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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI- REACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 13 Bealtaine 2015

Wednesday, 13 May 2015

The Committee met at 9.30 a.m.

MEMBERS PRESENT:

Deputy Pearse Doherty,	Senator Sean D. Barrett,
Deputy Joe Higgins,	Senator Michael D'Arcy,
Deputy Michael McGrath,	Senator Marc MacSharry,
Deputy Eoghan Murphy,	Senator Susan O'Keeffe.
Deputy Kieran O'Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

two years, and that's really all we had. So we've changed that round about to make sure that we have other punishments as well that we could do, if you want to take it like that, and financial ... from a financial point of view.

The third question is the notes ... valuers would have notes, valuer's notes on every valuation. So when you go to look at a site you would have a valuation and you would have your valuer's notes, so you would write your valuer's notes down in your valuation. Now, that could take in the form of e-mails, it could take in the form of site visits, it could take in the form of telephone conversations, so you would, again, expect every valuer to have a site notes and to have them up-to-date, but I can tell you one ... one sort of a small fact which ... from ... I just ... I checked, in the past couple of days, about our ... we would run, with an insurance broker, a professional indemnity scheme for members to make sure that they're covered, and in the past four years, from 2010, '11, '12, and '13 ... In 2010, we've had two claims on our professional indemnity policies. We've had one in 2011, one in 2012, and one in 2013. Now, these policies are written by an insurance company, obviously. They're written by a broker first who would pass them onto an insurance company, so that if there are incorrectness with valuations, that's the place they should go. So, like-----

Deputy John Paul Phelan: Do you have figures for the previous years? I know you weren't in the current position but-----

Mr. Patrick Davitt: No ... I ... I don't ... I didn't get them, because, like, normally these claims would take a year or two to work out like this, but I ... I know that in ... I haven't got the actual figures for the ... the official figures of the insurance company for 2009, 2008, 2007, but I know that they're still quite small, and if they weren't very small, like each of these ... there's over 500 policies on this particular scheme with all on ... on a separate basis. So if they were actually large, you can be sure the insurance company wouldn't be actually taking the cover ... or they wouldn't be at a reasonable price. So the amount of claims in professional indemnity insurance in Ireland for valuers is very, very low.

Deputy John Paul Phelan: Thank you.

Chairman: Okay. Thank you very much. Okay, with that said I'm going to bring matters to a conclusion. Mr. Davitt, is there anything further you'd like to add this morning before we close?

Mr. Patrick Davitt: No, just to thank the committee, and ... and for hospitality and for your questions. I hope I was of some help to you. Thank you very much, Mr. Chairman.

Chairman: Okay. In that regard I would also like to thank you, Mr. Davitt, for your participation here today, and for your engagement with the inquiry. And now to just formally excuse you, and in doing so, I also propose that we suspend until 3 p.m. where we will resume with Mr. Pat Cullen, managing partner, Deloitte Ireland, and Mr. Gerry Fitzpatrick, partner head of audit, Deloitte Ireland. Is that agreed? Okay.

Sitting suspended at 2.03 p.m. and resumed at 3 p.m.

Deloitte Ireland - Mr. Patrick Cullen and Mr. Gerry Fitzpatrick

Chairman: Alright, if both of you are ready and if committee members are ready, I'm going

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

to go back into public session. So I now propose that the committee return into public session, is that agreed? We now commence this afternoon's proceedings with a public hearing with Mr. Pat Cullen, managing partner of Deloitte Ireland, and Mr. Gerry Fitzpatrick, partner head of audit, Deloitte Ireland. The Committee of Inquiry into the Banking Crisis is now resuming in public session and I can remind members and those in the public Gallery to ensure that their mobile devices are switched off.

Today we continue our hearings with auditors who had roles during the crisis. This afternoon, we will now hear from Mr. Pat Cullen, managing partner, Deloitte Ireland, and Mr Gerry Fitzpatrick, partner, head of audit at Deloitte Ireland. Pat Cullen has been the managing partner of Deloitte Ireland since 2011. He joined Deloitte in 1978 and became a partner in 1986. Mr. Cullen is a past president of the Irish Taxation Institute. Mr. Gerry Fitzpatrick is a partner and head of audit with Deloitte. From 2004 to 2008, he was group audit partner for Ulster Bank. Mr. Cullen and Mr. Fitzpatrick, you're both welcome before the committee this afternoon.

Before I hear from the witnesses, I wish to advise both of you that by virtue of section 17(2) (I) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you are directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to so do, you are entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given. I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry, which overlap with the subject matter of the inquiry. Therefore, the utmost caution should be taken not to prejudice those proceedings. Members of the public are reminded that photography is prohibited in the committee room. To assist the smooth running of the inquiry, we will display certain documents on the screens here in the committee room and, for those sitting in the Gallery, these documents will be displayed on the screen to your left and to the right and members of the public and journalists are reminded that these documents are confidential and they should not publish any of the documents so displayed.

The witnesses have been directed to attend the meeting of the Joint Committee of Inquiry into the Banking Crisis and you have been furnished with booklets of core documents. These are before the committee and will be relied upon in questioning and form part of the evidence of the inquiry. So, with that said, if I can now ask the clerk to administer the oath to Mr. Fitzpatrick and Mr. Cullen this afternoon.

The following witnesses were sworn in by the Clerk to the Committee:

Mr. Patrick Cullen, Partner, Deloitte Ireland.

Mr. Gerry Fitzpatrick, Partner, Head of Audit, Deloitte Ireland.

Chairman: I now invite members to give their questioning. The two leads ... they are Deputy McGrath and Senator O'Keeffe. Deputy McGrath, you've 25 minutes. Oh, sorry, my apologies, I need an opening statement. I'm jumping ahead. My apologies, Mr. Cullen, Mr. Fitzpatrick. If I can invite you to make your opening comments, please.

Mr. Pat Cullen: Good afternoon, Chairman, Deputies and Senators. Firstly, I'd like to thank the members of the committee for your invitation today. My name is Pat Cullen, I'm a partner in Deloitte, specialising in taxation, with over 30 years' experience and, for a four-year

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term from mid-2007 to mid-2011, I served as managing partner of Deloitte. As managing partner, I was responsible to the partners and the firm's executive committee for the management and operation of all aspects of the firm's affairs. In my role as managing partner, I oversaw the management of the firm, including the provision of professional services to our clients, the skills and resources of our people and the financial management of the practice.

In my written statement - provided to the committee of inquiry some weeks ago - I provided the inquiry with a summary of salient aspects of our legal framework and governance structures, together with key features of our audit quality processes, which are of such fundamental importance to all of the work we carry out as auditors to a wide range of clients. In the interests of brevity, I'm not going to read my written statement. Instead, I'm going to refer to some areas that I consider may be of particular interest. Audit quality is a key area of public and stakeholder interest and delivering the highest standards of services and advice to our clients is our continuing and overarching objective. An important part of my responsibility as managing partner was to ensure that we had the appropriate processes in place to carry out our responsibilities in this regard. At an overall level, this helps to ensure that our professional services and our business conduct were in the public interest. Our audit approach is centred on providing clients with the most skilled audit partner and team appropriate to the needs and complexity of their case. Our quality governance processes require engagement partners to be fully responsible for the services they provide and for understanding our clients' business. Their involvement in the audit process is required from the very outset of any engagement, with partner-led audit planning key to our audit approach.

Our audit practice is structured into specialist industry groups, led by partners with a great depth of experience and expertise in that industry. Our financial services group, which includes banking, is one such group. These groups collaborate in order to share their understanding of market developments, risk assessments and emerging trends and this is of particular value during times of market turbulence and change. Audit partners are also supported by our professional practice directors and by the audit risk and reputation leader. The professional practice directors are responsible for technical, accounting and auditing support and their approach is responsive and consultative. Deloitte member firms are also part of a network of similar industry groups from around the world. These groups include experts with day-to-day, first-hand experience of the application of accounting standards across different legal and regulatory environments and include designated experts who are available to advise audit partners on engagements in dealing with complex or contentious accounting or auditing issues. The availability of these resources ensure that there is specialist support available if required to deal with difficult issues as they arise and to support our audit teams.

A review of our audit practice is carried out annually and this is overseen by Deloitte globally. The practice review determines whether we have complied, in all material respects, with Deloitte policies and procedures, applicable professional standards and applicable legal and regulatory requirements. Our audit practice is also subject to external review by the Chartered Accountants Regulatory Board, the independent regulatory board of Chartered Accountants Ireland. The results of our practice reviews are considered by our executive management committee and action is taken, as and where appropriate, to implement measures to address the recommendations made. It is a key element in our continuous drive to improve and enhance audit quality.

As I explained in my written statement, all partners who act as audit engagement partners for statutory audits have been granted responsible individual status by the Chartered Accountants

tants Regulatory Board and are registered statutory auditors. Personally, I am not, and I never have been, a registered statutory auditor. My professional expertise lies primarily in the area of taxation. Therefore, I'm joined here today by Mr. Gerry Fitzpatrick, who is a registered auditor and a specialist in the banking sector. Mr. Fitzpatrick kindly advised me on the responses in my written statement to the lines of an inquiry in your direction of 2 April. Today, Mr. Fitzpatrick will address some of the issues in your lines of an inquiry in the context of his role as lead audit partner on the audit of Ulster Bank Ireland Limited, UBIL, from 2004 to 2008. Before I hand you over to Mr. Fitzpatrick, I would like firstly to make it clear what I understand to be the purpose of financial statements and our role and responsibilities as auditors.

International financial reporting standards, or IFRS, which is a framework used by the directors of UBIL to prepare the bank's financial statements, describe the purpose of financial statements as being, "A structured representation of the financial position and financial performance of an entity", the objective being to provide information about the financial position, financial performance and cash flows that's useful to a wide range of users in making decisions and presenting the results of management's stewardship of the entity's resources. The whole essence of IFRS is to provide for recognition, measurement, presentation and disclosure of specific aspects of financial reporting in a way that leads to a true and fair view being shown of the financial position and profit or loss of the entity. IFRS states that, in virtually all circumstances, an entity achieves a true and fair view by compliance with IFRS. Objective, professional judgment must be applied by the directors to ensure that financial statements give a true and fair view. Under the Irish Companies Acts, every company of the size of UBIL must appoint a statutory auditor and that auditor must make a report to the members on the financial statements examined by them, with the primary purpose being to state whether, in their opinion, the company's balance sheet and profit and loss account have been properly prepared in accordance with the provisions of the Companies Acts and give a true and fair view of the state of the company's affairs as at the end of its financial year and of the company's profit or loss for the financial year. Over the years there has been much done to provide direction and guidance to auditors in carrying out the audits of specialised entities. This includes practice note 19, the audit of banks in the Republic of Ireland. While its main purpose is to provide guidance on the application of auditing standards to the audit of banks, it also comments on the objectives of the Financial Regulator and the objectives of the auditor, emphasising that while they may have complementary concerns, there are fundamental differences in their objectives. The Financial Regulator is primarily concerned with maintaining the stability of the banking system and fostering the safety and soundness of individual banks in order to protect the interests of depositors. The auditor's primary responsibility is to report his opinion as to whether the financial statements of the bank being audited present a true and fair view.

It's clear that the banking crisis has had an enormous impact on a wide range of stakeholders. It is absolutely regrettable that a number of major factors came together back in 2007-2008, including international market conditions, major banking failures like Lehman and a slowdown in the Irish property market, which conspired to create conditions of an economically catastrophic nature, which few, if any, could consider would lie within the range of expectations that one could normally predict.

Consequently accounting standards were faced with challenges which they found exceedingly difficult to keep pace with, as, for example, the concept underlying the incurred loss impairment model. The occurrence of loss events was happening at a pace and on such a systemic basis that the quantum of impairment provisions could change from day to day, let alone from month to month. And that was the difficult background against which audits were carried out in

2009. Hindsight does have the benefit of 20:20 vision and in the cold light of day, some seven or eight years later, yes, there is scope for asking questions about, “What if?” There is a broad need to learn from the crisis, and we support inclusion of the role of auditing in any reviews being carried out. Across the globe and in Ireland, the auditing profession has reflected on their role and considered how financial reporting and auditing could be enhanced. Deloitte has engaged and been a leader in such developments, some of which Mr. Fitzpatrick will comment on.

I’m now going to hand you over to Mr. Fitzpatrick.

Chairman: Mr. Fitzpatrick.

Mr. Gerry Fitzpatrick: Thank you, Pat. Good afternoon and thank you for the opportunity of addressing the committee. My name is Gerry Fitzpatrick and I’m one of the Deloitte partners engaged with auditing the banking sector. I’ve worked with Deloitte for over 30 years and have been an audit partner for 15 years, and I was, as stated, a partner on the auditing of Ulster Bank Ireland Limited, or UBIL, from 2004 to 2008. I’ve provided a detailed written statement addressing our role as auditors of UBIL and I would propose to take that statement as read. I will now make some introductory remarks.

As independent auditors to UBIL, our role was to report to the shareholder in accordance with the requirements of the Companies Acts. Our work was carried out in accordance with international standards on auditing. The UBIL financial statements were prepared by the directors in accordance with international financial reporting standards and under the requirements of companies legislation. A true and fair view is normally achieved when the financial statements are prepared in accordance with IFRS standards. Auditors do not set the accounting framework but rather, we provide an opinion on whether the financial statements prepared by the directors give a true and fair view. An audit is a point-in-time examination of the reporting of financial performance and position, measured in accordance with standards and an audit is primarily an examination of historical data prepared by the directors and presented in their annual report. Shareholders and capital markets value the audit process, as the audit underpins the trust and obligation of stewardship between those who manage a company and those who own it, and with a range of other users. To demonstrate the stewardship, the financial statements are prepared under IFRS to provide extensive analysis, both of accounting policies adopted by the directors and in preparing the financial statements’ extensive financial data. Separate to the financial statements, the bank submits various capital and liquidity returns to the regulator. Those returns are prepared under separate rules or sent directly to the regulator, and are not subject to audit.

Our audit process is focused on the financial statements. The process commences mid-year, when a plan is presented to an audit committee. The plan sets out our work on key audit areas, on key issues, on major judgments, together with a summary of our proposed approach. That approach is a risk-based one, which includes tests of controls, reviewing the work of internal audit, evaluating control and remediation within the organisation, IT audit testing and tests of financial data. And that testing work commences in quarter four of the year, looking then at the transactions to the end of September. And following the conclusion of the year, we finalise our testing work and examine the financial statements prepared. The audit process is detailed and uses sample testing of the tens of millions of transactions and balances that the bank has recorded on its financial systems. Sample items are agreed to supporting records and to external confirmations. In the case of areas of judgment, we examine the evidence provided by management and challenge the nature and source of that data. We seek evidence of contradictory data available either internally or externally. Our work on UBIL was linked closely to the

work of Deloitte RBS Group audit team and we reported the results of our work to them also. And throughout our audit, we met regularly with management and the audit committee of the board. When the directors have approved the financial statements and our audit is complete, we issue our report on those financial statements and the report for 2008 year issued ... was issued in February 2009. It was an unmodified, true and fair view opinion. And in reaching our opinion, we consider the results of our audit work, we assess the accounting policies and, where appropriate ... and consider where they were appropriate. We consider the nature and risks of and uncertainties in how they were disclosed and then adequate disclosure to be made on key items, such as loan impairment and going concern.

In addition to our statutory audit opinion, which is included in the annual report, we provided a detailed audit summary report to the audit committee of Ulster Bank Group, which included a summary of our work on UBIL. A copy of that report and similar reports for other years were submitted to the joint committee in February. In our own summary report, we provided the audit committee with details of our audit work, we showed analysis of risks in customer lending and data on corporation coverage by lending category. We reported on the impairment process tested by us. For 2008, as example, we refer to the absence of up-to-date collateral evaluations and the need for enhanced documentation of the impairment process. We also reported that the going concern assessment relied on RBS Group, the group's management of capital and funding, and in addition to being presented to the audit committee, our summary reports are made available to the regulator.

Our summary is presented to the audit committee as they approve the financial statements and those financial statements, as I've mentioned earlier, provide extensive analysis both of the accounting policies and the financial data. In taking the 2000 financial statements, by way of example, across 80 pages, these included accounting policies and disclosures on a wide range of topics.

I would like to highlight some key aspects of those disclosures relating to loan quality and finding. With regard to loan quality, the directors described in their financial statements six important elements. Firstly, the accounting policy was set out detailing the incurred loss approach which is required by the accounting standard IAS 39. Next, the directors highlighted key judgments and uncertainties which they explained could cause the actual losses to differ materially from those reported from their reported impairment provision. A third item was the detailed analysis of the quality of all loans, and this was done by reference to the bank's internal credit grading system. That data showed details of deterioration in the quality of the bank's loans in the year, showing that the gross value of loans in the lower quality categories had increased from €6.3 billion at the end of 2007 to €14 billion during 2008. Other aspects, including overdue payments, were also shown. A fifth item was the analysis of lending exposure by industry and sector, which provided insight into the lending strategy, showing, for example, that of the total exposures that property and related exposures included, construction, 6%; home mortgages, 19%; and property, 22%. And lastly the impairment for the year ... charged for the year was disclosed.

With regard to the funding model of the bank, the financial statements disclosed, amongst other things, three important aspects. Firstly, that 46% of the funding was provided by RBS Group entities. Next, that 75% of the financial liabilities fell due within three months of the balance sheet date. And lastly, the directors explained that, in their judgment, it was appropriate to prepare the financial statements of the bank on a going concern basis, and that the bank had adequate resources to continue its business for the foreseeable future. The directors disclosed

that they had concluded this assessment having considered the financial position of the bank, and referenced the ongoing support of RBS Group by way of capital funding and liquidity facilities. Similar disclosures on loan impairment and going concern were provided with financial statements for other years.

The analysis presented by the directors within the financial statements shows the transparency of disclosure made available to both the shareholder and to the regulator. Our role was to ensure the measurement and disclosure was in accordance with a true and fair view. Our role, as Mr. Cullen has pointed out, is fundamentally different to the role of the Financial Regulator, who is primarily concerned with maintaining the stability of the banking system. And whilst audited financial statements contribute to the regulatory process, the determination of capital, the undertaking of tests for future stress, and the setting of regulatory buffers are functions undertaken by the regulator. That process is not under statute part of the scope of the audit, of the external audit. In providing our opinions on the financial statements, I believe we discharged our responsibility professionally and with due care and diligence. Finally, I would echo Mr. Cullen's comments and recognise the financial crisis has had a normal impact ... enormous impact on a wide range of stakeholders and our profession has recognised the need to learn from the crisis and has reflected on how financial reporting and auditing could be enhanced. We have engaged in a variety of reviews across the world and at Deloitte in Ireland, we support the enhancements explored in those reviews and I would highlight just five things: firstly, the development of a new expected loss accounting standard, IFRS 9, which subject to EU approval, is due to be implemented in 2018. The development of with the regulator of an expanded auditor assurance protocol and this involves auditors reporting separately on aspects of governance processes at financial institutions and this expanded process has commenced from 2014. Thirdly, recommended changes in auditor reporting to audit committees and shareholders are now in place. Next, availability of new audit tools was proposed and that is now in place. And, lastly, enhanced dialogue around the audit process with regulators and this has been a feature for the audited banks in Ireland since 2009.

Whilst these are not changes to the scope of the core audit, such initiatives can, through enhanced communication of the existing scope and the setting of a wider scope, help to create a broad level of awareness of banking models and their underlying economics and, in some way, mitigate some of the understandability and relevance issues of historic financial information. Nonetheless, the preparation and audit of financial statements will continue to require significant judgment. Finally, the financial statements contain valuable data, but, as a point in time measure, can only attempt to present measures based on that point in time judgment. And the scope of an audit is an assessment of whether those financial statements present a through and fair view and, in that regard, has significant value. Thank you, Chairman.

Chairman: Thank you very much. If I can now invite Deputy McGrath. Deputy, you have 25 minutes.

Deputy Michael McGrath: Thank you very much, Chair, and you are very welcome, Mr. Cullen and Mr. Fitzpatrick. Can I just start by taking, for example, the Ulster Bank Ireland Limited financial statements for 2007 and 2008, which were audited by Deloitte and provided an unqualified, independent audit opinion? In hindsight, knowing now what you know about the bank and the issues that it was facing, would you still say that those accounts gave a true and fair view at that time?

Mr. Gerry Fitzpatrick: Deputy, I am absolutely satisfied that that opinion was appropriately given. As I explained, the framework for the audit involves looking at a point in time

judgment, looking at the available data that supports the directors' view of the financial statement. So they are the directors' accounts ... they prepare them on the basis of assumptions of available data. What we have seen, I suppose, is a fairly dramatic series of movements post-year ends, which were unimaginable in some ... in some respects. But I think in relation to the data that was prepared, the appropriate framework which was IFRS ... the measurement of data and the governance that the board went through and the work that I've done which, I believe, is comprehensive ... that those accounts were ... and those opinions stand as at that point in time and were appropriate.

Deputy Michael McGrath: Can I ask Mr. Fitzpatrick if you held concerns about, for example, the over-exposure of the bank to property lending, the concentration of risk, the possibility of the risk of a collapse in asset values, and you wanted to impart that information to the readers of the financial statements, what options would you have to impart that information on the statements?

Mr. Gerry Fitzpatrick: I guess, firstly, the financial statements are the directors' financial statements so my job is to make sure that the directors properly reflect all of those aspects. And so the key role and the challenge that the auditor provides to the board is to make sure they are giving disclosure of those elements. You've instanced any concerns one might have in relation to asset values or liquidity and some of the disclosures I described were very important in allowing the reader understand the maturity of debt facilities, the funding gap the organisation had with the ... with the short-term funding model and a long-term asset base, and on the asset base, gave reference to the quality of that loan book. My concerns were to ensure that the directors were properly reflecting what was happening in those on the ground in terms of their records and their financial systems, ensuring that the financial statements properly capture those elements of disclosure.

In terms of my discussions with the audit committee, clearly, as an audit process, as I described, starts in terms of setting out a plan. And that plan would include looking at particular areas of focus and some of the areas like loan impairment, like going concern and other significant judgments would have been disclosed and discussed with an audit committee and I would have set out my approach to testing that, but, ultimately, my concern is to make sure the financial statements present the information that the directors have in terms of their records.

Deputy Michael McGrath: What constraints did IAS 39 place on you in terms of making provisions that if you did ... if you believed that it would be prudent to make provisions, what constraints did that standard place on you?

Mr. Gerry Fitzpatrick: Again, I don't need to ... the IFRS puts constraints ... is ... is set for the directors to measure the financial statements. So when I challenge the directors in terms of the way they followed that standard that I think was appropriate, that that was a standard that dealt specifically with loan impairment, I think, has been discussed and well flagged that is an incurred loss model. And there is good reason why, I guess, that that standard was set in that way.

Previous standards had had a notorious capacity for manipulation where people made big bath provisions and, therefore, the comparability of information from one organisation to another was difficult. So the idea of setting a standard that it was an incurred loss model was well-intentioned and-----

Deputy Michael McGrath: When was that standard introduced? IAS 39.

Mr. Gerry Fitzpatrick: 2004-05 I believe. As I said earlier, the standard setters are regulators and legislators. Obviously, our profession gives some input to that but it's the accounting profession and the regulatory structures that set the accounting standards.

Chairman: Just because it's an important issue it might be important to explain what IAS 39 actually was and you can correct it here that, "This was a standard that outlines the requirements for the recognition and measurement of financial assets, financial liabilities and some contracts to buy or sell non-financial items and the standard outlines how a provision for bad debts should be calculated from one year going into the next".

Mr. Gerry Fitzpatrick: Correct, Chairman. It covers a whole range of issues in relation to the financial instruments and has this element, which is an incurred loss model, which says you must look for objective evidence of the incurrence of a loss and at that point you make provision. And-----

Deputy Michael McGrath: I suppose the point I'm getting at Mr. Fitzpatrick is that, okay, you were somewhat constrained by IAS 39 and I understand the financial statements are the preserve of the directors and you're performing the statutory audit. But if you had concerns about events that might transpire, there may be a collapse in asset values, but you were constrained from providing for that in the financial statements, or advising the directors to provide for that in the financial statements because of that accounting standard, what other facility did you have to convey that information or convey your concerns and ensure the directors conveyed those concerns to the readers of the financial statements? Could you, for example, have insisted upon a note to the financial statements along those lines?

Mr. Gerry Fitzpatrick: I think for someone to give a disclosure in relation to a judgment, they have to have data to support that judgment. And warning of concerns in the future of something that might happen is given in the financial statements. And again, I referenced that in my opening statement that the standard makes it clear that there are ... it's based on judgment and that loss, impairment losses may be different depending on how events turn out. But, ultimately, to give any quantification of that, you would actually have to have better data and I think the situation the directors faced was in looking at the valuation of ... of loans was to establish what was the ... what was the data. They were relying on market data and I think if you recall at the time, we now know in relation to, for instance, house prices, the property index was 100 in 2005. In 2009, it was only 92. It took until 2011, 2012 for it to go down to 67.

So some suggestion with hindsight that the directors knew that this was going to happen I would have ... I would have had a major concern if I thought the directors believed that their judgments were over-optimistic and I would certainly bring that to their attention. And through the audit process I, by looking at individual loans ... there's a process for challenge of that data ... but the challenge we gave was to look at both that bottom-up analysis of loans and on a case-by-case basis, which was being done across the bank in a credit review process but also to try and look at a top-down analysis to say, "Well, looking at your loan portfolio and looking at how it is supported by collateral, what type of impairment loss would you expect given what we had seen in the market?"

So I think the challenge and you referenced concerns, I think the issue is one of challenge from my perspective showing scepticism to say, "Is your judgment based on data that is available?" And to look for any contradictory evidence of other data that might suggest it wasn't available, but to flag some concern that things might get worse, you need to put some quantification on it and I don't think that would have been appropriate.

Deputy Michael McGrath: Okay. An auditor would discuss their findings privately with management and any significant risk would be formally recorded in a management letter. Can you recall any issue which could have potentially led to a qualified audit report but which after discussion with bank management was regarded as not warranting inclusion in a formal management letter?

Mr. Gerry Fitzpatrick: I guess the first thing in a qualified audit report, a management letter is an output for the audit, separate to the qualification ... potential qualification in the set of accounts. I mean, things that would cause a qualification to a set of accounts would be inappropriate standards or inappropriate measures. Clearly we would have discussions but there was certainly no record, and my information, if I had had some dispute with management, would have been recorded in my audit summary presented to the audit committee. There were no such instances of me saying I was in disagreement with the organisation. And then, I guess, the next process which you mention is the management letter, I mean ... in a management letter, we make disclosure of any material items in a ... from a control perspective, that haven't already been identified by the organisation. So we would have had, and observed, certain significant issues. In relation to the 2007-2008 period, there was an integration process that was ongoing, there was issues raised in relation to control environments and what we say in our management letter is that ... what we are raising ... we would raise, would be items that haven't already been reported to management. Therefore those issues were clearly of concern to us in terms of our audit process, in terms of understanding how those had been dealt with, what impact they might have on financial records, what the response to group internal audit ... findings have been and to be able to establish whether those issues were giving cause of concern for the actual measurement of assets or liabilities, and if we had had serious concerns on other matters, not reported by internally, we would have put them in that ... in a management letter.

Deputy Michael McGrath: Can I ask when did Deloitte win the Ulster Bank audit? When did you first carry it out?

Mr. Gerry Fitzpatrick: We were appointed in 2000, the year 2000.

Deputy Michael McGrath: And do you still have it?

Mr. Gerry Fitzpatrick: We are currently the auditors ... in the change in Europe in rotation of auditors, audit tendering is now a mandatory requirement so the bank put the ... the RBS Group put the audit out to tender for 2016. We were included in that process, but because we would obviously had only a small number of years, because we are timed out in rotation process, we weren't successful. The audit will change for 2016.

Deputy Michael McGrath: Okay, so you won't have it after 2015?

Mr. Gerry Fitzpatrick: Correct.

Deputy Michael McGrath: Okay, and can I just ask about the audit fees? There was a very substantial hike in the audit fees from 2009 to 2010. In 2009, the audit fees were €283,000 and in 2010, that jumped to €894,000. What's the reason for that?

Mr. Gerry Fitzpatrick: There's a number of reasons. The overall Ulster Bank ... so Ulster Bank Ireland Limited is part of the overall structure of Ulster Bank Group. There wasn't any significant change from those years in terms of the total quantum of fee. What happened in that period was certain subsidiaries were unwound. So First Active - which had been a regulated entity separately to Ulster Bank Ireland Limited - was wound into Ulster Bank Ireland Limited

and there was a rebalancing of the overall fee of Ulster Bank Group. So it was the way the fee was being charged around the group, together with a restructuring that had that impact. It didn't reflect a particular change in the dynamic of our overall audit for Ulster Bank Group.

Deputy Michael McGrath: So was it a reporting issue? Is it that you were earning similar fees in previous years but they were sitting in separate bank statements?

Mr. Gerry Fitzpatrick: The Ulster Bank Group is an agreed fee, under the Royal Bank of Scotland process, that the audit committee of the Royal Bank of Scotland would monitor and then report to the audit ... committee of Ulster Bank. The allocation of fee for each individual entity was part of ... was a part of internal accounting and therefore, the change was as a consequence of some of the changes of activity, rather than any change in the nature of the audit process.

Deputy Michael McGrath: Okay. So for example, in previous years Deloitte would have received similar levels of fee income from Ulster Bank for the audit?

Mr. Gerry Fitzpatrick: Correct.

Deputy Michael McGrath: So, it would've been in the region of €800,000 to €900,000 for say 2008-2009?

Mr. Gerry Fitzpatrick: In that region, for the wider audit of Ulster Bank Group and its subsidiaries, of which there were obviously a number of subsidiaries covering a wide range of activities ... be they property-holding companies, regulated licence entities, nominee companies etc.

Deputy Michael McGrath: Okay, and then in 2011 the figure jumped again from €894,000 to just under €1.1 million. Is that a more natural increase or is that reflected by a change in reporting as well, or is that an actual increase in fees?

Mr. Gerry Fitzpatrick: There was an increase at that point. Because of rotation rules for all the partners, we can only spend a certain number of years on a client so I had finished my involvement, my direct involvement and obviously for client confidentiality reasons, I wouldn't be involved in the detail of Ulster Bank post that event. But I understand, as Ulster Bank was doing restructuring of its loan books and the Royal Bank of Scotland Group was doing a lot of work in relation to its core and non-core activities, there was a significant increase in ... in the ... in the audit work because of the restructuring and that may have caused ... that caused a real increase in cost.

Deputy Michael McGrath: Okay, then there was also very significant non-audit fee income and very often it is said that auditors will get the foot in the door by getting the statutory audit but will earn very significant fees from non-audit work. So for example, there was a figure of €381,000 in 2010, which was the highest of years around that time, but what kind of work did Deloitte do for Ulster Bank apart from the statutory audit?

Mr. Gerry Fitzpatrick: I guess first of all there is a framework for ... two frameworks that are really important in terms of doing non-audit work. One is an ethical requirement that whatever we would do can't fall within what we call a restrictive service - something that would be ... would cause us to be ... to have bias in our audit. The other process was a very detailed Royal Bank of Scotland process where any non-audit fees paid to the auditor had to go through an approval process. The work in the Royal Ulster Bank Group ... non-audit work, tended to fall

on Ulster Bank Ireland and so perhaps the ratio in Ulster Bank Ireland was higher than for the overall group because I think over the ten-year period under review, the non-audit fees would be less than 20% of the audit fees. But the work would have been independent business reviews or receivership work that might have been happening on Ulster Bank clients.

Deputy Michael McGrath: Do you think is it healthy, Mr. Fitzpatrick, for an audit firm to have the audit of the bank for 15 years?

Mr. Gerry Fitzpatrick: There's been quite a lot of debate in relation to the benefits and ... and ... of audit rotation. I think ... there's a lot of learned, in experience, in terms of understanding an organisation. I think the way we as a firm, and our profession, have mitigated that with rotation of audit partners. So in terms of the risk that you might think that might exist - it might be one of bias or whether one had too close a relationship in terms of the judgments made - the rotation of audit partners both right around the Royal Bank of Scotland Group and the Ulster Bank Group caused, to my mind, that to be mitigated. I think an audit process is a very detailed process. I described tens of millions of transactions and very complex processes and therefore transitioning audit can be quite a challenge, so I see no issue - as long as the right safeguards are in process or in place shall we say, and the scrutiny that an audit committee puts an auditor under - to have an audit for a 15-year period.

Deputy Michael McGrath: And what would you say to the argument that, you know, getting the audit is a very lucrative business, huge streams of revenue for your firm and essentially an auditor is not going to rock the boat because an auditor wants to be back the following year doing the same job again and earning massive fee income? What would you say to that argument?

Mr. Gerry Fitzpatrick: I would say, from a personal perspective, there is nothing in the ethic of our firm, or my personal ethic which caused me to produce a report that I didn't agree with. So as a personal perspective, I have an ethical responsibility, a professional responsibility to be clear in my audits. In terms of bias caused by other commercial relationships, that is a risk and I think our profession is very clear in terms of how you ... how that risk should be mitigated in terms of separation of teams, separation of responsibilities, having clear guidance and ultimately ... having the audit community of the organisation approve any non-audit services. We don't certainly set out our pricing on our contractual arrangements in relation to audit in contemplation of any other fee because that would be both unethical and unwise, and obviously a lot of audit committees have parameters where they would restrict the amount of non-audit fees and regulation will change that a little bit further in the future.

Deputy Michael McGrath: Returning briefly -----

Mr. Pat Cullen: Deputy if I could add to that?

Deputy Michael McGrath: Sure Mr. Cullen yes.

Mr. Pat Cullen: In the context of the overall firm of Deloitte, the Ulster Bank total fees never exceeded roughly 1% of our revenue. So putting it in the context of the overall firm, although a sizable fee, it's not as if we were significantly dependent on Ulster Bank as a client which would in any way have impacted on our relationship.

Deputy Michael McGrath: Returning briefly to IAS 39 Mr. Fitzpatrick, it has been very significant in the context of Irish banks. Did the adoption of that standard mean that audited financial statements no longer had to comply with the true and fair view standard? It didn't

remove the true and fair view standard?

Mr. Gerry Fitzpatrick: No, the true and fair view is what's in law. I guess what the true and fair view is, is a concept going back many years when a framework for accounting standards wasn't as clear as now. It has been for many years an international framework. A common, accepted view would be that international financial reporting standards are rebuttable presumption to achieve a true and fair view. And in a situation where you have a specific standard that deals with a specific issue, you ... it would be exceptional for one not to follow that standard.

Deputy Michael McGrath: And did you personally, and Deloitte generally, feel it was an appropriate standard?

Mr. Gerry Fitzpatrick: I think the history has shown that perhaps it didn't cause the ... identification of provision as earlier as the new standard would. I think at the time ... I think ... and as I've referenced earlier, there have been huge concerns in relation to the kind of, the discretionary impact that previous provisioning had which would actually hide ... could cause people to make provisions in a good time and then wouldn't see the performance of the bank. So I thought it was a good standard in relation to the comparability factor. I think the danger would be that anybody would think that a new standard would actually be able to predict the future. So the new standard ... and unfortunately it's not yet actually EU endorsed so we don't actually know for 2018 whether we'll be able to use that standard. It is an expected loss model and therefore books more of the provisions. I guess, as an auditor, the losses have already been incurred before you're measuring it for provisions purposes, so that the lending criteria are long made before you're actually measuring for impairment. Impairment happens down the road. But an expected loss model certainly will allow some greater prediction of impairment, albeit with significant huge judgments. And if you look at the house price index I referenced earlier, even an expected loss model will only use the date and the time, and won't necessarily say, well, that ... what could predictably happen in the future in relation to asset values. It will use current asset values.

Deputy Michael McGrath: Okay. The Central Bank Act 1989, as you know, places an obligation on auditors to report to the Financial Regulator if they have any reason to believe that there are any circumstances which would affect the bank's ability to meet its financial obligations, for example. Did Deloitte make any such report to the Financial Regulator under section 47, pertaining to Ulster Bank?

Mr. Gerry Fitzpatrick: We made reports annually. First of all, I guess, the report we make is a confirmation of whether we may had ... had circumstances during the period. The criteria set out in that Act is something that would jeopardise the continuous functioning of the organisation, as you referenced, either inability to meet depositors' requirements or perhaps other material factors.

Deputy Michael McGrath: Yes.

Mr. Gerry Fitzpatrick: And we didn't identify any items that warranted communication to the regulator in that regard.

Deputy Michael McGrath: So it was a nil return, as such, each year.

Mr. Gerry Fitzpatrick: Correct.

Deputy Michael McGrath: Okay. And apart from that statutory duty to report to the Fi-

nancial Regulator, as auditor of the bank, would you have had other interaction with the Financial Regulator relating to Ulster Bank?

Mr. Gerry Fitzpatrick: Not specific to the audit. I guess, during the audit process, clearly, a detailed understanding of concerns the regulator would have would be part of our audit work, so review of regulatory correspondence and an understanding of how the concerns of the regulator might have an impact on the financial measures, whether provisions might be required as a result of that. So we would have a good understanding of what the regulator was writing to the organisation on. We would have made our returns and obviously given copies of our audit summary documents and, at a more thematic level, from time to time, we, as an organisation, would be talking to the regulator about, perhaps, the guidance notes they would be issuing on a whole range of things, but specifically in my period as auditor to Ulster Bank Ireland Limited, the regulator didn't seek any input from me in relation to particular issues they were dealing with.

Deputy Michael McGrath: Okay. Can I just take you to the booklet of core documents, Vol. 1, page 34. So it's from Ulster Bank Limited board paper, UBIL capital injection requests, August 2007, and on page 34. So we see that Ulster Bank Ireland had-----

Mr. Gerry Fitzpatrick: Not yet. Yes, very good.

Deputy Michael McGrath: It's coming up on the screen there as well. Ulster Bank Ireland had transferred over €4.5 billion of-----

Mr. Gerry Fitzpatrick: Sorry, one second. I'm not seeing it on the screen here.

Deputy Michael McGrath: Okay.

Mr. Gerry Fitzpatrick: I think the screen was off, or maybe I turned it off.

Deputy Michael McGrath: It's page 34 of the booklet.

Mr. Gerry Fitzpatrick: I can see it now.

Deputy Michael McGrath: Yes, can you see it?

Mr. Gerry Fitzpatrick: Yes.

Deputy Michael McGrath: Okay. So we see that Ulster Bank Ireland had transferred €4.5 billion of Republic of Ireland property risk to a different company to stay within property sector limits set by the Financial Regulator. Were you aware of the fact that €4.5 billion had been shifted, in essence, to get around any breach of the regulatory limits, and what was your view of it?

Mr. Gerry Fitzpatrick: I certainly was aware. There's no doubt in terms of, again, the audit process that we start in understanding what the organisation is doing, reading board minutes, reading audit committee minutes, reading ALCO minutes are very important. In this particular paper, I think, is in the context of the way RBS was particularly managing its capital around both RBS and the Ulster Bank Group Limited. In the previous pages, on page 28, for instance, there's a reference to Ulster Bank Group having significant euro surplus capital. So, basically, the way it managed it ... it had a lot of capital. It just was whether it was in the right entity. So this transaction, which you say was designed to mitigate something, to my mind it was appropriate transaction. An organisation that has a number of licensed entities will have capital in one and perhaps risk in another and is obviously ... must retain its capital ratios appropriately,

and, therefore, the transfer of loans and the risk associated with loans, into another regulated entity, as long as that entity has sufficient capital, and in this case, Ulster Bank Limited, which is FSA regulated, which we were also the auditors to, I was fully aware that that transaction was taking place and was properly reflected in the books and records of Ulster Bank Limited. So, yes, we were aware of it.

No, I didn't have concern about it as long as it was properly reflected. I would be concerned if a transaction like this happened and wasn't properly recorded in the financial statements of the two regulated entities. And I think, as explained in this document and in the earlier document, it was about efficient capital management, and that's ... nothing unusual about that. You can either shift the asset book or shift the capital. A lot of international financial service companies based in Dublin would have capital and would have loans transferred to them by other entities around their global organisations and that wouldn't be either unusual or inappropriate.

Deputy Michael McGrath: Okay. As you know, Mr. Fitzpatrick, Ulster Bank Ireland ultimately required a bailout of over £14 billion from RBS, so when you look back now at the period for which you were the auditor in charge of the audit for Deloitte, is there anything further that you could have done to ring any alarm bells, signpost any risks to a greater extent, made the readers of the financial statements more aware of what may happen in the future? Could you have done anything more?

Mr. Gerry Fitzpatrick: I think the financial statements that I was auditing were properly reflecting the transactions and the level of risks, the kind of disclosures I referenced earlier in relation loan quality, and funding actually quite highlighted that. The one issue that was difficult was to predict the extent that judgments would change. And an audit process, as I said earlier, challenges the data, looks for contradictory evidence, but the significant deterioration of asset values ... and that took a number of years to happen, wasn't contemplated at that stage and I don't think it was reasonable to assume could have been imagined. A whole roll call of commentators were talking about what might happen and, certainly, we were living in a stressed situation. I think the level of risk the organisation was undertaking was properly reflected on its disclosures. So in terms of other matters, I don't think there was anything different that I would have done in relation to the information at that point in time.

Deputy Michael McGrath: Thank you. Thank you, Chair.

Chairman: Thank you very much. Senator O'Keefe.

Senator Susan O'Keefe: Thank you, Chair. If I could just follow up on that thought, Mr. Fitzpatrick. I mean, you can imagine that it's quite difficult for members of the public at large who, perhaps, have never had an auditor, don't know an auditor, and don't know what an audit actually might mean, but in their heads, believe that it's something that protects, and is something that ... if something's been audited, it's okay in their heads, and yet we see in this case the Ulster Bank losing ... having to have that much money put into it. It's quite a leap for people to understand. Indeed, I'd include myself in that. How can it be that a bank was in such a bad state and yet the auditors were, if you like, going through and saying, "We've done our job as competently and as well as we can"? I'm just asking for maybe-----

Mr. Gerry Fitzpatrick: Yes, it's a fair question.

Senator Susan O'Keefe: Yes.

Mr. Gerry Fitzpatrick: As I say, in terms of the audit process and making sure that it's

properly understood is a challenge auditors have had from time immemorial in terms of expectations. When you say the organisation was in a mess, it subsequently had challenges because of asset values. At the points of measurement, an audit can only establish that the records and transactions that have happened are properly reflected, that they're measured in accordance with accounting policies, and there are very, very substantial judgments that underpin the calculations, and I think the financial statements are quite lengthy, I understand, 80 pages. In fact, there's many ... many ... more detailed notes in new standards that have caused ... will be even more lengthy. But the financial statements present a picture of the point in time. They analyse the extent of risks. They show the level of judgments.

But this is not an insurance policy or a prediction of the future. It's saying, at this point in time, have things been measured correctly looking at the historic situation. And it's not saying, as in an accounting standard, for instance, on impairment, that you would book future losses. In fact, that standard said that you didn't recognise those losses no matter how likely they were to be. It was trying to measure and adopt a neutrality of measures so that you can compare organisation to organisation. The stresses that the organisation had were about lending concentration and about funding gap and the disclosures of the ... in the financial statements were quite comprehensive and the reader could see what this level of concentration was and the level of funding gap that was supporting it. Whether those assets were going to be recoverable if the situation worsened was not something that the financial statement nor the auditor was trying to purport to display. So, I do understand that it is a challenge but they are complex statements, financial statements. And they're not simply a case of one measure, there's quite a lot of measures that are disclosed and the reader has to understand. So it's not a prediction of the future. I think people use it as an important element of the measure into the stewardship of the ... of the organisation and directors present information and, clearly, if they haven't presented it properly in accordance with their knowledge, or with the auditors challenge in relation to other information, then that will be a concern. But I think when you look at a set of financial statements you will understand that they are a historic set of information at a point of time, using a series of judgments. If the information was ... or if that data and those judgments were based on unreasonable data, then certainly the auditor would have an issue. But we had a situation which was very dramatic over periods of years ... after audited accounts and they couldn't have been contemplated in terms of the deterioration in asset values. So the fact that there was going to be further default and a recovery of assets and the extent of that, at that point in time, for instance at the end of 2007, couldn't have been contemplated in my mind and the events were so dramatic and the assets shifts ... the level of----

Senator Susan O'Keefe: It couldn't ... they couldn't have been contemplated?

Mr. Gerry Fitzpatrick: I certainly ... was challenging the organisation to understand what data they had. I think a whole roll call of organisations, from the IMF through to the EU through to economists and various others that the committee has been talking to, have seen that was a very difficult thing to do. Certainly there was stresses in the system and, I think, organisations were showing that, so deterioration in loan quality in the Ulster Bank 2008 accounts showed that there were some stresses in the situation. But predicting that those stresses could be ... could anticipate asset value falls that we saw subsequently, so by 2011 or 2012, where an index, which was at 92 in 2008 fell to 67, I don't believe was contemplated. And, in any event, that would have been a future loss and the reader understood that because that was quite clearly explained in the accounting policy ... that it was a future loss model ... or an incurred loss model, should I say.

Senator Susan O’Keeffe: Mr. Cullen, could I ask for your view on that also, please, on that whole idea that it’s very difficult for people to understand how a bank ends up in that state and yet its audited accounts are by the book and they’re okay?

Mr. Pat Cullen: Well, I’d be giving you an opinion as a non-auditor and a non-banking expert but, as Mr. Fitzpatrick has said, there has been that challenge for decades in terms of the role of the auditor in relation to the accounts. And it is very much a point-in-time picture of the organisation. And as long as the accounts are prepared in accordance with the accounting standards which apply at the time-----

Senator Susan O’Keeffe: That’s okay?

Mr. Pat Cullen: It’s not a fact that it’s okay, but those are the rules. And the auditor’s duty is set out in the Companies Act in terms of what the auditor must do in accordance with the rules. And the big issue at the time obviously was how you recognise the level of impairment which subsequently happened when most of the opinion at the time, which would’ve been considered to be more expert in valuation probably than what we would be in relation to property, was saying that, “There isn’t going to be a drop in value to that extent.”

Senator Susan O’Keeffe: Mr. Fitzpatrick, do you believe your audit team ... the audit team that was in place at that time had sufficient expertise and experience in banking and property, particularly? Did you, for example, have to bring in auditors from anywhere else or did you have sufficient ... because obviously you can have auditors that then become specialists in particular sectors, so given what was going on and the concentration of property activity in Ireland was higher, I think, than in many other places, do you believe that you had the expertise and experience?

Mr. Gerry Fitzpatrick: Yes and that was, I guess, based on a whole range of factors. Certainly within our own team, auditing skills and knowledge ... and in terms of experience in the audit ... I mean, there was a question earlier in relation to is it appropriate to have 15 years involvement in audit ... yes, you need that actually to have people who have that skill and a knowledge of that industry. So there was a whole range of people in that team who have had years experience within Ulster Bank and understand banking.

Secondly, in terms of market trends, it is hugely important, obviously as a firm, that we’re aware of things that are happening both from an accounting standards perspective or an expertise perspective. So the link to our Royal Bank of Scotland audit team is critical. That team ... I was very much a part of that team, they attended all the committees here with me, so I was certainly linked into international thinking in relation to financial markets and that is obviously another way ... very important way of gathering information. We would have learning programmes and then we have other specialists around our firm who we use from time to time to help support areas where I might personally have knowledge. And that would range everything from ... there is very complex IT systems in banks and we would have computer audit experts, we have taxation matters, we bring in experts from that perspective and we would have corporate finance people ... experts who are dealing from time to time with transactions in property or otherwise who can add to that expertise from time to time.

And, lastly, I suppose, when I talk about contradictory evidence, we’re certainly on the ... our challenge and our scepticism has to be to look to see what information we can see that might prove the directors’ assumptions incorrect and, therefore, briefings from valuers was a regular feature to our firm to make sure we understood trends in valuations, both in terms of IPD

indexes, valuers themselves, in terms of how they are going about valuations. And certainly around the 2008 period the challenges in actually getting valuations. So I think those factors in terms of our knowledge over a period of time of the organisational running of a ... of the bank, the link to RBS and its expertise that we could get from that source and bringing specialists from other disciplines within our organisation to bear in terms of my judgments ... I think that was an appropriate way to have ... to have that knowledge. Auditors aren't experts on every industry they audit in, so you can audit a nuclear power plant and you can audit a bank. So you are not saying you're necessarily an expert in nuclear power or in lending. What you have to understand is the risks associated with those things, so I have never been a lender and I am not ... I've not lent money. But I understand the risks associated with how you measure lending and measure lending impairment and how those things get disclosed under accounting rules, which is the critical factor that I am trying to achieve in terms of giving my audit opinion, which I think, as I said earlier, was reasonably given.

Senator Susan O'Keeffe: Did your team ... and I assume there would have been a team of people assembled over a period of time that would have been some core people and some would have come and gone ...did you use, sort of, junior trainee auditors-accountants as part of your team?

Mr. Gerry Fitzpatrick: There are a whole range of levels of expertise in audit teams. So some people will be ... they would all be graduates, they all would've been either qualified accountants or studying for the chartered accounting exams. I guess the processes in an audit are multitudinous so in some cases you're looking at basic process and documentation flow and, therefore, people who ... where we've had set structures of how you map transactions, that can be done by very bright graduates. When it comes to areas of judgment in relation to loan impairment, in relation to pensions calculations, in relations to taxation, then you need much more experienced people. And, clearly, in relation to something like loan impairment, I would've been very much active in that process. At the time there was ... there were three audit partners involved in the audit, including myself, plus an IT audit partner. So I think, yes, the answer is there were people at all levels, but for the more significant areas of judgment and that required a challenge to management particularly reporting to the board, that would have been my role and I would've put a significant amount of time into that.

Senator Susan O'Keeffe: But I am correct in understanding what you've said, both to me and to my colleague, that you are broadly happy and satisfied that Deloitte did a good job as auditor to Ulster Bank in Ireland at this time?

Mr. Gerry Fitzpatrick: Absolutely. I think I had a duty of care of a professional standard. I believe it was a difficult environment to work in because judgments were quite difficult. I can see that the ... in hindsight the shortcomings in a historical measurement of financial information could be misinterpreted. But in no way did I feel that I was either unable to give a report, because in that case I would have to qualify. But I looked for the appropriate data at the time and I thought the board ... because ultimately it was their accounts, were searching and looking to make sure that they had measurement, and that included trying to understand what the state of impairment was in their loan book, and having reasonable processes, not always perfect processes, to do that. And then, secondly, having identified those cases that were impaired, the question was what collateral value would you recover. And that was a challenge but seeking out information, as I say, from a bottom-up, looking at individual cases, and then a top-down, at portfolio level saying "What is the level of risk?", they measured that in appropriate ... in accordance with the appropriate standard. It didn't ultimately transpire to be that way because

the assumptions proved to be flawed, because ultimately the market and future events caused collateral values to fall further and further and further. But ultimately that, as I say, it is not a future-loss model.

Chairman: 12 minutes coming up there.

Senator Susan O’Keeffe: Looking back, as you must have done, do you have any thought at all that Ulster Bank may have, at any time, withheld information from you and your team from your firm, in any way, shape or form?

Mr. Gerry Fitzpatrick: That’s a factor. One always has to have critical ... in one’s mind. In fact, a key element of an audit process is considering fraud risk. That could be either fraud risk internally or fraud risk by inappropriate information. The provision of information to auditors is a requirement under law and we know that certain processes that that requires, including makings of representations. So, do I believe that I was misled? I don’t. I have no cause to believe that.

Senator Susan O’Keeffe: Okay. Deputy McGrath raised just the issue of what you might have done for your non-audit fee, and I’m wondering whether or not you ... you gave some responses and I’m wondering whether or not you were ever involved in setting up any kind of offshore vehicles for Ulster Bank, or any sort of favourable taxation vehicles for the bank?

Mr. Gerry Fitzpatrick: We were not tax advisors to Ulster Bank and not involved in any structuring of transactions offshore or otherwise with Ulster Bank so “No” is the answer to that.

Senator Susan O’Keeffe: We are aware from our engagement with Ulster Bank that obviously the Financial Regulator brought concerns, its concerns to Ulster Bank on a number of occasions and I’ll refer to them if need be but just in short would that have been something you would have been aware of or would that have been relevant to you or would you not have come across that level of engagement?

Mr. Gerry Fitzpatrick: It certainly would be an obligation on me to be aware of those situations so I think as was recalled I think in the book as well were issues like the Dublin mortgage centre or exception reporting. So in something like a process system like a centre which is going through an integration as having challenges in terms of operational efficiency, it would be absolutely critical that I would understand that. That would arise initially from my understanding of how that was being reported at the board level, but also from on the ground visits that we might have to understand elements of the controlled environment. We met with internal audit and obviously attended audit committees and understood the reports they were presenting so in that case of, of something like a mortgage centre we were fully aware of the risks that we were ... that were arisen in that situation.

Senator Susan O’Keeffe: Because we had quite a lot of engagement with the bank in relation to that and some of the observations that the witnesses said, was that they were concerned at the time that the Financial Regulator they had wished that there might have been more on the ground conversation rather than the Financial Regulator going away and writing back to them. But Mr. McCarthy said on ... it’s on page 77 of his own evidence he said, “...we self-raised them, the regulator was aware of them, we took significant steps with Royal Bank of Scotland to fix them, and by the end of 2007 they were fixed.”

There has been a long, long series of correspondence 2003, 2004, 2006 and again in 2008 in relation to commercial property. So I’m just wondering how much of an issue it was ... what

was the auditor to do? Were you to encourage Ulster Bank to fix those problems, to make sure that they were fixed to see evidence? I'm just not clear of what you ... if you like in plain English what would you have been doing?

Mr. Gerry Fitzpatrick: You have instanced a whole number of issues-----

Senator Susan O'Keeffe: I have I'm sorry----

Mr. Gerry Fitzpatrick: No that's fine but they weren't all interconnected so if you take a single issue, and clearly the concern would be if they were interconnected you would say, "Is there a flaw in the overall attitude to control in this organisation?" If we take the most recent one which was the 2006 Dublin mortgage centre issue which then had an internal audit report at that time and then proceeded into another internal audit report, my concern was always to say well actually how has this issue affecting the measurement of loans given within the organisation, so my understanding would be to understand how they were responding to the regulator's concerns. So the regulator in that case had a letter some time in 2007 which was referred to in Mr. McCarthy's evidence. And clearly I would want to understand how they were responding to that issue because obviously I would be concerned in relation to some of those elements also.

In relation to the method of engagement with the regulator, I wouldn't have been there when those queries were being shared with the regulator. I certainly saw subsequently that, you know, the provisioning information perhaps hadn't been strong because actually a lot of the queries appear to be ... as a recall, being responded to by information being provided. Now whether that was because of the mechanics of the process or Ulster Bank's process of providing that information, it didn't seem to be a very well organised on both sides inspection.

But my concern was to see were those issues being closed down. So yes if loans had been processed with a control weakness was that an isolated incident or was that wholesale and could that have an impact on the actual properly, proper recording of loans? And then lastly if loans were given and the process in the mortgage centre wasn't identifying impairment because people were maybe not paying on loans and maybe the system didn't allow Ulster Bank to understand that, that would be a concern I would have. So it wasn't because I could see they were rectifying those issues so they had arrears because maybe things hadn't been processed well but they were closing them down and I don't believe from my understanding and my recollection of the 2007 audit there was material loss associated with the Dublin mortgage centre. There had been a lot of operational mismanagement that they were correcting but it didn't have financial loss and therefore didn't require loans to be written off because they had been given in an inappropriate way.

Senator Susan O'Keeffe: In the bank's growth strategy ... the growth strategy appears to have been predicated on gaining significant market share from their competitors and they did discuss that with us. Did Deloitte, did you ever analyse the risk level associated with the percentage share of the property related lending market and the retail market targeted by Ulster Bank? And again if you can be a bit concise with your response. Did you ever analyse that risk level, was that part of your job or not?

Mr. Gerry Fitzpatrick: Our audit summary would have shown an analysis of the risk across different categories, then the report we would have given to the audit committee would have show that.

Senator Susan O'Keeffe: Okay, and would it have shown any concern? Because that was

the thing they were pursuing and they have been open about that. Would you have any-----

Mr. Gerry Fitzpatrick: The concern to my mind was (a) was it properly reflected in the financial statements by concentration risk, and (b) had it the funding model to allow to follow that business strategy.

Senator Susan O’Keeffe: And you believed it did?

Mr. Gerry Fitzpatrick: Well it ... I understood ... it clearly did have that funding model because it had both wholesale funding and the backstop funding of its parent company.

Senator Susan O’Keeffe: And was sufficient priority given in the external audit to the consideration of the risks associated with both borrower concentration levels and sectoral concentration levels?

Mr. Gerry Fitzpatrick: It was a major focus of our work.

Senator Susan O’Keeffe: Right. I’m just wondering for either of you but perhaps particularly for Mr. Cullen, did you ever have any engagement with the Department of Finance with the Minister for Finance, with the Taoiseach, with the Central Bank? You mention in your own statement you would have had some engagement with the Central Bank, but would you ever have sought out to speak with them about concerns about your thoughts or indeed did they seek you out as being people in the financial sphere who might have had a view? Especially as things began to tighten and change.

Mr. Pat Cullen: At an organisation-specific level we would have a client confidentiality issue certainly sharing information.

Senator Susan O’Keeffe: Of course. Yes I don’t mean specifically about Ulster Bank.

Mr. Pat Cullen: I think it’s also important to mention the Central Bank Act gives us a duty to report on certain things but doesn’t give us a right to report on certain things. So the Central Bank Act is a duty rather than a right, so we wouldn’t have shared particular concerns. If I had a concern in relation to the standing of the organisation I would have had an automatic duty to go to the regulator and I didn’t have that concern so I wouldn’t have talked about Ulster Bank to those parties in other matter. As I said from time to time we might have thematic discussions about how they were setting the regulatory environment or their standards or guidance and we might give input to that, but it would not be on a specific Ulster Bank theme.

Senator Susan O’Keeffe: You’re mixing me up, I’m asking about whether or not broadly speaking in the context of the financial world in which you both inhabited at that time, would you have ever had calls to discuss as things were changing, were you concerned, did you have any thoughts? Or were your heads down being auditors if you’ll excuse my-----

Mr. Gerry Fitzpatrick: We were focused on the audit of our clients and I certainly wasn’t bringing any of those, any concerns in relation to making sure their accounts were accurate to the Department of Finance if that’s your question, no I didn’t.

Mr. Pat Cullen: And certainly nobody ever approached me in my role as managing partner with any questions or concerns.

Senator Susan O’Keeffe: Okay thank you. Did your audit have any dealings with the global restructuring group within Ulster Bank, obviously Ulster Bank Ireland now as opposed

to Ulster Bank, as opposed to the RBS?

Mr. Gerry Fitzpatrick: As I said my audit was up to 2008 my understanding was that acronym GRG was a construct from that point on. There was a special lending services unit if I recall before that. So I think it might have been a precursor of that so they were the organisation or at least part of the organisation that looked at particularly stressed cases but no ... but the construct of the global restructuring group is not something that was I recall in place in 2008.

Senator Susan O’Keeffe: How much of the auditors’ work is generated by the bank’s own internal auditors? Again I’m thinking here of the public not quite understanding ... in a simple way of describing that. Clearly internal audit is an ongoing process so do you guys come in and take that and work from there or do you have to go back and review all that or how-----

Mr. Gerry Fitzpatrick: We are informed by their work. In the case of Ulster Bank we didn’t rely on their work so auditing standards in some cases allows you to rely on their work, but only if you’ve planned it and know exactly in advance what they’re doing and have helped direct that. So they had a particular programme of work they worked with an audit committee on so we weren’t going to interrupt their work, so therefore we didn’t rely on it we had to do ... we used all of our own work. However their work would have informed our understanding of risks and was very, very helpful so a very active dialogue with the head of internal audit, understanding how they were rating the systems, understanding their view of controlled culture, understanding where significant stresses in the system were was really important to help us understand how we would go about our audit. But no we didn’t use their work as a reduction of our own work.

Senator Susan O’Keeffe: Professor Ed Kane when he was here giving testimony he said on page 233, “One may know that the firm is in grave trouble but the auditors may not have sufficient information to allow them to determine that.” Is that-----

Mr. Gerry Fitzpatrick: I’m not sure quite what he was ... I suppose I can see two scenarios in that situation. One is if the funding or if the availability of funding isn’t strong, one might in an organisation - I’m not saying Ulster Bank - the question will be how you can be reasonably assured that it will have sufficient funding. That wasn’t the case in this case because it was part of an integrated group with scaled sophistication and collective balance sheet management. That wouldn’t have been something unknown to us. The other factor, the unknown, is what we talked about earlier in relation to the judgment factors, assumptions of property valuations, but if the concern he had was that the auditor wouldn’t be given that information, I wasn’t ... I didn’t feel that I was ... that information was withheld from me and certainly not to my knowledge.

Senator Susan O’Keeffe: Finally, in 2011, the corporate watchdog, Paul Appleby, said there were grounds for questioning and I’m quoting what he said, “the consistency and quality of audit work within the profession.” He went on to say he thought, “Auditors report surprisingly few types of company law offences to us”, and went on to say that the so-called Big Four, of course of which you are a member, “the so-called big four auditing firms reporting the least often to his office at just 5% of all reports.” You might care to comment on those observations.

Mr. Gerry Fitzpatrick: It’s difficult to comment in terms of where he based his information from. He was questioning the quality of work. He isn’t the regulator for auditors, so I don’t know what basis he had to challenge the work. As I had interpreted it and I vaguely recall that statement, which was he was saying the number of reportable incidents to him were less. I don’t believe that is again in my ethic not to report those things. It may be that larger firms

have clients which have more structured corporate governance, and that might typically be the case. We have lots of small clients as well as big clients, but perhaps that concentration in the bigger organisations would have meant that the things that are reported to him, which are specific breaches of company law, loans to directors in relation to their own situations, might be more applicable to the smaller audit firms. I don't know but I certainly don't feel that in our engagement with ODCE and understanding the rules of ODCE, that we engage in any way differently in relation to our client group. And his view that that was caused by some quality issue in our firm, I find difficult to understand how he could make a statement that not being the regulator of audit. We are regulated in, as Pat has described, in relation to practice reviews and by the Chartered Accountants Regulatory Board, which is overseen by ASA, which is another independent body. And those had not found failings in our work that suggest the consistency and quality of our firm's work could be criticised in that regard, so I would find it difficult to accept that ... at that statement.

Mr. Pat Cullen: Just to add to that, we do have a legal obligation to report and we would be very much cognisant of our legal obligations, and if we came across those situations, we have no choice other than to report.

Chairman: I will just bring in Senator D'Arcy before we go to the break. I just want to tidy up one matter in IAS 39. In earlier testimony that we had, in the Context Phase of this and in other documentation, one of the critiques or challenges that arises from that was the supposed backward looking nature of IAS 39 in that it required evidence of a loss before the loss is actually written down, that the process meant that the auditor is very much looking at the nature of the bank in this current situation and, I suppose to use an analogy, that the auditing process is looking in the rear view mirror of the car instead of the road ahead. Would you agree with that sentiment?

Mr. Gerry Fitzpatrick: Gosh, there is quite a lot of sentiment in that. First of all, the accounting standards and the preparation of the numbers are by the directors, so the accounting standards may ... are backward looking, it is a measurement of a point in time. IAS 39 meant that there was a particular constraint in looking at what was incurred at the time so it does represent, perhaps, a ... some limitation of what ... predicting expected loss might be. So I guess the new standard will allow some greater forward looking, but it still has to be an expected loss, not an unexpected loss. There is no standard that allows you predict the unexpected, and I think any view that there's a kind of forward future proofing or early warning system for things that might happen in the future, that won't be the case under even the expected loss standard, because you still have to have data and say, "What will this impairment likely turn out to be?" And you have to have an assumption, which is what the collateral value might be when you realise it in an impaired loan and, therefore, you have to have a view on the current state of the market, not the future state of the market.

Chairman: And in this morning's testimony and other testimonies we heard, that sort of transitional period between 2006 and 2008 where, in 2006, a lot of the people that have come before this inquiry have said that there was still an upbeat kind of forward looking, you know, positive view of things, that if things were to slow down, they wouldn't crash, that there'd be a soft landing and all the rest of it. How would that impact upon IAS 39 in the basis that, by 2008, we could see, whatever was in the rear view mirror, the road ahead was completely different. Was there any recognition that there was going to be that level of acceleration, so it just wasn't going to be a percentage increase on what came the year before - what was going to happen in the coming period was a major acceleration of loss?

Mr. Gerry Fitzpatrick: Well, there was going to be a major deceleration in business activity, first of all, I suppose and that was well known. I guess the question was what degree of loss is going to arise. We didn't know at the time but the CSO index, as I referenced earlier, at the end of 2008 was 113 so the suggestion that the losses emerged very very quickly in property value, I don't think is that clear. The index was set in 2005; it was 130 by the end of 2007; it was 113 by 2008; it was still only 92 by the end of 2009 so the prediction of future loss was ... that data wasn't there. We know that from the valuation data that we had.

Chairman: Thank you very much. Listen, I am going to propose that we actually take a break now. We will return at 4.45 p.m. or so, no later than 4.50 p.m. so we'll be finished by 6 o'clock. Just a note for Members as well, we just have one item to deal with in private session before we conclude today. So if I can just propose that we take a break. The witnesses are reminded once again before giving evidence, they should not confer with any other person other than their legal team in relation to evidence of matters that are being discussed before the committee. With that in mind, I now suspend the meeting until 4.45 p.m. and remind the witnesses that they are still under oath until we resume. Okay. Is that agreed? Thank you.

Sitting suspended at 4.25 p.m. and resumed at 4.45 p.m.

Chairman: Mr. Cullen, Mr. Fitzpatrick, are you okay? All right, thank you. Okay so, I'm going to ... I now propose that we go back into public session, is that agreed? And our next member to question is Senator Michael D'Arcy. Senator, you've ten minutes.

Senator Michael D'Arcy: You're welcome, gentlemen. Mr. Cullen, you're the senior person in Deloitte. You didn't have audit responsibilities, is that correct?

Mr. Pat Cullen: That's correct, yes.

Senator Michael D'Arcy: Did you listen to what contrarian views were saying from that period, early noughties onwards? Did you think there was any store in anything that they were saying or did you just dismiss their views entirely?

Mr. Pat Cullen: Well, I suppose, as managing partner, I'm certainly very aware of what was happening in the economy. I was very clued in to all the international developments and, clearly, there was a bit of a storm which was coming. But I suppose, from my point of view, what I needed to be satisfied on was that, particularly in the context of Ulster Bank, that we had the right team in place, with the right expertise to deal with the issues which were occurring. I needed to make sure that the team were tied in with our international colleagues who were also involved in the banking sector so we were fully up-to-date with the impact it was going to have on the audits and-----

Senator Michael D'Arcy: And did your international colleagues question anything that was coming in relation to the banking sector in Ireland? Ulster Bank were involved in some of the largest commercial real estate deals in the State. The scale of those deals, the size of them, did anybody say that these were in any way ... that the appropriateness of the risk was appropriate?

Mr. Pat Cullen: Well, certainly nobody had a discussion with me around that. Like, I wasn't involved in any of the detail around Ulster Bank. I didn't have any banking expertise, so it would have been surprising if anybody from the international organisation had spoken to me around that. I suppose the size of the risk is always evaluated in the context of the ability of the group to fund the risks associated with that and clearly there was a funding model in place

in the group so it had to be looked at in that context.

Senator Michael D’Arcy: Were you surprised at the scale of the recapitalisation costs that were required from the RBS Group, with Ulster Bank at around 3% and less of the entire group taking one third of the moneys that came from the British taxpayer for Ulster Bank?

Mr. Pat Cullen: Well, clearly, I think, nobody predicted the size of the losses in general, across the whole banking sector. Ulster Bank clearly ... the issues that RBS had in Ireland were mainly around the property side. The issues they had in other areas were to do with other financial instruments and different issues, but certainly, obviously the size of the losses they had in their Irish book related to property were very significant. And clearly the outcome of that still has to be finally determined.

Senator Michael D’Arcy: Were you surprised at the size of them?

Mr. Pat Cullen: I would have been surprised, yes.

Senator Michael D’Arcy: Mr. Fitzpatrick, you said that it was unforeseen what came down the tracks internationally. In Simon Carswell’s book *Anglo Republic*, I can’t remember the exact page but I think it was page 57, he said that Mike Soden said that if liquidity ... if a liquidity crisis occurred, that Anglo were sunk. He was concerned about a liquidity crisis and he left Bank of Ireland in summer 2004. Can I ask ... you said that it was unforeseen, it wasn’t unforeseen by everybody. Did you, as a person who was participating in the Ulster Bank audits on behalf of Deloitte, did you listen to what some of the contrarians were saying-----

Mr. Gerry Fitzpatrick: Absolutely.

Senator Michael D’Arcy: -----in the Irish sector?

Mr. Gerry Fitzpatrick: I mean, I think what ... clearly an audit process involves understanding the environment that is ... the bank is operating ... or any company is operating in. You’ve referenced a liquidity crisis as part of that and Mr. Soden, and I’m not familiar with Bank of Ireland, or its operations, so it’s ... funding banks is clearly a major issue. As I highlighted in relation to the example of 2008, the balance sheet is very much driven by a short-term funding model for long-term assets-----

Senator Michael D’Arcy: Yes.

Mr. Gerry Fitzpatrick: -----and any drying up of liquidity is an issue, so I was absolutely aware of that and absolutely focused on understanding what implications it could have. You could see, in 2007 - and perhaps earlier - that the model for funding which included securitisations, which is a normal model for banks such as Ulster Bank, the appetite the market had for taking up securitisation notes was reducing and therefore that had an implication. So, capital planning was hugely important and so clearly that was something that was unpredictable but obviously the processes, in a sophisticated group like RBS, allowed them understand what that was. The unmanageable piece, in my mind, was more in relation to asset values that were underpinning the potential future loan losses and that was much more unpredictable. I mean, I think when we saw events happen through 2007 and into 2008, when we had all the various things that happened in the global credit crisis-----

Senator Michael D’Arcy: Yes.

Mr. Gerry Fitzpatrick: -----those things were flagging up to all institutions, and people

were trying to respond as to how their organisations would sustain, so I was certainly aware of those issues.

Senator Michael D’Arcy: In terms of the firm’s annual audit plan and the risk assessment underpinning it, did the risk assessment approach adopt a change to meet the prevailing challenging environment?

Mr. Gerry Fitzpatrick: Yes, I mean, I think the loan impairing ... the areas of focus and the depth and balance of work and where it gets deployed certainly changed. In relation to a major financial institution, loan provisioning will always be an aspect, regardless of the ... kind of ... how the environment is. But as the environment got more and more difficult, clearly greater levels of focus was required in that space, both in terms of the process for identifying difficult loans, understanding how they were managing them, understanding the kind of risk analytics that were required in relation to understanding concentrations. Certainly the ... we, we ... it didn’t change the risk, but it certainly changed the focus.

Senator Michael D’Arcy: And in 2004 Mr. McCarthy and Mr. Torpey came from First Active?

Mr. Gerry Fitzpatrick: Yes.

Senator Michael D’Arcy: And subsequent to that First Active had ... prior to that First Active had 100% mortgages, and Ulster Bank subsequently brought forward the product of 100% mortgages. Were Deloitte concerned about the provision of a 100% mortgage to the market for the first occasion?

Mr. Gerry Fitzpatrick: The concern I had was to make sure that that risk was properly disclosed in the financial statements, the level of lending. In terms of concern that I would have it as a product, it wasn’t something that I was examining in terms of a sense of its significance as a product. I recall, and certainly I think reference was given to its level of significance to the balance sheet, I think it was 4% of all mortgages. This was a €61 billion balance sheet, so the 100% was a significant ... was a factor, and needing to understand how it was provisioned and what control processes were gone through, and certainly, I think as referred to, as Senator O’Keeffe’s, the way we were talking about Dublin Mortgage Centre, how those systems were ... had some flaws in them, that was a concern I had. But as a product, the question was, as an auditor, is to make sure that loans, as they are provisioned and underwritten, they’re properly reflected in the financial statements and properly categorised.

Senator Michael D’Arcy: Did the firm conduct their own independent assessment of the bank’s credit risk methodology to satisfy the principles process adopted by the bank?

Mr. Gerry Fitzpatrick: The process of? Yes, is the answer. The process of understanding the credit cycle, it’s hugely important to our understanding of the organisation. They had a quite a sophisticated credit control risk framework around the organisation, including a risk policy, so that cascade from the group audit ... or the group credit committee in Royal Bank of Scotland down through various tiers, was an important part of understanding how that operated. So the infrastructure for risk and control was important. Ultimately, I suppose, any system is only as good as the people who are ... and the assumptions they have underlying it, so we understand the ... now that certain events happened that caused some of the credit risk decisions to be ... to be flawed, and assumptions they made to be seriously flawed but at the time, yes, we were looking at the credit provisioning ... or credit underwriting process, and understanding how that

was reflecting itself in properly disclosed financial information.

Senator Michael D’Arcy: On the booklet, Deloitte Vol. 1, page 55 ... excuse me.

Chairman: Final question now.

Senator Michael D’Arcy: It’s a memo from Ruth Carroll from Deloitte to Martin Reilly from Ulster Bank. On the last paragraph-----

Mr. Gerry Fitzpatrick: Sorry, Senator, it’s from Martin ... it’s from ... to ... from Ruth Carroll of Deloitte to Martin Reilly of Deloitte. Just to be clear.

Senator Michael D’Arcy: Oh sorry, yes, sorry, okay. In terms of the last paragraph, I’m not going to read it out, because I don’t have time, there’s a-----

Chairman: I’ll afford you a bit of time to read it out, but I need you to get on to the question then afterwards, okay?

Senator Michael D’Arcy: Okay. I’ll read it out:

Furthermore, the mortgage system does not automatically flag cases of underwriting outside discretionary levels or credit policies. Identification of such exceptions is a manual process, done by looking at two of the loans approved per member of the Underwriting Team a week. If a loan is underwritten outside of discretion[ary] levels, and the underwriter omitted to catalogue this loan in the Exceptions Report, the only way it could be detected would be if the loan in question was selected as one of the files reviewed each week.

Can you outline your concerns in relation to that type of practice that effectively left loans that are outside the discretion off the books?

Mr. Gerry Fitzpatrick: Off the books? I’m not sure what you mean by “off the books”?

Senator Michael D’Arcy: Well-----

Mr. Gerry Fitzpatrick: Certainly they were on the books. I guess the question was whether the control process was properly captured.

Senator Michael D’Arcy: Was able to find them, yes.

Mr. Gerry Fitzpatrick: I take that point. So certainly my concern ... obviously is to make sure things were on the books and therefore properly recorded. I think ... I mean this is an example of one of the elements ... one of the small elements ... the hundreds of steps that were involved in the review of mortgage processes. So this is just one of many ... I mean ... I don’t ... I think it highlights how we were looking at the depth of understanding. What isn’t clear here in relation to that piece is, was, there were other entry level controls we call it, which were higher level reviews, so this was a particular step-through working on this particular element. But there were other controls that aren’t referred to in that memo. So I was concerned and obviously when we identify an issue like that our concern is to talk to those who had raised them previously in terms of self-identifying -----

Senator Michael D’Arcy: Can I just make the point that the date of that is 12 December 2007. The show is over at this stage -----

Chairman: Deputy. Can we not make statements? Ask questions.

Senator Michael D’Arcy: We had gone over the peak of the boom. We had gone over the peak of the boom at that stage. Certainly that type of an exception should have been, one would imagine, should have been reported earlier.

Mr. Gerry Fitzpatrick: By ... it was, I believe.

Senator Michael D’Arcy: Earlier.

Mr. Gerry Fitzpatrick: By ... group internal audit. This is a reflection of what was happened. Group internal audit had done reviews on this. We had talked to group internal audit about that. I’m not entirely sure this was, how this was identified but it was partly self-identified. So this was an issue that we were aware of. The question was how the bank was mitigating a risk like that and therefore, I think that when you say, I don’t know what your phrase was, ‘the boom was over’, this is a process issue. This is, the loans are given after we come to review them and to test them.

So the question is, can you properly capture the risk associated with the lending and properly reflect it in the financial statements? So whether the boom or whatever it was was over or not, this was an issue that I needed to address and there are many other pages in our audit report where the multiple steps in provisioning and underwriting loans would have been looked at. This would have been something that we would have been trying to see and as I say, this is one paper out of hundreds and therefore I think this shows us the kind of understanding of the systems that we were doing and we would have looked for a mitigating control to say, could this cause a material error in the financial statements to be misreported?

Senator Michael D’Arcy: And how long before that ... I just want to finish my point, Chairman because -----

Chairman: I know, but you are out of time so make it very quick.

Senator Michael D’Arcy: How long before ... how long was this practice going on before it was finished? In terms of that last paragraph?

Mr. Gerry Fitzpatrick: The ... I, I can’t recall, Deputy, or, Senator. The issues in the Dublin mortgage centre were referred to in other minutes, were identified late 2006. A series of internal audit reports were addressed and, and any issues were closed down by the end of 2007 when the financial statements ... after which we had assigned our financial statements. So my understanding is the processes and weaknesses in mortgage centre were cleared and there was a substantial ... I can’t remember the phrase internal audit used, for instance ... but that they were substantially addressed by the end of ... by an audit report in December, later in December or early January 2008.

Chairman: Deputy Joe Higgins.

Deputy Joe Higgins: Mr. Fitzpatrick, Mr. Cullen in his opening statement to the inquiry, as I see it, sums up the role of the audit to check about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions and in that sense, that it’s tight and limited according to regulations and law. Would that be a fair representation of what an audit is about?

Mr. Gerry Fitzpatrick: It’s, yes, I think it is, it has a definition under law as to what it is. There’s obviously ... and it is this process of seeing is the stewardship in the previous period

properly reflected so the user or the shareholder can understand what the profit or loss or cash flows were in that period, and associated notes that would help them understand the components of the balance sheet. So yes, I think that-----

Deputy Joe Higgins: There has been a lot of comment on the role of auditors in relation to the period of bubble and bust. And just to try and understand, we get people watching us from the stand and indeed, myself. Let me just put this short analogy to you and ask you if you think it's fair or not. So a patient comes to a GP for a heart check and a blood pressure check. Doctor checks the two ... "You're grand in those two fronts ... good luck", not mentioning "by the way you have a serious tumour that should be checked out." So time passes, tumour develops ... catastrophe for the patient ... doctor says, "Don't blame me, I reported on what I was supposed to." So, patient is the bank being audited, doctor is the auditor. In Ireland's bust and bubble or bubble and bust, would that be a fair analogy or not?

Mr. Gerry Fitzpatrick: It's an analogy. I don't think it's a fair one. I think the reason I would feel that there is some question about it is the patient in your analogy has to explain his symptoms, and so they have to be measurable. So if the patient has some issue that can't be predicted - because it's something that's about ... that is unseen and is about to happen in the future and doesn't share that with his physician - I'm not sure the physician will call out that issue. I agree with you if the physician or the doctor saw that there was an issue and didn't call ... that was clear and identifiable and there was objective evidence that the person had this condition and then just ignored it, that would be different. I don't know whether that answers your question, Deputy.

Deputy Joe Higgins: Well, let's tease it out a little bit further. When you were examining Ulster Bank, the Governor of the Central Bank, currently Patrick Honohan, said in the Economic and Social Review summer 2009:

A very simple warning sign used by most regulators to identify a bank exposed to increased risk is rapid balance sheet growth. An annual real growth rate of 20% is often taken as the trigger.

And if you look at Ulster Bank loans and advances to customers, they grew massively in the mid 2000s - not exactly the same as balance sheet, but it gives a good indication. Now, would that for you not raise, you as an experienced auditor of 30 years standing, raise serious issues that should be brought to attention, even if you weren't required legally to do so?

Mr. Gerry Fitzpatrick: They would and they were. I think ... the growth wasn't hidden, so if you are saying the concern was there was growth, that was reflected in the financial statements prepared by the directors and audited by us. The concentration was there and disclosed in the financial statements and the loan quality of that was disclosed. I think perhaps your concern is, was the speed of that undermining the model, and therefore was that of a wider concern? I think in the context of an organisation that's moving, having had acquired a business like First Active moving to grow its loan book, there would be a period where significant growth would be there. My concern in that situation would be to understand is the funding available to allow them do that. So that the quote you made was in relation to standard - I would imagine in relation to standard banking practice - where there's consistent loan growth without the funding for it. So where would the funding come from? But if you have a supply of funding -----

Deputy Joe Higgins: But there's the rub Mr. Fitzpatrick. In a sense of course the information was there, but the danger of what that information indicated ... as the Governor hints, and

for example in evidence Dr. Alan Ahearne referred to a study he did in 2005 of, I think it's 44 housing boom and slumps, showing how over extension of credit, etc., finishes up in disaster. Should those figures not have sent alarm bells ringing for yourself in relation to a potential difficulty for the bank?

Mr. Gerry Fitzpatrick: I mean alarm bells ... it certainly raises that the scrutiny trying to understand what's going on in an organisation. If one thought the depositors or the structure of those lending money to the organisation were in jeopardy as a result of this, one might consider that, but I suppose the funding model and the capital plan was there and I understood where those sources of funding were coming from. I was absolutely at pains to make sure, and I think the directors to be fair were also doing lots in that they weren't reflecting this analysis in their financial statements. The setting of the capital plan that ... under ... that ... as to what a licensed bank, I don't ... you know that I suppose ... I don't license the organisation - the organisation that licenses it decides what level of capital in a growth environment like that could be, and decides what scalars to put on its capital. It can say "There's a minimum capital level, but because you're growing so fast you need different capital levels." And that's ... the regulator uses the financial information to make those decisions. So clearly the regulatory structure, and the licensing of banks means you should look at the financial information and decide whether that pace of growth is sustainable by capital and funding. But it was properly explained I thought in the financial statements.

Deputy Joe Higgins: But were you or not perhaps looking at all the waves as they were coming towards the shore one by one, concentrated on that and you didn't see the tsunami that was being generated further out that eventually overwhelmed the system?

Mr. Gerry Fitzpatrick: There were two tsunamis that came. One was the funding crisis - how or where banks were going to create this funding. So we certainly were focused on that, on understanding where the funding was coming from. The tsunami you talked about on the other side of the balance sheet was the asset side, and I don't believe in relation to ... whilst there was a serious credit crisis arriving, the assumptions that when ... in recognising that, the assumptions would've said, well, that property values were going to fall by 60%, 70% in commercial property or ... in residential values ... were going to fall by 55%. As I said, at the end of 2009, they'd only fallen 8%. So that tsunami took a long time to come in relation to reflecting in asset values, which is where, perhaps, you feel my concern should've been.

Deputy Joe Higgins: So, Mr. Cullen-----

Chairman: Just over two minutes now, Deputy.

Deputy Joe Higgins: Sorry?

Chairman: Just over two minutes.

Deputy Joe Higgins: Nearly three, Chair.

Chairman: Yes.

Deputy Joe Higgins: Mr. Cullen, various sectors have come in here and said they accepted certain responsibility for the horrific crisis that emerged from the bubble. Does the auditing profession take any responsibility for what happened, the bubble and the bust?

Mr. Pat Cullen: Well, I suppose, you get back to the fact that the accounts are prepared by

the directors and, as auditors, our role is to report on those accounts in accordance with the accounting and auditing framework which is there. And even Nyberg, in his report, said that we carried out that function quite professionally and well. But I think what ... the question it did raise was whether the scope of what the auditor does is adequate. And the auditing profession, certainly, has been looking at that question very closely since that time. And, as Mr. Fitzpatrick went into in some detail in his opening statement, there are quite a lot of changes which have already come in or changes which are in progress, which ... certainly the hope and expectation would be that those changes would certainly mitigate the risk of a similar situation arising again.

Deputy Joe Higgins: Mr. Fitzpatrick, can you comment on the maintenance and availability of concise and accurate management information on a group-wide basis by Ulster Bank Ireland Limited? Were you satisfied, for example, that you had access to accurate management information which allowed you to discern the full financial position of the group at all times?

Mr. Gerry Fitzpatrick: Over the period that I was involved I was satisfied. There were times when that became stressed. There was a time at the end of 2006, as referred to in some of the papers, where they transferred their financial reporting to a shared services centre in ... in ... in the ... under the control of Royal Bank of Scotland. That was a concern. The issue there, I think, I was satisfied, was that the core data wasn't affected. There were some challenges for a period of time, in getting what they call the cube of information that gave the information the way they were familiar with it. But I didn't feel that affected my view in relation to the way the financial information was being reflected in the audited accounts. So it was a ... so generally through the organisation it was an organised structure of financial reporting. There were stresses in the system in particular in that period and that obviously was a particular focus for our work, trying to understand that information, and so ... and if the controls weren't working we had to do more work to make sure the numbers were accurate.

Deputy Joe Higgins: Were there any possible issues relating to the generation of reports used to inform the financial statements, for example, the level of use of manual rather than system-generated spreadsheets for the preparation of reports, the completeness of reports, if drawn from across the groups, and the possibility of imprecise figures as a result?

Mr. Gerry Fitzpatrick: No, I think the ... I mean, a lot of big organisations struggle with straight-through processing of data and use manual processes. That certainly, again, will be a focus for our work. The question in my mind has been obviously that increases the risk of error and ... because it's a manual process. But, again, that would've been a focus of our work and didn't, certainly, result in us believing there was a material error in the control process we were checking, which might have been manual, as you described.

Chairman: Thank you very much, Deputy Higgins. Deputy Kieran O'Donnell. Deputy, ten minutes.

Deputy Kieran O'Donnell: Thanks, Chairman. I want to welcome Mr. Fitzpatrick and Mr. Cullen. Can I just deal with the whole issue in terms of the valuation of the security that's offered in respect of loans? And would ye have performed a review in respect of the valuations received for the assets offered as security? And, given the fact, we'll say, that property was falling in value, how would ye have felt about the accuracy of the valuations? And then, would ye have reviewed in that context as well Ulster Bank's process for the registration of mortgage securities, because obviously that was ... would be implicit in terms of the value of the loan?

Mr. Gerry Fitzpatrick: Yes, I mean, our process of understanding the underwriting in-

volves looking at how security is taken and looking at how ... when a loan becomes impaired, how you assess the potential valuation of that collateral. So we look and see what the bank is doing in terms of trying to determine that. Clearly, what you're looking for in that situation is that they have undertaken or have had a valuation undertaken on the collateral. If that valuation is in place, you are trying to understand who undertook that valuation, were they informed ... was any scope restrictions on their works, because sometimes valuers say, you know, it was based on the desktop versus inspection, etc. So yes, understanding that valuation process is important. At times and certainly as I referred to in the opening statement, at the end of 2008 it was very difficult to get valuations, and so in any control process what you are trying to say is that if the process isn't working because there isn't data available, how is the organisation responding to that? And as referred to in the audit summary memo that we gave to the audit committee, we were concerned that valuations weren't up to date. The bank was explaining that valuers weren't in some cases willing to give those valuations. We did report that they had been very materially reduced in line with indices, so that is the next piece you go to, so you say, is there any external data which tells... or internal data so the bank was certainly talking to panels, or values, or to say what was the valuation adjustment.

Deputy Kieran O'Donnell: But we'll say, in simple terms, did you ever commission independent valuers to carry out evaluation of some of the... a sample of the loans, the security for the loans in the bank?

Mr. Gerry Fitzpatrick: No.

Deputy Kieran O'Donnell: Okay. Secondly, if you had those concerns in terms of the valuation of the security, why didn't you qualify your audit opinion?

Mr. Gerry Fitzpatrick: Because I was comfortable with the valuations that were given, as what the process we went through, is we had concerns as how the valuation-----

Deputy Kieran O'Donnell: But you said it was significant.

Mr. Gerry Fitzpatrick: I did.

Deputy Kieran O'Donnell: You said... okay so therefore, surely in terms of true and fair... sorry I-----

Mr. Gerry Fitzpatrick: Well, I was... I mean I think the question you asked me was, did I give an incorrect opinion, and the answer is "No". The question was, how did I come to that opinion.

Deputy Kieran O'Donnell: Well I asked-----

Mr. Gerry Fitzpatrick: It's a valid question.

Chairman: Without interruption there Deputy, please.

Deputy Kieran O'Donnell: Sorry?

Chairman: Without interruption. Mr. Fitzpatrick, you have the floor.

Deputy Kieran O'Donnell: We are... I just want to say Chairman, we are on the same page. I only want to know the process by which you got to it. I wasn't asking.

Mr. Gerry Fitzpatrick: The process I got to was to say, if in the absence of valuations,

how has the bank valued the collateral. It was significant, you look to various... there were valuations, the question was was the valuations they were doing reflective of the internal data and external data in relation to valuations ... property valuations. So we had a series of internal valuation reports. They had panels of valuers where they were consulting with valuers in relation to collateral movements by a particular type of geography. Then we were looking to external sources of data, IPD indexes, valuers indexes, briefing by valuers and we inquired of them in 2008 to undertake a process which I would call a top down process to say, "Where are all your stress loans? What year were they written in? What if the situation is that there is a loan... a value that falls by X amount? And is that consistent with the impairment number that came up from the bottom up analysis?"

Unfortunately that situation, looking back in time, the stresses they were assuming in terms of the fall in collateral values were reflective of the information generally understood in the market at that time as the incurred loss models we described which is, not the future loss the current loss. And obviously those assumptions in hindsight were flawed, but at the time I satisfied myself that they went through an appropriate valuation process and therefore that is how I validated their judgment.

Deputy Kieran O'Donnell: The fact, Mr. Fitzpatrick, that it was so significant right, why didn't you draw attention to it in your audit report by way of an emphasis a matter, not strictly speaking a qualification?

Mr. Gerry Fitzpatrick: To my mind, the emphasis would have meant that I was unclear about something that the directors were stating. So you emphasise something if you think the directors have caused something out, that they have been unable to deal with. I was happy, it was the way I guess the industry was looking at it, not only in Ireland but around the world, in terms of how do you deal with the valuation of any asset where there is an illiquid market? So, not to digress too much, but I suppose there were lots of instruments at that time where markets just weren't functioning. And the question was, was their a realistic approach taken to the valuation. And I thought it was reasonable, Deputy, and I thought that the process that they went through was rigorous, and it was reasonable and therefore emphasising it meant that I was... would have suggested that I was unhappy, and any amendment to an audit report for a bank was is-----

Deputy Kieran O'Donnell: Looking back, the fact that €13 billion of, effectively from RBS went into Ulster Bank Ireland. On reflection, what would you feel about not qualifying the reports in any shape or form on the valuation?

Mr. Gerry Fitzpatrick: I believe my opinions were appropriate at the time.

Deputy Kieran O'Donnell: On IAS 39, can you just confirm ... clarify to me that the valuation basis for looking at impaired loans. Am I correct in saying that the way you valued the loans was based on looking at any loss would be a measure between the difference between what the asset was being carried at on the balance sheet of the bank and the net present value of the cash flow from the loans? So, I suppose the question I am asking is, you had a situation where you had property prices falling in 2007 and 2008. They fell nearly 13% between those two years. You would have been signing off the '08 accounts in February '09. Surely the fact that there was a drying up of liquidity and the market was falling, surely then-----

Chairman: Ignore the surely, just ask the question.

Deputy Kieran O'Donnell: Well, the provision you provided, which was €304 million of impairment for 2008, surely that was grossly inadequate?

Mr. Gerry Fitzpatrick: I don't believe so ... I don't believe so, and I really genuinely believe that the process we went through was correct. I don't want to correct you but I didn't make the provisions; the bank made the provisions and my role is to scrutinise and-----

Deputy Kieran O'Donnell: But you've signed off on the provisions.

Mr. Gerry Fitzpatrick: And I'm happy that I did but I want it to be clear that the provisioning process is something I test and, as I described the process, I go through it. It's hard for me to ... your premise I think your suggesting is that I did an incorrect audit and I don't believe that.

Deputy Kieran O'Donnell: No, no I'm asking you ... surely with the valuation basis under IAS 39, that you look at the difference, you're looking at the future cash flows from loans. So it's not strictly correct to say you do not book losses until they're realised. The valuation method under IAS 39 is based on future cash flows that come in from the loans and to evaluate those, and I'm saying against the market of where you had valuations falling significantly and you'd a drying up in liquidity surely on that basis, for 2008, you should have provided more than €304 million of a provision, which was roughly just over 1%, 1.3% of the loan book in terms of loans.

Mr. Gerry Fitzpatrick: I don't ... again I don't make the provisions. What the provisions were made was first of all on impaired loans, so you don't make a provision on the loan book; that's general provisioning. You make it on the specific cases.

Deputy Kieran O'Donnell: It's still very low as a percentage of the overall.

Mr. Gerry Fitzpatrick: Now we know that in terms of what happened in the asset values, the net present value is done. There are a number of factors you're looking at. You're saying, "Where is the asset value sourced?" You're right, Deputy, in terms of a net present value. You actually then also have to look at when the collateral might be realised because you're discounting it. Part of the analysis - and you'll see in my own summary document where we discussed it with the audit committee but not just the valuation issues but actually when collateral in a tightened market might be realised. We forced them to do some stress test to say, "Well, actually you're saying you'll realise the collateral in maybe 2009, 2010; we're saying what would the impact of-----

Deputy Kieran O'Donnell: The question I'm really asking Mr. Fitzpatrick, am I correct in saying is the IAS 39 is not strictly about showing the loss when you realise or sell the asset? It's actually about looking at the future cash flows from a loan. And the point I'm making here is, on that basis, surely the provisioning should have been higher by the banks and, consequently, the audit report should have reflected that there was an under-provision.

Mr. Gerry Fitzpatrick: No, I don't believe that. You use the value of collateral as you understand it to be. If you think the value is going to fall in relation to a future event because the market will fall further, you're not predicting that future event. I know that's quite difficult to do but you can't suddenly say, "Well, I think it will go down by 20%". If the directors said to me they think it'll go down by 50%, they would have been potentially misrepresenting the information, the financials because they wouldn't know what it was. It would be pure conjecture. And the idea of the standard was an evidenced, verifiable evidence-based standard. And we may believe there are flaws in that but a verifiable evidence-based standard is actually better than one that is purely based on conjecture. If a group of directors are saying to me, "We have

looked at the valuations and actually yeah we think we'll hack off another 60%", that would be misrepresenting because it would be based on conjecture. So it is a difficult thing I agree with you. I think we're in agreement that the standard does require you to look at what would be realised and to net present value it but you have to use the available data in terms of what you believe valuations are standing at the moment. Valuations can equally increase and decrease; it would be conjecture otherwise not to use the available data. Just like if you're holding a security, Deputy, like interest in a stock or share, it could go down in the future but you value it at the point in time even though you mightn't sell it, you mightn't sell it for ten years-----

Chairman: Last question now.

Deputy Kieran O'Donnell: In hindsight, Mr. Fitzpatrick, looking back now, would you have done anything differently in terms of, particularly the audit of the '08 accounts?

Mr. Gerry Fitzpatrick: I believe that the audit I did and the opinion that I raised was appropriate and that I did the work required. And I think Mr. Cullen and myself both described how the process for future looking, which is outside the audit scope, can be enhanced. And, therefore, the process the regulator has now put in place in terms of reviewing other aspects of organisations, their governance, etc., under what's called GL44 and a whole series of new audit reports is a good thing. But in relation to the past I'm, I'm comfortable with the opinions I gave.

Chairman: Okay. Deputy John Paul Phelan. Deputy, you have ten minutes.

Deputy John Paul Phelan: Thank you Chair and good afternoon, gentlemen. Firstly, I want to ask you, maybe both, in your opinion, did the management structure of Ulster Bank impede provision of good governance within the bank or what impact did it have, if any, in your opinion?

Mr. Gerry Fitzpatrick: I certainly wouldn't start by impeding it. As a structure, they benefitted from good practice internationally. I think that compared to other organisations was a particular benefit they had, so they had a strong governance culture, they had a good framework, which was consistent with how similar organisations in the RBS network were managed. So from a starting point, the structure was good and the materials I saw going to board, although they had laws at times, that was in terms of some elements, they were always corrected and I always found that there was a good attitude towards control so if they had a process with something that was identified, there was an escalation process and it got addressed. Maybe not always the speed that they might like, but that process seemed on the face of it, quite good. There was obviously a number of legal entities. UBIL, which is the Irish entity, First Active, and so the boards, they very much looked to an Ulster Bank Group. That was an agreement with the regulator, which is the proper way it would be done, that actually they would look across the totality of their arrangements. I thought the structure was reasonable, in terms of an active board and a reasonably structured governance environment.

Deputy John Paul Phelan: Mr. Cullen, you referenced the Nyberg report. We have had discussions with Mr. Nyberg and others, who have referenced this report as well. I want to put to you a particular passage which is well known and has been discussed at this committee before. Page 56 of this report, paragraph 3.6.2. The quote is as follows, "The Commission would have expected a bank auditor, exercising necessary professional scepticism, to have concerns where there were growing property and funding exposures, combined with material governance failings." Do either of you believe that that criticism or that comment has application in terms of the role that Deloitte had, in terms of auditing Ulster Bank Ireland?

Mr. Gerry Fitzpatrick: Again, to be clear about what Mr. Nyberg did, he looked at covered banks, so he wasn't looking at the auditor of Ulster Bank or the financial statements of Ulster Bank. I am not aware if he spoke to the people in Ulster Bank. Governance concerns may have applied to other organisations but I am not aware if the regulator was raising governance concerns in relation to Ulster Bank Ireland Limited. From my recollection, they were raising serious queries at times, as regulators rightly do, and I said in relation to concerns, I think I have voiced this earlier, which is if the concerns were about the business model, the concern was to make sure that the reader of the financial statements fully understood that business model, which was where the lending was being done, what the quality of that loan book was, ensuring that credit quality analysis was provided in the accounts and then most particularly, and maybe was unique, and maybe therefore not why Mr. Nyberg wasn't covering it, was the liquidity issue, which was more acute for those who are stand-alone entities, was a different environment. It still required the liquidity that a bank needs but it was different because it was done in the context of an RBS capital model, which looked at capital, which was over one hundred and something billion right round the organisation, and therefore the concerns I think ... I don't think his concerns were about Ulster Bank.

Deputy John Paul Phelan: Do you believe to use that phrase "necessary professional scepticism" that you were necessarily professionally sceptical in your role as the auditors of Ulster Bank Ireland?

Mr. Gerry Fitzpatrick: It is a question auditors have to ask themselves every day, which is, "Am I being sceptical, am I being biased, is my, is there confirmation bias to what I'm doing, is someone giving me information and I'm going "well, that looks sensible"." So it is something we really always try and work on. I think the process we went through to try and challenge what the organisation is doing, to look at all the sources of data was sceptical. I guess the judge of that can probably not be best myself, but I suppose we have had reviews of our work, both of our audit work and I don't recall that someone, in the context of my audit work, questioned that scepticism and equally, in the context of financial reports, whilst we went through this significant crisis, securities regulators in Ireland or abroad didn't require or didn't demand the withdrawal of accounts that were presented because I think they understood that yes, that they were historic information, that maybe there could be enhancements to them going forward. But there wasn't a withdrawal of the financial statements, nor a request to restate the financial statements by the regulator or others, in terms of, as the period went on. I think people accept what it was that was reflected in those financial statements.

Deputy John Paul Phelan: Following on from the Nyberg report, the auditing ... professional Auditing Practices Board, in March 2012, produced a paper on the concept of professional scepticism and it noted that the auditing standards defined professional scepticism as, "An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence." Following on from that, have you instituted changes in your own practices, be it in relation to auditing Ulster Bank Ireland or other auditing that you've done since the publication of that report in 2012?

Mr. Gerry Fitzpatrick: I wouldn't say we've done it differently. I think that the emphasis around our whole organisation about the importance of scepticism is reinforced and maybe more so reinforced which is that idea of constantly reinforcing that view of the sceptical mind. I don't think it has changed the way we've done our audit process and I guess ... but reinforcing that scepticism and being alert is something that we have got to do. I think the ... some of the tools that maybe are available to us in terms of data analytics now, maybe allow a greater level

of analysis of certain things which maybe help that scepticism but it doesn't change the way we approach things, which is with a sceptical mind.

Deputy John Paul Phelan: Okay. Can I change, for my last few minutes, onto the actual nature that the audit of Ulster Bank Ireland would take within Deloitte in terms of the numbers of people who were involved, the grades ... I don't want to know anything about individuals other than, you know, roughly speaking, what ... how many people from different grades within the organisation of Deloitte would be involved within the audit of Ulster Bank Ireland?

Mr. Gerry Fitzpatrick: I don't have the exact data to hand but I can give you a flavour and it would probably be at the Ulster Bank Group level because that's the way we co-ordinate our overall team. I'd say, in all ... and this is from memory, Deputy, that we have about 50 people involved in that work, from a variety of disciplines, as I described earlier in relation to core audit team, to specialists, some with many years of experience, some with less experience. I would say, and again, if you'll allow me just ... from a guesstimate, the kind of ... the senior cohort of the time, in terms of people who were long experienced managers, partners, specialists in tax, pensions and IT would be about over 30% of that time. The amount of time, if you take that group plus all the qualified staff ... people, not just graduates, of ... which is our own intake, but people who've done the exams of either Institute of Chartered Accountants or other institutes, would probably ... would represent more than 50% at the time. And those involved in ... who are less experienced would be subject to the review of those people in the 50%, if you get me.

Deputy John Paul Phelan: Okay. A perception, correctly or incorrectly, may exist in some quarters that significant numbers of very junior staff are involved in the auditing process of some of the institutions. I just want to ask in relation to your own ... but I also want to ask, in relation to the staff and the level that they would be at within the organisation, how do you square the conflicting interests of the necessity to rotate, which was mentioned earlier on, but also the maybe necessary sceptical requirement of continuity that, you know, a professional auditor is ... in an institution or examining their books for a number of years and can identify maybe concerns over, you know, that particular period of time and knows what they're looking for, rather than, you know, perception that a significant number of junior staff would be doing most of the grunt work, for want of a better term?

Mr. Gerry Fitzpatrick: There is certainly a perception, I think, and there are people who are young - and we have recently qualified graduates in our number - but I'd say about anybody who is in that level, there's people with honour degrees in ... from third level, they're studying for exams of an institute. They're spending, in terms of a training timetable within our firm, four to five weeks a year on simply that training and then plus another two to three months training for the exams. So there's quite a lot of infrastructure, even for those who have a small ... number ... of experience. My issue obviously is that, as the person who signs an opinion with 50 people doing the work, how do I know, I think this was your question, that they are all ... they all get the message? And what we do ... and probably at the risk of further boring you in relation to other processes, but we have this process driven by an automated audit tool which still looks at this risks and material misstatement. And I set out what those risks I believe are. And the techniques then you try and use to try and get my scepticism across to those doing the work is to ensure that you're following a process that actually addresses those risks. And we benefit from that as being what we call, in our audit methodology, the tools and techniques people use are not just the ones I decide on, but people right around our firm, nearly 200,000 people globally, not all are doing banking work, but those who are in banking work are contributing to a model and a database of risks and controls, so I feel that group of people are informed. It does fall on me,

I'm the person who makes the decisions to make sure that those risks are correct and for me and my team to review the work of anybody who has less experience. And every piece of work will be reviewed by another person, including my own, and, therefore, I'm subject in that scepticism to an independent partner who is not directly involved in the audit process looking through my opinion, my key working papers, my audit summary document, and saying, "Is there a risk, Gerry, that you're being ... that you have a bias here, or that you're subject to this confirmation bias, which is information that passes you is the one that you think is the most relevant at the time?" So, your initial point was, was there a perception? There possibly is a perception. I'd say there's superb, really bright people working for us, who have lots more skills in some areas than I have. They are put together in a model and we train them and it's a value-training process, and the amount of specialist time and expertise that goes into it, drawing from the best of our organisation is put into it. Ultimately, these things aren't all processed though, and I think ... the earlier comments which ... there are judgments around big issues, and that requires people of experience to apply to, and that's where I certainly focus my efforts in an audit process.

Chairman: Thank you very much, Deputy Phelan. Can I maybe just summarise where we are at the moment before I bring in Deputy Doherty? Mr. Fitzgerald, earlier in your evidence you, just to confirm again, you're stating that Deloitte were aware of the risks in Ulster Bank, i.e. concentration levels and such, yes?

Mr. Gerry Fitzpatrick: Yes.

Chairman: Okay. And that these risks were then detailed in the accounts.

Mr. Gerry Fitzpatrick: Yes.

Chairman: Okay. That being the case, how did Ulster Bank not see the risks?

Mr. Gerry Fitzpatrick: The risks were the exposure they had, so what they didn't see, I think, within, they didn't foresee was the series of events that would cause a concentration risk to be ... to have such a calamitous effect in terms of the future. So, yes, the financial statements disclosed the concentrations and the funding model. I think they would have described, and I saw parts of what they described, which was a whole series of events that happened that meant the assumptions they'd made about be it soft landings or the impact of collateral values, they were unfounded, so what they didn't see was the consequences rather than the core data, so what we ensured was the core data was properly described. I think it's the consequences that wasn't, and they felt obviously, as I understand it, that core demographics, economic activity, soft landing, etc., meant that it wouldn't be as acute as it was, and, ultimately, they set out a capital plan which got submitted to the regulator, who was saying, "Well, you need to have a certain amount of capital put away in this ICAAP process the regulator does." And that looks at potential scenarios and stresses, and those stresses, unfortunately, weren't severe enough, in their evaluations.

Chairman: Okay, so just staying with the stated accounts, Mr. Cullen, you're on record earlier this evening as saying that the accounts were not an insurance policy or a picture for the future, Mr. Fitzpatrick with a question with Deputy Phelan and others, have spoken at length detailing the skill sets and experience of the auditing team. So in that regard, did the auditors not think, and being aware of the risks associated that we just discussed now with the lending strategy adopted by the bank, that they did not have an obligation to make it clear, make this clear in the accounts, for example, by putting a note in the accounts in this regard? Did you put a note in the accounts in that regard?

Mr. Gerry Fitzpatrick: I'm not fully sure I understand the question, but I'll answer-----

Chairman: I'll repeat it, if you want.

Mr. Gerry Fitzpatrick: The question is about ... the note in the account are the directors' notes; I don't put notes in the accounts. What I was ... what they did have in the accounts were notes that described credit quality, funding gap, spending concentration, so I thought the notes in the accounts met the requirement for disclosure that was set out for this framework.

Chairman: We'll go back to the very, very start of this conversation. You're saying that Deloitte were aware of the risks, i.e. the concentration levels, and that these were detailed in the accounts. Now, we went over Ulster Bank's explanation as to whether they saw the risks or not saw the risks. But I'll move back to what I'm asking you now. Is ... we've spoken at length, I ... you've explained to us at length of skillsets and the experience that the auditing team actually had inside there, but the question I'm putting to you, in this regard, did the auditors not think, in being aware of the risks associated with the lending strategy adopted by the bank - and we've spoken about the concentration levels - that they did not have an obligation to make this clear in the accounts, that this issue specifically would be made clear and that a note would be put in the accounts in this regard? Was that done?

Mr. Gerry Fitzpatrick: Maybe I didn't answer very well. I clearly didn't because you were ... because the question ... the risks I was seeing was the risk that the financial statements might be misdisclosed, misrepresented, there might be error in them. Not that the business model was risky, that the financial statements ... that's what I'm trying to report ... which is ... might the recorded profit and loss account balance sheet, cash flows, etc., be ... have risks of material error because the measurement wasn't done correctly, or wasn't ... so I believe that those risks were ... were considered by us on our team, in our ... in our work, be that of the risk of impairment ... what level of credit quality was disclosed, the risk of liquidity, that was disclosed in relation to the funding gap, and also in relation to the basis of growing concern. So, I do think the notes the directors put in in relation to those issues did point to the ... the measurement risks and were appropriately disclosed. It may not be that future-proofing objective that maybe you might want in ... in terms of that idea of proofing the future, but I thought the risks and the ... of measurement of numbers were reasonably well disclosed and the accounting standards required that and they met that measurement standard.

Chairman: Okay. Even with the full knowledge of time you would still think that they were accurate at that time?

Mr. Gerry Fitzpatrick: I think ... I think the only-----

Chairman: And I'm not looking back ... 20:20 may be hindsight-----

Mr. Gerry Fitzpatrick: No, I think ... I think the ... what it has taught us, I suppose, is that maybe that sensitivity analysis ... so that you're saying, okay, it is this point-in-time picture, and the reader needs to see that, the question then is the what ... so you want to get people measuring it to a consistent standard, bank to bank to bank, that maybe more focus ... and the newer standards have a little bit more focus on, well, maybe the "what if" piece, which is, okay, well ... which is trying to say, well, not so much what will happen, but if something happened, if we had a 1% movement in something, what cause that might have. So, that is where standards maybe currently are looking to push more on, and that may be somewhere that that will give it. But it still is ... you still have to work with ... you still have to be able to say, well, can I anticipate

what's going to happen, and in terms of ... you never anticipate the unexpected, and I think there was a significant level of unexpected in the long-term deterioration in asset values.

Chairman: Okay. Thank you. Deputy Doherty.

Deputy Pearse Doherty: Go raibh maith agat, a Chathaoirligh, agus fáiltle roimh an bheirt chuig an coiste. Can I ask you, to start off, did Deloitte perform any stress testing as part of your external audit of the bank to take into account the correlation between the different types of property being financed, that being residential, commercial, development land and speculative land banks?

Mr. Gerry Fitzpatrick: We didn't carry out our own stress testing, we examined stress testing that was done on the bank's books and, therefore, lending concentrations. And their review of property concentration was something we would have examined but we didn't stress it to our own scenarios.

Deputy Pearse Doherty: And, in relation to how it was being financed in terms of realising equity that was in one project, financed in another project, did you look at that area?

Mr. Gerry Fitzpatrick: That would have been looked at if ... if you've ... if you'd a loan that was ... had objective evidence of impairment, you're trying to see, well, what is the collateral value. If that was based on the value of a property, as you say, that had been previously financed, you'd be looking to understand how that valuation was carried out, and how was it stood up.

Deputy Pearse Doherty: And were you satisfied with what you'd seen?

Mr. Gerry Fitzpatrick: In terms of the valuation process, we've talked a little bit about what ... how we went ... go about doing that. I was satisfied that they had a process for establishing valuation. If that collateral was ... was in place, you have to test the security of it and you need to understand the assumptions that underlied it. So I was ... I ... I obtained the evidence I required to make my conclusion in relation to impairment of those assets.

Deputy Pearse Doherty: And the stress test that you examined ... what ... what factors did you ... what percentage drops were included in those stress tests, say, for example, on the 2008 returns that you audited?

Mr. Gerry Fitzpatrick: What I ... what I said ... what I asked the bank was to do certain stresses and they looked at ... at peak-to-troughs at that stage, which were ... and perhaps some further more ... but it was certainly looking at ... and Deputy I ... I don't remember the numbers, but it was 10% to 20% further falls in value.

Deputy Pearse Doherty: Of residential or commercial?

Mr. Gerry Fitzpatrick: Of commercial property.

Deputy Pearse Doherty: That's peak-to-troughs?

Mr. Gerry Fitzpatrick: They were looking to see ... yes, what the impact of further ... further falls in valuation might be.

Deputy Pearse Doherty: Okay. We've heard from Professor Eamonn Walsh before the committee previously and he talked about the IAS 39 which we ... we've examined in ... in de-

tail here at this committee. Professor Walsh also said in his evidence, it's on page 7 ... 478, and I'm going to quote it, so just for your benefit, he said:

One could have a disclosure which says the impairments are low, the profits are high, and loans have been made which could go bad quite quickly. A disclosure could be made to investors which states that loans may get into difficulty despite the fact they are not reflected in the balance sheet or the income statement.

Did this happen in practice?

Mr. Gerry Fitzpatrick: I'm not sure where, what kinds of disclosure, he really wants. That sounds like a boilerplate suggestion that things can go up and down ... if that's what I'm hearing. There was a disclosure which just said the directors highlighted the key judgments and uncertainties which could cause actual credit losses to differ materially from the report of impairment efficiency. That was a statement made by the directors in the accounts, so I think if that's the statement he makes, the reference to the profits high and impairments low is not a statement I would have thought was appropriate but certainly, the statement that of risk which is the risk that judgments may be incorrect is required by standard and was made, as I said, which says-----

Deputy Pearse Doherty: But is that statement not ... just a general kind of statement that you would see in nearly every statement of audited accounts? Would that be a general statement instead of saying, "Look, we have to value this in terms of IAS 39, we have to audit this in terms of IAS 39 and why ... while the bank is very profitable, while the impairments are low, the profits are high at the bank, we see trouble in the horizon?". That is what I assume he was getting to and is something like that possible?

Mr. Gerry Fitzpatrick: I think it's not quite there. What standards require you to do is to say ... certain items can be measured, there is no judgment of it, cash is cash. What you're required to do is to say where the significant judgment required in the determination of an asset or a liability, you've got to describe that uncertainty. So in relation to pension liabilities, in relation to asset impairment, so in significant debts and judgments, you are required to make statements about it. So I think that's what he is referring to which is IAS 1 says you must do that and I think that was properly done. The question is what depth you can put on it, because you're saying "Well, something could move, as you say, which is a boilerplate statement." You don't know what it might move by, you're just highlighting to the user that this is something that is based on judgment.

Deputy Pearse Doherty: Okay. Are you familiar with that Anglo went beyond the provisioning that was required under IAS 39 and provided for, I think, half a million ... half a billion euro additional provisions?

Mr. Gerry Fitzpatrick: Chairman, I think we should all be careful about this questioning in terms of-----

Deputy Pearse Doherty: Indeed. It was evidence that was provided to the committee.

Mr. Gerry Fitzpatrick: Yes, I read that piece and I think that might be misunderstood. That's ... there is a thing called ... stop me if I'm getting too technical ... there is a thing called IBNR. There is a recognition that at a point in time, at the balance sheet date, there are certain things that are incurred but not yet recognised, so if you have a situation where maybe ... so you're saying ... you know, it takes up three months to find an impaired loss, you make a provi-

sion for that loss in terms of an emergence period, it takes a month so-----

Chairman: Please, just be mindful here now.

Deputy Pearse Doherty: That's fine if you think that-----

Mr. Gerry Fitzpatrick: -----that concept is not general provision, it's part of IAS and it was part of all banks including we'll go back to Ulster Bank ... it was part of Ulster Bank's-----

Deputy Pearse Doherty: Okay. We can leave that.

Mr. Gerry Fitzpatrick: -----and IBNR is part of that mechanics and something I would have looked at. Ultimately, though, that is based on data which you are saying "Well, if things have gone wrong in the last month or two what loss", ... you're back to the same assumptions on valuation of collateral.

Deputy Pearse Doherty: Okay. The Nyberg report gave you the label, when I say "gave you", I'm taking about external auditors of the silent observers. He explains on the page, he says:

The problems in the Irish banks [and I am quoting] were building for several years before the crisis. These were problems of credit quality, sustainable lending practices and adequacy of internal procedures; they were not generally operational problems related to ... IT systems or the mechanics of loan documentation. Auditors, there ..., did not feel that commenting on the implications of such business model problems fell within their proper remit. In fact, it may be questioned whether they even saw them as problems since very few others appear to have seen them either. On these issues, they appear generally to have stayed silent.

Do you believe, from Nyberg's analysis, that you were one of the silent observers?

Mr. Gerry Fitzpatrick: I believe I wasn't silent in terms of ... but I think the point was in terms of what the scope is, so I was very vocal in terms of what I was looking at in terms of around the organisation, challenging people, so I think in terms of ensuring that the financial statements reflect what they show, I think, maybe I'll just take it personally, that silent observer was pointed at auditors, seem to be a unique heading pointed to the auditors. We were looking at presenting good financial information. I think the capital standing stability was not part of our role and I think he referred to that. So I think he referred us to doing our role, I think what is referred to earlier, there are some now enhancements in terms of talking to the Central Bank about not changing that role but adding a new role in terms of looking at governance and maybe that would allow more objective observation of the things he suggested.

Deputy Pearse Doherty: Okay.

Mr. Gerry Fitzpatrick: But I think the suggestion of silent observers means we had something that we hid and I don't believe that's fair.

Deputy Pearse Doherty: Okay. In relation to going concern, it was stated in the opening statement there that, in assessing whether the going concern assumption is appropriate, that you take into account all available information about the future, which is at least, but not limited to, 12 months in advance. Can I ask you, Mr. Fitzpatrick, because you've mentioned a number of times the CSO residential property index and you say that, by 2009, it was 8% below; now, that's 8% below 2005 figures. Can I ask you, just bearing in mind these figures and bearing in

mind we've had evidence from the economists from within the banks, including Ulster Bank, which believes that commercial property was the major factor in terms of the losses to the banks - and you may have an opinion on that or not - but Jones Lang LaSalle property index shows that by the end of December 2008, property values had dropped by 36.4%. Indeed, by the end of March 2009, just a number of days after you submitted your audit report for that year, it had dropped 40.5%. Commercial ... or residential property had dropped, peak to trough in that period, from 128% at the start of 2008 to ... to, the time you submitted your report, 108%-----

Chairman: ... please, Deputy.

Deputy Pearse Doherty: Well, the first ... the residential property that shows a drop state-wide from 128.7% at the start of 2008 to 108.5% at the time you submitted your report is the CSO reference and Jones Lang LaSalle has their own property index which is on their website, which comments that there has been a decrease in commercial property in that year of 36.4%, in 2008. When you look at the CSO, also you actually see that property decreases were accelerating during that period. Why, given all of that, did you not suggest more provisioning or suggest that there was a concern in relation to the future viability of the business model of the bank that you were auditing?

Mr. Gerry Fitzpatrick: The initial question was about going concern, so what the going concern assessment is saying, not that you change the values of the assets, which is the incurred loss model, what you say is having determined that valuation and that balance sheet assessment based on the judgments at that point in time, you then say, well, has there ... is there a reasonable expectation of this entity in the head winds it might be having it, or the tail winds, that has a reasonable expectation that that organisation will continue in business? Not that it's going to make profit or loss; simply it has the facility to stay ... be in business within 12 months. In the case of Ulster Bank, the directors, as I've explained, had the support, liquidity and capital and otherwise from Royal Bank of Scotland and, therefore, there were reasonable expectations that that ... that provision of that facilities of liquidity and capital would be available. So they were perhaps in a better position than others to make that assessment, so the going concern is saying you don't change the values-----

Deputy Pearse Doherty: Sorry, sorry, you had to be convinced as the auditor-----

Mr. Gerry Fitzpatrick: Yes, and I was-----

Deputy Pearse Doherty: -----that there was no issue of going concern because in the statement you say that the-----

Chairman: This is a supplementary now, Deputy, to wrap it up.

Deputy Pearse Doherty: Sorry. In the statement you say that the ... it was the board of directors but the auditor has to be-----

Mr. Gerry Fitzpatrick: Has to be-----

Deputy Pearse Doherty: -----convinced of ongoing concern.

Mr. Gerry Fitzpatrick: Yes. So, the bank make the assessment, the directors make the assessment of going concern and then I have to make an assessment that I believe that's reasonable. The directors make it based on all reasonable assumptions and I look at those assumptions to say are they reasonable. The big assumption in this case was the support of its parent and

that was a significant assumption because of the sources of funding, the percentage of the balance sheet that was coming from that source and that, I believed, was reasonable expectation. It ... and when capital was needed in 2009, that expectation was borne fruit because there was a number of ... a couple of hundred million in 2009 that Royal Bank of Scotland did inject into the company. So, that was a reasonable expectation, therefore, the going concern assessment the directors made, based on the support of RBS, was reasonable and I ... and I made ... and I formed the view also that I thought it was reasonable.

Deputy Pearse Doherty: The ... and I know I'm over time, but the core issue there was that commercial property had decreased by 40% in 2008 or, sorry, 36.4% in 2008 and was accelerating and residential property the same, yet the provision ... you didn't suggest additional provision in relation to that, even though you were supposed to. You talked about looking at the IMF and other bodies for data but this data was available through Jones Lang LaSalle and the CSO.

Mr. Gerry Fitzpatrick: I believe that the valuation, which is a separate part of ... in relation to the assets reflected the ... in terms of the assessments they did reflected the valuations that were ... that there was ... I'm not ... I can't reconcile with those exact peaks and troughs but those ... that market available data was being reflected. Deputy, there was ... the question was ... the subsequent losses weren't necessarily in relation to those cases that were impaired at 31 December of any year because, in subsequent years, other things happen and other loans get impaired, so losses, there's a pro-cyclicality, as people say, which is as the market turns not only the items that you think are impaired are in one period, further items get impaired. It's not all about the loss identified in one year, and then it goes down further. There's new losses that arrive in a subsequent year as businesses or properties ... or sorry, businesses or individuals default on ... in a future. But that future loss-----

Chairman: All right.

Mr. Gerry Fitzpatrick: -----is not an element of the provisional process.

Chairman: All right. Okay, thank you, Mr. Fitzpatrick. Senator Barrett. Ten minutes, please.

Senator Sean D. Barrett: Thank you very much, and welcome, gentlemen. How many people in Deloitte worked on the Ulster Bank audit?

Mr. Gerry Fitzpatrick: I mentioned earlier, I don't have the exact facts to hand, but my recollection would be a team of approximately 50 would be involved in the audit in a year. But it's some years ago, I don't have that exact data.

Senator Sean D. Barrett: And then I think there's about €2 million on the audit paid to you between 2004 and 2010, and about €1 million on other activities. What were the other activities?

Mr. Gerry Fitzpatrick: There were certain business reviews done on ... in relation to ... I don't have the full list of them again, Chairman, but they were engagements to do reviews of businesses that the bank might have been looking at in terms of their structure or otherwise. I explained earlier, the process was if there was any non-audit work to be carried out, it had to be done ... firstly, that it's not restricted. So the ethical rules say you can't do certain types of work, absolutely not. For instance, the building of systems, the doing of tax structures. And then equally you have to be aware of any threat that might be involved. But if there was a receivership, and most of them were in that kind of business review or receivership area, that was

something that was ... is allowable under the standards and would have been reviewed by the audit committee.

Senator Sean D. Barrett: Thank you. Did you ever have any concerns about the exceptions to lending policy in Ulster Bank?

Mr. Gerry Fitzpatrick: Certainly it was an area that I needed to be aware of, and I certainly was aware of the process for exceptions, and therefore where you have ... I mean, any process that you have allows for exceptions, because the way it's written, and the ... what would concern me was that ... were those exceptions properly governed? There were times, I think, back in 2004, as highlighted by the regulator, enhanced governance by bringing it to the board was important, so I think that was a useful development. But I didn't have concerns that they were being made without the control environment or the four eyes principles that-----

Senator Sean D. Barrett: And who did you express the concerns to?

Mr. Gerry Fitzpatrick: No, my concerns were in relation to my focus on my work, so to understand the control process and how it worked. So if there were exceptions in any system, reconciliations, differences, something outside policy, I'd need to understand how that was governed. So my concerns were to understand how that was governed, what kind of data was available, who was reviewing it, and were they satisfied those exceptions were appropriate.

Senator Sean D. Barrett: And were Ulster Bank aware of your concerns?

Mr. Gerry Fitzpatrick: I think I may have ... So my concerns were in terms of that there could be risk of misstatement in the accounts. So they weren't concerns that they were inappropriate. My concerns were to make sure that they were being governed correctly. So concerns where, in the audit process, you're saying, "Here is a process; it has exceptions to it; should those exceptions apply? And if they are, who governs that process and who signs off on those exceptions?" To understand if they're properly ... they're properly governed. But they weren't concerns, Senator, that these were ... that these weren't acceptable exceptions. The question was who was, you know, in an escalation process where if someone gets authority to do something, if they need to do something above their authority that somebody else has the underwriting capability to do that, and therefore the exceptions have to be reported to a higher level, and that was where my concerns ... So my concerns weren't about impropriety, Senator.

Senator Sean D. Barrett: I know, but who did you express the concerns to? Were Ulster Bank aware that you were concerned?

Mr. Gerry Fitzpatrick: They would have ... well, they would have seen that I was testing in that area, so that's how my concerns ... I have to get myself satisfied, and therefore my concerns were to make sure that that process was working. So I think maybe we're misunderstanding what concerns ... to me concerns are, could this process with exceptions cause the numbers to be incorrect? And therefore my concern is what I call a risk focus. It wasn't that this was an ... that this process was inappropriate, and that's ... if I thought it was inappropriate I would have-----

Senator Sean D. Barrett: So you ... so I take it you weren't concerned that these were 40% in 2006? You were concerned about how the numbers were made up?

Mr. Gerry Fitzpatrick: I beg your pardon? Sorry, I didn't-----

Senator Sean D. Barrett: You weren't concerned that these were 40% in 2006, these-----?

Mr. Gerry Fitzpatrick: I was concerned to see who was ... what process was being governed over the exceptions.

Senator Sean D. Barrett: Okay. Professor Brennan, who is an accountant, in 2004 she said that she was concerned about the level of sanctions outside limits, especially with regard to those who had breached both the loan-to-value and the debt service ratio limits. That was 2004.

Chairman: Have you the document there?

Senator Sean D. Barrett: Yes, thank you, Chairman. That is Deloitte, Vol. 1 and it's on page 40. So were you aware that there was concern about these matters at the board level in Ulster Bank ... by ... by an eminent accountant?

Mr. Gerry Fitzpatrick: Sorry ... can I just get the reference on page 40? It is UBI-----

Senator Sean D. Barrett: It is 31/04 and "Professor Brennan queried the level of sanctions outside limits, especially with regard to those which breached [the limits] ... which breached both the loan to value and the debt service ratio limits."

Mr. Gerry Fitzpatrick: I certainly was aware because I would've review ... I would've reviewed the board minutes. What I was ... what I ... when someone raises ... and you would expect this at a board meeting for people to have questions and raise questions in relation to what was happening. The process I would be seeing is ... well ... whether that concern was sustained. And I don't believe that that action was ... there was a ... that having addressed the matter that there was an open item ... I thought that the item was taken seriously and the action was taken. So if a board member had a concern that sustained, then I would be certainly questioning that ... at the time of the approval of the accounts, whether they thought that their accounts were, therefore, materially misstated. And I don't believe that .. that ... that concern or that question sustained because I think the ... the issue was addressed as far as I was aware ... because the regulator-----

Senator Sean D. Barrett: Well, I think it was greater in 2007 than it was 2004 when Professor Brennan raised it.

Mr. Gerry Fitzpatrick: The board members who raised questions approved the accounts. So, therefore, if their concerns are unsatisfied, they obviously need to ... they would ... I would be ... that would have come up at the approval of the accounts. So, yes, it's right to have concerns in relation to exception limits. It's right to highlight them. It's right to have processes that address, kind of, the approval of those. But ... but I don't believe, and maybe I'm wrong in terms of the documents, that that concern was sustained through that period in terms of 2004 because otherwise it would have appeared in the board minutes on an continuing basis. I don't believe Professor Brennan or others continued to raise that issue.

Senator Sean D. Barrett: I do believe there were concerns still of that kind in 2007. In fact, that was one of the questions we were putting to people. How was this ... raised by Professor Brennan in 2004 and nothing ... and it getting worse by 2007-----

Mr. Gerry Fitzpatrick: I think ... I think, Senator, in terms of the concerns the ... the concerns in 2000 and ... without going into each of the documents ... there were different concerns. Certainly the .. the level of reporting of it in 2004 was an issue. There were certainly issues

raised by the regulator that Professor Brennan and others queried in relation to the 2007 ... because of the Dublin mortgage centre. It wasn't a ... it wasn't the same issue. But, ultimately, Senator ... the ... if board members have concerns - and clearly I read the board minutes so I make sure that there is an action from my stake I follow it up -but the financial statements are approved by the board members, they give representations to the auditors and that's a particularly significant legal requirement. At no point were those concerns expressed to me as being unsatisfied by the audit committee or the board when they were signing the financial statements ... for which they're responsible.

Senator Sean D. Barrett: But do you not quantify these and see they were greater in 2007 than they were in 2004, when Professor Brennan raised them?

Mr. Gerry Fitzpatrick: But these were exceptions which were ... to policy ... which allowed for exceptions. So exceptions weren't ... isn't a breach of regulation. Exceptions-----

Senator Sean D. Barrett: I don't understand your use of the word "concern". Because each time we come to it you ... you're not concerned. You ... you don't seek to correct the problems which the data disclose.

Mr. Gerry Fitzpatrick: I don't correct any of the data because I'm the auditor. What I do is ... I ... maybe I misused that word "concern". But what I see is a system. And I see what numbers are generated by the system. If there's a risk that the numbers that that system generates are inaccurate and, therefore, that the numbers recorded for loans, for impairment or for anything else are inaccurate, then my concern is to say well ... am I looking at the controls in that area and I can test that area. I can look at individual cases and satisfy myself that that number isn't materially misstated. Which ultimately is what the purpose of my-----

Senator Sean D. Barrett: And the controls didn't work. Let's go to loan-to-deposit ratio. It was 211 when it should have been 120. And you said that this was excusable because Royal Bank of Scotland was a sophisticated group with a strong governance culture. I don't think anybody in the United Kingdom believes that of the Royal Bank of Scotland. Record losses ... a bailout by the British Government and a chief executive who was deprived of his knighthood.

Chairman: Senator, Senator, I ask you ... Senator, Senator, please. Excuse me one second you can refer to the Chair, Senator. I would ask you to be more measured and more ... directed in questionings towards Mr. Fitzpatrick and Mr. Cullen, rather than taking maybe value judgments or implied value judgments either in this jurisdiction or in other jurisdictions. So I would ask you to reframe your question again and to put it to Mr. Fitzpatrick and Mr. Cullen.

Senator Sean D. Barrett: Was it a mistake to take the standards which Royal Bank of Scotland were operating in the United Kingdom?

Mr. Gerry Fitzpatrick: I am not aware that in relation to financial reporting the issues you refer to have caused the regulator in that jurisdiction to require revision of accounts or financial reporting - I am not aware of that, so no, I don't believe that information affected the financial statements in that group in terms of the preparation and the proper financial reporting. There were no withdrawals, as I understand, by the regulator or the securities regulator or requirements for restatements of financial statements. There may have been other issues, Senator, in relation to that organisation but I'm not familiar with them and I certainly haven't been involved in the audit of Ulster Bank since 2008 so I wouldn't be familiar with the detail of them as they pertain to Ulster Bank Ireland Limited.

Chairman: Senator MacSharry.

Senator Marc MacSharry: Thank you and welcome gentlemen. Can I ask Mr. Cullen to confirm or not that Deloitte & Touche are an international ... they're a global company?

Mr. Pat Cullen: It is an international network of individual firms, so Deloitte in Ireland is a member of the international network of Deloitte -----

Senator Marc MacSharry: And is there a consistency of approach, standards, professionalism, ethics across all of those, or are they different from country to country?

Mr. Pat Cullen: In general, unless there is a difference caused by a difference in the legal system in a particular country. Other than that we try and apply common policies in approaching similar types of issues.

Senator Marc MacSharry: For example in auditing?

Mr. Pat Cullen: Yes.

Mr. Gerry Fitzpatrick: In auditing we would have a consistent audit approach, as Mr. Cullen refers to it. Local regulation might require ... so there are international standards in auditing for Ireland and the UK. They might be different to some of the standards in ... so there's specific rules for auditing in the US perhaps. But the framework for how we address risk - the process we do our audit, to the training we give our people, the scepticism and the kind of ... the learning messages, the alerts we get around issues - we use the infrastructure to inform us of those things.

Senator Marc MacSharry: Would it be fair to say or not that I suppose the level of thoroughness or intrusiveness for want of a better expression, internationally would be broadly the same in auditing would it?

Mr. Gerry Fitzpatrick: I believe so yes. I mean we have a practise review process that looks at .. that holds us to account for the same standards, country by country.

Senator Marc MacSharry: Who regulates your company, your profession?

Mr. Gerry Fitzpatrick: So that the ... in Ireland -----

Mr. Pat Cullen: Sorry, the audit practice is regulated by the Chartered Accountants Regulatory Board

Senator Marc MacSharry: The which? And in audit?

Mr. Pat Cullen: The auditing is regulated by the Chartered Accountants Regulatory Board and IAASA, which is a State organisation, then supervises CARB, as it's called.

Senator Marc MacSharry: CARB is the Chartered Accountants Regulatory Board and IAASA then is the Irish Auditing and Accounting Supervisory Authority, isn't that right?

Mr. Pat Cullen: Yes.

Senator Marc MacSharry: Okay, so did these organisations review your bank auditing work?

Mr. Gerry Fitzpatrick: CARB - can we refer to the Chartered Accountants Regulatory

Board CARB - reviewed our work.

Senator Marc MacSharry: Why? Are both organisations seen as one?

Mr. Gerry Fitzpatrick: No. Chartered Accountants Ireland is the umbrella body for chartered accountants in Ireland. There are other regulatory bodies equally for other groups of accountants -----

Senator Marc MacSharry: Did they review these audits?

Mr. Gerry Fitzpatrick: CARB would have reviewed ... which is our ... which is a body connected with independent ... is called ... reviewed our work, and yes would have reviewed our work on bank audits.

Senator Marc MacSharry: And that includes IAASA, no?

Mr. Gerry Fitzpatrick: No IAASA then has a supervisory activity over CARB and their activities. Not necessarily in relation to every single thing that CARB does, but in certain aspects of its work. And that's in a period of transition because IAASA was only set up in -----

Senator Marc MacSharry: So would they have reviewed these audits for example?

Mr. Gerry Fitzpatrick: CARB would have reviewed the audits.

Senator Marc MacSharry: Okay. And what was the findings of that?

Mr. Gerry Fitzpatrick: There were no ... there would be findings in relation to certain minor matters, documentation, but there were no adverse findings in terms of formal ... what they would call adverse findings.

Senator Marc MacSharry: And would you describe their review as intrusive or, for want of a better expression, light touch?

Mr. Gerry Fitzpatrick: Thorough. I guess they ... they too benefit if I recall, and I don't exactly, they use inspectors who had experience of the UK environment in banks. So some of the inspectors, they had local inspectors, and I must declare as I have on my CV, that I am a member of one of the quality assurance boards - not obviously looking at my own work. But they have local inspectors and they bring in experts as well, so they have an expertise in auditing and in auditing our firm, and globally and also in relation to banks.

Senator Marc MacSharry: They made no adverse findings. And would their activities be the same as, or less intrusive than, the Public Company Accounting Oversight Board in the United States for example?

Mr. Gerry Fitzpatrick: I guess ... they review to different standards, so that's going back to your earlier point, is there are ... there are global Deloitte approaches to work but local regulators have standards, so the PCAOB, the public ... the regulator in the UK, or US, has a series of different standards and therefore they have a different inspection process.

Senator Marc MacSharry: And would you be aware that ... and this is why I asked earlier. I mean, is there a similar and a consistent approach taken internationally, that on a review in 2014, that the Public Company Accounting Oversight Board found that 25% of audits were deficient in the United States, and citing in particular testing controls over the valuation of long-lived assets, purchased loans-----

Chairman: Could you just reference that bit for us?

Senator Marc MacSharry: I will in a second, if it's okay.

Chairman: Sure, yes.

Senator Marc MacSharry: -----impaired loans-----

Chairman: Or maybe reference it first and then give it to us.

Senator Marc MacSharry: Yes, I'm quoting from *The Wall Street Journal* of June 2, article by Michael Rapoport.

Chairman: Okay.

Senator Marc MacSharry: Okay.

Chairman: Okay, I don't know if the witness is familiar or not with it but we'll get the question now.

Mr. Gerry Fitzpatrick: I'm familiar with the environment. I mean, in terms of-----

Senator Marc MacSharry: Yes. No, that's-----

Mr. Gerry Fitzpatrick: -----I don't believe Ulster ... I mean, I know Ulster Bank Ireland Limited wasn't part of that regulatory inspection so-----

Senator Marc MacSharry: No-----

Mr. Gerry Fitzpatrick: But clearly I'm aware that there are some improvements.

Senator Marc MacSharry: -----of course it wasn't. I'm merely asking, if we're applying the same standards internationally, if we have the same approach internationally, and we're finding these kind of deficiencies in similar activities in the United States on 25% of audits, and the regulator here is finding that everything is in good shape, I'm just merely trying to ascertain, do both regulatory organisations take the same intrusive approach or is the one here less intrusive, or are we just better here in Deloitte & Touche than our colleagues in the United States?

Mr. Gerry Fitzpatrick: What I believe is that they are auditing to a set of standards in the US which are different to the standards here, so, I mean, I can't say what is, that is in that difference. What I don't have to hand, Chairman, is their grading of finding, so they ... in any audit process you will have findings and make observations and there are some divisions. I don't believe in 2004, 2014 our firm would have had withdrawals of audit appeals as a result of that, so I'd have to see the grading system and I just don't have it to hand.

Senator Marc MacSharry: Yes. No. Again, I'm just asking because it's something that came up on another-----

Mr. Gerry Fitzpatrick: Well, I suppose ... I guess ... there is no doubt in the US that Sarbanes-Oxley, which is a whole series of Acts, put in particular attestations required of directors and particular auditing standards and they are ... they're-----

Senator Marc MacSharry: And their treatment of impaired loans and purchase loans is different, is it, very substantially to here?

Mr. Gerry Fitzpatrick: Well, they have different accounting standards as well, so they have ... the don't ... they're not using IFRS, they're using SEC standards, but ... so it is a different environment of accounting but I don't know to what point that is relevant to the Ulster Bank audit.

Chairman: Well, okay, I might allow some space for it, Senator, and I'll bring you back in. It is a part of the job of this inquiry is to provide recommendations at the end, maybe look at activities in other jurisdictions, such as Sarbanes-Oxley, as you've mentioned already, and to see how other practices may be ... may be examined in terms of recommendation for this committee's work. So back to yourself.

Mr. Gerry Fitzpatrick: I guess ... I suppose, to be fair to the local regulator, I ... they have to be allowed to explain the differences in terms of their process. I feel that they're ... I haven't been subject to a PCAOB audit inspection, but I have been subject to local regulatory inspection and they are comprehensive. Whether the two compare, I think you'd have to ask them to be honest, because I haven't-----

Chairman: Just coming up to two minutes there, Senator.

Senator Marc MacSharry: Yes. How would you briefly characterise the firm's interaction with the Financial Regulator in the period 2003 to 2008, Mr. Cullen?

Mr. Pat Cullen: Well, our ... as an auditor, our interaction with the Financial Regulator is set out under a specific piece of legislation, which Mr. Fitzpatrick referenced already.

Senator Marc MacSharry: Okay. That's the process, but how was it? Good, bad?

Mr. Pat Cullen: Mr. Fitzpatrick?

Mr. Gerry Fitzpatrick: I think the dialogue ... we didn't have active dialogue. Certainly, I was aware of all the ... sorry, we won't use that word again ... the issues they were raising in relation to our correspondence. But in terms of direct contact, there wasn't a protocol in place that ... for active dialogue. We were looking for that, and that was put in place I think in 2009, because, as I said earlier, we have a duty to report, but we don't have a right to report, and so ... so I think more active dialogue is one of the lessons learned that I ... they instanced earlier, and ... but there has to be two-way dialogue, but I think certainly if you look at what happens now, it was certainly less active or proactive than ... sorry, it wasn't ... it was less proactive than it is now.

Senator Marc MacSharry: So since 2009, would you have ever had occasion to say to the regulator, "Look, we have concerns, to use your word, about client X", or-----

Mr. Gerry Fitzpatrick: I'd to be careful here, Chairman, in terms of-----

Senator Marc MacSharry: I'm not asking him to name them.

Chairman: I wouldn't even say his words. I will let Mr. Fitzpatrick use his own language in his response.

Mr. Gerry Fitzpatrick: Again I will have to, kind of, take your guidance here, Chairman. I was auditor to ... auditor to Bank of Ireland Limited in 2008. I have been auditor to other organisations since that point. If I was to be suggesting that I was or wasn't talking to the regulator about issues, that would suggest that I was talking about those other organisations, and I'm

not here to talk about those organisations.

Chairman: All right, fair enough.

Mr. Gerry Fitzpatrick: And I think, you know, from the documentation ... so the point is our firm wouldn't... I think in the generalities-----

Chairman: I think the question can be reframed. Can you comment on the role of the Financial Regulator and what they played in the period leading up to the crisis?

Senator Marc MacSharry: No, it can't be reframed to that. In fairness.

Chairman: Well, it's not a case of letting him away or anything else-----

Senator Marc MacSharry: Well I'm not letting anybody away. But I mean like, the reality is, I'm not asking him to name any clients at all. What I'm saying is, you said that you sought the ability to ... you said you had a legal obligation first of all to report, but you didn't have a facility to report. So you sought that, and it was given in 2009. All I'm asking is, did you ever use it?

Mr. Gerry Fitzpatrick: Well, I'm not trying to be difficult here, Senator. I've active dialogue with the regulator in relation to banking audits at the moment. That doesn't-----

Senator Marc MacSharry: Did it change after 2009?

Mr. Gerry Fitzpatrick: -----suggest, that dialogue is not necessarily one of raising issues.

Chairman: Okay, I'm going to hold it there, because we are slipping outside of the directions here that was given to Mr. Fitzpatrick as well. So I just need to ask you to move to your final question.

Senator Marc MacSharry: Do you feel that the report issued to the Financial Regulator provided them with enough information to enable them to discern the full regulatory position of the group?

Mr. Gerry Fitzpatrick: The report as in ... do you mean the Deloitte and Touche report? So the Deloitte and Touche letter, the section 47 letter, as it is referred to, is a confirmation of certain statutory requirements, so those requirements are at a high level in relation to things that jeopardise the organisation. The information that is given in ... outside of that report, which is the audit summary document, which shows what we are talking to the audit committee, talks about the issues we are dealing with. We don't report on the capital calculations or the liquidity calculations; that's not required by statute. So the regulator gets that information directly, although it reconciles with the financial statements, but there are lots of returns, Senator, that the regulator uses which aren't the subject of the audit and, therefore, they have that information directly - the monthly, daily reports that flow through to the regulator that allows them to make that decisions, and I'm sure that you can ask them whether they thought that information ... I'm not ... what I have to do is in my audit, if I come across a flaw in that, a serious flaw in a regulatory return, I would have to under section 47 report it. And I didn't come across serious flaws in the way ... because I would have reported them otherwise.

Chairman: Okay, thank you. I just want to move into two issues, then I'm going to take the wrap up. Can I maybe ask you one brief question and Mr. Cullen and Mr. Fitzpatrick can answer that? In the firm's opinion, did the external audit fulfil its role or not?

Mr. Gerry Fitzpatrick: I'm satisfied that the opinions that I raised under the legal requirement of a law... under the Companies Acts, met those requirements. So I'm satisfied, yes.

Chairman: Mr. Cullen?

Mr. Pat Cullen: Absolutely, yes.

Chairman: On a related matter, and as I mentioned earlier, this committee will have finding of recommendations when we conclude in November. One proposed recommendation that was put to us was put by Professor Bill Black earlier, back in February 2015, and it was in a response to a question put by Deputy Phelan actually at the time, and a follow up to an earlier question. And Deputy Phelan was asking Professor Black, "Will he outline for the committee the changes to those rules with regard to external auditors that could be made?" And one suggestion that Professor Black made was that the straight answer is not to allow "the bankers to pick the auditors. There should instead be a panel of qualified auditors that are assigned to each of them, and we should track the performance of those auditors. It would be like [regulation, or] relegation [sorry, actually]. If someone had a record of screwing up, they get yanked out from the panel...". Then he goes on to say that they'd go on to "do smaller accounts and prove over the five years that they can do it right, and then get back up to [do] the "bigs.". That being the big four and the big eight or whatever. When asked who should operate the relegation process, he said the United States Government, but in the context of this inquiry, it would be the Irish Government. Do you have any comment on such an approach?

Mr. Gerry Fitzpatrick: I am not aware that is the approach in the US, the United States or anywhere else. I think the ... this is to probably to fundamental point of company law. The directors are responsible for stewardship, they have to account for that stewardship and have an auditor appointed. So it's a scrutiny process that an independent auditor is appointed; I think that auditor is independent, but I would do because I am one of them. And I don't think selection of auditors by another body who wouldn't know the right skills that was required for that organisation, I can see some flaws in that. So it's not a process I have seen. I think the regulation of audit and the certain recent changes in relation to audit regulation are constant, which are requiring greater rotation, and that might achieve the same objective.

Chairman: Okay, thank you. Wrapping up, Deputy McGrath.

Deputy Michael McGrath: Yes, thank you very much Chair. Mr Fitzpatrick, can I just, by way of example, I've been looking at the 2007 financial statements for Ulster Bank Ireland Limited and there is reference in the ... in the report of the directors to risk management and the key risks are cited and one of them is credit risk, and then note 25 is much more detailed in terms of risk management. But what would you understand to mean from credit risk in that context, as a risk that the bank was facing?

Mr. Gerry Fitzpatrick: It's ... what you are required to disclose in that situation is the inherent risk the organisation had so by lending you incur credit risk and therefore it's the risk that, that the credits you don't properly manage that credit exposure.

Deputy Michael McGrath: That you won't be repaid by your customers?

Mr. Gerry Fitzpatrick: Well that-----

Deputy Michael McGrath: Would that be part of it?

Mr. Gerry Fitzpatrick: Yes.

Deputy Michael McGrath: Okay. Now in note 8 to the accounts, dealing with asset quality there are a number of tables, which as you indicate, do statistically break down, you know, the loans that have been provided and there are descriptions given including, the word property is used as one heading, construction is used as another but no commentary. And when you go on to note 25, which deals with risk, there isn't, as I can see, a reference to concentration risk in terms of the concentration of the bank's exposure to property construction development, for example. Yes, the figures are in the tables in note 8, but in note 25, where really the directors are describing their approach to risk management, there isn't any reference that I can see for 2007, for example, to what emerged as a key risk for the bank. An overdependence on one sector and the risk of the collapse in that sector meaning many of the loans simply couldn't be repaid.

Mr. Gerry Fitzpatrick: I don't have the financial statements here but I suppose, I take your word that that's the disclosure so I'm not questioning that. I think the table gives that analysis. Perhaps the narrative could have been greater, I don't think it would have, I think what they're trying to describe is their credit management process, which would include a whole range of things from their appetite to their concentration list. So they're saying they have a process in place, it is not ... the standard doesn't require a narrative to say this is what we currently have and this is what we're currently doing about it, so they're meeting their requirement in describing risk management processes, rather than specific details. If they were to list ... that narrative hasn't been a part of the analysis. Now there are some new standards that have perhaps enhanced some of the risk analysis subsequent to 2007, but again they're still commenting on the data and not giving comment to say, "well we think this is right or this is wrong".

Deputy Michael McGrath: Okay. But would I be right in saying that even back then, say in 2006 and 2007, there wasn't any impediment or prohibition on the directors providing additional information, additional commentary in the note dealing with risks that the bank was facing?

Mr. Gerry Fitzpatrick: No, there's no prohibition on additional disclosure, no.

Deputy Michael McGrath: Okay. I asked that really in the context of one of the first questions I asked earlier on. And if I can rephrase it; if you had been absolutely certain in your own mind back in 2007 that this was heading over a cliff, that the bank, the banking system, was facing a crash but you'd no evidence for that because it hadn't happened yet, but if you were certain as the auditor that this is not sustainable, it's heading over a cliff, what could you have done? And I'm using this by way of example because we'll have to make recommendations as a committee and you know the role of auditors is certainly an element of that, but what could you have done? What could you have advised the directors in terms of disclosures in the accounts for example?

Mr. Gerry Fitzpatrick: If I was certain, then I would have been in a different position. If I was certain that these were things that were going to happen, I definitely would be doubting any of the assumptions they made-----

Deputy Michael McGrath: But you had no evidence.

Mr. Gerry Fitzpatrick: Correct. So, so, you have to have objective verifiable evidence, so I can't be certain and not have evidence; I'm an auditor. To be certain about something you have to have gathered the evidence.

Deputy Michael McGrath: But personally certain, as in, you know, you had a gut instinct that this simply is not going to last. What could you have done as auditor? Could you have requested additional disclosures, could you have requested that the risk note, for example, be much more detailed?

Mr. Gerry Fitzpatrick: It sounds to me as predicated on me being certain and I wasn't. I was, I was happy that they were reflecting ... I didn't have a future crystal ball to say-----

Deputy Michael McGrath: Okay. If you strongly felt.

Mr. Gerry Fitzpatrick: If I didn't believe their assumptions, I would have qualified the accounts so, I would have challenged that, so if I had data to show that their assumptions were incorrect, I would obviously have to pursue that and tell them that I was unhappy with the accounts and they would have to change them or else I qualify.

Chairman: If there was evidence external to the bank, for instance, that-----

Mr. Gerry Fitzpatrick: Yes, I look for contradictory evidence, but this idea of me being certain, I suppose, is hard for me to get my head around, because I didn't have that certainty.

Deputy Michael McGrath: A final question for Mr. Cullen. You said that the fee income from Ulster Bank, I think, was, even at the peak, less than 1% of the total income that Deloitte had. Was it one of the largest clients, was it among your top ten clients, for example?

Mr. Pat Cullen: I can't be absolutely certain. I would have felt it probably was in the top ten.

Deputy Michael McGrath: Yes, was it your largest financial services client?

Mr. Pat Cullen: If not, it certainly would have been in the top 20.

Deputy Michael McGrath: Sure. Was it the largest financial services client for Deloitte?

Mr. Pat Cullen: It would have been probably in the top two or three financial services clients. I can't say for certain it was the top one.

Deputy Michael McGrath: Okay. Thank you.

Chairman: Senator O'Keeffe.

Senator Susan O'Keeffe: I have a few very short questions and then a couple of longer ones. Mr Cullen, on page 3 of your own statement you say ... I'm sorry, page 7 of your own ... you talk about PN 19 (1) includes section B which deals with the auditor's right and duty to report - "It requires that where an apparent breach of statutory or regulatory requirements comes to the auditor's attention, the auditor should" do various things. Is that "should" or "must"? It is just a "Yes" or "No". Does "should" mean "must" or not?

Mr. Pat Cullen: I'm not an auditor so this is not part of my core competence-----

Senator Susan O'Keeffe: Okay, well you put it in your statement Mr. Cullen so.

Mr. Gerry Fitzpatrick: And I advised him on that.

Senator Susan O'Keeffe: Okay, well fine. Is it "should" or "must"? Does "should" mean "must" or not? "Yes" or "No"?

Mr. Gerry Fitzpatrick: Yes, it does.

Senator Susan O’Keeffe: It does. Thank you. Did you ever ... Did Ulster Bank or the RBS ever say anything to you after 2008-2009 about the audit or about their concerns given what happened?

Mr. Gerry Fitzpatrick: No, not to me. I wasn’t the auditing partner. I passed 2008, I rotated off it, but to my knowledge there was no request for re-statement or challenge in relation to prior adjustment to those financial statements, because the directors would have to have made that determination themselves if they were making ... if they felt their statements were wrong.

Senator Susan O’Keeffe: Obviously, thousands of loans are made in any bank. Who would choose the sample for the audit of the loans? Would you guys choose them or would the bank choose them and give you the sample?

Mr. Gerry Fitzpatrick: We would choose them.

Senator Susan O’Keeffe: You would choose them. Can you tell me then, in relation to your statement, you say on page 2, point No. 10, “The quality of loans had deteriorated during 2008.” Had they also deteriorated during 2007?

Mr. Gerry Fitzpatrick: I believe they would have been ... I don’t have the data. I can get the table out but it was in the financial statements. By a much smaller degree.

Senator Susan O’Keeffe: By a much smaller degree.

Mr. Gerry Fitzpatrick: I don’t have the ... Maybe I do have it.

Senator Susan O’Keeffe: Okay. In point 19-----

Mr. Gerry Fitzpatrick: Sorry, it went from €6.3 billion to €14 billion, from ‘7 to ‘8, it went from €5.5 billion to €6.2 billion in the previous year, so there was a deterioration.

Senator Susan O’Keeffe: So they were deteriorating. There was a trend.

Mr. Gerry Fitzpatrick: Yes.

Senator Susan O’Keeffe: Okay. In point 19 yourself, you say: “We reported that the going concern assessment relied on the RBS Group’s management of capital and funding on a group-wide basis”. I take it this is in reference to point 14, where you say the directors confirm “it was appropriate to prepare the financial statements of the bank on a going concern basis...”. So I’m taking it, is this some kind of qualification? “We reported the going concern assessment relied on the RBS Group’s management of capital funding on a group-wide basis”. It sounds to me like some kind of qualification but maybe not.

Mr. Gerry Fitzpatrick: It wasn’t a qualification; it was a statement of the importance of that reliance and, as I referred to earlier, I had to establish whether that was reasonable for them to have done that, but it wasn’t a qualification. It was an emphasis in my discussions with them. Because when this whole summary document is produced before they approved the accounts and they approved the going concern assessment as our last assessment and I was highlighting the importance of that reliance.

Senator Susan O’Keeffe: Just before that you say, “We referred to the absence of up-to-date collateral valuations and the need for enhanced documentation of the impairment process.”

What ... How significant was the absence of the valuations and the need for enhanced documentation, and why are you drawing our attention to them?

Mr. Gerry Fitzpatrick: Because it was a discussion I had with the audit committee, that document that it is drawn from is with the committee in terms of the papers we gave them.

Senator Susan O’Keeffe: Yes. I know.

Mr. Gerry Fitzpatrick: It was an explanation of my ... of the issues faced in the auditing terms of understanding judgments and therefore, to me, I was pointing out that I had come across this point about valuations. I’d satisfied myself because ... the statement goes on much further to say how I satisfied myself. And in relation to loan documentation, I was pointing out to them that they had a body of work to do. Even though I had established for each case by case, the documentation that was required to make my assessments, I was pointing out to them that work was required to make sure that was in a coherent way from case to case.

Senator Susan O’Keeffe: But this was between you and them. This wasn’t a ... this wasn’t something that went into the accounts or wasn’t a note to them-----

Mr. Gerry Fitzpatrick: No, this went to them and the regulator.

Senator Susan O’Keeffe: Okay.

Mr. Gerry Fitzpatrick: But it ... I ... but ultimately, I had made a conclusion that these issues didn’t cause a material misstatement of a financial statement. I was pointing in proper disclosure to them about things I was coming across in my audit.

Senator Susan O’Keeffe: And finally then, at point 15, “Similar disclosures on loan impairment and going concern were provided in financial statements for earlier years.” So again, there were loan ... what are you trying to tell us there?

Mr. Gerry Fitzpatrick: Is it the disclosures about the loan quality assessment that I refer to-----

Senator Susan O’Keeffe: Yes.

Mr. Gerry Fitzpatrick: And in paragraph 10, and the loan in paragraph 13 was talking about the funding. So it just said that ... I was trying to point out maybe delicately was the disclosure in 2008 as I had been giving it as an example, were also in the directors’ disclosures for earlier years. So I was just saying it wasn’t a 2008 event that their disclosures were comprehensive. It was every year they made comprehensive disclosures.

Senator Susan O’Keeffe: So there had been loan impairments in previous years?

Mr. Gerry Fitzpatrick: Yes. And the table of loan quality was given in earlier years.

Senator Susan O’Keeffe: And again a trend of loan-----

Chairman: Senator.

Senator Susan O’Keeffe: Final question. A trend of loan impairment at that point when you look at then the eventual disparity between what was said in the accounts and what resulted, would that trend not have again been saying to you, “Hm, loan impairments.” I mean, I’m sorry, I’m a layperson, so loan impairments, loan impairments, loan impairments.

Mr. Gerry Fitzpatrick: The impairment number went from €52 million in 2007 to €304 million ... so what they wrote off was €52 million in one year, so I think it was reflecting that trend. So it went from €52 million as a loss in 2007 to €304 million in the subsequent year.

Senator Susan O’Keeffe: But in reality, much more than that.

Mr. Gerry Fitzpatrick: Well, subsequent events proved that a lot more impairment happened and therefore, yes, a lot more impairment got reflected in subsequent years. It wasn’t to say-----

Senator Susan O’Keeffe: Thank you, Chairman.

Mr. Gerry Fitzpatrick: -----that the €304 million was wrong. It was simply that further-----

Senator Susan O’Keeffe: It was less than-----

Mr. Gerry Fitzpatrick: -----impairment happened.

Senator Susan O’Keeffe: It was less than adequate.

Mr. Gerry Fitzpatrick: No, no, at the time it was adequate. What happened was, further impairments of other loans happened. So a single loan that was on the balance sheet in 2007 could’ve gone bad in 2008, 2009, so the subsequent losses are to do with events that happened subsequent to that year end.

Senator Susan O’Keeffe: Thank you.

Chairman: Alright, Mr. Fitzgerald, I just want to bring matters to conclusion, so-----

Mr. Gerry Fitzpatrick: Fitzpatrick, sorry.

Chairman: Sorry, Mr. Fitzpatrick, sorry.

Mr. Gerry Fitzpatrick: It’s alright.

Senator Susan O’Keeffe: It’s the end of the day.

Chairman: My porridge I had this morning is after wearing off. Okay, it’s agreed that the notes highlighting the risks, concentrations, etc., were included in the accounts. We covered that ground earlier. So we can take that as agreed, yes?

Mr. Gerry Fitzpatrick: Yes, a good disclosure framework.

Chairman: Alright. Notwithstanding this, the bank continued with the strategies adopted that’s very much the narrative of your position today as well, yes?

Mr. Gerry Fitzpatrick: Yes.

Chairman: Okay. So in that regard, how effective do you feel the communication of these risks were to Ulster Bank and could you have provided more clarity or direction to them?

Mr. Gerry Fitzpatrick: I think they were clear in ... they would ... doing the analysis, I was clear that their analysis was accurate and therefore true and fair and therefore I think they had the appropriate analysis. What was ... if ... what was ... and this the question I got asked

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before, if I had known that the assumptions underlying their disclosures were inaccurate, then that would've been something I would've communicated. I didn't know that those assumptions were flawed.

Chairman: Okay.

Mr. Gerry Fitzpatrick: And neither did the organisation.

Chairman: Okay, alright, fair enough. Thank you for that. I'm going to bring matters to a close. Is there anything else you'd like to add, Mr. Fitzpatrick or Mr. Cullen?

Mr. Gerry Fitzpatrick: I guess it's been a long day. I hope we have been helpful. Thank you.

Chairman: Alright, thank you. So with that said, I would like to thank Mr. Cullen and Mr. Fitzpatrick for their participation today and for their engagement with the inquiry. The witnesses are now excused. Before I go for adjournment, there's just one item in regard to a direction that the committee needs to deal with, with one of the investigation teams, so if I can just hold on. It's a one single item agenda. I just want to suspend the meeting for a few moments to excuse the witnesses and we will resume just to deal with that particular item.

Sitting suspended at 6.24 p.m. The joint committee resumed in private session at 6.35 p.m. and adjourned at 6.36 p.m. until 9.30 a.m. on Thursday, 14 May 2015.