similar credit risk characteristics, with an impairment assessment performed on a collective basis³⁷. Any resulting provision is referred to as the collective or incurred but not reported (IBNR) provision.
177. For the purpose of the review the above descriptions 'Specific' and 'IBNR' have been adopted. In all cases the review noted that the Institutions' accounting policies as disclosed in the financial statements complied with IAS 39. However, individual Institutions have used different terms (i.e. 'individual', 'specific', 'collective', 'IBNR') in their annual reports in describing the categories of provisions.
178. For collective impairment assessments, loans are grouped on the basis of similar credit risk characteristics (e.g. on the basis of a credit risk grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Significant judgement may be required in choosing the relevant characteristics on which to group loans.

How Should the Amount of Impairment Losses be Measured?

179. Paragraph 63 of IAS 39 states that *"If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition)."*
180. Similar to the recognition process, the measurement process can be complex with significant judgement required:
 - Judgement as to the assumptions to be used in estimating the future cash flows.
 - A borrower may be in financial difficulty but there is limited available historical data relating to similar borrowers. In such cases, the Institution will need to use its experienced judgement to estimate the amount of any impairment loss.
 - An institution uses its experienced judgement to adjust observable data for a group of loans to reflect current circumstances, which was particularly relevant for the 2008 audits.

How was IAS 39 Applied by Institutions and Auditors?

181. In the lead-up to the first application of IAS 39 in 2005 a great deal of consideration was given to its objectives and the way in which it should be applied. This was considered for example by the audit firms on an international basis to ensure that the application was consistent

³⁶ Paragraph 63 of IAS 39

³⁷ Paragraph 64 of IAS 39

internationally. In one country, Spain, a different approach was taken to reflect the different bank capital regime set by the Central Bank.

182. In Spain, banking regulations required banks to implement a statistical formula-based provisioning basis since 2000, known as 'dynamic provisioning'. Banco de España stated it was able to adopt dynamic provisioning in compliance with IASB standards, and argued that dynamic provisioning is the equivalent to the "*collective assessment for impairment*" although it recognised that this was to an extent contrary to IAS 39. It also stated that "*IFRS need to be a little bit more flexible to allow for dynamic provisions.*" "*In fact, dynamic provisions are a way to improve IFRS*"³⁸. The regime did not serve to protect Spanish banks from the types of problem faced by Irish banks.
183. In other countries, including Ireland and the UK, it is clear that IAS 39 had been applied by the Institutions and auditors in a way that was widely accepted but was considered not to enable or allow institutions to make the provisions which in the absence of that standard would or should have been made.
184. In Ireland the Institutions and auditors recognised that, as an incurred loss model was in place, they could not provide for expected future losses.
185. It did lead to certain of the Covered Institutions considering that the financial statements did not tell what they saw was the full picture of the financial position. Therefore, an indication was provided, either in other sections of the annual report or in other published statements, of expected impairment charges that might arise in the two years following the 2008 financial statements. However, such estimates are not subject to audit and, as such, were not subject to the same audit rigour as impairment figures in the financial statements.

International Accounting Standard 1: Presentation of Financial Statements (IAS1) and 'True and Fair'

186. IAS 1 'Presentation of Financial Statements' which was in place in 2008/9 required that the financial statements "present fairly" the financial position, financial performance and cash flows of the entity. It further states that application of the accounting standards, with additional disclosure where necessary, is presumed to result in financial statements that achieve fair presentation.
187. IAS 1 also states that "*in virtually all circumstances, a fair presentation is achieved by compliance with applicable accounting standards*". The standard did provide for departures from a particular accounting standard but only in "*extremely rare circumstances in which management [of the entity] concludes that compliance with a requirement ... would be so misleading that it would conflict with the objective of financial statements set out in the Framework*".
188. Furthermore, IAS 1 states that "*If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework.*"

³⁸ <http://www.ifrs.org/Meetings/Documents/IASBFASBMar09/Prov0903joint7Cobs.pdf>

Section 5: The Contemporary Auditing Standards

Introduction

189. This section describes the audit regime and standards under which the 2008 audits were carried out. It points to the legal status of the auditor and the objective of an audit. It then introduces the many International Standards on Auditing (ISAs) with which the auditors of the 2008 financial statements were required to comply in relation to the audits of impairment provisions.

The Statutory Audit

190. In accordance with the provisions of the Companies Acts, certain classes of companies are required to have an annual statutory audit. For this purpose the company must appoint an independent statutory auditor to carry out the audit in accordance with ISAs and any legislative provisions relating to the specific entity subject to audit.

The Role of the Auditor

191. The role of the auditor is to provide an independent professional opinion on whether the company's financial statements give a 'true and fair' view in accordance with IFRS both as issued by the IASB and subsequently adopted by the EU. Although the concept has long been central to accounting and auditing practice, there is no statutory definition of 'true and fair.' The most authoritative statements as to the meaning of 'true and fair' have been legal opinions written by Lord Hoffmann and Dame Mary Arden in 1983 and 1984 and by Dame Mary Arden in 1993. Due to significant changes in accounting standards and company law since these opinions were written, the FRC commissioned a legal opinion³⁹ (Martin Moore QC – 21 April 2008) to ascertain whether there was a requirement to revise the approach to 'true and fair' taken in the earlier legal opinions. In his opinion, Mr Moore endorsed the analysis in the earlier opinions and confirmed the centrality of the true and fair requirement to the preparation of financial statements in the UK.

192. There is no equivalent legal opinion in Ireland. However, due to the dual applicability of the FRC standards in the UK and Ireland there has been a presumption that this opinion also applies in an Irish context. CARB would welcome clarity on this from Department of Jobs, Enterprise and Innovation (DJEI).

193. The FRC issued a document entitled "True and Fair" in June 2014 which included the following extracts:

"True and fair is not something that is merely a separate add-on to accounting standards. Rather the whole essence of standards is to provide for recognition, measurement, presentation and disclosure for specific aspects of financial reporting in a way that reflects economic reality and hence that provides a true and fair view."

³⁹ This legal opinion has been published on the FRC website: <https://www.frc.org.uk/FRC-Documents/FRC/True-and-Fair-Opinion,-Moore,-21-April-2008.pdf>

“...it is clear that if auditors are to discharge properly their legal and professional responsibilities, they should stand back as they approach finalisation of those accounts and consider whether, viewed as a whole and in view of the issues that they have addressed in the course of the audit, the accounts do indeed give a true and fair view.”⁴⁰

International Standards on Auditing

194. International Standards on Auditing are set by the International Auditing and Assurance Standards Board (IAASB). The IAASB is an independent standard-setting body that sets international standards for auditing, quality control, review, other assurance, and related services, and facilitates the convergence of international and national standards. The IAASB consists of a full-time chairman and 17 volunteers from around the world. The 18 board members comprise nine practitioners with significant experience in the field of auditing and other assurance services and nine non-practitioners (including the chairman) who are not members or employees of an audit firm.⁴¹
195. International Standards on Auditing provide the basis for the International Standards on Auditing (UK and Ireland) (ISAs) issued by the Auditing Practices Board (APB) (and subsequently by the FRC (which acquired the APB). Where necessary, APB/FRC will augment the international standards with additional requirements to address specific UK and Irish legal and regulatory requirements; and additional guidance that is appropriate in the UK and Irish national legislative, cultural and business context. In furtherance of its functions as set out in the Companies (Auditing and Accounting Act) 2003, IAASA participates in the FRC standard setting process.
196. The 2008 audits were required to be carried out in accordance with the ISAs issued by the FRC.
197. The auditors reported that the audits included an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and that they also included an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies were appropriate to the Institutions’ circumstances, consistently applied and adequately disclosed.
198. The estimates of impairments were recognised as important areas for attention and were subjected to detailed scrutiny. The principal requirements of the relevant ISAs by which the auditors’ procedures in respect of the impairment provisions were governed are set out in this section. It should be noted that there is no single ISA which deals directly and specifically with the procedures required to be adopted in the audit of impairments, ISA 540 being the standard which gives the most directly relevant requirements. It is therefore necessary for auditors to have regard to a large number of ISAs. Particular features of key ISAs are set out in this section.

⁴⁰ <https://www.frc.org.uk/FRC-Documents/Accounting-and-Reporting/True-and-Fair-June-2014.pdf>

⁴¹ For current IAASB members, see <http://www.iaasb.org/about-iaasb/members>

199. Paragraph 6 of ISA 200 states that ***“The auditor should plan and perform an audit with an attitude of professional scepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. An attitude of professional scepticism means the auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and is alert to audit evidence that contradicts or brings into question the reliability of documents or management representations. For example, an attitude of professional scepticism is necessary throughout the audit process for the auditor to reduce the risk of overlooking suspicious circumstances, of over generalizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof. In planning and performing an audit, the auditor neither assumes that management is dishonest nor assumes unquestioned honesty. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.”***
200. For the 2008 audits, it was critical that the audit teams applied and maintained an attitude of professional scepticism throughout the process, considering the:
- Extent of judgement required in estimating impairment provisions and the materiality of such provisions to the financial statements;
 - Reports at the time of market conditions up to each balance sheet date which were relevant to the estimation of impairment provisions (i.e. property price indices) and limited availability of relevant historical data used as inputs in provisioning models;
 - Susceptibility of impairment calculations to management bias, arising from the pressure to deliver on profit guidance given to the market, and
 - Continued deterioration in economic conditions during the course of the audits which could have impacted the nature, timing or extent of planned audit procedures.

[ISA 230 Audit Documentation](#)

201. Paragraph 9 of ISA 230 states that ***“The auditor should prepare the audit documentation so as to enable an experienced auditor, having no previous connection with the audit, to understand:***
- (a) The nature, timing, and extent of the audit procedures performed to comply with ISAs (UK and Ireland) and applicable legal and regulatory requirements;***
 - (b) The results of the audit procedures and the audit evidence obtained; and***
 - (c) Significant matters arising during the audit and the conclusions reached thereon.”***
202. Preparing sufficient and appropriate audit documentation provides evidence that an audit was performed in accordance with ISAs and applicable legal and regulatory requirements.
203. Considering the extent of judgement required in estimating impairment provisions, and in particular where the auditor has determined that there is a significant risk of material misstatement relating to impairment provisions (as was the case for the 2008 audits), it is crucial that the documentation on the audit file provides evidence of the audit procedures

performed and a record of the conclusions reached and the basis for the auditor's report. An audit file which explains the auditor's response to an identified significant risk of material misstatement (i.e. planned procedures, including changes from the prior year's approach and/or changes during the course of the current year's audit) and the auditor's evaluation of the results of audit procedures performed and conclusions drawn also assists in demonstrating the extent of professional scepticism adopted during the audit.

ISA 250 Section B: The Auditor's Right and Duty to Report to Regulators in the Financial Sector

204. Paragraph 51 of ISA 250B states that *"... where a statutory duty to report arises, the auditor is required to make such a report regardless of:*

(a) Whether the matter has been referred to the regulator by other parties (including the company, whether by those charged with governance or otherwise); and..."

205. Although the Financial Regulator may have been made aware of certain regulatory breaches and other reportable matters through notifications by the Institutions or meetings with the audit firms, ISA 250B and legislation place prescriptive requirements on the auditor in relation to reporting to the Financial Regulator (including timing and format).

206. Unlike the UK, it is only recently that the auditor of Irish financial institutions had a right (as opposed to a duty) to report⁴² to the Financial Regulator. This is a welcome development.

ISA 540 Audit of Accounting Estimates

207. Paragraph 2 of ISA 540 states that ***"The auditor should obtain sufficient, appropriate audit evidence regarding accounting estimates."***

208. Paragraph 4-1 of ISA 540 states *"In addition, audit evidence obtained is generally less conclusive when accounting estimates are involved. Consequently, in assessing the sufficiency and appropriateness of audit evidence on which to base the audit opinion, the auditor is more likely to need to exercise judgement when considering accounting estimates than in other areas of the audit"*.

209. Paragraph 10 of ISA 540 states that ***"The auditor should adopt one or a combination of the following approaches in the audit of an accounting estimate:***

(a) Review and test the process used by management to develop the estimate;

(b) Use an independent estimate for comparison with that prepared by management; or

(c) Review of subsequent events which provide audit evidence of the reasonableness of the estimate made."

210. The requirements in ISA 540 influence and determine the detailed procedures applied by the auditor in testing impairment provisions. For example, where the approach adopted by the auditor is to review and test the process used by management in developing the estimate, Paragraph 11 of ISA 540 sets out the steps ordinarily involved in this approach (i.e. evaluation of data, consideration of assumptions, testing of calculations, comparison of prior year estimates to actual results, consideration of management's approval procedures). In

⁴² Section 58, Central Bank (Supervision and Enforcement) Act, 2013

evaluating assumptions, under Paragraph 16 of ISA 540, the auditor would consider whether they are reasonable in light of actual results in prior periods, consistent with those used for other accounting estimates and consistent with management's plans which appear appropriate.

211. Considering the significant amount of time and effort expended in auditing impairment provisions, the particular approach adopted by the auditor should be clear from the audit file with evidence of sufficient and appropriate procedures performed to support the approach.

ISA 570 Going Concern

212. Paragraph 30 of ISA 570 states that ***“Based on the audit evidence obtained, the auditor should determine if, in the auditor's judgement, a material uncertainty exists related to events or conditions that alone or in aggregate, may cast significant doubt on the entity's ability to continue as a going concern.”***

213. Paragraph 32 of ISA 570 states that *“If the use of the going concern assumption is appropriate but a material uncertainty exists, the auditor considers whether the financial statements:*

- (a) *Adequately describe the principal events or conditions that give rise to the significant doubt on the entity's ability to continue in operation and management's plans to deal with these events or conditions; and*
- (b) *State clearly that there is a material uncertainty related to events or conditions which may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.”*

214. Considering the circumstances of the 2008 audits, significant judgement was required by the auditors in determining whether a material uncertainty existed that may have cast significant doubt on the banks' ability to continue as a going concern and whether particular disclosures were required in the financial statements.

Other relevant ISAs

215. Other ISAs which were relevant to the auditor's work on impairment provisions and which were considered during this review included:

- *ISA 220 Quality control for audits of historical financial information*
- *ISA 260 Communication of audit matters with those charged with governance*
- *ISA 300 Planning an audit of financial statements*
- *ISA 315 Understanding the entity and its environment and assessing the risks of material misstatement*
- *ISA 330 The auditor's procedures in response to assessed risks*
- *ISA 530 Audit sampling and other means of testing*
- *ISA 560 Subsequent Events*
- *ISA 700 The auditor's report on financial statements*
- *ISA 720 Section A: Other information in documents containing audited financial statements*

Practice Note 19 (I) (Revised): The audit of banks in the Republic of Ireland (June 2008)

216. During the review, regard was also given to Practice Note 19 (I) issued by the APB which contains guidance on the application of ISAs to the audit of financial statements of banks in the Republic of Ireland. Guidance is also given in the Practice Note on reporting to the Financial Regulator and the conduct of auditors' periodic meetings with the Financial Regulator. Practice Notes are persuasive rather than prescriptive, and are indicative of good practice. It is important to note that the purpose of Practice Notes is to assist auditors in applying auditing standards of general application to particular circumstances and industries, as opposed to the imposition of additional requirements on auditors. Although considered during the course of our review, any findings in the individual reports have been raised by reference to the relevant ISA, as opposed to quoting extracts from Practice Note 19 (I).

Section 6: The Findings from the Reviews of the Audits

6.1 THE AUDITS OF THE 2008 FINANCIAL STATEMENTS

Introduction

217. This section examines the relevant aspects of the audits of the various institutions to show the approach taken to the audit procedures and conclusions relating to the provisions for impairment of loans and advances to customers.
218. The auditors issued unqualified reports in respect of each of the 2008 audits. In one case the unqualified report included 'emphasis of matter' Paragraphs not related to impairment provisions.
219. The review team examined the firms' very extensive audit records to establish the facts upon which the judgements regarding impairment provisions had been based. The team then challenged the firms' judgments in detail by developing possible alternative judgements based on the recorded facts and an assessment of contemporary market conditions at the time of the audits. These alternative scenarios were then presented to the firms in detail and discussed thoroughly with the firms, both in writing and at a series of meetings. The ultimate outcome, after an inevitably extended process, designed to ensure that it was both thorough and fair, was that the review team were satisfied that the firms had exercised reasonable judgements based on appropriate audit evidence available at the time of the audits. The process revealed the areas where the recording of the firms' scepticism and challenge to management required improvement. The process was also extended as it was carried out by the small team within CARB, and it was not possible to bring in additional competent resources not already conflicted by previous involvement in related matters. The key findings are set out in this section.
220. The overall conclusion is that in carrying out the audit on impairment provisions the audit firms generally complied with the then current, relevant auditing standards. In a number of instances where the audit firms did not fully comply and areas for improvement were recommended, these were not material.
221. In relation to the individual loans reviewed CARB concluded that for the majority of loans reviewed there was significant evidence on the firms' audit files of the extent of the Institutions' assessment of the loan and the firm's audit procedures being applied to the Institutions' assessment. However, for a number of loans, where the firm considered management's assumptions, the review team made recommendations for improvement in the documenting of the firm's challenge to management (scepticism) and on the conclusion that management's assumptions were reasonable.
222. The following are the areas where the firms agreed to improve audit procedures; these applied to one or more of the firms subject to the review:
- Planning: At the planning stage all the firms identified the significant risk of material misstatement in relation to loan impairment provisions and tailored their audit

procedures accordingly. In relation to planning documentation it was noted that a number of firms could have set out more clearly in the audit documentation the manner in which they intended to use available market information as a basis for challenging management assumption, particularly where more market information came to light during the course of the audit.

- General Audit Procedures: In all cases the planned audit approach complied with the relevant auditing standards. In one case it was noted that the firm should in future ensure that there is sufficient audit evidence on file of the firm critically assessing loan groupings.
- Provisions: The firms generally complied with the relevant auditing standards and there were no material matters to note. The main area of improvement was that for a number of loans there could have been more extensive documentation on the audit file to demonstrate the firms' scepticism and challenge of management assumptions. Examples of improvements identified in audit documentation included-challenge on emergence periods; review of the quality of grading; challenge on application of loss rates; and overall assumptions as to the fall in property values.

Context of the Audits

223. The audits were carried out between June 2008 and May 2009, with much of the audit work conducted between November 2008 and March 2009. During this period the Irish economy and its banking sector experienced a combination of severe disruptions which ended an extended period of exceptionally strong growth. This resulted in the need for a number of Irish banks to be rescued by the Irish Government which had in September 2008 introduced the Government Guarantee. The auditors had to deal with the implications of this unprecedented set of circumstances while conducting the audits, during which the effects of the disruption to the markets, particularly the property markets, were unclear. This was an extremely challenging context for the audits, particularly as the scale and nature of problems emerged during the period of the audits.
224. The earliest of the 2008 audits occurred when the forward view was still reasonably positive with the contraction expected to be relatively small, consistent with a 'soft landing.' The scale of Ireland's economic problems was becoming much more apparent six months later. The concept of a 'soft landing' is widely referred to by economists but its actual meaning and implications are subjective and do not seem to be widely appreciated. It could be 'bumpy' involving substantial job losses and reductions in tax revenues.

Recognition that Impairment was an Important Issue in the 2008 Audits

225. At the time of the 2007 year-end audits various discussions took place around audit issues arising from the developing economic crisis. For instance the Big 4 audit firms, the Financial Regulator, and Chartered Accountants Ireland met on two separate occasions in 2008. At the first meeting, in January 2008, involving representatives of these parties, issues discussed included banking liquidity, valuation uncertainty, provisioning and auditor communication with the regulators. One firm's informal note recorded that "*FR [Financial Regulator] is looking for conservatism in provisioning but is aware of the difficulties in reflecting such prudence*

within the rules of IFRS". The 'difficulties' referred to are the implications of the incurred loss requirement of IAS 39.

226. The auditors realised during 2008 that banks' impairment provisioning would be the most important risk issue in the 2008 audits. They appreciated that the environment was very difficult; that the banks were exposed to property loans; and that the property markets, including those in Ireland, were in serious difficulties. Accordingly the audits started with plans to address these risks, which were discussed with the Audit Committees. This was discussed at a further meeting of representatives of the Big 4 audit firms with the Financial Regulator in November 2008.
227. In December 2008, as a response to the identified increased risk from the international and domestic market conditions, a meeting was also held between CARB, IAASA and the Big 4 firms, to discuss the appropriate approach to the 2008 audits. Detailed presentations were made by the firms present, covering the importance of such matters as the "*significant uncertainties, including going concern*", the need to "*ensure that engagement teams had collective capabilities, competence and adequate time to perform the audits*" as well as the "*cornerstone of auditing*", being the need to "*continually emphasize the need for professional scepticism for every audit*". With respect to loan impairments, in the "*context of illiquid markets and circumstances where objectively verifiable inputs may not be available*", emphasis was given to items such as the expectations arising from the ability to "*only provide for incurred losses*", the judgement involved and the need for training and consultation.

The Audit Procedures Adopted

228. Each firm had developed its own proprietary set of procedures to enable it to conduct the audits in accordance with ISA requirements. The various methods by which these procedures were used by the firms are illustrated in this Chapter by a small number of representative examples from the many identified during the review dealing with the key essential audit procedures and requirements.
229. As stated in the Introduction, in order to protect confidentiality, in these examples individual audit firms and Institutions may be referred to as Firm A and Institution A and so on, and to further guard the confidentiality these codes are scrambled. Thus Firm A in one context is not necessarily the same firm as Firm A in another context. In addition each example stands on its own and it should not be taken that each applies to every audit reviewed.

Audit Requirements-Planning

230. A number of ISAs set out the need for an audit to be planned appropriately, based on an understanding of the entity, the environment in which it has been operating and the risks of material misstatement.
231. Paragraph 2 of ISA 315 ***Understanding the entity and its environment and assessing the risks of material misstatement*** states that "*The auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, and sufficient to design and perform further audit procedures*".

232. Paragraph 6 of ISA 315 states that *“Obtaining an understanding of the entity and its environment, including its internal control, is a continuous, dynamic process of gathering, updating and analyzing information throughout the audit”*.
233. Paragraph 15 of IAS 300 **Planning an audit of financial statements** states that *“...planning of the auditor’s risk assessment procedures ordinarily occurs early in the audit process. However, planning of the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures”*.
234. Paragraph 22 of IAS 300 states that *“The auditor should document the overall audit strategy and the audit plan, including any significant changes made during the audit engagement”*.
235. These requirements were largely followed, as can be seen from Example 1, which shows the focus on a range of significant areas.

Example 1-Audit Planning

236. The planning of the audit of Institution Z by Firm C included a risk assessment prepared three months before the year end and presented to the Audit Committee at that time. It included observations on significant issues including:
- (i) Focus on loan growth during recent years. Credit crunch environment and economic recession has impacted on customers’ ability to service debt. The downturn in the construction industry which may result in the need for significantly larger credit provisions in the current year as the value of collateral falls and cash generation of customers is stressed.
 - (ii) Fall in share price poses risk of earnings management. Management will be aware of potential market reaction to low earnings and high credit provisioning. The calculation of provisions is a complex task and is subject to management estimation.
 - (iii) Market turmoil impact on [Bank Z’s] liquidity position, capital adequacy and funding gap. Risk that going concern basis of preparation is not appropriate.
237. In addition, the firm’s planning document included information on the economic environment. For example, the Irish economy expected to suffer a sharp contraction in the 2008-2010 period; the banks may become insolvent, requiring nationalisation; extent of the downturn and its impact on property values had generally been underestimated. Firm C had obtained details of various market indices.
238. An integrated audit plan was presented to the Audit Committee two months before the year end. This was a normal and appropriate procedure, and it notified the Audit Committee that the firm was planning to increase the audit work substantially in response to the significant risk of material misstatement in relation to impairment provisions.
239. In this example, Firm C complied with the relevant auditing standard. However CARB recommends that the firm’s planning documentation be improved to set out more clearly the manner in which it intended to use available market data as a basis for challenging management’s assumptions in relation to the fall in value of collateral (in particular,

development land, given the lack of transactions) and the impact on loan impairment, particularly where more market information came to light during the course of the audit.

Control Assurance

240. In relation to large complex regulated entities, such as the Covered Institutions, the basic approach was to conduct procedures designed to obtain appropriate audit evidence that the systems and controls adopted by the Institution were adequate to provide reasonable assurance that the financial statements were likely to be free from material errors. This included the systems in place for assessing the need for and amounts of any impairment provisions. This procedure would normally involve a review of a relatively small sample of loans to observe whether the specified systems were working as intended.
241. This is well illustrated by Firm Y in its Audit Findings Report on the audit of Institution T in the following example, which shows how the normal procedure operated:

Example 2-Controls Approach to Audit of Loan Loss Provisions

“Our overall approach to loan loss is a controls based approach, where we seek to rely on the comfort provided by the Bank’s own controls framework. These controls operate at group, divisional and business unit level.”

“Our controls testing is then supplemented by a combination of substantive analytical review, whereby we seek to understand and rationalise the movements year on year through trend analysis and benchmark comparisons of overall quantum, charge and coverage as a % of the impaired book.”

“Finally, we complete specific tests of detail in areas where the audit risk has not been reduced to a sufficiently low level. For [year], this would include re-performing some of the calculations performed by the collective and IBNR provisioning models and detailed case reviews of the impaired book (to consider the quantum of provision and support retained on the credit file) and unimpaired book (to consider whether unimpaired status was appropriate).”

242. This is an appropriate approach to this aspect of the audit and the review’s conclusion was that Firm Y complied with the auditing standards.
243. As a consequence of the realisation by the auditors that loan impairments would be the most important issue in the 2008 audits this normal procedure was significantly enhanced and each firm reviewed a much greater number of loans than would have been normally examined.

Exercise of Scepticism

244. Demonstrating professional scepticism is difficult as it is largely an attitude of mind. In a majority of cases the review found evidence as to the sceptical approach of the firms. This included, but was not limited to, additional audit procedures; extensive testing; and challenge to both management and the audit committees. In a small number of cases where the firm considered management’s assumptions, the review team made recommendations for improvement in the documenting of the firm’s challenge to management (scepticism) and on the conclusion that management’s assumptions were reasonable.

245. These are illustrated in the following examples.

Example 3-Scepticism Impacts the Amount of the Provision

246. Firm C, in the audit of Institution S, selected for audit a very significant sample of loans from the higher risk property and construction loan book amounting to approximately 35% by value of the loan book. These were the subject of frequent meetings with Institution S's Credit Team and Audit Committee to discuss the assumptions and provisions. The charge for the year, including the IBNR provision, increased significantly during the course of the audit which indicates the impact of prompting and questioning by the auditor and the Audit Committee.

247. Firm C was conscious of the high level of judgement involved in the assumptions regarding the individual loan assessments and rapidly deteriorating market conditions. In this climate the firm concentrated its efforts on communicating with both management and the Audit Committee that there was a need for a significant increase in the IBNR provision. This is demonstrated in the reports to the Audit Committee.

248. The firm had extensive discussion with management with regard to the IBNR methodologies and the firm's overarching concern at the appropriate overall level of the IBNR. Firm C had initially advised management that it may be necessary to put forward two differing opinions to the Audit Committee, one from management and one from the firm, as to the necessary level of the IBNR. However, as a consequence of its engagement with management the firm was in a position to state to the Audit Committee that *"we expect the increasing arrears across the Institution's books, downgrade migration and negative economic outlook will also result in significantly higher IBNR provision for 2008 versus 2007, both management and [Firm C's] assessment of which is on-going. We believe that in the current environment it is appropriate for [Institution S] to carry a large IBNR on its property and construction portfolio..."*

249. Firm C's Draft Audit Findings Report to the Audit Committee stated *"Given the illiquidity in property markets, the estimation of the quantum and timing of cash flows are subject to significant estimation error. If events do not progress as management anticipates, significantly higher provisions could be required. In many cases the decision as to whether [Institution S] should create specific provisions on an individual case is finely balanced and dependent on significant judgement. Relatively small adjustments to the timing and amounts of cash flows would, in many cases lead to individually significant provisions. In this context, it is our view that [Institution S's] credit provisions are at the low end of an acceptable range. There is significant degree of estimation error and the downside risk should be considered further before the year end provisions are finalised. We believe that there is a strong case for additional provisions to be taken in 2008 given the level of uncertainty particularly in relation to development land"*.

250. In the firm's next report to the Audit Committee it noted that;

"At the [previous] Audit Committee meeting [Institution S] management presented a top down assessment of the provisions [...] by considering scenarios where reductions in property values reduce security cover for loans and the level of defaults increases. By way of design this

exercise could not consider an individual borrower's ability to repay outstanding loans. Nevertheless, it does provide a benchmark against which to measure the [...] IBNR provision.

The valuation stresses presented on Scenarios 1 and 2 in the [Institution S] presentation may not be unrealistic in the current market environment where in the second half of 2008 there has been very few completed property transactions... [Institution S] have recorded a provision at year end of [...] which suggests, based on this top down assessment, that [Institution S] are at the lower end of the range of estimates”.

251. A significant additional provision was booked by [Institution S] on a basis recommended by its Group Risk Management function. The Institution's view was that the additional IBNR, which represented a 36% increase in the total impairment provision, put them within an acceptable range and based on their audit work Firm C did not disagree with this conclusion.
252. It is clear that Firm C played a significant part in the decision by Institution S to make the additional provision and that the firm satisfied itself that the overall provision was at the top end of what Firm C regarded as an acceptable range.

Example 4-Action when Sceptical Auditor Not Initially Satisfied

253. In the audit of Institution Z, Firm B selected a very significant sample of loans from the higher risk portfolios amounting in this case to approximately 60% by value of the loan book. Firm B questioned the approach taken by the management, and issued a strongly worded email to the Finance Director expressing a number of serious concerns. This email was provided to the Audit Committee and to the Financial Regulator, and resulted in frequent meetings with Institution Z's management to discuss the assumptions and provisions. The loans and the particular facts and circumstances relating to those loans were discussed with the Audit Committee. The Audit Committee and Board were largely comprised of individuals appointed in the latter half of 2008 and in January 2009 and whom Firm B believed had played no part in the previous management or governance of the Institution.
254. The scepticism of Firm B is illustrated by a number of features of the audit of the impairment charges. The charge for the year increased significantly during the course of the audit due to the prompting and questioning by the auditor. The level of provisioning resulted in Institution Z breaching its capital adequacy provisions. The additional questioning by Firm B until it was satisfied with the conclusion to the audit contributed to a delay in the announcement of the results requiring derogation from the Financial Regulator allowing for the Annual General Meeting to be delayed.

Audit Documentation

Example 5-Improvement in Documentation of Scepticism Required

255. Firm A's audit procedures in the audit of Institution X were designed to ensure that there were no material unidentified impaired loans, focusing on sectors that had been most depressed in the economic climate at the time. The firm's loan selection focused on high-value loans and high-risk sectors such as development loans. As a result, the firm tested a large percentage (approximately 60%) of the loan book. The firm's review covered all loan grades.

After examining relevant documentary evidence and discussions with appropriate officials, Firm A accepted the provisions made by Institution X in relation to the loans tested.

256. However the review team noted that, based on the information contained in the audit files, in a small number of loans conditions apparently existed that could have been indicative of loss events, such as, falls in value of collateral, granting of concessions for reasons relating to the borrower's financial difficulty; these were not recognised as objective evidence of impairment by the Institution, a view with which Firm A agreed.
257. The review noted that Firm A carried out an extensive review of the Institution's procedures in relation to the specific provisions and concluded that the firm generally complied with ISA 540. However, on a number of the individual loans reviewed the conclusion was that Firm A did not comply with ISA 230 Paragraph 9(c) (audit documentation). Consequently, given the firm's recognition of the high level of risk of material misstatement in the loan provisions and the extent of judgement involved in management assumptions in the individual loan reviews, the review concluded that Firm A should improve its documentation of the firm's challenge to management (scepticism) and on the conclusion that management's assumptions were reasonable.

Objective Evidence of Impairment

258. It was emphasised in the analysis of the main accounting standard IAS 39 in Section 4 that there is significant judgement and complexity involved in assessing whether there is any objective evidence that impairment has been incurred. This is an issue where different judgements can lead to very different provisions and require auditors to apply rigour and scepticism in examining these judgements. The following examples illustrate how auditors carried out their examinations but in a small number of cases the review found that there was room for improvement in recording the objective evidence of impairment of scepticism.

Example 6-Judgement Required in Assessing Objective Evidence of Impairment

259. In the audit of Institution T, Firm A carried out extensive reviews of the loans selected by them for substantive testing. They reviewed the assumptions of management and assessed their reasonableness. In a number of instances where management had determined that there was no evidence of potential impairment the firm disagreed and asked management to perform discounted cash flows.
260. However, for a number of loans, where the firm considered management's assumptions, based on the documentation included on the audit file, it was not evident to the review team as to the basis on which the firm effectively challenged the reasonableness of these assumptions.
261. The following are illustrations of management assumptions where additional documentation of the evidence would have been beneficial:
- Reliance on cross-collateralisation;
 - Reliance on availability of unencumbered assets;

- Valuation of sites on basis of ‘hold and develop’ over the medium-term despite plan to dispose of the site.
262. Given Firm A’s recognition of the high level of risk of material misstatement in the loan provisions and the extent of judgement involved in management assumptions, in the individual loan reviews there was room for improvement in the documenting of the firm’s challenge to management (scepticism) and on the conclusion that management’s assumptions were reasonable.

Example 7–Auditor’s Recommendation to Increase Provisions

263. Firm X attended a meeting with the CEO of Institution Y following which the firm recorded on the audit file:
264. *“[Firm X’s] view is that it is unlikely that Institution Y will be in a position to refinance assets or be repaid by developers in 2009/2010, and as such there is a requirement to discount the fair value of the collateral”.*
265. Furthermore, Firm X *“pointed out that a number of the more significant estimated provisions were the result of the fact that Institution Y had provided 100% loans at origination in return for a significant profit share in the particular project. At a time when property prices were declining, this meant that the underlying security was unlikely to realise sufficient cash to repay the outstanding borrowings”.*
266. Following engagement by the firm with the management of the Institution, more realistic discounted cash flows were produced by lenders. As a result a significant adjustment was made to the impairment provision, with an increase of 121%.

Market Information: Estimates of Loan Impairment Charges in Succeeding Years

267. Certain Institutions put into the public domain in varying ways during early 2009 estimates of total possible loan impairment charges for the year just ended and the two succeeding years. These estimates were not covered by the respective audit reports, although the auditors did acknowledge that they had been disclosed⁴³. These estimates were in addition to those contained in the Interim Management Statements issued by the Institutions.
268. Institution X, whose 2008 provision was approximately €1.5billion, said in its annual report *“In our Interim Management Statement we indicated an expected loan impairment charge in the region of €4.5 billion in the 3 year period to [month] 2011, indicating that if key economic indicators deteriorated there was downside risk to this estimate of up to an additional €1.5 billion. Given the change to consensus economic forecasts particularly in Ireland where circa 50% of the credit risk on our lending portfolio is based, we believe the more likely outcome of loan impairment for the overall Group is now circa €6 billion in the 3 year period to [month] 2011. Downside risk to this estimate arises in the event of even further deterioration in*

⁴³ For example, Bank of Ireland included figures for projected future loan provisions in the Group Chief Executives Review in the Annual Report 2009. AIB included figures for projected future loan provisions in the AIB 2008 Full Year Results Presentation to investors. See also Appendix 6.

economic conditions or further prolonged low levels of activity in residential and commercial property markets”.

Example 8-Institution’s Desire to Provide Additional Information on Provisions

269. Firm C explained to the review team that this disclosure had been made by Institution X to “offset and mitigate the perceived limitations in IFRS”, in that “IFRS is clear that provision cannot be made for future losses no matter how certain they are ...[which] leads to an expectation gap between the provisions made at a point in time and the ultimate expected provisions. In this sense, the accounting rules are seen by some as not “fit for purpose” as they do not afford an opportunity to adopt a more prudent expected loss approach.” Firm C stated that “...both Institution X and Firm C, as independent auditors, were acutely aware of this expectation gap under IFRS in a situation where credit conditions are expected to deteriorate in the future. Bank X addressed this concern through the disclosure [in the Annual Report] of what their best estimate of the future (i.e. not yet incurred) loan losses would be based on an external review by independent credit experts. Institution X [was] the first Irish bank to provide this level of transparency to the market”. The firm added that “This disclosure meant that users of the Institution’s annual report had information about the future expected loss deterioration as well as providing an external view on one of the key judgements taken by the Bank”.
270. CARB agrees that this type of disclosure is welcome and potentially of significant enhancement to the overall understanding of the financial situation of an Institution. CARB considers however that this disclosure would be enhanced by its inclusion in the scope of the audit reports.

Conclusion

271. As a result of its very detailed work, including its extensive discussions with and challenges of the auditors, the review team was satisfied that the audit procedures carried out by the firms generally complied with the relevant standards. This conclusion was based on a number of factors which were carefully considered by the team. These included:
- Audit conditions at the time, in particular ensuring that judgements were formed without using hindsight;
 - Auditing standards at the time, in particular the need for the auditor to assess the reasonableness of management assumptions and the level of judgement required in the auditor forming its views; and
 - The fact that there was no right or wrong answer in relation to the level of provisions and that there was an acceptable range.
272. Having formed this overall conclusion, however, the review identified a number of areas where improvements were required. These related to the need to document more fully the nature and extent of the scepticism adopted during the audits and the nature and extent of the auditor’s challenges to management assertions.

273. QAC accepted the overall conclusion that the firms generally complied with the relevant auditing standards. QAC noted the areas where the firms had not fully complied and where improvements were required and considered the commitment of the firms to maintain and improve the quality of their audit approach and to address the points noted by QAC. It determined that it would not take any regulatory action, while noting that the effectiveness of the firms' actions in respect of certain areas requiring improvement would be assessed in future monitoring inspections.

6.2 FINANCIAL STATEMENTS

Disclosures in Annual Reports

274. The directors of the Institutions were responsible for preparing the Annual Reports and the financial statements in accordance with applicable law and financial reporting framework.
275. In accordance with Paragraph 65 of ISA 330 **The auditor's procedures in response to assessed risks** the auditor *"should perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, are in accordance with the applicable financial reporting framework."*
276. The Financial Statements of the institutions, which include the notes, are substantial documents with very detailed and lengthy disclosures. For the years under review the Institutions made significant disclosures regarding, amongst other things, the requirements of IAS 39, the provision methodology and the provisions made. These disclosures were included in a number of different areas of the financial statements and while they conformed to the requirements of the standards they were not necessarily presented in a manner that enabled the reader to easily understand the most important assumptions. In addition the disclosures were frequently at a high level or generic in nature.
277. The review noted that the disclosures in the financial statements prepared by the directors of the Institutions were generally compliant with the relevant accounting standards. However the review team concluded that matters relevant to impairments could have been more clearly and specifically disclosed in the financial statements of the Institutions, and concluded that while areas for improvement have been identified the firms generally complied with the relevant auditing standards.
278. To ensure that the ISAs appropriately acknowledge and address the auditor's expected effort in relation to disclosures in financial statements, IAASB commenced a project in September 2012 to determine whether changes to the ISAs with respect to disclosures were needed. In July 2015, IAASB issued revisions to certain ISAs, effective for audits of financial statements for periods ending on or after 15 December 2016. Auditing standards applicable in Ireland and the UK are issued by the FRC and based on the ISAs issued by IAASB. These new standards have not, as yet, been brought into effect in the UK and Ireland.
279. In addition to disclosures made in the notes to the financial statements, the Institutions gave indications, in other information contained in their annual reports, of impairment provisions to be booked in future years. These disclosures varied from narrative references to downside

risk to more categorical statements that impairment charges would increase in future years. The annual report for one Institution included numerical disclosures of likely impairment charges over a three-year period (and also referenced indicative impairment charges disclosed in the Institution's Interim Management Statement). Appendix 6 contains quotations of Institutions' disclosures.

280. The above disclosures were made in sections of the annual report that were not subject to audit, i.e. separate to the notes in the financial statements dealing with impairment provisions. There was a certain amount of duplication throughout the annual reports of disclosures relating to impairment provisions. There was thus an opportunity for more cohesiveness in the structure and content of disclosures relating to impairment provisions, with the focus instead on providing more granular disclosures of the key assumptions. In the same vein, the FRC has been promoting the removal of unnecessary text and data from annual reports—'cutting clutter'.
281. Considering the circumstances of the 2008/9 audits, the auditors' reports would have benefited from the inclusion of tailored narrative explaining how the auditor had responded to the significant risk of material misstatement relating to impairment provisions. This was not possible at the time without issuing a modified opinion. The introduction of extended auditor reporting (see Paragraph 360), now affords the auditors the opportunity to provide such narrative.

Assumptions Underpinning the Recognition and Measurement of Impairment Provisions

282. It is recognised that annual reports and financial statements have become very complex and include a great deal of specified details. In respect of impairment provisions, questions have been raised as to the adequacy of the disclosed assumptions in enabling a full understanding of the assumptions to be gained.
283. Paragraph 116 of IAS 1 **Presentation of financial statements** states "*An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year*".

Example 9-Disclosure of Critical Assumptions

284. In its report to the Audit Committee of Institution X, Firm B suggested "*management consider the inclusion of extensive financial statement disclosures of the critical assumptions in relation to asset value declines and the timing of expected future cash flows which underpin the provision assessment.*"
285. The Risk Management Section of the Annual Report disclosed that, in relation to assumptions underpinning the calculation of impairment provisions:

"...the discounts applied to collateral values in its main markets are typically in the range of 20% to 50% with some property assets receiving greater discounts." "For property collateral

the timing of realisation of cash flows applied is typically greater than two years and can be up to five years.”

286. The review team suggested to Firm B that the disclosures would have been improved by distinguishing between the discounts for residential property, commercial property and development land meaning that disclosure of the assumptions underpinning the recognition and measurement of impairment provisions by the Bank could have been improved.
287. Firm B stated correctly that Institution X was responsible for drafting its disclosures and these were appropriate at that time. Suggestions made by the firm were accepted and incorporated into the final disclosures with which Firm B was satisfied. The review team agrees that the disclosures reflect what was done, but considers that more comprehensive disclosures would have enabled a fuller understanding of the provisions and their basis.

Example 10-Quality of Disclosures

288. In the case of Institution Z, Firm C stated that the required information in relation to assumptions was clearly disclosed in Note [x] entitled “*Significant accounting estimates and judgements to the financial statements*”.
289. The disclosures while meeting the requirements of the accounting standard were generic in nature and were more concerned with the impairment process rather than detailing specific assumptions underpinning the recognition and measurement of impairment provisions.
290. In CARB’s view, disclosure of the assumptions underpinning the recognition and measurement of impairment provisions by the Institution could have been improved by including wording such as the following in Note [xx] “Provisions for impairment”:
- The fall in property values was not deemed by the Institution to be a loss event for individual loans where the loans were otherwise performing; and
 - The fall in value of property used in the calculations e.g. peak to year-end fall of 30% in development land value used in IBNR.

Conclusion

291. In CARB’s view, disclosure of the assumptions underpinning the recognition and measurement of impairment provisions by certain of the Banks could have been improved. The disclosures are the responsibility of the Directors, but the auditors are required to include the disclosures in their audit examination.

Going Concern Issues

292. The going concern assumption is a fundamental principle in the preparation of financial statements. It was a very important issue at the time of the 2008 audits, at a time when the institutions were under enormous pressure to survive, even after the Irish Government’s guarantee of deposits on 30 September 2008 and the other steps taken including in various cases recapitalisation and nationalisation.

293. In accordance with its terms of reference, this review considered the auditors' assessment of whether there were material uncertainties about the Institutions' ability to continue as a going concern arising from issues related to loans and provisions for impairment, which needed to be disclosed in the financial statements.
294. Assessment of going concern from a funding and liquidity perspective would have required, in addition, consideration of matters such as reliance on the Government Guarantee, the banks' ability to obtain emergency funding from the Central Bank and the risks associated with such financial assets as the banks' tracker mortgage books. These matters were outside the scope of the review, which has been limited to observations to matters within its terms of reference, namely the impact on going concern related to loan impairment.
295. In the circumstances in which certain of the banks found themselves when the 2008 financial statements were being finalised, reliance was placed by the Directors in deciding that the going concern basis was appropriate on the effectiveness of the various measures, including the Guarantee, refinancing and nationalisation, introduced by the Irish Government. In none of these cases did the Institutions or the auditors obtain a formal written confirmation of the Government's on-going support. It was believed by the auditors that such written confirmation was not necessary or likely to be obtained if requested, in the wholly unprecedented situation which existed.
296. This section sets out the observations from the review, together with appropriate recommendations.
297. Paragraph 23 of IAS 1 **Presentation of financial statements** states that *"When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties shall be disclosed."*
298. Paragraph 6.8.3 of the **Irish Stock Exchange Listing Rules** states that *"In the case of a listed company incorporated in Ireland, the following additional items must be included in its annual report: ...*
- (3) a statement made by the directors that the business is a going concern, together with supporting assumptions or qualifications as necessary that has been prepared in accordance with "Going Concern and Financial Reporting: Guidance for Directors of listed companies registered in the United Kingdom", published in November 1994".*

299. The audit firms recognised this issue as one for critical attention. The response was shown by the examples below.

Example 11-Reliance on Government Support

300. Institution X assessed that a material uncertainty did not exist in relation to going concern and, consequently, did not include material uncertainty disclosures in the financial statements.

301. Audit procedures performed by Firm A included: discussions with Institution X's management; evaluation of management's plans; review of capital stress testing; review of the Institution's business plan; meetings with Financial Regulator and Department of Finance representatives; review of minutes of Board and Audit Committee meetings.

302. The going concern assumption and the fact that the Institution's paper on going concern did not provide sufficient comfort in terms of the audit was noted by Firm A, which decided, after extensive internal consultation to instigate meetings with the Financial Regulator and Government to obtain the necessary assurances. This was then done and the firm relied on oral assurances obtained in forming their opinion on going concern. The firm agreed with the Institution's assessment that a material uncertainty did not then exist.

Example 12-Disclosure of Going Concern Issues

303. On the basis that Institution X and Firm A were satisfied that a material uncertainty did not exist in relation to going concern, the disclosures in Paragraph 23 of IAS 1 were not required. However, as Institution X was a listed company, the Institution was required to make the statement required by Paragraph 6.8.3 of the Irish Stock Exchange Listing Rules.

304. Disclosures relating to going concern were contained in a number of places within the Annual Report. An overall 'Going concern' note, including at a minimum the key disclosures and cross-references to information elsewhere in the Annual Report, was not included in the Annual Report.

305. Firm A stated that there was an appropriate level of disclosure in the Annual Report to enable the reader to form a view on Institution X's going concern at that time. It stated that the disclosures were also consistent with the level of disclosure provided by other Irish institutions for 31 December 2008 year-ends.

306. The firm further stated that *"Determining the appropriate level of disclosures and risk factors in financial statements is a matter of judgement informed by the facts and circumstances at the time the financial statements were issued. Firm A considered the going concern disclosures and risk factors set out in Institution X's financial statements which were extensive. Firm A also gave comments on the draft disclosures. We were satisfied with the disclosures at the time and also do not believe that it would have been balanced and appropriate for all the matters suggested by the review team, [being*

- The difficulty in establishing the appropriate provision level
- Significant impairment losses projected to be incurred in the following two years
- Downgrading of Institution X's credit rating

- Risk to capital adequacy
- Details of funding and capital plan
- Availability of emergency funding facility from Central Bank.]

to be included in the financial statements”.

307. The review team accepts that Firm A considered all of the above in the course of the audit of the loan provisions and acknowledges that the level of detail suggested by the review team is not specifically required by the accounting standards. However, the review team concluded that for better understanding of the financial statements the disclosures in the Annual Report in relation to going concern could have been more clearly structured and cross referenced.
308. Furthermore, it would have been more satisfactory if a clear protocol had been agreed to clarify that in such critical situations it would be appropriate for Government support to be explicitly confirmed to the Institutions and the auditors.

Conclusion

309. The auditors took appropriate steps to determine if the going concern assumption remained appropriate. These included following normal audit procedures and, where necessary, meeting with the Financial Regulator and Government representatives.
310. The financial Institutions and the auditors placed considerable reliance on the commitment given by the Government to support these systemically important Institutions. The Institutions referred to this reliance in their financial statements. It would have been more satisfactory if Government support had been explicitly confirmed to the Institutions and the auditors.

6.3 REPORTS BY AUDITORS TO AUDIT COMMITTEES

Introduction

311. Auditors are required to report to and communicate with the Audit Committees of the Institutions, as set out in ISA 260. The review found that in all cases the firms communicated extensively with the respective Audit Committees.

Auditing Standards Requirements

312. Paragraph 4 of ISA 260 **Communication of audit matters with those charged with governance** states that *“For the purpose of this ISA (UK and Ireland), “audit matters of governance interest” are those that arise from the audit of financial statements and, in the opinion of the auditor, are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process”.*
313. Paragraph 11-14 of ISA 260 states that *“The auditor discusses in an open and frank manner with those charged with governance the auditor’s views on the quality and acceptability of the entity’s accounting practices and financial reporting”.*
314. How this was achieved in one case is set out in Example 13:

Example 13-Increased Engagement with the Audit Committee

315. During the course of the audit Firm D had extensive engagement not only with the Institution Y's management but also with the Audit Committee. The firm met with the Audit Committee on six occasions during the 2008 audit. The level of engagement was far in excess of that of prior years in recognition of the challenging economic environment in which the 2008 audit was being conducted.
316. Firm D's approach to engagement with the Audit Committee was to:
- (i) Discuss the proposed audit approach with management at planning stage. At planning stage the management and auditors of the Institutions informed the Audit Committee as to how IAS 39 would be interpreted in calculating the provision and how the audit would assess the assumptions of management and the final provision;
 - (ii) Discuss all major matters arising during the course of the audit; and
 - (iii) Discuss the major audit findings with the Audit Committee before signing the audit report.

Impact of Auditor Communication with the Audit Committee

317. During the course of the audits the audit firms provided the Audit Committees of the Institutions with very detailed and comprehensive documents on the majority of the most material loans reviewed. In a number of cases the level of engagement with the Audit Committee in discussing the risks and loan loss provisions on individual loans was significant and the firms were instrumental in driving the loss provision significantly upwards.

Example 14-Effective Reports to Audit Committee

318. Example 3 described the circumstance in which Firm C had engaged in extensive dialogue with the Audit Committee of Institution S relating to the overall levels of appropriate provisions.
319. This engagement with the auditor played a significant part in Institution S increasing the impairment provision by 36% which moved the provision to the higher end of an acceptable range of estimates.

Conclusion

320. The review found that the auditors took significant steps to keep the Audit Committees of the Institutions informed in relation to major judgements being made regarding the provision methodology and the appropriateness of the levels of provisions in the financial statements. The number of meetings increased considerably from prior years with the auditors' engagement with those charged with governance increasing from the usual level of engagement at the planning and conclusion stage.

Introduction

321. Irish auditors are required to report certain specific matters to the Financial Regulator, but have no right to report other matters not covered by statutory or regulatory duty. Nyberg noted the importance of this and concluded that “...auditors, working within the narrow/limited mandate of the statutory audit, highlighted valuable information to the FR on the banks...”⁴⁴
322. During the course of the review it became apparent that the auditors made significant efforts to engage with the Financial Regulator which at the time did not operate an open two way channel of communication with the auditors. There was even on occasion evidence to suggest that a number of meetings between the auditor and the Financial Regulator took place due to significant pressure from the auditor.
323. The conclusion is that a number of written statutory reports were not made to the Financial Regulator within the timeframe required by the legislation. The audit firms did however engage with the Financial Regulator at various meetings and brought a number of significant matters to the attention of the Financial Regulator. In addition following the introduction of the Government Guarantee representatives of the Financial Regulator were present at Audit Committee meetings of the Institutions; certain audit firms relied on these representatives to bring matters to the attention of the Financial Regulator.
324. Since the year-ends under review the auditors and the Financial Regulator have worked together to produce an Auditor Protocol. This is a welcome step which we hope will improve the openness and transparency of communications between the auditors and the Financial Regulator in the future.
325. The review noted that while most of the required matters were reported to the Financial Regulator, in a number of cases reports were not made within the time limits set or were not made in writing but orally at Audit Committee or other meetings at which representatives of the Financial Regulator were present.
326. It should be noted that regulated institutions are required by the Financial Regulator to submit capital and liquidity returns to the Financial Regulator in connection with regulatory capital and other requirements set by the Financial Regulator. These returns are based on rules set by the Financial Regulator, which are different to the IFRS on which financial statements are prepared. There is not a requirement for these returns to be audited. However, ISA 250 Section A—“Consideration of laws and regulations in an audit of financial statements” specifies procedures the auditor should perform to help identify instances of non-compliance with laws and regulations. In particular, the auditor should inspect correspondence with the relevant licensing or regulatory authorities.
327. This section explains what was required from the auditors and where improvements were recommended by the review.

⁴⁴ Nyberg, paragraph 3.8.5

Statutory Duty to Report

328. The auditor's duties are specified in the **Central Bank Act 1997** (as amended by the **Central Bank and Financial Services Authority of Ireland Act 2004**).
329. Section 27B(2) of the Act states that *"Within 1 month after the date of the auditor's report on the financial service provider's accounts, or within such extended period as the Bank allows, the auditor of the service provider shall deliver a written report to the Bank—*
- (a) stating whether or not circumstances have arisen that require the auditor to report a matter to the Bank under a prescribed enactment and, if such circumstances have arisen, specify those circumstances, and*
 - (b) where the service provider has, during that financial year, been required to provide the Bank with a compliance statement stating whether or not the requirement has been complied with".*
 - (c) Section 27C(1) of the Act states that "If the auditor of a regulated financial service provider provides the financial service provider, or those concerned in its management, with a report on a matter that has come to the auditor's notice while auditing the accounts of the financial service provider or carrying out any other work for the financial service provider of a kind specified by the Bank, the auditor shall provide the Bank with a copy of the report. The copy must be provided at the same time as, or as soon as practicable after, the original is provided to the financial service provider or those concerned in its management".*

Auditing Standards

330. The auditing Standard which sets out the requirement relating to auditors' duties of this nature is ISA 250:
331. Paragraph 51 of ISA 250B states that *"... where a statutory duty to report arises, the auditor is required to make such a report regardless of:*
- (f) Whether the matter has been referred to the regulator by other parties (including the company, whether by those charged with governance or otherwise); and..."*

Example 15-Late Submission of Report

332. In this example, the required written report was submitted late, where the auditor considered that the Financial Regulator was already aware of the significant facts.
333. Firm C submitted the Statutory Duty Confirmation in respect of Bank Y to the Financial Regulator 21 days later than the requirement to submit-one month after the signing of the audit report. No matters were reported, other than a liquidity breach previously reported by the firm to the Financial Regulator three months earlier.
334. In its responses, Firm C stated that the reason for the delay was the need to consider a number of issues that may have required reporting to criminal or other regulatory authorities, and that the Financial Regulator was kept apprised of these reasons.

Example 16 - Non Submission of Report

335. In this example, a similar situation was identified whereby the auditor did not submit a required report as it believed that the Financial Regulator was already aware of its content.
336. Firm A submitted its Audit Results Report in respect of Bank X (management letter) to the Financial Regulator. However, the firm also produced a document entitled “2008 Audit Results Update–Supplementary Audit Work”, which addressed the additional audit work performed after the management letter had been issued. This document was not forwarded to the Financial Regulator. Firm A stated that representatives of the Financial Regulator were present at the Audit Committee meeting during which the supplementary report was orally presented. Firm A highlighted in their written statutory duty confirmation to the Financial Regulator that an oral report had been made at a meeting at which representatives of the Financial Regulator were present.
337. However, the presence of representatives of the Financial Regulator at the Audit Committee meeting did not mitigate the requirement for the auditor to forward the document to the Financial Regulator.

Conclusion

338. While the Financial Regulator was made aware of certain regulatory breaches and other reportable matters through notifications by the Institution or meetings with the firm, ISA 250B and legislation place prescriptive requirements on the auditor in relation to reporting to the Financial Regulator (including timing and format). This area was noted as one where full compliance was absent and improvements were recommended.
339. A number of written statutory reports were not made to the regulator in the timeframe required by the legislation.
340. The audit firms met with the Financial Regulator and at these meetings a number of important matters were brought to attention of the Financial Regulator. In addition a number of audit firms relied on the Financial Regulator’s representatives on the Institutions’ Audit Committees to bring matters of significance to the attention of the Financial Regulator.
341. Notwithstanding the above, the review team concluded that in a number of cases improvements should be made to the firms’ audit procedures to ensure all reports are made, to the Financial Regulator, in the prescribed format and within the required time.

5 CHANGES AND IMPROVEMENTS SINCE 2008/9

Introduction

342. It is clear that the shocks which arose during 2009 and the following few years revealed a highly unusual and challenging set of circumstances, in that the 2008 audit reports of the covered Institutions were all unqualified during a period in which the Irish Government was having to support many of the Irish banks and financial institutions. The fact that this detailed review of the relevant parts of the audits concludes that the auditors generally complied with the then extant auditing standards, albeit noting that in a number of areas improvements were required, itself shows that changes would be required to enable audits to be respected in the future.
343. This Chapter sets out a summary of developments and proposals for the future made or initiated in the last six years, some arising directly from the crisis, which are designed to improve the quality and value of audits and financial reporting.

Accounting Standards

344. During the financial crisis, the delayed recognition of credit losses on loans was identified as a weakness in the existing accounting standard (i.e. IAS 39). As part of its response to the financial crisis, the International Accounting Standards Board (IASB) published IFRS 9 **Financial Instruments** in July 2014. IFRS 9, which will replace IAS 39, introduces a forward-looking expected loss impairment model that will require earlier recognition of expected credit losses. IFRS 9⁴⁵ is expected to be effective for annual periods beginning on or after 1 January 2018. Early adoption is permitted.

Scepticism and Audit Documentation

345. In March 2009, the IAASB completed its Clarity Project that involved a comprehensive review of all the International Standards on Auditing (ISAs) to improve their clarity and thereby facilitate their consistent application. Approximately half of the clarified ISAs included substantive changes aimed at improving practice in a variety of respects.
346. New ISAs were issued by the APB in October 2009, which incorporated the clarified ISAs issued by the IAASB, and applied to audits for periods ending on or after 15 December 2010. The APB's evaluation of the impact of the new ISAs on audit work effort suggested that the revised ISA 540 was one of three standards that was likely to have the greatest impact overall on auditor work effort.
347. The revised ISA 540 introduced requirements for greater rigour and scepticism into the audit of accounting estimates, including the auditor's consideration of indicators of possible management bias.
348. Given the significance of scepticism to the quality of audits, the APB published a paper in March 2012 which set out its considered views on the nature of audit scepticism and its role in

⁴⁵ This standard has not yet been endorsed by the EU.

the audit. In an appropriately sceptical audit, the auditor designs audit procedures to actively consider if there is any evidence that would contradict management assertions (as opposed to merely rationalising and documenting management's assertions). The auditor's documentation of audit judgements should set out not only the auditor's conclusion but also the rationale for the conclusion, relating it to the nature of the challenges raised in the underlying work and reviews, the strength of the evidence obtained and the perspective of shareholders (and other stakeholders).

349. In December 2014, the FRC published a report⁴⁶ on its thematic review of the audit of UK banks' loan loss provisions. The report noted improvements in the quality of aspects of the audit of loan loss provisions. However, in the majority of audits reviewed the FRC raised "*...issues regarding consistency in the quality of audit testing... In most cases the impact was not significant to the audit overall, but the issues demonstrate that auditors are not consistently applying a sufficient degree of challenge and/or scepticism at all times...*"

Going Concern

350. The topic of going concern is of significant interest in light of the global financial crisis and there has been a considerable amount of work carried out between 2009 and 2014 dealing with revised requirements and guidance.
351. In October 2009, the FRC published ***Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009***. The FRC Guidance was subsequently issued by Chartered Accountants Ireland⁴⁷, with permission of the FRC, in December 2009. The FRC Guidance was amended solely to reflect Irish specific company law references.
352. On 8 March 2011, the FRC announced the launch of an Inquiry led by Lord Sharman to identify lessons for companies and auditors addressing going concern and liquidity risks. The final report and recommendations of the Sharman Panel of Inquiry⁴⁸ was released on 13 June 2012.
353. On 17 September 2014, the FRC updated its UK Corporate Governance Code⁴⁹ to enhance the quality of information investors receive about the long-term health and strategy of listed entities, and raise the bar for risk management. The FRC also published on the same day:
- a) two associated guidance documents:
- (i) ***Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*** (a replacement for ***Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009***).

⁴⁶ *The audit of loan loss provisions and related IT controls in banks and building societies* (December 2014) Financial Reporting Council

⁴⁷ Chartered Accountants Ireland - *Going Concern and Liquidity Risk: Information for Directors of Irish Companies and Others Involved in the Financial Reporting Process* (December 2009)

⁴⁸ The Sharman Inquiry - *Going Concern and Liquidity Risks: Lessons for Companies and Auditors - Final report and recommendations of the Panel of Inquiry* (June 2012)

⁴⁹ The first version of the UK Corporate Governance Code was produced in 1992 with several revisions in the intervening years.

(ii) Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of Accounting.

- b) revised versions of ISA 260 *Communication with those charged with governance*, ISA 570 *Going concern* and ISA 700 *The independent auditor's report on financial statements*, reflecting consequential amendments to the responsibilities of auditors.

354. The revised UK Corporate Governance Code and revised ISAs are applicable to Irish incorporated listed companies on the Main Securities Market of the Irish Stock Exchange, (which issued an Irish specific annex to the UK Corporate Governance Code) for periods commencing on or after 1 October 2014.

355. In December 2013, the Central Bank of Ireland issued a Corporate Governance Code for Credit Institutions and Insurance Undertakings effective from 1 January 2015.

Reporting to Financial Regulators

356. A number of initiatives have been introduced in relation to the ability and requirements of auditors to report relevant information to Irish Financial Regulators:

- **Protocol between the Central Bank of Ireland and the Auditors of Regulated Financial Service Providers - "The Auditor Protocol", December 2011, updated December 2013**
 - The aim of this Protocol is to enhance the information sharing between the Central Bank of Ireland (Central Bank) and auditors of regulated financial service providers (RFSPs) thereby improving the regulatory and statutory audit processes.

- **Engagements pursuant to Section 27BA of the Central Bank Act 1997**
 - Part 4 of the Central Bank (Supervision and Enforcement) Act 2013 amended the Central Bank Act 1997 by inserting Section 27BA. This section enables the Central Bank to require the statutory auditor of a specified RFSP to conduct an examination with regard to obligations imposed by certain provisions of financial services legislation.

 - This examination is separate to the statutory audit of the financial statements of the RFSP. The relevant provisions of financial services legislation that may be the subject of the examination concern administrative or accounting procedures, internal control mechanisms or risk management, or the organisational structure or governance of RFSPs.

- **Skilled Persons' Reporting – Statement of Proposed Use, 19 November 2014**
 - Part 2 of the Central Bank (Supervision and Enforcement) Act, 2013 provides the Central Bank with the power to require an RFSP to produce a report on such matter(s) as the Central Bank may specify.

 - The Central Bank's Statement of Proposed Use (19 November 2014) sets out its policy and expectations when using the Skilled Persons' Reporting Powers as a supervisory tool. A Skilled Person may be an auditor, actuary, accountant, lawyer or any other person with the relevant business, technical or technological skills.

357. A number of changes have been brought into effect to address calls from investors to improve the transparency of audits and the manner in which the results of the audits are reported.
358. The European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010 (“the 2010 Regulations”) which came into force on 20 May 2010 introduced a requirement that the auditor’s report be signed by the individual engagement partner in his or her own name, for and on behalf of, the audit firm.
359. Revised versions of certain auditing standards⁵⁰, effective for periods commencing on or after 1 October 2012, introduced a number of changes to the auditor’s report, including requirements that:
- Auditors reporting on companies which comply with the UK Corporate Governance Code provide significantly increased disclosure around the work they have performed on the audit, specifically in three areas: risks, materiality and scope of the audit; and
 - Auditors read other information in documents containing audited financial statements to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by the auditor in the course of performing that audit.
360. One result of these changes has been the use of a greatly extended auditor’s report, which now extends to typically six pages rather the two previously. In its report on extended auditor’s reports⁵¹, the FRC found that there had been significant innovation in the following areas:
- Disclosing the materiality benchmark used;
 - Disclosing the magnitude of unadjusted differences being reported to the Audit Committee;
 - Reporting of detailed audit findings with respect to identified risks;
 - Experimentation with detailed broader explanation of the audit scoping process;
 - Improved presentation of auditor’s reports through the use of diagrams and graphs;
 - Addressing going concern disclosures in auditor’s reports;
 - Locating the auditor’s opinion at the beginning of the report rather than at the end; and
 - Moving generic descriptions of the scope of an audit to a web-site.
361. The FRC survey also suggested areas where further improvements might be made. These areas are:
- Increasing the entity specific risk reporting;
 - Improving the discussion of the auditor’s application of materiality and why a particular benchmark or level was chosen; and

⁵⁰ ISA 700 “The independent auditor’s report on financial statements”; ISA 705 “Modifications to the opinion in the independent auditor’s report”; ISA 706 “Emphasis of matter paragraphs and other matter paragraphs in the independent auditor’s report”; ISA 720 “Section A – The auditor’s responsibilities relating to other information in documents containing audited financial statements”

⁵¹ Extended auditor’s reports: A review of experience in the first year. Financial Reporting Council 2015

- Making a clearer link between the discussions of risks and materiality and the description of how these influenced the scope of the audit.

Audit of Public Interest Entities

Transparency Reporting

362. The 2010 Regulations, introduced by Statutory Instrument, require the publication, on an annual basis, of a transparency report by audit firms that undertake the statutory audit of one or more public interest entities. Included in the required contents of the transparency report is a description of the governance structure and internal quality control system of the firm.

Irish Audit Firm Governance Code

363. In June 2012, CARB published an Audit Firm Governance Code for auditors of public interest entities, applying to financial years commencing on or after 1 January 2013.

364. The objective of the Code is to provide a template which boards and shareholders can use to assess an audit firm's governance procedures. One of the key elements of the Code is the principle that audit firms should appoint independent non-executives within their governance structures. This is consistent with best practice governance within many types of organisation and should provide a basis for enhanced dialogue between stakeholders and audit firms. The Code should also play an additional role in enriching audit firms' transparency reports.

EU Audit Reform

365. New legislation to improve the quality of statutory audit across the EU entered into force in June 2014. Key measures include strengthening the independence of statutory auditors⁵², making the audit report more informative, and improving audit supervision throughout the EU. Stricter requirements will apply to public interest entities. The new legislation will become effective in June 2016.

⁵² The Auditing Practices Board issued on 17 December 2010 revised ethical standards on auditor independence, which applied from 30 April 2011, with certain new requirements applicable to all audits and others applicable to listed company audits.

Appendix 1: Glossary of Terms

'Banks', 'Covered Institutions', or 'Institutions'

AIB	Allied Irish Banks, plc.
Anglo	Anglo Irish Bank Corporation Limited, formerly Anglo Irish Bank Corporation plc.
BOI	The Governor and Company of the Bank of Ireland
EBS	EBS Building Society
ILP	Irish Life & Permanent plc.
INBS	Irish Nationwide Building Society
Postbank	Postbank Limited
2008 Audits:	The audits of the financial statements of the Covered Institutions for the year ended 31 December 2008, except for Anglo whose year-end was 30 September 2008 and Bank of Ireland, whose year-end was 31 March 2009
APB	Auditing Practices Board, part of the FRC which sets auditing standards in the UK and Ireland
Big 4	Deloitte, EY, KPMG and PwC
CARB	The Chartered Accountants Regulatory Board
CEO	Chief Executive Officer
CSO	Central Statistics Office
DJEI	Department of Jobs, Enterprise and Innovation
DOE	Department of Environment, Community and Local Government
ESRI	Economic and Social Research Institute
FASB	Financial Accounting Standards Board (US)
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
HFS	Held for Sale Financial Instruments
Honohan	The Irish Banking Crisis. Regulatory and Financial Stability Policy 2003-2008, (May 2010)
IAASA	The Irish Auditing and Accounting Supervisory Authority
IAS	International Accounting Standards
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IAVI	Irish Auctioneers and Valuers Institute
IBNR	Incurring but not reported
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
Institute	The Institute of Chartered Accountants in Ireland or Chartered Accountants Ireland
ISA	International Standard on Auditing
NAMA	National Asset Management Agency
Nyberg	The Report of the Commission of Investigation into the Banking Sector in Ireland, (March 2011)
PIE	Public Interest Entities
QAC	The Quality Assurance Committee of CARB
RAB	Recognised Accountancy Body
Regling and Watson	A Preliminary Report on The Sources of Ireland's Banking Crisis, (May 2010)
Regulations	The Audit Regulations of CARB, as approved by IAASA, which implement the provisions of the Statutory Instrument 220 of 2010, which concerns the regulation of auditors

APPENDIX 2: Quality Assurance Committee's Terms of Reference

Abbreviated Terms of Reference (full details included in the CARB Corporate Governance Framework at www.carb.ie)

Role

The Quality Assurance Committee is responsible for ensuring compliance with the Quality Review, Practising Certificate, Professional Indemnity Insurance, General Client Money, Audit, Investment Business and the Designated Professional Body Regulations. The role, responsibilities and powers of the Quality Assurance Committee in so far as they relate to the specific regulations will be included within those regulations.

Composition

The Board will each year appoint a Quality Assurance Committee which will have a balanced representation of members from different size firms and locations.

The Committee must:

- Consist of at least eight people.
- Include at least two members who are not accountants.
- Not include any member of the Board, the Council of the Institute, the Complaints Committee or Disciplinary Committee.
- Have a quorum of three members at least one of whom is not a member of the Institute.

Responsibilities and Powers

The Committee, in the execution of its duties under the regulations, shall have the power to:

- Require the co-operation of any member and any firm and the production of any document or information it considers appropriate for the proper performance of its duties;
- Authorise any sub-committee, the secretariat or other duly appointed agent to enquire into all matters as required by the Committee or its chairman.

The Committee is responsible for ensuring compliance with the Audit Regulations. The functions of the Committee include reviewing all reports made under the regulations and taking such regulatory action as deemed appropriate.

Appendix 3: Bank Audit Review Terms of Reference

Background

In response to the banking crisis the Irish Government commissioned 2 reports into the sources of Ireland's Banking Crisis⁵³ (the Reports).

Whilst the banking crisis was not peculiar to Ireland but part of a global loss of confidence, the Regling Watson Report in particular, points out that in many crucial ways Ireland's banking crisis was 'home-made'. In particular this report highlights that the 'credit risk controls [in the banks] failed to prevent severe concentrations in lending on property- including notably on commercial property-as well as high exposure to individual borrowers and a serious overdependence on wholesale funding.'

Having considered the contents of the Reports on the 8 July 2010 the Minister presented 'Statutory Instruments S.I.NO [x] of 2010 Commission of Investigation (Banking Sector) Order 2010 and proceeded to establish a Commission of Investigation headed by Dr Peter Nyberg.

Role of CARB

CARB was established in 2007 to regulate members and member firms of Chartered Accountants Ireland (the Institute) independently, openly and in the public interest. CARB's full responsibilities are set out in Bye-law 41 of the Institute's Bye-laws.

One of CARB's functions is to ensure that Chartered Accountants provide services of the highest quality, competently, honestly and with integrity by operating a risk-based approach to monitoring through the annual assessment of information and periodic on-site inspection.

The Board of CARB mindful of both its public interest responsibilities and its commitment to fair and proportionate regulation and the responsibilities placed on it in relation to the regulation of auditors carefully considered the Reports and the response of Government.

Having considered the matter carefully and having reviewed the final Terms of Reference of the Commission the Board agreed that two issues, relevant to the audit of the Institutions, merit further consideration:

- Whether the auditors of the Institutions commented in their audit reports or other communications to the Institutions on the failures of the Institutions to implement and adhere to appropriate standards and controls (including check and balances), in the context of corporate governance and prudent risk management policy and procedures; and
- Whether in the performance of their audits the auditors of the Institutions complied with appropriate legal, regulatory and professional standards in relation to the valuation of loans and the provisions for impairments of these loans for the financial years ending in 2008, or where relevant 2009.

⁵³ 'A Preliminary Report on the The Sources of Ireland's Banking Crisis' Klaus Regling and Max Watson. "The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008" Patrick Honohan Governor of the Central Bank.

The Board agreed that as the first matter was included within the scope of the Commission of Investigation that it would be inappropriate for it to seek to duplicate any statutory process.

Scope of the Review

The Board will undertake in depth reviews of the audit processes and procedures of the auditors⁵⁴ of the Institutions for the financial years ending in 2008 or where relevant 2009⁵⁵, with a view to determining whether those audit firms applied appropriate procedures and complied with relevant standards, practice notes and other legislative provisions in order to assert in their audit opinions that the valuation of book debts and provisions for impairments were appropriate.

The 2008 year ends have been chosen because the Board notes the Commission's terms of reference expire in January 2009 and therefore cover financial year ends of 30 September and 31 December 2008. The Board does not feel that a review of impairments for prior years is necessary at this stage. This is because if the 2008 reviews provide assurance in relation to 2008 it will be unnecessary to review prior years, and if the 2008 reviews do not provide assurance it seems likely that sufficient information will thereby be gleaned, with however the option to conduct prior year reviews if deemed worthwhile.

The review team will have full discretion as to whether it is necessary to review earlier or subsequent years.

In carrying out its functions on behalf of the Institute (which is a Recognised Professional Body) CARB is subject to the statutory oversight of the Irish Auditing and Accounting Oversight Body (IAASA) who have been consulted in the development of this review and will be kept informed throughout its course.

Methodology

A review of the auditors' performance will be conducted under the provisions of the Audit Regulations. For the year under review the Institutions were audited by 3 of the Big 4 firms.

CARB's inspection team in carrying out this review will review the audit files of the Institutions.

A high level public report will be produced by the independent expert.

Independent Expert

The Board agreed that the independence of the process and hence the credibility of the report would be enhanced by the involvement in the process of an independent expert of high standing. The Board agreed that the independent expert would be embedded within the process. The independent expert appointed by the Board will be a person acceptable to IAASA.

The independent expert's role will be to produce the high level public report.

In carrying out his/her functions the expert may:

- recommend the extension of the scope of the review;

⁵⁴ The auditors of the covered institutions in Ireland are KPMG, PricewaterhouseCoopers and Ernst and Young.

⁵⁵ For the Governor and Company of the Bank of Ireland the relevant year end is the 31 March 2009.

- provide advice to the inspectors on review methodologies; and
- participate in the carrying out or oversight of the review in any way he/she deems appropriate.

Covered Institutions

Following Ministerial orders made on the 24 October and 5 November 2008, the following credit institutions and subsidiaries are 'covered institutions' for the [purposes of the Credit Institutions (Financial Support) Scheme 2008:

- 1) Allied Irish Banks Plc and its subsidiaries AIB Mortgage Bank, AIB Bank (CI) Limited, AIB Group (UK) Plc, Allied Irish Banks
- 2) Anglo Irish Bank Corporation Plc and its subsidiary Anglo Irish Bank Corporation (International Plc)
- 3) The Governor and Company of the Bank of Ireland and its subsidiaries Bank of Ireland Mortgage Bank, ICS Building Society, Bank of Ireland (IOM) Limited
- 4) EBS Building Society and its subsidiary EBS Mortgage Finance
- 5) Irish Life and Permanent Plc and its subsidiary Irish Permanent (IOM) Limited
- 6) Irish Nationwide Building society and its subsidiary Irish Nationwide (IOM) Limited
- 7) Postbank Ireland Limited

Appendix 4: Experience and Credentials of Mr D.L. Spence

Mr Spence has widespread experience of investigations and reporting on serious and difficult matters as well as in auditing over many years. His work spans decades during which he has seen the impacts of many market 'boom and bust' cycles. In the 1970's he had to completely redirect his team from helping ambitious companies float on the London Stock Exchange to assisting in company rescues after the major crash in 1973/74. Twenty years later, in the 1990's he had to make a similar wholesale change in his focus following another market recession. Later in his career he built on this experience, together with his ongoing audit experience, to act as an expert witness in many high profile auditor negligence and related litigation cases. He appeared in court to give his evidence in such cases in the UK and Hong Kong. He also gave evidence in China relating to the audit of a major alleged fraudulent company.

Other investigations were carried out for government and regulatory agencies. In one such example he was appointed by the UK Department of Trade & Industry in 1988/89 as an Inspector, working alongside a leading QC, to investigate serious matters concerning National Westminster Bank PLC and its subsidiary County NatWest Limited in what had become known as the 'Blue Arrow' affair. The resulting report led to serious consequences, including the resignations of very senior officers of the bank, and shed light on the governance and regulatory requirements of UK banks after their move into investment banking following 'Big Bang' in the mid-1980's.

His other experience in relation to banking matters is widespread and long standing. He assisted a number of UK and other banks in workouts of major over-indebted customers during the UK recession in the early to mid-1990's. Further bank related experience included acting as an expert witness between 1999 and 2003 in auditor negligence litigation following the collapse of Barings Bank and an alleged bank fraud in the Middle East between 2010 and 2012.

Mr Spence became a member of the Institute of Chartered Accountants of Scotland in 1967. He served on its Council for a number of years and as its President in 1998/99. He was Chairman of the Chartered Accountants Joint Ethics Committee between 1995 and 1997, and served for one year on the Auditing Practices Board in 1998/9.

He was a partner of Grant Thornton UK, based in London, from 1970 until 2006. His experience as a Partner included audits, investigations, corporate finance, corporate turnarounds and also forensic and litigation work. Since leaving Grant Thornton he has been engaged in a number of litigation related assignments, mainly outside the UK, in the Middle East and Hong Kong.

APPENDIX 5: Summary of Recommendations

Report Reference	Recommendation	Stakeholders									
		Audit firms	Preparers	IAASB	IASB	IAASA	Financial Regulator	FRC	Government	Institute	CARB
61	CARB encourages preparers and auditors to submit potential IFRS implementation issues to the IASB discussion forum, as they arise. This should assist IASB in determining what, if any, action is needed to address such issues.	X	X		X						
62	Once effective (i.e. for financial periods beginning on or after 1 January 2018), CARB recommends that the Financial Reporting Supervision Unit of IAASA conducts an annual review of the implementation of IFRS 9 and its effectiveness and consistency of application, particularly for the first few years. As this is an international issue, we encourage cooperation at EU level and with bank regulators.	X	X			X	X				
71	CARB believes that all interested stakeholders should discuss how a principles-based framework for the future could be developed to ensure that lessons are learned from the past and that current rules are not simply replaced by another set of rules.	X	X	X	X	X	X	X		X	X
84	CARB recommends that the audit firms take immediate steps to introduce the improvements, agreed with the Quality Assurance Committee as a result of the review of the individual audits, which have not yet been implemented. This should be followed up in subsequent reviews by IAASA following the introduction of their new statutory powers from June 2016.	X									
85	CARB recommends that a survey on the application of Revised ISA 700 be carried out by IAASA in respect of the auditor's report on the financial statements of Irish Public Interest Entities as soon as practicable for the year ended on or around 31 December 2015 or 2016 as appropriate.	X				X					
86	As the use of assumptions will be inherent in the application of IFRS 9, CARB recommends that IAASA and the prescribed accountancy bodies provide input into any proposed changes to auditing standards (or associated guidance) relating to auditors' challenge of management assumptions.					X				X	
87	CARB recommends that Department of Jobs, Enterprise and Innovation (DJEI) and/or IAASA commission a legal opinion to provide an authoritative statement on the meaning of true and fair.					X			X		

Report Reference	Recommendation	Stakeholders									
		Audit firms	Preparers	IAASB	IASB	IAASA	Financial Regulator	FRC	Government	Institute	CARB
95	CARB recommends that the FRC revise its auditing standards in an equivalent manner to the revisions made by the IAASB in July 2015 in relation to disclosures.							X			
96	CARB recommends that the FRC develop a framework for providing assurance on forward-looking statements (whether included in annual reports or other documents), drawing where relevant, on existing standards issued by the IAASB, particularly in the light of the subjectivity that will be involved in arriving at the impairment provisions under IFRS 9.							X			
97	CARB recommends that, to ensure clarity in the situation where a financial institution is dependent on Government support to continue as a going concern, a clear protocol ⁵⁶ be agreed to enable the institution to seek and obtain clear and unambiguous confirmation from the Government of the terms and conditions attaching to such support and for such confirmation to be available to the auditor as part of the appropriate audit evidence.	X	X	X			X	X	X	X	X
103	CARB recommends that the audit firms ensure that their internal procedures are sufficient to ensure that all reports due to be submitted to the Financial Regulator are produced in the format and within the timeframe set by the Financial Regulator	X					X				
104	CARB recommends that the Financial Regulator in conjunction with the audit firms continuously review and if necessary improve the operation of the Auditor Protocol to ensure that the transfer of information between the auditors and the Financial Regulator continues to be open and transparent	X					X				
109	CARB recommends that IAASA carry out an Audit Quality Thematic Review in respect of the audits of Irish banks and building societies for the year ending on or after 31 December 2016. It is suggested that this review should conclude on whether the improvements recommended by CARB have been implemented by the firms.					X					

⁵⁶ A protocol could be developed similar to the existing protocol between the Central Bank of Ireland and the Auditors of Regulated Financial Service Providers.

Appendix 6: Disclosures in Financial Statements

AIB Annual Report – 2008 – Risk management - Page 61

The outlook for the global economy in 2009 has significantly deteriorated in recent months, including an expectation of continued deterioration of the economies of Ireland, the United Kingdom, the United States, Poland and other European countries. For example, in Ireland there is an expectation of further reductions in residential and commercial property prices, higher unemployment rates and reduced profitability of corporate borrowers. As a result, AIB has seen and expects to continue to see adverse changes in the credit quality of its borrowers and counterparties, with increasing delinquencies and defaults across a range of sectors. Ultimately, this trend will lead to higher impairment charges, higher costs, additional write downs and lower profitability for AIB.

BOI Annual Report – 2009 – Group Chief Executive’s Review - Page 7

In our Interim Management Statement we indicated an expected loan impairment charge in the region of €4.5 billion in the 3 year period to March 2011, indicating that if key economic indicators deteriorated there was downside risk to this estimate of up to an additional €1.5 billion. Given the change to consensus economic forecasts particularly in Ireland where circa 50% of the credit risk on our lending portfolio is based, we believe the more likely outcome of loan impairment for the overall Group is now circa €6 billion in the 3 year period to March 2011. Downside risk to this estimate arises in the event of even further deterioration in economic conditions or further prolonged low levels of activity in residential and commercial property markets.

Anglo Irish Bank Annual Report – 2008

Asset quality will be a critical area of focus for the Board and management. The economic environment has deteriorated since 30 September 2008, with the outlook now for an extended period of difficulty in our core markets.

The severity of the downturn will result in an increase in impairment charges for all banks internationally over the next number of years. We will continue to support clients where this ensures the best economic outcome for the Bank in the long term. A detailed bottom up loan review is being undertaken to assist the Board and management in assessing the current position. The results of this review will be included in the Interim Report for the period ended 31 March 2009.

[Letter from the Executive Chairman – Page 3]

A sustained deterioration in economic conditions will impact borrowers’ ability to service debts. This, combined with a fall in value of underlying collateral, will adversely impact credit quality resulting in an increased level of defaults and higher impairment charges. [Principal risks and uncertainties – Page 20]

ILP Annual Report – 2008 - Summary Performance Review

The group expects impairments to increase further through the cycle if economic conditions continue to deteriorate and is satisfied that it is sufficiently strongly capitalised to absorb any losses arising. [Page 8]

Credit impairments in 2009 are expected to more than double from the 2008 level, should economic conditions continue to deteriorate. [Page 9]

INBS Annual Report – 2008 – Principal risks, uncertainties and risk mitigants – Page 11

Credit risk:

The extent of actual losses may not be apparent for a number of years as exposures are worked out, accordingly the results in future years are subject to downside risk.

EBS Annual Report – 2008

EBS Commercial

Given the continued deterioration in the economy and housing market, the Group is realistically providing for future losses in its 2008 accounts and expects to make further provisions in the current year. [Group Chief Executive's Review – Page 8]

Whilst the ultimate amount of loan loss incurred through this cycle is impossible to estimate at this stage with any certainty, in the opinion of the Directors the provisions included in the year end accounts are a realistic estimate of incurred losses at this point. In particular, the provision booked reflects the Board's working assumption that market recovery will be slow to gather real momentum – being most likely early to mid-2011 before this is visibly evident both in terms of house prices picking up and employment rising again. In the interim, our priority focus is on facing up to the credit challenges and supporting borrowers as appropriate. [Financial Review – Page 11]

Appendix 7: Covered Institutions' impairments 2006 to 2013

Impairment provisions as % age of Loans before the provisions⁵⁷

	2006	2007	2008	2009	2010	2011	2012	2013
	€m	€m	€m	€m	€m	€m	€m	€m
1. Anglo (Year Ends)	Sep	Sep	Sep	Dec (15 mths)	Dec	Dec		
Charge in year (Chart 1)	66	82	724	14,444	7,660	1,544		
Loss/(gain) on transfer to NAMA					11,547	(776)		
Year end provisions - customers (excl. HFS)	270	295	914	4,846	9,577	10,339		
Year end loans to customers (excl. HFS)	49,142	65,949	72,151	30,852	24,364	17,689		
Loan before provision (excl. HFS)	49,412	66,244	73,065	35,698	33,941	28,028		
%age (Chart 2)	0.55%	0.45%	1.25%	13.57%	28.22%	36.89%		

2. AIB (Year Ends)	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec
Charge in year (Chart 1)	118	106	1,822	5,355	6,120	7,885	2,434	1,916
Loss/(gain) on transfer to NAMA					5,969	364	(159)	25
Year end provisions - customers (excl. HFS)	705	742	2,292	2,987	7,287	14,932	16,406	17,083
Year end loans to customers (excl. HFS)	107,115	127,603	129,489	103,341	86,350	82,540	72,972	65,713
Loans before provisions (excl. HFS)	107,820	128,345	131,781	106,328	93,637	97,472	89,378	82,796
%age (Chart 2)	0.65%	0.58%	1.74%	2.81%	7.78%	15.32%	18.36%	20.63%

⁵⁷ Source of all figures: audited financial statements

3 BOI (Year Ends)	2007 March	2008 March	2009 March	2009 December 9 months	2010 Dec	2011 Dec	2012 Dec	2013 Dec
	€m	€m	€m	€m	€m	€m	€m	€m
Charge in year (Chart 1)	103	227	1,435	4,055	2,116	1,983	1,724	1,665
Loss/(gain) on transfer to NAMA					2,241	(33)	1	
Year-end provisions - customers (excl. HFS)	428	596	1,781	2,997	4,975	6,344	7,544	8,241
Year end loans to customers (excl. HFS)	125,048	135,738	133,740	119,439	114,457	99,314	92,621	84,514
Loans before provisions (excl. HFS)	125,476	136,334	135,521	122,436	119,432	105,658	100,165	92,755
%age (Chart 2)	0.34%	0.44%	1.31%	2.45%	4.17%	6.00%	7.53%	8.88%

4. EBS (Year Ends)	Dec 2006	Dec 2007	Dec 2008	Dec 2009	Dec 2010	Dec 2011	Dec 2012	Dec 2013
Charge in year (Chart 1)	5	19	95	197	390	539	229	401
Loss/(gain) on transfer to NAMA					276	(27)	(1)	
Year end provisions - customers (excl. HFS)	18	37	114	149	420	949	934	1,352
Year end loans to customers (excl. HFS)	14,634	15,882	16,901	16,395	16,406	15,285	12,969	12,025
Loans before provisions (excl. HFS)	14,652	15,919	17,015	16,544	16,826	16,234	13,903	13,377
%age (Chart 2)	0.12%	0.23%	0.67%	0.90%	2.50%	5.85%	6.72%	10.11%

5. ILP (Year Ends)	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec
Charge in year (Chart 1)	14	28	82	376	420	1,434	883	927
Year-end provisions	57	75	139	477	883	2,298	3,150	4,035
Year-end loans	33,732	39,120	40,075	38,592	36,581	33,677	31,758	29,281
Loans before provisions	33,789	39,195	40,214	39,069	37,464	35,975	34,908	33,316
%age (Chart 2)	0.17%	0.19%	0.35%	1.22%	2.36%	6.39%	9.02%	12.11%

6. INBS (Year ends December)	Dec	Dec	Dec	Dec	Dec
Charge in year (Chart 1)	18	49	464	2,792	504
Loss/(gain) on transfer to NAMA					2,717
Year end provisions - customers (excl. HFS)	82	99	545	240	576
Year end loans to customers (excl. HFS)	10,410	12,332	10,474	2,400	1,947
Loans before provisions (excl. HFS)	10,492	12,431	11,019	2,640	2,523
%age (Chart 2)	0.78%	0.80%	4.95%	9.09%	22.83%

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THEME: C2

Role and effectiveness of the Policy appraisal regime before and during the crisis
Pre Crisis phase

LINE OF INQUIRY: C2c

The liquidity versus solvency debate

Independent Auditors' Report

Independent Auditor's Report to the Members of the Governor and Company of the Bank of Ireland

We have audited the Group and Bank financial statements of the Bank of Ireland for the year ended 31 March 2008 which comprise the Consolidated Income Statement, the Consolidated and the Bank Balance Sheets, the Consolidated and the Bank Statement of Recognised Income and Expense, the Consolidated and Bank Cash Flow Statements, and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Report & Accounts, in accordance with applicable Irish law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, are set out in the Statement of Directors' Responsibilities on page 68.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the members of the Governor and Company of the Bank of Ireland as a body in accordance with Section 193 of the Companies Act, 1990 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union. We report to you our opinion as to whether the Bank financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Acts 1963 to 2006. We also report to you whether the financial statements have been properly prepared in accordance with Irish statute comprising the Companies Acts, 1963 to 2006, Article 4 of the IAS Regulation and the European Communities (Credit Institutions: Accounts) Regulations, 1992. We state whether we have obtained all the information and explanations we consider necessary for the purposes of our audit, and whether the Bank's balance sheet is in agreement with the books of account.

We also report to you our opinion as to:

- whether the Bank has kept proper books of account;
- whether proper returns adequate for the purposes of our audit have been received from branches of the Bank not visited by us;
- whether the directors' report is consistent with the financial statements; and
- whether at the balance sheet date there existed a financial situation which may require the Bank to convene an extraordinary general Court of the Bank; such a financial situation may exist if the net assets of the Bank, as stated in the Bank balance sheet, are not more than half of its called up share capital.

We also report to you if, in our opinion, any information specified by law or the Listing Rules of the Irish Stock Exchange regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.

We review whether the Corporate Governance Statement reflects the Bank's compliance with the nine provisions of the Combined Code 2006 specified for our review by the Listing Rules of the Irish Stock Exchange, and we report if it does not. We are not required to consider whether the Directors' statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Report & Accounts and consider whether it is consistent with the audited financial statements. The other information comprises only Section 1: Business Review and Section 2: Governance (Report of the Directors, Remuneration Report and Corporate Governance Statement). We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Independent Auditors' Report

Opinion

In our opinion:

- the Group's financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2008 and of its profit and cash flows for the year then ended;
- the Bank's financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Acts 1963 to 2006, of the state of the Bank's affairs as at 31 March 2008 and cash flows for the year then ended;
- the Group's and Bank's financial statements have been properly prepared in accordance with the Companies Acts, 1963 to 2006, Article 4 of the IAS Regulation and the European Communities (Credit Institutions: Accounts) Regulations, 1992.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Bank and proper returns adequate for the purpose of our audit have been received from branches not visited by us. The Bank's balance sheet is in agreement with the books of account.

In our opinion the information given in the directors' report is consistent with the financial statements.

The net assets of the Bank, as stated in the Bank balance sheet are more than half of the amount of its called up share capital and, in our opinion, on that basis there did not exist at 31 March 2008 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general Court of the Bank.

Separate opinion in relation to IFRSs

As explained in the Basis of Preparation on page 78, the Group in addition to complying with its legal obligation to comply with IFRSs as adopted by the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion the Group's financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 March 2008 and of its profit and cash flows for the year then ended.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
Dublin

20 May 2008

Independent Auditors' Report

Independent Auditors' Report to the Members of the Governor and Company of the Bank of Ireland

We have audited the Group and Bank accounts (the "accounts") of the Bank of Ireland for the year ended 31 March 2007 which comprise the Consolidated Income Statement, the Consolidated and the Bank Balance Sheets, the Consolidated and the Bank Statement of Recognised Income and Expense, the Consolidated and the Bank Cash Flow Statements, and the related notes set out on pages 65 to 163. These accounts have been prepared under the accounting policies set out therein. We have also audited the information in the Remuneration Report set out on pages 52 to 61 that is described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Report & Accounts in accordance with applicable Irish law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, are set out in the Statement of Directors' Responsibilities on page 62.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the members of the Governor and Company of the Bank of Ireland as a body in accordance with Section 193 of the Companies Act, 1990 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Group accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union. We report to you our opinion as to whether the Bank accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Acts 1963 to 2006. We also report to you whether the accounts have been properly prepared in accordance with Irish statute comprising the Companies Acts, 1963 to 2006, Article 4 of the IAS Regulation and the European Communities (Credit Institutions: Accounts) Regulations, 1992. We state whether we have obtained all the information and explanations we consider necessary for the purposes of our audit, and whether the Bank's balance sheet is in agreement with the books of account.

We also report to you our opinion as to:

- whether the Bank has kept proper books of account;
- whether proper returns adequate for the purposes of our audit have been received from branches of the Bank not visited by us;
- whether the directors' report is consistent with the accounts; and
- whether at the balance sheet date there existed a financial situation which may require the Bank to convene an extraordinary general Court of the Bank; such a financial situation may exist if the net assets of the Bank, as stated in the Bank balance sheet, are not more than half of its called-up share capital.

We also report to you if, in our opinion, any information specified by law or the Listing Rules of the Irish Stock Exchange regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.

We review whether the Corporate Governance Statement reflects the Bank's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Irish Stock Exchange, and we report if it does not. We are not required to consider whether the Directors' statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Report & Accounts and consider whether it is consistent with the audited accounts. The other information comprises only the Governor's Statement, the Group Chief Executive's Operating and Financial Review, the Corporate Governance Statement and the Report of the Directors. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Group's and Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

Opinion

In our opinion:

- the Group's accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2007 and of its profit and cash flows for the year then ended;
- the Bank's accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Acts 1963 to 2006, of the state of the Bank's affairs as at 31 March 2007 and cash flows for the year then ended;
- the accounts have been properly prepared in accordance with the Companies Acts, 1963 to 2006, Article 4 of the IAS Regulation and the European Communities (Credit Institutions: Accounts) Regulations, 1992.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Bank. The Bank's balance sheet is in agreement with the books of account.

In our opinion the information given in the directors' report is consistent with the accounts.

The net assets of the Bank, as stated in the Bank balance sheet are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 March 2007 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general Court of the Bank.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
Dublin

30 May 2007



THEME: C3

Appropriateness and effectiveness of the Department of Finance actions during crisis

LINE OF INQUIRY: C3c

Effectiveness of reviews of banks' loan books and capital adequacy

Scope and Process

Smaller developers

Anecdotally, we have heard that smaller developers are experiencing greater difficulties. They tend to have a greater proportion of their net worth tied up in their businesses and as a result have limited fall back positions. We have not reviewed smaller developers or any other small businesses as part of our work. This may distort the view being given by our review of larger developers. In addition if any of the larger developers were to fail it would have a knock on effect on the wider economy and also on developments they are joint venture partners in.

Financial Statements

In the case of Anglo, the management accounts for the year ended 30 September 2008 were in the process of being finalised for audit, including the final review of advances and treasury assets for impairments. The 2008 final audit has only recently commenced. As such the final reported 2008 position could change from that reported to us by management. In the case of Bol the management accounts for the six months ended 30 September 2008 are subject of a detailed internal review because they form the basis for the Interim Announcement of Results to the Stock Exchange. For the other Institutions the information used in this report is based on the 30 September management accounts with the exception of ILP for which the most recent consolidated management accounts were prepared to 30 June 2008. **As such the information in this report is price sensitive for the purposes of public reporting.**

PwC Risks/Observations

Where we have made comments and observations about possible asset write downs and scenarios, these are for indicative purposes only. We have not sought to mark to market property assets in the present economic environment, (where the market for property assets is largely illiquid); in that context it is difficult to forecast the outturn of any immediate short term assets sales or asset developments.

Because events and circumstances frequently do not occur as expected, there will always be differences between predicted and actual results, and those differences may be material.

LTV ratios

LTV ratios and their calculation are not consistently treated between Institutions or even between cases within the same Bank. Issues resulting in inconsistent treatment include the use of older external valuations, lack of current valuations, and desktop valuations. In addition there are different discounts applied in arriving at 'stressed' valuations and in arriving at work in progress valuations. As a result security values should be taken at face value when reviewing any given loan case.

For the above reasons, this report may not have identified all matters that might be of concern to you.

The latest available capital information for the Banks shows current core Tier 1 ratios ranging from 5.9% (Anglo) to 8.6% (INBS) as at 30 September 2008 before any stress testing or scenario analysis

Capital and RWA

€ in millions	AIB	BOI	Anglo	INBS	ILP	EBS
	Sep-08	Sep-08	Sep-08	Sep-08	Sep-08	Sep-08
Tier 1 Capital	10,642	10,142	7,202	1,364	1,955	818
Non core	2,092	2,833	2,139	-	-	-
Core Tier 1	8,550	7,309	5,063	1,364	1,955	818
Tier 2 Capital	4,108	4,088	3,123	471	-	255
Total Capital	14,750	14,230	10,325	1,835	1,955	1,073
Risk Weighted Assets	141,883	116,179	85,853	15,812	19,426	9,791
Tier 1 Ratio	7.5%	8.7%	8.4%	8.6%	10.1%	8.4%
Core Tier 1 Ratio	6.0%	6.3%	5.9%	8.6%	10.1%	8.4%
Total Capital Ratio	10.4%	12.2%	12.0%	11.6%	10.1%	11.0%

Source: Management information

- The table opposite sets out the Banks' estimated capital ratios and risk weighted assets at the 30 September 2008.
- Core Tier 1 ratios vary from 5.9% (Anglo) to 8.6% (INBS).

PwC scenario analysis is based on a number of assumptions and, other than INBS, has not been reviewed by management in the Institutions. This scenario analysis is not our assessment of likely losses but is to illustrate sensitivity to increased levels of losses.

Scenario Analysis

Loan Category	Impairment bps	
	Scen 1	Scen 2
Residential Mortgages	15	15
RIPS	120	120
Commercial / Corporate	150	125
Development land without planning permission	1,000	1,500
Development land with planning permission	600	1,000
Consumer lending unsecured (incl credit cards)	300	300
Consumer lending secured	150	100

Source: Pw C scenario

This change has only a €7.5 million impact in the scenarios below.

Losses and bps - PwC Scenarios

€ in millions	Institution's Loss Scenario (2009)		PwC Scenario 1		PwC Scenario 2	
	Loss	bps	Loss	bps	Loss	bps
AIB	2,040	152	3,203	233	4,052	294
BOI	1,458	100	2,359	163	2,799	194
Anglo	1,450	200	2,255	303	2,980	401
ILP	52	13	316	76	320	77
EBS	19	13	105	62	125	74
INBS	138	121	387	346	N/A	N/A

Source: Pw C Analysis

The impact on RIPS of a 20 bps change in the sensitivity is circa €92.2 million. For Commercial / Corporate the impact of a 25 bps change in the sensitivity is €453.5 million. Note that this does not include INBS.

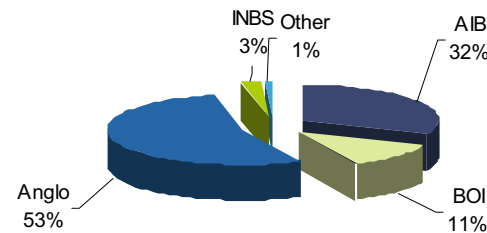
- On the following pages, in addition to management's assessment of worse case scenarios we have included estimates of loan losses based on PwC Scenario 1 set out in the table opposite. Note that this is not our assessment of the likely losses but is for illustrative purposes only to show the sensitivity of the Institutions to losses of this quantum.
- Except for INBS, the Banks have not seen these loan loss impairment charges. INBS management believe the PwC scenarios to be unrealistic.
- There were a number of assumptions made in allocating the balances to the categories opposite. These assumptions and the calculations have not been reviewed by management in the Banks (other than INBS who completed the calculations themselves) and may therefore include misclassifications which would therefore impact, potentially significantly, the estimated impairment charges. In addition, the charge is on the gross balance as information was not available in all cases to allocate impairment provisions to each category of loan.
- The table opposite sets out:
 - The loss for each institution based on their most severe stress scenario. These stresses were completed on different bases and at different times and are not therefore directly comparable; and
 - A summary of the application of PwC's Scenarios 1 and 2 to the Institutions' forecast loans to customers.
- AIB and Anglo have more significant development exposures and are therefore more severely impacted by the PwC development land loss scenarios.
- The move from PwC Scenario 1 to Scenario 2 is driven by impairment increases of €907 million on development land without planning permission and €1,592 million in relation to development land. This is offset by reductions of €446 million from commercial / corporate and €7.5 million on unsecured consumer lending.
- The impairment charges in bps are greater than historic peaks.

The top 22 exposures across the six institutions we have reviewed total €25.5 billion of which €13.7 billion (53%) is in Anglo and €8.1 billion (32%) in AIB

Top Exposures at 30 September 2008

€ in millions	Total			Asset		Risk rating
	Balance	Land & Development	Facility Limit	Interest shortfall	disposal required	
	2,874	-	2,874	X	√	●
	2,381	1,629	2,762	√	√	●
	2,335	928	3,123	X	X	●
	1,838	-	2,323	√	√	●
	1,691	871	1,809	X	√	●
	1,670	659	1,753	√	√	●
	1,613	358	2,127	X	X	●
	1,237	908	1,370	X	X	●
	1,087	612	1,234	√	√	●
	995	-	1,087	X	X	●
	888	-	941	√	√	●
	885	783	1,021	√	√	●
	705	-	750	√	√	●
	658	615	737	√	√	●
	650	110	750	X	X	●
	647	-	648	X	X	●
	606	-	1,044	X	X	●
	588	124	631	√	√	●
	546	170	654	√	√	●
	543	-	567	√	√	●
	529	529	570	√	√	●
	570	484	598	√	√	●
	25,535	8,779	29,372			

Top 22 exposures by bank as at 30 September 2008



- The top 22 exposures across the six banks we have reviewed total €25.5 billion in drawn balances and €29.4 billion in facilities. The top 10 exposures are each in excess of €1 billion accounting for €17.5 billion (70%) of the top 22 exposures.
- Loans to finance land & development accounts for c.€8.8 billion (c.34%) of the total exposure across these loans. The most significant land & development exposures relate to [REDACTED]
- Based on our review we have attributed a risk weighting to each of the top 22 exposures as set out opposite. This takes into consideration the following:
 - the client’s ability to continue to fund interest payments on their debt in the short to medium term; and
 - the requirement for asset disposals to assist in the payment of interest.
- We note that the risk we have highlighted in the table opposite may only relate to part of the connection. These exposures are summarised in Section 4.

Source: Loan review sheets and management summaries

Note: Interest shortfall implies a shortfall between the rental stream/cashflow from the underlying assets

Asset disposal in some cases relates to the disposal of residential/commercial completed stock (including surplus stock not sold to date)

- Lower Risk
- Moderate Risk
- Higher Risk
- High Risk

Sectoral analysis shows a large exposure to building and construction and property companies in AIB, BoI, Anglo and INBS. BoI and AIB have large home mortgage businesses in addition to traditional mortgage lenders.

Sectoral analysis

€ in millions	AIB Sep-08	BOI Sep-08	Anglo Sep-08	INBS Sep-08	ILP Sep-08	EBS Sep-08
Personal						
Home mortgages	31,829	64,108	103	1,648	26,599	14,944
Other	9,813	9,595	4,074	676	-	-
	41,642	73,703	4,177	2,323	26,599	14,944
Corporate/Commercial						
Agriculture	2,688	1,681	36	-	41	6
Energy	2,054	1,531	171	-	-	-
Manufacturing	7,536	8,244	749	-	46	-
Building & construction	14,261	13,602	2,465	1,763	13	-
Property companies	36,154	24,182	58,099	5,638	1,512	1,346
Distribution	14,090	4,727	727	-	-	-
Transport	2,238	2,252	382	54	12	-
Financial	2,261	2,185	1,126	-	13,322	-
Other services	14,690	13,022	5,760	2,089	(13)	530
	95,972	71,426	69,514	9,544	14,933	1,882
Total	137,614	145,129	73,691	11,867	41,533	16,826

- The table opposite sets out a sectoral analysis of lending by the Banks as at 30 September 2008.
- The key points are:
 - Large home mortgage exposure in BOI as well as traditional mortgage providers;
 - Personal exposure in Anglo relates to finance for investment;
 - Large exposure to property companies in Anglo

Source: Quarterly Central Bank Return for 30 September 2008 and Management Information

78.2% of Anglo's book is lent to property companies, 5.5% for personal investment and 6.3% to hotels. 44.2% of BoI book is in home mortgages. It appears that concentration limits may be exceeded in a number of cases.

Sectoral analysis

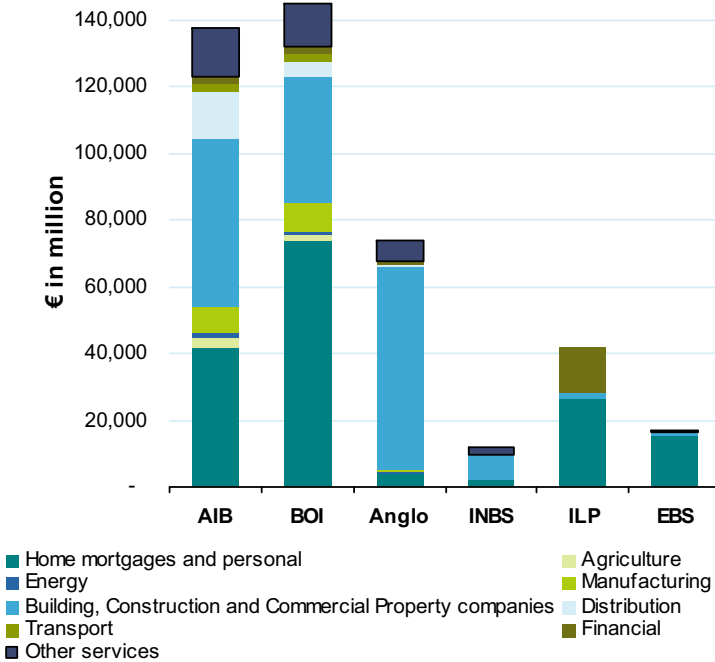
	AIB Sep-08	BOI Sep-08	Anglo Sep-08	INBS Sep-08	ILP Sep-08	EBS Sep-08
Personal						
Home mortgages	23.1%	44.2%	0.1%	13.9%	64.0%	88.8%
Other	7.1%	6.6%	5.5%	5.7%	-	-
	30.3%	50.8%	5.7%	19.6%	64.0%	88.8%
Corporate/Commercial						
Agriculture	2.0%	1.2%	0.0%	-	0.1%	-
Energy	1.5%	1.1%	0.2%	-	-	-
Manufacturing	5.5%	5.7%	1.0%	0.0%	0.1%	-
Building & construction	10.4%	9.4%	3.3%	14.9%	-	-
Property companies	26.3%	16.7%	78.8%	47.5%	3.6%	8.0%
Distribution	10.2%	3.3%	1.0%	-	-	-
Transport	1.6%	1.6%	0.5%	0.5%	-	-
Financial	1.6%	1.5%	1.5%	-	32.1%	-
Other services	10.7%	9.0%	7.8%	17.6%	-	3.2%
	69.7%	49.2%	94.3%	80.4%	36.0%	11.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Quarterly Central Bank Return for 30 September 2008 and Management Information

- The table opposite sets out the sectoral analysis as a percentage of the overall book by Bank.
- The Financial Regulator applies a limit on sector concentrations equating to 200% of own funds for one sector or 250% of own funds for two related sectors. At 30 September 2008, AIB plc's property exposure (excluding Poland, UK and part of Capital Markets) totalled 275% of own funds and 390% when combined with development and land exposures therefore breaching the above limits. We understand that the sector concentration framework is currently being reviewed by the Financial Regulator.
- We have not conducted any detailed analysis or held discussions with any other Institution in this regard, however, it appears that other Banks may also be in excess of regulatory concentration limits.

Lending sectoral analysis by bank highlights the extent of their exposures to residential mortgages and building, construction and commercial property companies

Sectoral Analysis by Bank as at 30 September 2008



- The chart opposite sets out a sectoral analysis of loans by Bank as 30 September 2008.
- This highlights the exposure to home mortgages and personal (mainly home mortgages) and also building, construction and commercial property across the six Banks and the specific concentrations in individual Banks.

Source: Management Reports

THEME: R2

Effectiveness of the supervisory practice
(Central Bank, Financial Regulator and
Department of Finance)

LINE OF INQUIRY: R2c

Adequacy of the assessment and
communication of both solvency and liquidity
risks in the banking institutions and sector

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Banking Supervision Department
Financial Regulator
P.O. Box 9138
College Green
Dublin 2
Attn: Thomas Brophy

18th June 2008

Dear Sirs,

Statutory Duty Confirmation: Statement by the auditors for Bank of Ireland Group plc. to the Financial Regulator

This letter and attached schedule constitute a report as required by section 27B of the Central Bank Act 1997 in relation to our statutory duty to report certain matters to the Financial Regulator, as specified in s.47 of the Central Bank Act, 1989 ('the CBA, 1989') and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations'). The schedule to this letter lists the reporting periods in which we acted as auditors of Bank of Ireland Group plc and related entities and are therefore subject to the statutory duty from 28 June 2007 to 13 June 2008.

Respective responsibilities of directors and auditors

It is the responsibility of the directors of the Bank of Ireland Group plc:

- to take appropriate steps to provide reasonable assurance that the regulated entities comply with applicable legislation and the requirements of the Financial Regulator set out in Guidance Notes, Notices, Handbooks, Codes and other authoritative pronouncements ('the Supervisory Requirements');
- to establish arrangements designed to detect non-compliance with the Guidance Notes, Notices, Handbooks, Codes and other authoritative pronouncements ('the Supervisory Requirements') and to report any breaches to you;

Ronan Murphy Olwyn Alexander Damian Byrne Pat Candon John Casey Mary Cleary Siobhán Collier Andrew Craig Thérèse Cregg Bill Cunningham Richard Day Fiona de Búrca David Devlin John Dillon Ronan Doyle John Dunne FCCA Kevin Egan Martin Freyne Teresa Harrington Paul Hennessy Ken Johnson Paraic Joyce Ciaran Kelly Joanne P. Kelly Chand Kohli John Loughlin Vincent MacMahon Tom McCarthy Enda McDonagh John McDonnell Ivan McLoughlin Robin Menzies Brian Neilan Damian Neylin Andy O'Callaghan Jonathan O'Connell Denis O'Connor Donal O'Connor Marie O'Connor FCCA Paul O'Connor Dave O'Malley Garvan O'Neill Michael O'Neill Joe O'Shea Ken Owens Bob Semple Mike Sullivan Billy Sweetman Paul Tuite Tony Weldon

Also at Cork, Galway, Kilkenny, Limerick, Waterford and Wexford

Chartered Accountants

- to report to the Financial Regulator any information which they know or have reasonable cause to believe is of material significance for the Financial Regulator's supervisory functions.

Our responsibilities are to report to you matters which come to our attention in the course of our work as auditors and are of regulatory concern to you, in accordance with s.47 of the Central Bank Act, 1989 ('the CBA, 1989') and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations') and to report on an annual basis to you in relation to whether circumstances indicating such matters have been identified in the course of our work.

Basis of statement

In discharging our statutory duty to report to you we have had regard to Practice Note 19(l) – Banks in the Republic of Ireland. In doing so, we are required to consider matters of which we have become aware in the capacity as auditor listed in the schedule to this letter.

Statement

No circumstances have come to our attention, in our capacities described in the schedule attached to this letter, that have given rise to a statutory duty on us to report to you under s.47 of the Central Bank Act, 1989 ('the CBA, 1989') and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations').

Our report is prepared solely for the confidential use of the Financial Regulator as required by section 27B of the Central Bank Act 1997. It may not be relied upon by Bank of Ireland Group or the Financial Regulator for any other purpose whatsoever. PricewaterhouseCoopers neither owes nor accepts any duty to any other party and shall not be liable for any loss, damage, or expense of whatsoever nature which is caused by reliance on our report.

Yours faithfully



PricewaterhouseCoopers
Chartered Accountants & Registered Auditor

Schedule to Statutory Duty Confirmation: financial institutions to which the firm has acted as appointed auditor.

Capacity	Reporting Period	Reference to basis of work
Auditor of The Governor & Company of Bank of Ireland	Financial year ended 31 March 2008	Audit report dated 20 May 2008
Auditor of ICS Building Society	Financial year ended 31 December 2008	Audit report dated 28 February 2008
Auditor of Bank of Ireland Mortgage Bank	Financial period ended 31 March 2008	Audit report dated 20 May 2008
Auditor of the consolidated financial statements of Bank of Ireland Group	Financial year ended 31 March 2008	Audit report dated 20 May 2008

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Banking Supervision Department
Financial Regulator
P.O. Box 9138
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Dublin 2
Attn: Thomas Brophy

28th June 2007

Dear Sirs,

Statutory Duty Confirmation: Statement by the auditors for Bank of Ireland Group to the Financial Regulator

The annex to this letter lists the reporting periods in which we acted as auditors of Bank of Ireland Group and which therefore are subject to the 'statutory duty' as described by s.47 of the Central Bank Act, 1989 ('the CBA, 1989') and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations') for those reporting periods. We submit this statement to you in accordance with section 27B of the Central Bank Act, 1997, the instructions to credit institutions issued by the Financial Regulator and Practice Note 19(I) 'Banks in the Republic of Ireland'.

Respective responsibilities of directors and auditors

It is the responsibility of the directors of the banks:

- To take appropriate steps to provide reasonable assurance that the banks comply with the Central Bank Acts, 1942 to 1998 and the Central Bank and Financial Services Authority Acts 2003 to 2004 and also the statutory instruments enacted and administrative notices issued in relation to EU Directives that relate to the supervision of banks ('the Supervisory Requirements'). Administrative provisions, as referred to above, also include the Financial Regulator's Licensing and Supervision Requirements and Standards for Credit Institutions;
- to establish arrangements designed to detect material non-compliance with the Supervisory Requirements, and to report any breaches to you;

Donal O'Connor Olwyn Alexander Damian Byrne Pat Candon John Casey Mary Cleary Siobhán Collier Andrew Craig Bill Cunningham Fiona de Búrca David Devlin John Dillon Ronan Doyle Kevin Egan Martin Freyne Teresa Harrington Paul Hennessy Ken Johnson Paraic Joyce Ciaran Kelly Chand Kohli John Loughlin Vincent MacMahon Tom McCarthy Enda McDonagh John McDonnell Declan McKeon Ivan McLoughlin Robin Menzies Neil Murphy Ronan Murphy Brian Neelan Damian Neylin Andy O'Callaghan Jonathan O'Connell Denis O'Connor Marie O'Connor FCCA Paul O'Connor Dave O'Malley Garvan O'Neill Michael O'Neill Joe O'Shea Ken Owens Pat Roche Bob Semple Mike Sullivan Billy Sweetman Paul Tuite Tony Weldon

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PricewaterhouseCoopers is authorised by the Institute of Chartered Accountants in Ireland to carry on investment business.

- to report to the Financial Regulator any information which they know or have reasonable cause to believe is of material significance for the Financial Regulator's supervisory functions under the Supervisory Requirements.

Our responsibilities, with respect to our statutory duty to report to you matters which come to our attention in the course of our work as auditors and of regulatory concern to you, are as set out in the CBA, 1989 and the Post BCCI Regulations.

Basis of statement

In discharging our statutory duty to report to you under the CBA, 1989 and the Post BCCI Regulations, we have had regard to Practice Note 19(I) – Banks in the Republic of Ireland. In doing so, we are required to consider matters of which we have become aware in the capacity as auditor listed in the Annex to this letter.

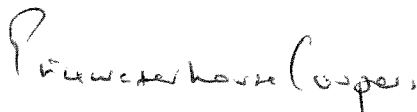
The basis of the work done in respect of our capacity is referenced in the Annex to this letter. We are not required to carry out any additional work to identify matters to be reported under the statutory duty.

Statement

No matters have come to our attention, in our capacity described in the Annex attached to this letter, that have given rise to a statutory duty on us to report to you under the CBA 1989 and the Post BCCI Regulations.

Our report is prepared solely for the confidential use of the Financial Regulator as required by section 27B of the Central Bank Act 1997. It may not be relied upon by Bank of Ireland Group or the Financial Regulator for any other purpose whatsoever. PricewaterhouseCoopers neither owes nor accepts any duty to any other party and shall not be liable for any loss, damage, or expense of whatsoever nature which is caused by reliance on our report.

Yours faithfully



PricewaterhouseCoopers
Chartered Accountants & Registered Auditor

Annex to Statutory Duty Confirmation

Capacity	Reporting Period	Reference to basis of work
Auditor of The Governor & Company of Bank of Ireland	Financial year ended 31 March 2007	Audit report dated 30 May 2007
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