

# HOUSES OF THE OIREACHTAS

Volume 2

No. 15

Morning

No. 16

Afternoon

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## AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI- REACHTA

### JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

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*Déardaoin, 14 Bealtaine 2015*

*Thursday, 14 May 2015*

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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.

after the September guarantee-----

**Chairman:** Sure.

**Mr. Richard Burrows:** -----I kept the Minister for Finance pretty well informed as to how we were progressing in relation to trying to find third party funds to supplement our capital base. And so he was well aware and we had quite a number of discussions about how that was progressing. And indeed, I think his officials had with Brian Goggin and with others in the Bank of Ireland. So there was a continuing dialogue about that.

**Chairman:** So we know the conclusion of that dialogue ended with a capital ... with a State capitalisation into Bank of Ireland. But are you saying to the committee today that in the period after the guarantee in 2008, that Bank of Ireland was discussing the necessity and the requirement for capitalisation from the State?

**Mr. Richard Burrows:** Yes, up to the point where the capital actually was injected.

**Chairman:** Thank you very much. I'm going to bring matters to a conclusion. Mr. Crowley and Mr. Burrows, is there anything finally, or further you would like to add before we wrap up?

**Mr. Richard Burrows:** I don't think so, Chairman. I would just like to thank you and the members of your committee for the courtesy with which you have received us this morning. And if I may just also put on the record my thanks, seeing as I left Bank of Ireland in 2009, I've relied enormously upon the support of former colleagues there in order to prepare for today. So thank you to all of them. And if I may, just one final word. There is a bunch of people in .... watching all of this in Malahide, Clontarf, London, Miami. Thank you to them.

**Chairman:** I didn't know you were broadcast that far, Mr. Burrows, thank you very much. Mr. Crowley -----

**Dr. Laurence Crowley:** Yes, I'm very happy -----

**Chairman:** -----maybe you could go a bit further geographically.

**Dr. Laurence Crowley:** I'm very happy to endorse what Richard has just said.

**Chairman:** A bit of order, please. I'm just getting order, Mr. Crowley.

**Dr. Laurence Crowley:** I really have nothing to add to that. I wish you well with your important work and we will, of course, continue to offer you our co-operation if and when you require it.

**Chairman:** With that said, thank you both, Mr. Crowley and Mr. Burrows. I would like to thank the both of you for your participation here today and with your engagement with the inquiry. I now state that the witnesses are excused and that we suspend until 2.45 p.m. at which time we will resume to hear from KPMG. Is that agreed? Agreed.

*Sitting suspended at 1.26 p.m. and resumed at 2.45 p.m.*

#### **KPMG - Mr. Terence O'Rourke and Mr. Paul Dobey**

**Chairman:** So I now propose that the committee return back into public session. Is that

agreed? Agreed.

Okay. And this afternoon's session is a public hearing with Mr. Terence O'Rourke, former managing director, KPMG, and Mr. Paul Dobey, partner, KPMG Financial Services. The Committee of Inquiry into the Banking Crisis is now resuming in public session and can I ask members and those in the public Gallery to ensure that their mobile devices are switched off. Today, we continue our hearings with senior auditors who had roles during and after the crisis. This afternoon, we will hear from witnesses from KPMG: Mr. Terence O'Rourke, former managing director at KPMG and Mr. Paul Dobey, partner, KPMG Financial Services.

Terence O'Rourke was managing partner at KPMG from 2006 until his retirement in April 2013. He was a member of KPMG's global board, global executive team and EMA board from 2007 to 2013, head of audit, KPMG, from 2003 to 2006, and audit partner from 1988. Mr. O'Rourke was appointed chairman of Enterprise Ireland in August 2013. Mr. Dobey is a partner in KPMG Financial Services. He has been with KPMG since 1987 and became an audit partner in 1998. He is currently the AIB audit partner in KPMG.

Mr. O'Rourke and Mr. Dobey, you're both welcome before the inquiry this afternoon. And before I commence proceedings, I wish to advise the witnesses 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 do so, 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. For those sitting in the Gallery, those documents will be displayed on the screen to your left and right, and members of the public and journalists are reminded that these documents are confidential and that they should not publish any of these documents so displayed. The witnesses have been directed to attend the meeting of the Joint Committee of Inquiry into the Banking Crisis. You have been furnished with booklets of core documents. These are before the committee, will be relied upon in questioning and form part of the evidence of the inquiry. So if I can now ask the clerk to administer the oath to you.

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

Mr. Terence O'Rourke, former Managing Partner, KPMG.

Mr. Paul Dobey, Partner, KPMG Financial Services.

**Chairman:** So once again to thank Mr. O'Rourke and Mr. Dobey for being here this afternoon with us, and if I can invite you, in which either order you choose, to make your opening comments and statements to the inquiry, please.

**Mr. Terence O'Rourke:** Thank you, Chairman, and good afternoon, members of the joint committee. As managing partner of KPMG from 2006 to 2013, I welcome this opportunity of discussing with you the role of KPMG as auditors in the period you're looking at. I have provided a written ... a detailed written witness statement in response to the themes identified

by the committee. These themes include the integrity of financial reporting and the impact of prevailing standards in recognising risks. In this brief opening oral statement I will deal with a number of matters in that witness statement, specifically the role of an audit, the purpose of financial reporting and the basis of the accounting standards used in financial reporting, the going concern issue when preparing accounts, and, finally, I'll speak briefly about changes in these areas since 2008, which might have contributed to the avoidance of the crisis like the one we've gone through.

Personally, I've spent all my professional life in KPMG since joining in 1975. I was a partner from May 1988 to April 2013. I was head of audit from May 2004 to December 2006, which also involved participation in a number of financial institution audits, including a role on the AIB audit. I held the position of managing partner from December 2006 to April 2013. I've not held an active role within KPMG since retiring as managing partner in April 2013 but the firm has provided support and assistance to me in preparing for today, and I confirm that, in particular, I have consulted with, and received input from, Mr. Paul Dobey, who's also here today, and who was the lead partner on the AIB audit.

I'd, firstly, like to discuss the purpose of financial statements and the role of the external auditor, as there can be misunderstandings in relation to what an audit actually is and what certain commentators think or would like it to be, particularly in relation to the strategy and risk appetite of an entity. The management of an entity is responsible for the preparation of its financial statements. The overall responsibility for financial statements rests with the board. The role of the audit is to provide a report to shareholders on those financial statements. In reporting on whether the accounts present a true and fair view, auditors do an extensive amount of work in checking and verifying the systems producing the accounts as well as the financial information that is presented. Those who prepare the accounts and the auditors who audit the statements must comply with an extensive framework of technical rules known as financial reporting standards and auditing standards. These standards are set by independent international bodies, apply currently in some 280 jurisdictions, and are underpinned by national and by EU regulation. The objective of having clearly defined financial reporting and auditing frameworks, standards and rules is to provide uniformity, consistency and transparency to the users of financial statements. Without such rules, it would be very difficult to ensure the level playing field ... to ensure a level playing field in comparing the results and financial positions of companies across the world and the quality of audit reports on the accounts of those companies. As far as KPMG is concerned, our work was carried out in accordance with our quality control framework for performing high quality audits and we believe that the accounts of the financial institutions we audited were prepared in compliance with the relevant international standards and that KPMG audited those accounts in accordance with their statutory duty and the auditing rules.

In addition, I'd make the following two points. Financial statements are a point-in-time record of financial information of an entity, including its results. By definition, financial statements are a record of past financial performance and do not seek to forecast or predict future performance. An audit opinion, which deals with whether accounts give a true and fair view in accordance with IFRS, does not assure, for example, the long-term success or sustainability of the business model of an entity nor the effectiveness with which management has conducted its affairs. This responsibility rests with the management and boards of the entity.

I would like briefly to discuss the accounting rules which make up the financial reporting framework. From 2005 onwards, the rules that applied to Irish financial institutions was the set of international financial reporting standards known by the acronym IFRS. The IFRS was

developed by the International Accounting Standards Board, IASB, through a formal system of due process and broad international consultation involving the accounting profession, investors, governments, regulators and other interested parties. IFRS seeks to ensure that financial statements provide consistent information about the financial position, past performance and cash flows of an entity that is useful to those making economic decisions. The adoption of IFRS in 2002 across the EU was endorsed with an overwhelming majority vote in the European Parliament and IFRS has force of law in Ireland by way of statutory instrument.

The auditing framework applicable to the audits of the financial statements of Irish institutions was the auditing and assurance pronouncement issued by the UK's Financial Reporting Council, a body independent of the auditing profession. The use of this framework is part of the statutory licensing regime for auditors in Ireland. The directors of our financial institutions which audit clients thus had responsibility for the preparation of financial statements in accordance with IFRS from 2005 onwards. It was, and remains, KPMG's view that the financial reporting of the relevant institutions was conducted in accordance with the requirements of IFRS.

The KPMG teams performing bank audits during the relevant period were experienced in the application of auditing standards in IFRS and had an in-depth understanding of the banking sector. These teams monitored emerging best practice through their connection with fellow KPMG firms in Europe and the US. These audit teams had particularly close ties with our UK firm and were, therefore, familiar with best practice in the UK market and how the accounting and auditing standards were being applied there.

One of the most significant accounting standards impacting the Irish institutions was IAS 39, and its requirements regarding the recognition of provisions for loan losses. My colleague, Paul Dobey, will deal with the issues arising from the fact that IAS 39 is based on an incurred rather than an expected loss model.

I said earlier that accounts were a point in time, and that the numbers that auditors reported on were historic and thus backward looking. There is one matter however that falls to be considered in preparing a set of accounts that is forward looking, and that is the going concern basis of preparation. This means that every year, when preparing the annual accounts, the directors of the company or a bank are required to consider whether they believe the entity will be in operational existence for at least one further year. Typically directors make that assessment based on forecasts, budgets and an evaluation of the risks that the business faces. Auditors are then required to assess whether directors' judgments and conclusions are reasonable and whether it is appropriate for the accounts to be prepared on the going concern basis.

Up to and including 2006 year end, the assessment of our audit teams, based on the economic assessments and forecasts of respected bodies, was that the going concern basis of preparation of the banks' financial statements was appropriate. The additional steps taken by our audit teams in respect of the subsequent years, in light of the unprecedented economic conditions, will be dealt with by Mr. Dobey.

KPMG is very conscious of and acknowledges the significant adverse impact which the banking crisis has had on our society, our people and our clients. We recognise the important work of the joint committee in looking at the systemic issues involved in the crisis and more important, in identifying steps that might be taken to avoid a repeat. KPMG is committed to and is assisting in this process, in particular in relation to further developing audit and corporate and financial reporting standards to reflect the lessons learned from the crisis.

And so the final issue I want to address are the changes in financial and reporting standards since 2008. In light of the global financial crisis the International Accounting Standards Board, the IASB, completed a review of what changes might need to be made to accounting standards. This review considered the lessons learned across more than 100 jurisdictions in which the IFRS had applied by 2008. The IASB's post-crisis review confirmed the important role of financial reporting in providing unbiased, transparent and relevant information. However, it also recognised that only so much can be expected of accounting. The IASB noted, and I cite the IASB chairman who said, that accounting standards could contribute to financial stability, but they should not be expected to provide a veneer of stability by ignoring volatility when it is really there.

The most important conclusion of the review, however, was probably that there should be a more forward looking impairment model for loan loss provisions. It is only recently, after much debate and lots of transatlantic dialogue, that the IASB has agreed a new revised loan loss provisioning model that specified an expected rather than incurred loss model for loan loss provisioning. This standard should permit the earlier recognition of loan losses. As a result, it will be possible to recognise expected losses in the downturn when there is evidence of expected impairment.

Apart from the issue of how losses are recognised, a more wide ranging debate is also under way globally regarding how corporate reporting can be improved. One body, the International Integrated Reporting Counsel, a global coalition of regulators, investors, companies, standards setters and the accounting profession, is examining ways in which to better set out in an integrated report what is happening in a business in more than just financial terms. Such an integrated report would be a concise communication about how an organisational strategy, governance, performance and prospects in the context of an external environment, is intended to lead to the creation of value in the short, medium and long term.

To conclude, I have sought to give the committee an overview of the context of which financial statements are prepared and audited, the legal framework within which that work is done and some developments in standards since the crisis. Mr. Dobey will address now, in more detail, how these principles and standards were applied now in the case of AIB. Thank you.

**Chairman:** Thank you, Mr. O'Rourke. I call Mr. Dobey.

**Mr. Paul Dobey:** Thank you, Chairman. And thank you for the opportunity to give evidence to assist the committee in its very important work. I am here specifically in view of my role as lead partner on the AIB audit from 2005 to 2008. I'll make some high level comments on the lines of inquiry dealt with in detail in my witness statement. Specifically, I will explain why it is KPMG's view that the AIB financial statements were prepared in accordance with IFRS and Irish law.

KPMG audited AIB in accordance with our statutory duty and the auditing rules. The AIB accounts gave a true and fair view and the accounting rules and related laws were not a contributing factors to the banking crisis in Ireland. Notwithstanding this, there are important lessons to be learned for the accounting profession from the crisis.

AIB was a large and complex organisation with over 25,000 employees in 2008 operating in Ireland, the UK, Poland and the US. AIB had a very experienced board of directors, and an audit committee drawn from a wide range of disciplines. The board oversaw the implementation of the strategy. The audit committee oversaw the internal control and financial reporting

of the bank. The AIB accounts are very complex and expertise was required to make sure the transactions, balances and disclosures in these accounts were complete and the accounting was in accordance with IFRS.

The KPMG audit team, which comprised approximately 20 partners and over 200 managers and staff, had the expertise to deal with these matters. The team applied the best practice auditing and accounting standards to the bank's published accounts. A quality review partner for KPMG UK and an SEC reviewing partner from our US firm was also involved in the AIB audit, bringing a further international perspective.

As Mr. O'Rourke has outlined, AIB was required by EU and Irish law to comply with the IFRS accounting rules. Similarly, KPMG was required to carry out its statutory duties as auditors in accordance with Irish law and the relevant auditing rules which were international standards on auditing. The AIB team took all the necessary steps to form an opinion that the AIB accounts gave a true and fair view.

The financial statements set out AIB's exposure to each sector, including the property and construction lending. KPMG is satisfied that the financial statements appropriately disclosed the banks property related lending exposures. AIB was aware of the risks arising from these business strategies, but like other financial institutions, did not anticipate the scale of the adverse circumstances which would give rise to unprecedented losses.

AIB had an extensive risk infrastructure and semi-annual risk reports were presented to the AIB board by the chief risk officer. These reports dealt with the top ten risks facing AIB, including credit risk, operational risk, market risk and liquidity risk. The risk relating to credit and liquidity featured with increasing prominence in these reports in the period from 2005 to 2008. As Mr. O'Rourke has mentioned, there is a common misunderstanding in relation to the role that an auditor plays regarding the strategy and risk appetite. For KPMG to have sought to determine AIB's business strategies would have been beyond our role and expertise as auditors, and would undermine our ability to give an independent auditor's report on the financial statements of our audit clients.

What KPMG did do, was to identify and report the risks to the AIB audit committee in the context of our audit work in order to ensure that the financial reporting implications were properly reflected in the financial statements. Our consideration of these risks, and the audit findings on other communications with the AIB audit committee, were circulated to the Financial Regulator at the end of each audit.

Turning, if I may, to the integrity of financial reporting. The most relevant standard for loan loss provisioning was IAS 39 which required the use of an incurred loss model. This model has been criticised because, in order to avoid smoothing of profits which was and is considered undesirable, it did not allow banks to create or hold general provisions in the good years to offset problems in the bad years. It is the view of KPMG that the operation of IAS 39 was not a contributing factor to the issues which AIB faced in 2008. I am not saying that IAS 39 was perfect, we have learned from the crisis that it needs to be changed and Mr. O'Rourke has outlined some of the steps being taken in this regard. The major shortcoming of IAS 39 was that it delayed the recognition of the loan loss provisions when the downturn came in 2008. It was always acknowledged that IAS 39 was pro-cyclical and would give rise to significant additional provisions in a downturn. The scale of these additional provisions would reflect the scale of the downturn as it occurred. When the downturn came in 2008, AIB was not permitted by IAS 39 to make impairment provisions for all of the losses it was forecasting for subsequent years.

It was for this reason that AIB disclosed to the market in its investor presentation in February 2009 that it expected to book further losses of between €4.6 billion, base case, and €6.7 billion, stress case, in 2009 and 2010 as the Irish economy further contracted and property prices further declined. These estimates were based on models and assumed a contraction of the economy in 2009 of between 5.5% and 7% and a peak-to-trough decline in property values of between 20% to 50%, excluding land, and 30% to 80% for land. It is now known that the economy contracted by over 10% in 2009 and certain categories of property such as land became almost worthless. As a result, the actual losses recorded by AIB in 2009 and 2010 were much greater than the forecasts. Finally on this issue, I would add that financial regulators can require banks to hold additional capital to absorb losses that could arise in a downturn. This was done in some jurisdictions such as Spain and Canada. Regulators may also do this in the downturn to reinforce confidence, and that was done in Ireland in 2011.

Chairman, I'd just like to make a few comments on the liquidity and solvency of AIB in 2007 and 2008. At each year end, our audit team was required to consider whether the going concern basis of AIB's financial statements was appropriate. In performing the 2007 year-end audit in early 2008, we were concerned about the effect of worsening financial markets on the liquidity and funding position of the bank. AIB prepared a detailed going concern paper in early 2008, and based on this and AIB's liquidity plans, KPMG was satisfied with the going concern basis. One year later, when it came to our 2008 year-end audit, our audit team had very significant concerns in relation to both liquidity and solvency of the bank. These concerns arose for a number of, from a number of factors. There was great uncertainty in Ireland and the economy was contracting rapidly, AIB was forecasting losses of up to €8.5 billion between 2008 and 2010. It had agreed to take €3.5 billion from the Government in preference shares. The position in relation to the availability of emergency liquidity access from the Central Bank and the euro system was not at all clear. In early 2009, we informed AIB that we needed to take additional steps on the going concern issue and engage with the regulator, the Central Bank and the Government as part of our 2008 year-end audit completion process. Confirmation and clarification was sought of our understanding of the public statements made by the Minister for Finance in relation to the Government's support for AIB. This was provided to the AIB audit team at meetings held in February 2009 with the head of banking supervision of the Financial Regulator, with the deputy governor of the Central Bank of Ireland and the assistant secretary general of the Department of Finance.

The onset of the global financial crisis was a shock to all of us. The worldwide financial system broke down and regulators and Governments were forced to take unprecedented steps in response. In my role as lead audit partner in AIB, I experienced some of these challenges first hand. From mid-2008, the KPMG team knew that the 2008 audit of AIB was going to be the most difficult we had ever done. Based on the Irish and international environment at the time, there were factors at play on this audit that were without precedent. In the face of these challenging circumstances, our audit team and AIB, in late 2008 and early 2009, worked tirelessly to deal with those issues. We brought all of the global expertise and local expertise of KPMG to bring to bear, and all of our personal energies to bear, in completing and ensuring that the audit was in compliance with the required standards, both for the bank and for us.

Chairman, to conclude my opening statements I would reiterate that the AIB financial statements in each of the years, relevant years, was prepared in accordance with IFRS and Irish law. KPMG audited AIB in accordance with our statutory duty and auditing rules. The directors of AIB had a legal obligation to prepare accounts that gave a true and fair view and fulfilled this obligation. We formed an audit opinion that AIB's accounts gave a true and fair view. The



accounting rules and the related laws did not, in our view, contribute to the banking crisis in Ireland. However, as I said at the outset, there are important lessons to be learned by the accounting profession from the crisis and I would be happy to give my views on some of these to the committee if it considers it helpful in its questioning. Thank you.

**Chairman:** Thank Mr. Dobeý and thank you, Mr. O'Rourke, for your earlier statement. Just to restate as well that your purpose before the joint committee is to give evidence relating to your roles as partner and lead engagement partner at KPMG. So it's not just about what KPMG were doing but your specific roles actually inside there. So with that said, if I can invite Senator MacSharry. Please, Senator, you have 25 minutes.

**Senator Marc MacSharry:** Thanks very much, welcome gentlemen and thanks for being here. Can I ask at the outset who regulates KPMG?

**Mr. Paul Dobeý:** Our work is regulated in a number of different ways. Firstly, we are registered with the PCAOB in relation to our SEC registrants, and AIB was a SEC registrant. The accounts of AIB were reviewed regularly by the SEC, the Securities and Exchange Commission in the US and they would have looked at the detailed application of accounting policies, including IFRS. They looked at fair value accounting in 2008, they looked at credit risk disclosures in 2007, they looked at compliance with IAS 39 in 2005 and they looked at the M&T accounting in 2005.

**Senator Marc MacSharry:** So who was regulating this, sorry?

**Mr. Paul Dobeý:** There's a number of regulators, that was the SEC.

**Senator Marc MacSharry:** Okay.

**Mr. Paul Dobeý:** The PCAOB also. We also are regulated by IAASA and by CARB.

**Senator Marc MacSharry:** And did they ever specifically review your audit, say, of financial institutions?

**Mr. Paul Dobeý:** Yes. CARB reviewed our AIB audit for 2007, and that was completed in early 2009 with no negative findings. You may also be aware that there was a review carried out by CARB in relation to the 2008 audit for all the covered banks, and that work is not complete but we ... we have spoken to CARB and have asked them what we can say to the committee.

And if I may just read out some of what CARB have said we can say. Our firm is registered as a statutory audit firm by CARB. CARB is subject to oversight by IAASA. CARB, as part of its regulatory responsibilities, carried out inspections of the firm's compliance with auditing standards. CARB, as part of its ongoing regulatory responsibilities, is reviewing the audits of the covered institutions for the financial years ending 2008 and, where relevant, 2009. The purpose of these reviews was to determine whether the auditors applied appropriate procedures and complied with relevant standards in the audit work carried out on the provisions for impairment as part of the firm's audit of the financial statements as a whole. CARB's review is not yet concluded. On their conclusion, CARB will prepare and issue a public report, in accordance with its governance procedures, which will outline the overall results of the reviews conducted without naming specific firms. Conclusion has been reached in relation to our firm and we have received a report on AIB. And I note what CARB have said is, audit work of the firm in relation to all of its financial institution audits complied with relevant auditing standards. While there are a number of instances where improvements were recommended, these are not material.

Should further questions arise, for example, regarding improvements required, these are set out in detail in the firm's responses to the quality assurance committee. The report arising from the review could be sought by the committee but it should be sought directly through CARB.

**Senator Marc MacSharry:** Okay, that's interesting. Can I ask, of the issues that have been highlighted, has there been lessons learned ... from the, you've got the report from CARB from the look at your 2008 and 2007 audits of AIB, in particular, or other financial institutions? And are there lessons, with the benefit of hindsight, that they've raised and that you've taken action to remedy?

**Mr. Paul Dobey:** Yes. As you know, when regulators do a review, they would have findings. The findings in relation to our audits, as CARB had said, were not material. There was a couple of matters in relation to documentation ... there was, specifically, we had a consultation in the firm in February ... sorry, in January 2009 in relation to the going concern basis of preparation and that involved the partner I mentioned earlier from the UK firm, myself, Terence and our risk management partner. I prepared a detailed agenda for that meeting with some actions suggested which we subsequently took. I think CARB would prefer it if we documented that better; I think the actions were clear. We also communicated with the regulator in writing and it's in the pack on 29 April. Given the matters raised ... our concerns in relation to going concern and liquidity, we engaged with the Financial Regulator and had meetings with them - that I mentioned during my opening statement - in February. I think CARB would have preferred if that ... the letter that we sent on 29 April had gone in earlier and there were some other minor documentation matters but nothing of substance.

**Senator Marc MacSharry:** And all firms, to your knowledge, were subject to these reviews, were they?

**Mr. Terence O'Rourke:** They ... they viewed audits of the covered banks, so all the firms were auditing the covered banks.

**Senator Marc MacSharry:** Okay. Can I ask ... the 2007 and 2008 financial statements were audited and provided an unqualified independent audit opinion. So in hindsight, would you provide those opinions and the accounts as a true and fair view, with the benefit of hindsight?

**Mr. Paul Dobey:** I'm very comfortable that the opinions we gave in 2007 and 2008 did give a true and fair view. I've outlined in my opening statement some of the steps we took in relation to liquidity in 2007 and some of the very detailed and unprecedented steps we took in relation to engaging with the Government and others in 200, in relation to going concern based preparation. So, very comfortable with ... that those accounts give a true and fair view.

**Senator Marc MacSharry:** Okay. In a property construction loan portfolio of 3 November 2008 report to the audit committee, it states and quote: "there has been a significant deterioration in the quality of the Property and Construction loan portfolio".

**Chairman:** That is coming up on the screen, okay, that's page 11 to 14, KPMG audit committee, 3 November, it's coming up now.

**Senator Marc MacSharry:** Sorry, I meant to ... so I'll let you get it there first. That said, just quoting, "there has been a significant deterioration in the quality of the Property and Construction loan portfolio", continued later, "Given the concentration of advances to the Property and Construction sector in the [Republic of Ireland] division, we are carrying out extensive

loan review procedures on this portfolio.” Did KPMG ever perform a review on the valuations received for assets offered as security and were KPMG satisfied with the valuation policy?

**Mr. Paul Dobey:** We did carry out reviews of valuations. When we looked at each individual loan in our sample, we looked at what the security was, what the circumstances of the borrower was and we looked at the collateral value as well. In most instances, certainly for the large cases, AIB sought valuations. However, as we moved into late 2008 and early 2009, valuations were not very reliable so we were applying haircuts, as were AIB, of between 20% to 30% in the latter part of 2009 ... sorry, the latter part of 2008. And when we got to 2009, our view was that the haircuts that needed to be applied were 40%, particularly for land, and maybe 30% for property.

**Senator Marc MacSharry:** Okay, that’s because we had no clear market at the time, is it or not?

**Mr. Paul Dobey:** I was because that was the view as to the extent of the client in the market.

**Senator Marc MacSharry:** When ... you said that in most instances you were happy with the valuations. Were there instances of any large ones that you were unhappy, that looked-----

**Mr. Paul Dobey:** Yes, we looked at ... where we were unhappy with the valuations, we would have looked at steps ... the analysis that AIB had done to assess the provision - because they may have looked at the valuation as well - and if we weren’t satisfied with the provisions that were made by AIB, we requested that they would make additional provisions.

**Senator Marc MacSharry:** Did you ever come across a situation where you felt that the valuations weren’t being provided?

**Mr. Paul Dobey:** If valuations weren’t provided, we wouldn’t have relied on the collateral in assessing the loan.

**Senator Marc MacSharry:** Did KPMG ever review AIB’s process for the registration of mortgage securities?

**Mr. Paul Dobey:** We did and we were satisfied that the registration of mortgage securities were fine. There was a practice in the market in relation to getting solicitors’ undertakings for security ... more for commercial lending but we were satisfied with the security arrangements for the mortgages.

**Senator Marc MacSharry:** And this practice in the market, did that have a foundation in law or regulation?

**Mr. Paul Dobey:** Not particularly. I mean, there was an issue with the registering of security and there was a delay in that process. And what would happen was AIB would appoint ... for the larger loans, would appoint a top tier firm to perfect the security after the loan was given. That would take some time but we would ... we and AIB would rely on the solicitors’ undertakings in the period where ... between when the loan was given and when the security was perfected. There were some delays in that process.

**Senator Marc MacSharry:** But it was taken as given that if, as you put it, a top tier firm were to say “Leave it to me”, then the practice was that was accepted as gospel.

**Mr. Paul Dobey:** No. There was a follow up process in AIB, they had a register of security

that hadn't been perfected. That ... there was a large number of outstanding matters towards ... in mid-2007. There was a project under way within AIB to perfect the security but while that project was under way, we were satisfied that we could rely on the solicitors' undertakings.

**Senator Marc MacSharry:** And in 2008, for example, would there have been a large amount of these?

**Mr. Paul Dobey:** I can't ... I can't be sure of the numbers but there was a project under way that commenced in 2007 and continued into 2008.

**Senator Marc MacSharry:** And just to the best of your recollection, would that project have gone back over six months, a year, five years, ten years?

**Mr. Paul Dobey:** The majority ... there was just a delay in the process ... so the majority would have ... of the solicitors' undertakings where security hadn't been perfected would've been the newer loans, if can put it that way.

**Senator Marc MacSharry:** So recent, as opposed to historic?

**Mr. Paul Dobey:** There may have been some older ones as well but the majority of the cases was recent.

**Senator Marc MacSharry:** Does this practice still exist?

**Mr. Paul Dobey:** It's been tidied up.

**Senator Marc MacSharry:** Okay. In regulation or in-----

**Mr. Paul Dobey:** Just process. There's less ... there's less-----

*(Interruptions).*

**Senator Marc MacSharry:** The practice has improved or there's been a law to improve it?

**Mr. Paul Dobey:** No, I think it's just been improved. It's been recognised that it needs to be improved. There's a register now and the banks haven't got the same level of volume of loans and there isn't the same level of backlog and there's more discipline in the banks around how this process works.

**Senator Marc MacSharry:** Do you feel that the process and controls around such things are sufficient now?

**Mr. Paul Dobey:** They're better.

**Senator Marc MacSharry:** They're better. Okay. When NAMA acquired loan portfolios from AIB, NAMA imposed a haircut of 40% of the nominal loan ... on the values of the assets at the particular time. Were you satisfied with the valuation methodology used by NAMA in assessing the value of AIB land and development loan book and the potential impact on subsequent provisioning?

**Chairman:** Page 17 of KPMG, annual report and financial statement 2011.

**Senator Marc MacSharry:** So it's the KPMG annual report and financial statement 2011.

Page 17.

**Mr. Paul Dobey:** I wasn't involved in AIB at the time and I wasn't involved in the process ... I'd no involvement in the process that AIB ... sorry, that NAMA used to assess those discounts.

**Senator Marc MacSharry:** No, I appreciate that you'd no involvement but I am asking were you satisfied, as a firm of auditors - as a firm that had a professional opinion on these issues - were you satisfied that the valuation methodology in assessing was right, was good, what did you feel about it?

**Mr. Terence O'Rourke:** As a firm, I think we understood what NAMA was doing. NAMA was acquiring the loans on a very specified basis. They went through that process and all the audits that have been done of NAMA since have not shown anything to show that that valuation ... on that special basis ... it was a particular basis that NAMA took over the loans on ... and it seemed that they acquired the loans on that basis, properly.

**Senator Marc MacSharry:** So, I mean, the practice was just to take it as read or not or did you have a view at the time, "Look, that looks a bit high ... it looks a bit low"?

**Mr. Terence O'Rourke:** I mean, in the case of AIB transferring loans to NAMA, AIB got what NAMA valued the loans at. AIB, you know, took ... so from the point of view of our audit of AIB, all we could do is accept the values that AIB got and that was it. So we didn't have a view on it, one way or the other, except to make sure that AIB recorded the correct values in which loans had been transferred.

**Senator Marc MacSharry:** And can you provide an explanation in your view as to why the haircut was so high?

**Mr. Paul Dobey:** Yes, I can. As I mentioned in my opening statement, when AIB announced to the market in early 2009 that they expected through ... they expected to take additional provisions in 2009 and '10. And those provisions ... and they were some €6.2 billion I believe ... those provisions were based on this investor presentation from AIB that's ... that contained this information. It's still on the AIB website. But it assumed certain declines in values. So, for example, it assumed, on a base case ... a base case declining values of ... for residential property between 20% and 40% in a base case and 50% on a stress case for zoned land. A base case with a decline of values of 25% to 50% and a stress case of 70%. So ... and ... so broadly, declines on a stress scenario were between 50% and 70%. So, in that light, there would've been equity in a number of the transactions that were transferred to NAMA so the 60% ... the 56% discount isn't a particular surprise in the context of the numbers that AIB issued to the market in 2009. They wouldn't have planned to ... AIB would've planned at the time to hold these loans to the cycle. What happened, with the benefit of hindsight, is these loans were transferred to NAMA at the bottom of the cycle.

**Senator Marc MacSharry:** Okay, I just take a ... on then to page 29 of core documents, AIB report to the audit committee, 23 July 2008. In the KPMG report to the audit committee of 23 July 2008, it outlines: "We expect the increasing arrears across the bank's books and sectors will continue to feature in the second half of 2008 and into 2009 as the worsening economic conditions in Ireland and the UK take hold." Given the market environment, did KPMG express an opinion on the planned dividend payment to shareholders?

**Mr. Paul Dobey:** No, we do not have any role regarding dividends that are paid by our audit clients to their shareholders.

**Senator Marc MacSharry:** I suppose I should've asked earlier. Apart from auditing, do KPMG, at the time, provide other services to AIB?

**Mr. Paul Dobey:** Our primary role in AIB was to provide audit services in that period and AIB viewed us as their auditor. We did do some audit-related work, particularly in relation to the SOX project, which was a very significant project for AIB and was very important to AIB in the context of its securities listing on the US markets. And we did some relatively small amounts of tax work, so the lion's share of the work that we did for AIB was audit work and audit-related work in that period ... in the period I was involved anyway.

**Senator Marc MacSharry:** So, would you have a view on the appropriateness of paying a dividend, given the situation at the time?

**Mr. Paul Dobey:** I'm familiar with the decision-making process that happened in AIB at the time. It's documented in the minutes. There was a dialogue. AIB took a decision to declare that dividend, I believe, in July and then it was paid subsequently in September and I think the view is, it was committed from July to pay that dividend and, ultimately, paid it in September. There was a lot of dialogue within AIB and at the board of AIB and I do recall having a discussion with the, certainly the finance director and the chief executive in relation to the dividend, and I understand the reasons why it was done.

**Senator Marc MacSharry:** And what were the reasons?

**Mr. Paul Dobey:** I think it was to show strength. AIB believed it was in a relatively strong position at the time from a capital and liquidity perspective and it wanted to show strength to its shareholders.

**Senator Marc MacSharry:** Okay. In July 2006, the bank's exposures to the broad property and building construction sector amounted to 260% of all funds when the Central Bank's limit was 250%. The bank continued to breach these limits and such lending reached a level as high as 390% at September 2008. Did KPMG ever analyse the risk level associated with the percentage share of the property-related lending?

**Mr. Paul Dobey:** We were aware of all of this. In the accounts of AIB, the sectoral exposure is set out in great detail and was set out in great detail for all of the years. If you go back to 2004, we would've been highlighting a concentration of credit risk in property and construction, also in 2005, 6 and 7, as a matter that needed to be considered in the context of disclosures in the financial statements. As I mentioned in my opening statement, AIB were setting the strategy but we were concerned to make sure that the risks associated with those strategies were set out in the financial statements and they were very clearly set out in the financial statements ... set out all the exposures to the property lending and the exposure to the Irish economy in particular. And the breaches were addressed. The breaches first started to happen in June 2006. We had ... we attended all of the AIB audit committee meetings and we would've read the AIB board minutes. And we read the board minutes of 27 July, which are in the pack, which set out a dialogue that the management of AIB were having with IFSRA at the time. It was discussed subsequently at a board ... at an audit committee meeting, I remember it being discussed. It was probably either at the meeting just after ... just before ... around that time in July 2006. And we were very happy that that dialogue was happening at the board level, as, you know ... there was an open dialogue at the board level, there was an open dialogue at the audit committee, there was a discussion with the regulator, there was-----

**Senator Marc MacSharry:** It was being discussed, but it was increasing.

**Mr. Paul Dobey:** Yes, AIB was going through a process with the regulator of getting its Basel models approved and the view in AIB, likely or not at the time, was that the Basel models would look at the exposures at a borrower level and apply capital ... allocate capital at a borrower level and that-----

**Senator Marc MacSharry:** The definitions of Basel were going to be different and, therefore, the exposures wouldn't be as high. Is that what you mean?

**Mr. Paul Dobey:** The ... well, no ... therefore, the capital allocation would be different and these sectoral limits might be superseded.

**Senator Marc MacSharry:** Okay. In terms of ... just on page 47 of ... is it page 47 of the evidence book? It shows an individual worth €3.2 billion ... total bank borrowing of circa €1.8 billion comprising residential and commercial developments and investment properties. It had a peak underwrite of facilities of €790 million with AIB in September 2007. So the top 30 exposures of AIB accounted for €8.8 billion or 29% of the total portfolio. Was there ever concerns raised by KPMG about group large exposure policy limits?

**Mr. Paul Dobey:** We were ... we looked at the group large exposure policy and the group large exposure policy was such that, if limits were breached ... sanctioning limits were breached at one level within the organisation, they kept getting elevated up through the process. And the reason why those limits exist is when the exposures get larger, you want to make sure that there's a fair amount of distance between the lender ... the lending ... the relationship person and the borrower. So there's a process of going through approvals. This would've come through the AIB ROI credit committee and it, ultimately, came to the board. I believe this document is a summary that went to the chairman's committee and there was a very large document that supported this, that analysed it in very great detail that went to the chairman and would've been considered by the group credit committee. So there was a process by which AIB considered this loan. It elevated it up through those processes and, ultimately, it was approved by the board. So when I mentioned in my opening statement AIB board set the strategy, their strategy was, in relation to this lender, to advance more on the basis of what they thought was a very good LTV position or they believed it was a very good LTV-----

**Senator Marc MacSharry:** Would you have a view on the top 30 exposures accounting for 29% of the total portfolio?

**Mr. Paul Dobey:** It was very clearly disclosed in the financial statements, all of those exposures.

**Senator Marc MacSharry:** But you wouldn't have a view that----

**Mr. Paul Dobey:** Well, I have a view that it was properly disclosed in the financial statements.

**Senator Marc MacSharry:** Okay. Just one final question for Mr. O'Rourke. At any time in your period as managing partner, would any financial institution have ever complained to you about the intrusive nature of auditing?

**Mr. Terence O'Rourke:** Certainly in the case of AIB, that didn't happen, okay?

**Senator Marc MacSharry:** No, no, but any financial institution?

**Mr. Terence O'Rourke:** Well, I don't think I'm going to mention any other names-----

**Senator Marc MacSharry:** All right, I'm not going to mention the names.

**Mr. Terence O'Rourke:** In terms of, generally speaking, as a practice in my experience as managing partner, occasionally and rarely happened that we did get approaches from companies to say, you know, we're not getting on well with the audits ... a member to the audit team. In those circumstances, where there was any request for a change in audit team, we would take that very seriously because obviously, that's an issue in terms of audit independence. If an audit partner, for example, is causing too much trouble, we need to be very sure that the request for any changes are ... is well-founded and all the rest. So we will take any such requests to a separate group on the firm and any such issues would've been referred to a group, including myself as managing partner, the head of audit and the head of risk. We would've looked to the issues and we would've tried to understand the circumstances that were going on and we would have sought to make sure that the independent position of the firm was unaffected. And that if, you know, we can see life is life and personalities don't get on sometimes and it is a matter if there's somebody, you know, not liking the way somebody sat or looked at you or something like that, then we will accede to requests but if a person was doing the right thing, and the client was not liking the way they were doing the right thing, well then we would do the right thing and we wouldn't change an audit partner for that. Any such decision would involve us, the client didn't request ... we would appoint any replacement partner, we decided who the right person was to reflect the skills required and the experience ... and the client didn't have any choice as to who they got. We decided who the partner would be in those ... and, as I say, it's very rarely happened over my life as managing partner.

**Senator Marc MacSharry:** Just to finish this line, if it's okay. So, how many times did it happen in your time as managing partner?

**Mr. Terence O'Rourke:** I would say that I would think, probably ... of kind of ... it would've come to my attention maybe three or four times as managing partner-----

**Senator Marc MacSharry:** And of the three or four times that it happened, was the person removed from the audit team, or how many of the three or four times were they?

**Mr. Terence O'Rourke:** I would think in, I would say once we persisted with the person and the other times we changed.

**Senator Marc MacSharry:** Okay. And of those instances that ... that ... that you removed the two or three ... that the person was removed, was the complaint over-intrusiveness or the way the person sat or a personality - use your own-----

**Mr. Terence O'Rourke:** Well, yes, I mean, there are two sides to any story. So the client will tell us it's personality and all the rest and the audit partner might say "Well, I'm not sure of that, I think I was just doing a good job". So we'd have to sit back and say "What's going on here?" No, the right thing is that for us to do our job properly, we've got to have an effective audit relationship. We've got to have people who can walk in, get full co-operation with the client, have respect for the client, lead the team, apply the judgments, get things done - that's the most important thing for us.

**Senator Marc MacSharry:** And you don't want to lose the ... you don't want to lose the business, either.



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**Mr. Terence O'Rourke:** Well, we want to get the right audit. I mean, we've walked away from business too, there's, you know, we want to do the right job is what we want to do. So we want to make sure the right person does the job. In circumstances where we've felt the client was just, it wasn't going to work, there was no point in us persisting with somebody that wasn't going to work with the client ... but we often make sure that if there was intrusiveness to be done, there was ... intrusiveness continued ... and the new partner may have a different style but he was going to address the same issues and carry on the same way.

**Senator Marc MacSharry:** Did it happen with Irish Nationwide?

**Chairman:** Senator-----

**Senator Marc MacSharry:** Am I'm allowed answer that, no?

**Chairman:** If you get the question ... I will be bringing you in at the end. You'll get some more time later towards the wrap-up.

**Senator Marc MacSharry:** I don't know whether I'm allowed ask this so I'll-----

**Chairman:** Well, if you don't know whether you can ask it maybe ... we'll be taking a coffee break later and you can find out if you can ask it or not.

**Senator Marc MacSharry:** Okay. Well, we'll ask it now and you can rule me out of order: did it happen with INBS?

**Mr. Terence O'Rourke:** Chairman, I'm being ...

**Chairman:** I'd say we'll move on the next questioner. I just want to deal with the dividend issue there before I move into Senator D'Arcy, and just bring you to core document ... page 33, it's the minutes of the board's meeting of AIB in December 2008, and, Mr. Dobey, you were speaking to Senator MacSharry there a while ago, with regard to the appropriateness or inappropriateness of the view of AIB on this. Can I just ask you ... if you look at paragraph three in that ... Mr. Sheehy reported that investors were expressing concerns with respect to capital adequacy and dividend policy. He considered the capital position to be satisfactory and did not foresee a need to go to the market for equity. With respect to dividend, he advised that, in due course, management was likely to recommend a 10% increase in the interim dividend. Some directors expressed reservations in relation to such an increase. Now, in your own comment there earlier, you said that your interpretation of this is ... was that it was a show of strength. Now, a show of strength can be a real show of strength or an implied show of strength. Which do you think it was?

**Mr. Paul Dobey:** It's a difficult question to answer.

**Chairman:** It is, that's why I'm asking you.

**Mr. Paul Dobey:** I can only say that I believe AIB believed it was a real show of strength, that's my understanding of it at the time, based on my discussions with AIB at the time. I believe Mr. Gleeson has addressed this in his evidence and has expressed his view on it now.

**Chairman:** Okay, ah, but the ... and I know that, I'm not asking you for a view of Mr. Gleeson's opinion but, as an auditor, I would imagine that you would've been looking at the group management accounts and how would you have interpreted the group management accounts?

**Mr. Paul Dobey:** Well, we had just completed an interim review, that's not an audit, but it is an interim review. AIB had raised capital, I think it's referred to earlier in the minutes, it has raised tier 2 capital, around that time, so the capital markets were still open to AIB at that time. And ... we didn't have to form a view, as auditor, as to whether that opinion ... that dividend was appropriate. The circumstances where an auditor would get involved in whether a dividend was appropriate would be as part of our year-end audit, if there's a distribution made that is illegal or is beyond ... brings them beyond the capital distributed reserves, then that's an issue. But at that time, AIB's belief was that they had distributed reserves and based on our previous audit -we hadn't done an audit at the half-year but we had done some work - the AIB financial statements were still showing very significant distributed reserves.

**Chairman:** Thank you. And just on the issue of the 30 loan concentrations, might that have had an influence on the going concern consideration?

**Mr. Paul Dobey:** I mentioned in my opening statement ... when we got to February 2009 we were very concerned about a number of aspects of going concern, including liquidity and solvency. The fact that AIB was predicting ... had taken loan loss provisions of €1.8 billion in 2008 and was predicting a further €6.2 [billion], I believe, on a stress case, was ... important in our consideration of the going concern and yes, it was important, and we engaged. So we were concerned in 2009 about liquidity and we spoke to the deputy governor of the Central Bank around the availability of ELA, and we got assurances in relation to that matter. We were also concerned, in 2009, about the capital of the bank and solvency, if I can put it that way. They had agreed ... the Government had agreed to put capital into the bank of €3.5 billion. That came in Q2. We weren't sure whether that was enough and we spoke to the Department of Finance ... to the assistant secretary general of the Department of Finance in February 2009 to get assurances that if more capital was required it would be made available.

**Chairman:** Okay, thank you, Mr. Dobey. Senator MacSharry. Sorry, excuse me, Senator D'Arcy.

**Senator Michael D'Arcy:** Chairman. Gentlemen, you're welcome. To Mr. O'Rourke - CARB ... who funds CARB?

**Mr. Terence O'Rourke:** Who ...?

**Senator Michael D'Arcy:** Who funds CARB?

**Mr. Terence O'Rourke:** CARB is funded by the Institute of Chartered Accountants.

**Senator Michael D'Arcy:** Pardon me?

**Mr. Terence O'Rourke:** It is funded by the Institute of Chartered Accountants.

**Senator Michael D'Arcy:** So it's funded by the industry itself.

**Mr. Terence O'Rourke:** It's funded by ... yes. CARB is part of the legal structure of the Institute of Chartered Accountants. Its board, of which I was a member from 2007 'til last May ... May '14 ... its board ... is a majority of non-accountants on the board of CARB, so it is an independent body within the Institute of Chartered Accountants framework.

**Senator Michael D'Arcy:** And, Mr. Dobey, you said that the review wasn't concluded about the AIB '08 accounts, is that correct?

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**Mr. Paul Dobey:** Yes. They've issued a report to us-----

**Senator Michael D'Arcy:** But it's not concluded.

**Mr. Paul Dobey:** That's final, but they're completing a process of preparing the public report that will be made available publicly.

**Senator Michael D'Arcy:** And, Mr. O'Rourke, you were a member of the board, was it?

**Mr. Terence O'Rourke:** Yes.

**Senator Michael D'Arcy:** Would it usually take that long to conclude a review?

**Mr. Terence O'Rourke:** No. I wasn't involved in this process at all-----

**Senator Michael D'Arcy:** Yes, I understand-----

**Mr. Terence O'Rourke:** -----I was not involved in any discussions, there were quite long periods-----

**Senator Michael D'Arcy:** I'm talking in general.

**Mr. Terence O'Rourke:** In general, no.

**Senator Michael D'Arcy:** Do you have any ... can you offer an opinion of why this is taking so long?

**Mr. Terence O'Rourke:** The audits of the banks are very complex audits. As I say, I was not party to the discussions at all.

**Senator Michael D'Arcy:** Okay. Mr. O'Rourke, there were ... during your tenure as managing partner, did KPMG audit any other financial institution within the State?

**Mr. Terence O'Rourke:** Yes, they did.

**Senator Michael D'Arcy:** Who?

**Mr. Terence O'Rourke:** Permanent TSB, Irish Nationwide ... we took over the audit of Educational Building Society, EBS, for its ... for the December 2009 audit, we audited Bank of Scotland Ireland and we audited a number of other IFRS banks ... sorry, IFSC banks.

**Senator Michael D'Arcy:** And any of the other non-Irish domiciled banks, but banks that trade here, KBC, Rabo?

**Mr. Terence O'Rourke:** Yes, well, help me now - DEPFA we would have audited; HSBC, we were auditors too; sorry, Postbank we were auditors to as well in Ireland-----

**Senator Michael D'Arcy:** So you've a lot of banks on your books.

**Mr. Terence O'Rourke:** We've quite a few banks on our books, yes.

**Senator Michael D'Arcy:** Can I ask about the ... I mean, you've a lot of banks on your books ... can I ask about the changing of staff who would go in to ... would you leave particular staff with a bank? I see in a document here ... you've been auditing AIB from '02 to '10. Do you change them around, do you leave the same people? What way does that work?

**Mr. Terence O'Rourke:** Well, the key person is the partner because the partner is the person who directs the audit and the partner is the person, at the end of the day, who expresses the opinion and decides whether they're going to sign the audit report or not. The rotation was that partners ... would spend no more than five years in charge of the AIB audit. As it happened, the auditor who, when we were appointed auditor in 2002, the partner who was in charge of the audit retired about three or four years later so he didn't do it five years. And then somebody, Paul, did it for five years after that-----

**Mr. Paul Dobey:** Three. For three.

**Mr. Terence O'Rourke:** For three, three years after that. And then we had another partner after that 'cause Paul changed role in the firm so he had another responsibility. So we did rotate people, and then below that level there would be other people coming through as well, there would be changes. There'd be a combination of continuity and some changes, yes.

**Senator Michael D'Arcy:** But your , your, your standard rate near ... standard term is five years.

**Mr. Terence O'Rourke:** Standard term for-----

**Senator Michael D'Arcy:** A maximum, maximum of five.

**Mr. Terence O'Rourke:** -----the maximum of the noted partner of a public interest client including a bank, would be five years.

**Senator Michael D'Arcy:** And is that ... in your view is that too long?

**Mr. Terence O'Rourke:** No, I think a bank's a very complex entity to understand, and to understand the, the systems and to understand the people, understand the strategies, understand the business models, and if you've got to, sort of, every year, every two years, you get a new person in there, it just takes a huge amount of learning. So I think the most effective way is to get somebody in, and, typically, when somebody's taking over they would probably be shadowing the year before they take over to get an understanding of it, so they come in ... so it's ... it's an extensive process, and I think five years is about right to get familiarity and in-depth knowledge, but not too long to be over-familiar, and not to be fresh in your approach to it.

**Senator Michael D'Arcy:** And in terms of the staff who were there, are you satisfied that they had enough banking knowledge and experience?

**Mr. Terence O'Rourke:** Yes, we are, yes, 'cause, as I say, KPMG, not just in Ireland, but globally, would have a strong market share in ... in banking audits. Our teams were not only working on bank audits but they got extensive training in bank audits, some of which we organised locally, some of which would be part of KPMG international training as well. So we were very conscious-----

**Chairman:** Including property experience as well, yes?

**Mr. Terence O'Rourke:** Pardon?

**Chairman:** Include property experience as well, at the bank.

**Mr. Terence O'Rourke:** Property experience as well, yes we did have, yes. I ... the thing we'd obviously take a look at every now and again, when I was head of audit and the managing

partner ... make sure there'd be the right level of expertise in the main audits and every now and again, we'd take a look at the make-up of the teams in each of our main clients, and we'd make sure we got the skills, we got the appropriate experience, we got the people doing ... who got the right training. AIB is also an SEC registrant, so in terms of being knowledgeable of the US rules, and the SEC rules, we had to make sure they had ... the people that were assigned to those, those audits, had the full range of experience and expertise.

**Senator Michael D'Arcy:** And, in particular, the people with property experience, what profession would you pull them from?

**Mr. Terence O'Rourke:** Well, the ... say ... in auditing banks you can be lending to lots of different sectors so we didn't necessarily have people in-depth knowledge of those sectors. Obviously the, the-----

**Senator Michael D'Arcy:** Should you have?

**Mr. Terence O'Rourke:** Pardon?

**Senator Michael D'Arcy:** Should you have?

**Mr. Terence O'Rourke:** Well, I think we had sufficient knowledge. I mean, I was quite happy that, obviously, property lending was a feature of banks' audits, has always been, and banks always have lent to property. So I was ... anybody who has experienced knowledge of the bank audits, who understood the issues of property lending, they understood the issues in terms of the ... the lending decisions, the credit decisions, collateral, all those issues. So I'm quite happy that the people involved in the audits of AIB and other financial institution audits understood property lending and understood the issues in assessing the quality of the loans.

**Senator Michael D'Arcy:** And specifically, within property, in terms of commercial real estate property, did you have enough expertise within your firm to be able to be satisfied that, specifically for commercial real estate property, that those people have enough experience?

**Mr. Terence O'Rourke:** Yes. Yes, I believe so, I mean, our client ... in AIB ... they would do extensive work. There was huge papers produced in terms of, of the bank clients, they would produce papers. But there's also KPMG international guidance as well, in how you went auditing commercial real estate and all the rest. So we had access to lots of material in terms of the kind of risk you looked at, for the kind of audit procedures to apply, they would have been absolutely ... I'm sure our people are fully competent and fully expert in that.

**Senator Michael D'Arcy:** Were they experienced enough?

**Mr. Terence O'Rourke:** I think they were experienced enough, yes.

**Senator Michael D'Arcy:** In terms of, of IAS 39, you spoke about it earlier, Mr. Dobey, can I just read some quotations from, from evidence that has been presented to us previously? And I'm going to make a statement and I'm going to ask you to comment upon that afterwards. In terms of IAS 39, does that mean that the "audited financial statements no longer had to comply with the true and fair view standard" and the previously accepted standard-----

**Chairman:** You made a statement, Senator.

**Senator Michael D'Arcy:** Yes. I'm going to qualify that now, Chairman. In evidence, Mr. Donal Forde, when asked, "Did you understand the flaw in [the] standard when it was intro-

duced?” he replied, “I had a view that it wasn’t an appropriate formula”. That view was held by all the senior people in AIB. Subsequently, in Mr. Eugene Sheehy’s evidence, he stated, “It’s a totally nonsensical accounting standard from a banking point of view”, and “We discussed whether we should go to the regulator with our concerns”. Could you offer your view, for both gentleman, in relation to those statements from those very senior banking officials within AIB?

**Mr. Paul Dobey:** The first thing to say is I don’t believe that AIB senior management held a view that the accounts reflecting IAS 39 didn’t give a true and fair view, and that’s very important to me because the primary responsibility for the true and fair view, given by the accounts, rests with the directors. And indeed, the directors, including the chairman, and the directors, signed the financial statements and approved them in the belief, I believe, that they gave a true and fair view. So, the first part of your question, I don’t believe that the application of IFRS negated the true and fair view. In actual fact I believe the true and fair view was informed by IFRS, and our opinions state that the accounts give a true and fair view in accordance with IFRS, which is an explanation of what the true and fair view is. The true and fair view must be informed by some rules because, your true and fair view and my true and fair view ... they’d be a different true and fair view by individuals, it’s a pretty broad term. So it’s ... it’s explained by reference to accounting standards. So that’s the first and very important, point. And ... and if I believed that AIB were saying that they didn’t believe the accounts gave ... gave a true and fair view that would be something, that would be significant. I don’t believe that’s the case. I’m aware, though, of the views of AIB in relation to IFRS, and I was aware at the time. There was an extensive dialogue in AIB around the application of IFRS. One of the issues in IFRS ... the reason why IAS 39 was introduced in relation to loan loss provision was to stop income smoothing. And there was a very significant debate around income smoothing in, in the US actually, in 1998, when chairman Levitt of the SEC outlawed earnings management. And there was a very significant dialogue between the SEC and the Fed in the US, that went on for ... for three years until it eventually resolved in 2001, what, yes, 2001, that the incurred loss model prevailed. And the issue here was, that the Federal Reserve, like regulators, for example, would like to have significant buffers in their general provisions, by general provisions to enable banks, maybe, to report less volatile earnings. The Fed might like that there would be more buffers and provisions to smooth earnings, because that encouraged confidence, it avoided volatility. What the SEC were very focused on was to make sure there wasn’t earnings management.

**Senator Michael D’Arcy:** Okay. Mr. O’Rourke, in your opinion, did KPMG feel it was the right standard to adopt, IAS 39?

**Mr. Terence O’Rourke:** I certainly understood the reasons why it was introduced. The benefits of accounting standards is that they are objective and what .... IAS 39 was certainly a very objective standard. It tried to remove any subjectivity, in other words, people deciding, well, it’s ... we’ll put away this amount this year, and this amount another year. And the problem beforehand was that people were putting away different amounts in different places, so analysts, in trying, and investors trying to understand the financial statements of banks were coming up with different answers. When IAS 39 came along, the benefit was you knew that the only things that were provided for were incurred losses. Now, there is , I mean, there is, we grew up with the concept of prudence in banking and prudence was this concept of putting away more money but there is another side to the coin, which is the objective, and it’s good to have objectivity as well. I think what ... this debate has now moved on, the IASB are moving towards an expected loss model. But it was one of the things about an expected loss model, is you only provide for expected losses, you don’t provide for unexpected losses. It’s still got to be done on the basis of evidence of credit deterioration. So, expected loss is not providing for

unexpected loss then, it's not back to the old general provisioning, we just put away whatever we think we should put away. And, therefore, I think there, there was definitely merit in IAS 39 and I think where we're getting to now is probably a more sensible situation.

**Senator Michael D'Arcy:** In Donal Forde's evidence, also, previously, when he was asked, "Did you express that view to anybody?", about the standard, he replied, "It would have been a point of discussion with our external auditors", and I continue, in Michael's Buckley's evidence, when asked did he recall expressing these concerns to the regulator he stated, "A lot of these discussions we would have had with the auditor". Mr. Dobey?

**Mr. Paul Dobey:** Yes, there was some dialogue in ... on the transition to IAS 39, sorry, IAS generally, with AIB. As I recall it, AIB wrote a letter to the EU, I think it went in Michael Buckley's name, I couldn't find it actually when I went looking for it over the last couple of days, but I recalled that they did actually write a letter to the EU making a submission as to-----

**Senator Michael D'Arcy:** AIB?

**Mr. Paul Dobey:** Yes. As to, as to why they thought it wasn't an appropriate standard, and there was a big ... the French banks had a very ... had great difficulties with IFRS, and they actually ... Jacques Chirac held up the transition to IFRS as a result of the French banks' concerns, which-----

**Senator Michael D'Arcy:** Mr. Buckley, did you have any contact with the Financial Regulator about the implementation of ... of the standards?

**Mr. Terence O'Rourke:** No, not ... previous in my life I had been involved in the Institute of Chartered Accountants and we would have had discussions about bringing in IFRS and we would've probably been in discussions with the Financial Regulator at that stage and it was one of the issues that we would be coming to that but financial statements can only provide ... I mean, the financial statements tell the story of numbers based on certain rules but there are other things to be taken into account and the Financial Regulator has other weapons and other methods of assuring and I mean, banks have a way of making sure that they have enough capital. I mean, putting aside additional audit provisions is one way of doing it but there are other ways of doing it as well. So the fact that IAS 39 came along didn't mean that suddenly all the accounts were on that.

**Senator Michael D'Arcy:** One of the other issues that you touched upon, I'm not sure which of you touched upon the going concern that the business would be trading in 12 months. Was there any time that any of the firms that you were auditing were not going to meet that going concern threshold?

**Mr. Paul Dobey:** If we were concerned about going concern on any of our banks and we were concerned in relation to AIB and a number of our other banks, we took certain steps. In 2008, we took steps to obtain assurances from the Financial Regulator and that was to address just what ... make sure they were aware of what the Financial Regulator was aware of. We spoke to the Central Bank because we wanted to understand ELA and the information ... what dialogue was going on between the Central Bank and the euro system. And we did that in 2008 and we got the assurances we need from the deputy governor of the Central Bank of Ireland and we also spoke to the Department in relation to capital. Now, when we came along ... and we, therefore, concluded that those banks were going concerns, that there wasn't a significant ... there wasn't a matter that cast a significant doubt on their ability to continue as a going concern

because if we had concluded that there was such a matter, we would have included an emphasis of matter in our reports. When we got out to 2010, we sought ... sorry, in 2009 we got the same assurances, we had the same concerns and when we got out to 2010, I think, maybe we were just after an election ... there wasn't a Minister for Finance in place and we didn't get the assurances that we required and we did put an emphasis of matter paragraph into the accounts for a number of banks ... that we audited.

**Senator Michael D'Arcy:** And can I ask Mr. O'Rourke, were you satisfied that you had access to accurate information which enabled you to discern the full financial position of the group at all times?

**Mr. Terence O'Rourke:** Yes, we were. AIB had extensive risk management processes, extensive internal reporting and I must say we were very happy with the adequacy and the comprehensive nature of the way that matters reported up the chain in AIB and the matter was being reported to the board. We never had a situation where we found things in our audit that hadn't been reported to the board. So, we were happy with the quality of information the AIB board had, yes.

**Senator Michael D'Arcy:** And in terms of within the financial sector in general, the cross-collateralisation of security and loans, some of the banks didn't know exactly who had what loans where and the securities were mixed up and took quite some time to resolve. If they didn't know, how did you know?

**Mr. Paul Dobey:** In the case of AIB, we knew AIB would have some sense of the securities they had. They would have other security that they might have liked to have. When the downturn hit, there was that issue that you've referred to of multiple borrowers having borrowed from multiple banks and that was very, very difficult for the banks to resolve because each bank then was scrambling to strengthen its security position and, actually, I think, in that regard, NAMA was very helpful because NAMA could get all of those borrowers under one roof and resolve the security package together. So, there was that issue in relation to resolving the position in relation to borrowers but AIB would have known exactly what securities it had, it just mightn't ... might have liked to have more ... as the position in the economy deteriorated and there was a scramble for security.

**Senator Michael D'Arcy:** Tell me, within your firm did ... KPMG were the auditors for some of the 30 major developers. Was there a potential conflict of interest?

**Mr. Paul Dobey:** No, they're completely separate teams and we do maintain client confidentiality rules because, obviously, the team in client A don't tell the team in client B what's happening, so we keep the client confidentiality rules.

**Senator Michael D'Arcy:** In terms of what changes, if any, to the auditing process should be taken to enhance the current approach, what would you recommend?

**Mr. Terence O'Rourke:** Well, a couple of things have already happened. I mean, one of the things, I think, more dialogue with the regulator along the way through. I mean, we did report every year to the regulator as required but the new protocols now of the regulator are to meet more regularly to have dialogue with the regulator and to discuss ... make sure each side knew the other. The regulator is also constrained. In some meetings we did have with the regulator, the regulator was unable to tell us things. We'd tell the regulator something and they said, "We can't tell you anything back because we're constrained by confidentiality". Now some of those



confidentiality rules have been lifted, so there's a more open dialogue now between regulator and auditor which, I think, is important.

A couple of other things, one is the going concern basis and the basis on which banks decide that they are a going concern, there is now agreement there should be extensive disclosures of what the issues the directors took into consideration when they're making those things. The guidance, for example, previously would have focused on liquidity and now it's very clear that going concern decisions should be based both on liquidity and solvency. Also, the previous guidance on going concern was more about a point-in-time, intermittent, "Are we a going concern today when we do our accounts?". And now the view is that this should be a matter of constant ... under constant attention by a company and they should be looking to make sure they're a going concern at all times. So, those things are helpful.

And finally, I would say in audit reporting, we now see that audit reports which are boilerplate ... they were beforehand, there was a lot of things we had to say but they were pretty much the same things we said to everybody. Now, auditors are required to identify the major risks that they have identified, so that in their published audit report to shareholders to say, "These are the things that we think could give rise to most risk of the accounts being wrong and this is why we think those things are the biggest risks." We also ... Auditors also use materiality, in other words, we don't audit every last penny because we'd be there forever if we .... so we take a material ... and make sure everything is materially right, whether the balance sheet is €100 million or €99.9 million, it doesn't make much difference but if it was €90 million it would be a big difference, so there's a materiality aspect and auditors now have got to disclose in their audit report what materiality judgments they use. And, finally, auditors have got to now to say in their audit report in a bespoke way what they've done in terms of the major risks they identified - so, what audit work have they done to work on the major risks. So, those are now published and are in the audit reports of public interest entities and are a new feature which was not there in the crisis. So, all those are helpful, I think, for readers----

**Senator Michael D'Arcy:** And finally, you said KPMG audited PostBank, HSBC, Defpa, INBS, AIB, EBS at one stage or now ... sorry ... currently, PTSB and BOSI at one stage also. Did you always ensure that there was no crossover in teams? And then if somebody was moving from one bank to another bank, was there a cooling-off period before they went in or not?

**Mr. Terence O'Rourke:** Paul, you had the financial services audit, so you'll be involved in the-----

**Mr. Paul Dobey:** We weren't concerned with a crossover of teams on the banks because ... and we would have spoken to our clients about that because what we needed to make sure was that the banking expertise was brought to bear on all of our clients-----

**Senator Michael D'Arcy:** But had a lot of banks?

**Mr. Paul Dobey:** Yes.

**Mr. Terence O'Rourke:** So there were some people who were involved in more than one bank, yes.

**Senator Michael D'Arcy:** Was there?

**Mr. Terence O'Rourke:** Yes.

**Mr. Paul Dobey:** And that was in our view-----

**Senator Michael D'Arcy:** And is that appropriate?

**Mr. Paul Dobey:** We believed it to be totally appropriate and our clients were very comfortable with that because what we were making sure was we brought the expertise, the very best expertise that the firm had to bear to all of our clients.

**Senator Michael D'Arcy:** And would that person have been senior or perhaps more junior?

**Mr. Paul Dobey:** We could have had partners working on multiple banks.

**Senator Michael D'Arcy:** All right, Chairman.

**Chairman:** I just have a few moments there if you want take ... I think it's No. 14, okay. I'll just take one question in that regard. It's did KPMG ever review loans that were outside the lending policy? This would be kind of the exceptions to loans or lending policy loans. Did it ever, in its engagement with AIB, find itself in that space?

**Mr. Paul Dobey:** Where we were reviewing them on the other side?

**Chairman:** Yes.

**Mr. Paul Dobey:** I can't ... I don't know.

**Chairman:** Okay. So what I'm simply asking there is as part of your audit process, did you ever end up in a position where you were reviewing loans that were outside lending policy? These are the exceptions to lending policy.

**Mr. Paul Dobey:** Oh, sorry. Yes, we would have reviewed ... I suspect we reviewed all of the large loans in 2008 and some of them in 2007 in great detail.

**Chairman:** Okay. And did you have any concerns with these exceptions to lending policies and the level of exceptions?

**Mr. Paul Dobey:** We had ... our concern in relation to the exceptions of lending policies was to make sure that the AIB processes were adhered to so that they got elevated appropriately up to the board, if need be. We also would have made sure in our auditing approach ... in looking at the audit of those loans, that they were recoverable and, in 2009, some of those large loans would have been-----

**Chairman:** So, who were they reported to and how where they then addressed?

**Mr. Paul Dobey:** Within the bank ... there was detailed sanctioning limits within the bank. AIB was organised on a divisional basis. There would have been a credit committee at a divisional basis if ... there would have been a sanctioning limit for individuals, there would have been a sanctioning limit for credit committees, divisional credit committees and then the group credit committee and certain decisions beyond those sanctions would have gone up the board. And that process happened and we wouldn't have seen exceptions to that process, if I can put it that way. We were satisfied that all of the matters reserved for the board went to the board.

**Chairman:** Were the exceptions in a particular area? Were they in construction or were they in business investment or where were they?

**Mr. Paul Dobey:** The large loans tended to be in either property or construction, or large real estate loans in capital markets.

**Chairman:** So, it would have been a broad construction, property sectoral area?

**Mr. Paul Dobey:** Yes. There would have been some syndicated loans, large syndicated loans in capital markets also, I believe.

**Chairman:** Okay, thank you.

**Senator Michael D'Arcy:** Senator MacSharry had asked that previously.

**Chairman:** Oh sorry, I missed it. Can I take in Deputy John Paul Phelan please?

**Deputy John Paul Phelan:** Thank you, Chairman. You've caught me by surprise there. Gentlemen, I've a general question at the start about risk assessment and maybe it's more appropriate for Mr. Dobey, but feel free to answer, Mr. O'Rourke, if you wish. With regards to the preparation of the firm's annual audit plan, and the risk assessment underpinning it, did the risk assessment approach adopted change to meet the prevailing, challenging environment in the period which we're discussing and if you can maybe outline if it did change and how it did change? And, furthermore, did the firm conduct their own independent assessment of the bank's credit risk methodology to satisfy themselves that the principles and processes adopted by AIB were appropriate?

**Mr. Paul Dobey:** Maybe to answer the second question first, we did look at the processes and methodologies and we were satisfied that they were appropriate in terms of processes. I think, as I've mentioned in my opening statement, what was underestimated by AIB was the extent and scale of the downturn and the implications it would have, but we didn't have the concern about their detailed processes. As I mentioned also there was a very detailed risk assessment process within AIB that identified all of the risks. They were aware of all of the risks. They may have underestimated the consequences of some of those risks but they were aware of them. Maybe to answer the first part of your question if I may, and I don't wish to go on for too long, but we did a very detailed assessment and I can take you through, if you wish, some of the comments that we would have been making-----

**Deputy John Paul Phelan:** Briefly.

**Mr. Paul Dobey:** ----- in ... I'll try. So, in 2004, we would have been talking about strong credit in the economy. We would have been talking about economic conditions and competitive pressures that could exacerbate profitability caused by increased competition and falling margins.

In 2005, we talked about continued credit growth and demand in AIB's markets, particularly in Ireland. We talked about a risk that credits might deteriorate post-approval and policies are not reviewed to reflect the changes in economic environment which could adversely affect credit quality. Also in 2005, we highlighted the level of exposure to different economies and sectors.

In 2006, we highlighted significant and continued growth in the new business volumes and increased credit concentrations in the property sector. At that time, there was increasing ECB interest rates and we were concerned about its impact on the Irish economy; that didn't end up being a big issue. We talked about the competitive environment and we made a comment on the

aggressive new entrants to the local market with an established infrastructure. We talked about competition to secure long-term capital funding and we talked about the integrity of management information and financial reporting which was dependent on the effectiveness of internal control systems and the tension between that and the drive to maintain EPS momentum and control costs.

In 2007, things were getting a little more difficult. We talked about the provisioning assumptions will require continuous monitoring and appropriate revision as credit grading policies and procedures develop. The favourable credit environment in AIB's markets is reflected in the current provisioning levels. However, as interest rate rises take effect and additional information becomes available, the provisioning may need to be updated to take account of the impact of any deterioration in the credit environment. That was in late 2006, in the context of our 2007 audit. We talked about underwriting in the current environment and breaches of underwriting limits. We talked about the deterioration of credits post-underwriting approval, including the impact of current market turmoil. We talked about credit rating and liquidity positions to support growth aspirations, the significance of the Irish economy to the group and its impact on generating sustainable growth, and we talked about the natural tension between maintaining the integrity of management information versus the ongoing drive to maintain EPS momentum.

And I can continue, if you wish.

**Deputy John Paul Phelan:** No, no, and I'm not wishing to cut you short, but I only have limited time and I've a whole series of questions that I wish to ask. Did you see the evidence from your counterparts yesterday from Deloitte and Touche?

**Mr. Paul Dobey:** I did, yes.

**Deputy John Paul Phelan:** Okay. I want to put a quote to you from Mr. Fitzpatrick from yesterday. I asked him whether ... he's the head of audit in Deloitte ... whether they do bank auditing differently now than they did when they were auditing Ulster Bank prior to the collapse and in light of the findings of the Nyberg report. His response was:

I wouldn't ... I wouldn't say we've done it differently. I think that ... 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.

Do you do your bank auditing differently as a result of what you've learned from the crash or, indeed, in light of the findings of the Nyberg report?

**Mr. Paul Dobey:** Well, firstly I would say you are always sceptical in relation to our bank audits and that's a state of mind. I've given you some examples, as we've talked ... I've just given you some and I've talked to you about the going concern assessment that we ... and steps we had to take in 2007 and 2008 and we were quite concerned about AIB in 2008 and for us to take those steps and talk to the Government was unprecedented actually, so that reflected the scepticism. What I can say is that bank audits ... auditing has changed. The engagement with the regulator has changed, that's a change for the better. There's much more active dialogue now and-----

**Deputy John Paul Phelan:** Is the physical way that an audit is conducted different in any respect?

**Mr. Paul Dobey:** I think-----

**Deputy John Paul Phelan:** In any substantial way.

**Mr. Terence O'Rourke:** More electronic is one way.

**Mr. Paul Dobey:** Yes. I suppose what we would say in relation to the AIB audits is we were very thorough. We did a very thorough review of all of the loans' exposures when the downturn happened. We were looking at those beforehand, but we weren't overly concerned about the recoverability because of the strength of the economy and the elevated property prices. We need to be sceptical, and maintaining that scepticism is important and having that expertise within our firm is important. Having the international ... the dialogue with our international colleagues is important. We were doing that in 2007, we've continued to do it. Obviously, audits need to evolve to reflect the changing environment. I would say our bank audits ... there's much more dialogue with Government and regulators now and that's important.

**Deputy John Paul Phelan:** Okay. Can I ask, in relation to the auditing of AIB, how many people are involved in the team in total? I don't want to know particularly about individuals, but what sorts of grades of staff are we talking about?

**Mr. Paul Dobey:** We had 20 partners on the AIB audit. Some of those were in Poland, some were in the UK, we had a number in Ireland, we had the treasury operation-----

**Deputy John Paul Phelan:** How many in total then? Twenty-----

**Mr. Paul Dobey:** Twenty partners.

**Deputy John Paul Phelan:** Twenty.

**Mr. Paul Dobey:** And over 200 staff.

**Deputy John Paul Phelan:** Okay. And typically then would the ... and the phrase I used yesterday was the "grunt work" of the audit be carried out by more junior members of staff, with senior partners supervising their work or-----

**Mr. Paul Dobey:** We hire graduates from-----

**Deputy John Paul Phelan:** Yes.

**Mr. Paul Dobey:** And they are the lifeblood of our firm. They perform a very important role in our audits and we invest very heavily-----

**Deputy John Paul Phelan:** So most of the 200 would be pretty junior?

**Mr. Paul Dobey:** No. I was just making the point that the junior staff on our audits are very important. They bring a fresh perspective and they do a very important role and they are the lifeblood of our firm. I would say, on AIB, it would be ... certainly in ... if I go back to 2008, where we allocated ... we had a very challenging audit, as I mentioned in my opening statement. We would have brought in additional partners and directors to review the loans in late 2008, early 2009. I would say we probably had ... and I'm sorry, I am guessing, but I would say it was half of that 200-----

**Deputy John Paul Phelan:** Okay.

**Mr. Paul Dobey:** -----would have been-----

**Deputy John Paul Phelan:** Okay, that's grand.

**Mr. Paul Dobey:** -----partners and directors.

**Deputy John Paul Phelan:** I want to turn to the Nyberg report, page 56, paragraph 3.6.2 - you'll be familiar with it, I would think, anyway, gentlemen - where he says, "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 you accept that finding of the Nyberg report in relation to your audit of AIB?

**Mr. Paul Dobey:** I presented to Mr. Nyberg, to the commission. I pointed out to him, as I have pointed out to you, the steps that we took in all of the relevant years. I think Nyberg's primary criticism of auditors is that we didn't point out the implications. So, we pointed out the risks and he would have expected us to point out the implications. I think, if you look at some of the documents that we've presented, maybe they were presented in a particular way. We were making ... we were dealing with the very senior members of the audit committee and if you look at ... there's a document we referenced earlier, Mr.-----

**Deputy John Paul Phelan:** I only have 40 seconds left.

**Mr. Paul Dobey:** Yes.

**Deputy John Paul Phelan:** In relation to that comment, does it apply to your auditing of AIB?

**Mr. Paul Dobey:** I don't believe it does.

**Deputy John Paul Phelan:** Okay. Finally, earlier, very early, much earlier in our inquiry, Professor William Black was here. He was an American ex-regulator and under questioning from me he made the following quote, he ... in relation to auditors:

The straightforward answer is not to allow the bankers to pick the auditors. There should instead be a panel of qualified auditors that are assigned to them, and we should track the performance of those auditors. It would be like relegation. If someone had a record of screwing up, they get yanked from the panel, assuming what they did was not criminal. If it was criminal, they are driven out of business, but if it was just inept, they get relegated.

Firstly, and to use his phrase, do you regard any of the audit practices of KPMG in relation to AIB as being "inept"? And that's his ... his word, not mine. And, secondly, would you care to comment on his view that banks shouldn't be choosing their own auditors, and that such a system of relegation would apply for auditors who are shown, maybe, to have not performed their duties correctly?

**Mr. Paul Dobey:** Well ... sorry, go ahead. Go ahead.

**Mr. Terence O'Rourke:** Well, first of all, absolutely, we were not inept. We did very high quality audit on the AIB, I'm quite sure of that. Secondly, in relation to the other matter, the auditors are chosen by, these days, the non-executive directors. The audit committee are the people who choose it on behalf of shareholders. We are the shareholders' auditors and they're chosen by representatives of the shareholders, who are the non-executive directors. Also, our

work is reviewed by regulators, so if we were, you know, inept, or if there was auditors who weren't doing what they're doing, the regulators would be calling them out. And that's the way, I think, that the system should work.

**Mr. Paul Dobey:** You probably won't be surprised to hear that I wasn't keen on what Mr. Black had to say. I thought he questioned the integrity of auditors generally, and there was a generalisation made that I didn't recognise in his evidence, particularly in so far as it relates to Ireland. I'm not sure what experience he had in the savings and loans process in the US. And maybe ... I think if there was ... somebody was doing inept ... an inept job in our firm - that very rarely happens - but we would be absolutely comfortable that person should be yanked from whatever role they were fulfilling.

**Deputy John Paul Phelan:** Thank you.

**Chairman:** With that said, I now propose that we take a break. The witnesses are reminded that, once again, once they begin giving evidence they should not confer with any person other than their legal team in relation to their evidence or matters that are being discussed before the committee. And with that in mind, I now suspend the meeting until 4:35 p.m. and remind the witnesses that they're still under oath until we resume. Thank you.

*Sitting suspended at 4.22 p.m. and resumed at 4.39 p.m.*

**Chairman:** I'll propose that we go back into public session. Is that agreed? Agreed. Okay, so with that said, I call on Deputy Eoghan Murphy. Deputy.

**Deputy Eoghan Murphy:** Thank you, Chairman. And you're both very welcome, gentlemen. I just want to return to a question that Senator D'Arcy asked you earlier on, Mr. Dobey. He asked if you were satisfied that you had access to accurate information which enabled you to discern the full financial position of the group at all times in relation to AIB and I think you said that you were satisfied.

**Mr. Paul Dobey:** I was.

**Deputy Eoghan Murphy:** Okay.

**Mr. Paul Dobey:** I mean, there was a very ... it was a very open dialogue between ourselves and AIB at all times and they were very open in providing us with information.

**Deputy Eoghan Murphy:** And you came into auditing AIB in around ... is it 2002?

**Mr. Paul Dobey:** Yes. We ... There was a competitive tender and we won that competitive tender in 2002.

**Deputy Eoghan Murphy:** Okay. If we could just look at a board minute, and it's in the document on page 4 of the KPMG core document. It's a board minute from December 2001, if you have it in front of you.

**Mr. Paul Dobey:** Yes, I do.

**Deputy Eoghan Murphy:** The page is mostly redacted but at the top we've the group chief executive's report and in that main paragraph, Mr. Buckley talks at the bottom of the paragraph, about the need to make a significant capital investment in the development of a "single information management architecture." So would you have come across this problem when you were

then auditing - in 2002 - the year 2001?

**Mr. Paul Dobey:** AIB had a lot of legacy systems and there was a lot of workarounds required to gather information but it had those workarounds in place. There was a very extensive programme put in place between 2002 and 2007, particularly in relation to the ROI division. We called it Project Alpha. And that was designed to facilitate better information flows and particularly in relation to customer information. And would have also facilitated things like credit provisioning. But AIB had a lot of manual processes, this was a suggestion that they needed to be more ... better systems and more systemised processes. There was also a very active dialogue in AIB... well, sorry, this predated the Rusnak fraud, which was before our time. But post-Rusnak, there was very detailed work done in AIB to change all of its processes. I think they talked ... the AIB people who came before you talked about the very extensive processes they went through. John Hyman did some work with them, Deloitte did a review of all their credit processes and there was also, in that time, some change to their risk infrastructure. They were a very decentralised organisation prior to the Rusnak crisis, post that they put in certain ... they centralised risk and they centralised finance over time. And I think that was what ... this was the genesis of that.

**Deputy Eoghan Murphy:** And you said that it took until 2007 to bring in that single information management architecture?

**Mr. Paul Dobey:** Actually, I'm not sure if that system was ever implemented. It was a huge ... a huge process. They went through a huge change process, they had lots of consultants trying to develop that system and I think it got overtaken by events, actually, is my recollection.

**Deputy Eoghan Murphy:** Without the implementation then of such a management system for information ... I mean, could you be confident that you had a full picture?

**Mr. Paul Dobey:** AIB had legacy systems that were inefficient and it was harder to extract information but they had data warehouses and other processes to gather information that we were then able to use in conducting our audit. But it was a change process and this was about streamlining the processes, reducing the number of people and having a more automated process.

**Deputy Eoghan Murphy:** Okay, if we could turn then to page 9 in the same document please. And you talked, Mr. Dobey, in your opening statement about the effective communications of risks between KPMG and AIB. And here we have, in relation to credit control and credit provisioning, an observation in the second paragraph on the left hand side, "During the course of our audit, we noticed 11 significant provisions raised in December 2004, nine of which were without the prior approval of the relevant credit committee." So, is that an example of you as auditors catching something that AIB itself weren't aware of?

**Mr. Paul Dobey:** I'm not sure if AIB weren't aware of it, but there was a process in AIB where, towards the end of the year, they would process their loan loss provisions. We would've preferred that they did it throughout the year, but it was done towards the end of the year. There was a number of reasons why this was a practice we didn't ... we weren't particularly keen on. Firstly, as I've mentioned earlier, in a bank, the closer the relationship manager is to the loan, the greater the risk. So, in this instance, and the way ... the way banks manage that is by having approval processes and credit committees. In this case, we would have liked to have seen where loans were being written off, and I'm not saying there was a fraud, but there is an increased risk of fraud between the borrower and the lender ... the lending ... the relationship manager ... and



the bank's controls on that was to have all write-offs or provisions go through a credit committee. There was obviously, I would say, a lot of work done towards the end of this particular year and credit provisions were processed. We would've been happy that they were processed timely but we would have preferred if they'd gone through the credit provisioning process ... the credit committee process. And one of the key... it's on the right hand side of that page ... one of the key matters ... what's really important about when credit provisions are taken is that there is learnings from that loan loss. So, if you advance a loan and then you have to take a provision against it, the most critical thing from the bank's perspective is that you learn the lessons from that loan. What was the problem? Why did this loan go bad? Was it the underwriting decision that was wrong? Was it the management of the loan over the period or whatever, right? So, as I said, the main purpose of the markup is to analyse the cause of the loss and to learn from our loss experience, in addition to confirming the appropriates of the provision. So it was those two things that we were pointing out. So you're absolutely right, this was something that we were, sort of, picking up and ... and improvements that we thought AIB could make.

**Deputy Eoghan Murphy:** And in the management response then on the right hand side, that's AIB accepting your observation and recommendation?

**Mr. Paul Dobey:** Yes.

**Deputy Eoghan Murphy:** And is that then case closed?

**Mr. Paul Dobey:** No, no, the next year you would have looked at it again and we would have expected them to do it differently and to follow through on this recommendation. And in our management letters, when we raise management letter points, we'd raise them in one year, the following year we'd look, if the matter came up again we'd highlight it again. If there was an action from the previous year that wasn't dealt with, we'd capture that as an action that wasn't dealt with, and the chairman of the AIB audit committee at the time was very focused on items getting resolved on a timely basis. So one of his key metrics as chair of the audit committee was; how many items did internal audit raise, how many items did external audit raise ... and is management dealing with those matters on a timely basis? And that would have been, you know, about an appropriate control environment.

**Deputy Eoghan Murphy:** Thank you. I want to just move into another area there in relation to IAS 39. KPMG is an international company.

**Mr. Paul Dobey:** Yes, indeed.

**Deputy Eoghan Murphy:** KPMG operates in Spain?

**Mr. Paul Dobey:** We do.

**Deputy Eoghan Murphy:** Do you audit banks in Spain?

**Mr. Paul Dobey:** We do.

**Deputy Eoghan Murphy:** So what are the recommendations that came out of the Nyberg report on page 20? He talked about the big auditing institutions having access to warning signs, and it was unexpected, he said, that the international experience that big auditing firms had was not used more. Would KPMG in Ireland have been aware that the Spanish banks and the Spanish regulator were not implementing IAS 39 fully?

**Mr. Paul Dobey:** Absolutely we would have, I mean we would get together as banking fi-

financial services partners regularly and discuss various best practice. One of the things, I'm not an expert in Spanish law, but it's different than Irish law. So when the EU ... IFRS regulation was brought into Irish law it was brought in fully with no carve-outs, and we didn't have the option of having that carve-out that was available in Irish law, sorry, that was available in Spanish law, and I have to say I don't understand all the details around Spanish law. I can say that the audit firms in Spain qualified the accounts of the Spanish banks to say that they were not in compliance with IFRS. Now for AIB, given that it had access to ... European capital markets and US capital markets, it wanted to apply IFRS and wanted that opinion from its auditors and the market would have demanded its opinion from its auditors in relation to IFRS.

The other thing I can say is while what was called dynamic provisioning was operated in Spain, it was only operated in relation to a small portion of its book and it was there for a particular reason, which I think was to do with holdings that Spanish banks held in Spanish companies. And, all I can say as an observation is that the additional provisions that were set aside as a result of that were, were not sufficient to save the Spanish banks from the, the, the ... very significant issues that they faced.

**Deputy Eoghan Murphy:** Was the Spanish approach, or the carve-out as you described it, was that better practice?

**Mr. Paul Dobey:** Well, I have to take you back to the comments I made in my opening statements. If a bank thinks it needs more capital, it can hold capital. It can decide not to pay dividends, we had that discussion earlier on. It can decide to raise capital in the markets. If the regulator thinks there's greater risk in the banks than they would like to see, they can specify that greater capital should be held against those risks. So IFRS accounting is only one small piece in the picture here, and the other thing I should say to you; when general provisions are set aside by banks, they're not necessarily a buffer against capital because the capital adequacy rules, under the CRD are such that those loan loss general provisions get added back to capital. So they're not available always as buffer. Now they get ... it's technical but they get added back to tier 2 capital. But they do get added back to capital and it's not necessarily a buffer against loss in that circumstance.

**Deputy Eoghan Murphy:** Thank you and just then to conclude on that point. I mean did you discuss this issue about what was happening in Spain or the discussions that you'd had with AIB about this accounting standard? Did you discuss them with the Financial Regulator?

**Mr. Paul Dobey:** No, but we would have been aware. I mean, the regulators do various different things in different countries and we would look at, you know, in Canada they did something different. In Germany they do something different and there is a college of regulators that gets together across the EU where they would discuss those matters and I assume they were aware of what other regulators are doing; there is a forum for them to do that. But we wouldn't have discussed this with the regulator and we wouldn't have viewed it as our role to set the capital for the banks. That was the role of the regulator.

**Chairman:** Thank you very much, Deputy Murphy. Just in follow up to Deputy Murphy and either Mr. Dobey or Mr. O'Rourke can answer this. Do you feel that due to the lack of one system as we have just been discussing that there was any material information gaps that might have helped you as an auditor to get a clearer picture of the AIB accounts?

**Mr. Paul Dobey:** This is in relation to Project Alpha and the data.

**Chairman:** Yes.

**Mr. Paul Dobey:** What I can say is that when the crisis hit AIB in 2008, and I mentioned earlier on that the 2008 audit of AIB was the most difficult audit that we did to that time. There were difficult audits subsequently also. It was great difficulty in gathering the information that we needed to assess the loan loss provisions, and we allocated a huge amount of man hours to that. AIB allocated huge amounts of man hours to it. We got to the right answer in February but it was very very difficult, and very expensive and costly.

**Chairman:** In an earlier response to Senator D'Arcy, Mr. Dobey, you stated that AIB knew what securities they had. Did they know what securities they had that would not register for more than 90 days from your examination?

**Mr. Paul Dobey:** We had a register of their backlog.

**Chairman:** Was KPMG aware of this?

**Mr. Paul Dobey:** Yes, and it was discussed at the audit committee.

**Chairman:** In relation to the loan concentrations, Mr. Dobey, you stated that in 2008 it was considered as an issue re the going concern concept, in response to Deputy Phelan that in 2006 you revised your audit schedule to address the increase in concentration of property lending. Should this not have been a concern in the going concern concept as well? We were talking about 2008 but in 2006 these issues were on the table also.

**Mr. Paul Dobey:** They were on the table for AIB as a significant risk and I mentioned the semi-annual risk reports that were presented by the chief risk officer to the board and the audit committee. At that point, property prices were elevated. We now know that they were inappropriately elevated if I can put it that way, but there were transactions happening at very high levels and those loans were recoverable and could have been recovered at that time.

**Chairman:** That would have been the view held by both the auditor and the bank, yes, at the time?

**Mr. Paul Dobey:** At the time, absolutely.

**Chairman:** Okay, thank you. Deputy Michael McGrath.

**Deputy Michael McGrath:** Thank you very much, Chair. You are very welcome, Mr. Dobey and Mr. O'Rourke. Just for disclosure purposes, Chair, I worked with KPMG in Cork from 1997 to 2001 where I trained and qualified but did not work in any financial services audits, just to put it on the record. Can I start by asking Mr. O'Rourke if any legal action was taken or threatened against KPMG in respect of your audits of AIB over the last number of years?

**Mr. Terence O'Rourke:** Not that I am aware of, no.

**Deputy Michael McGrath:** Not that you are aware of. Would it be correct to state that as partners you do not have limited liability in the legal sense?

**Mr. Terence O'Rourke:** Correct. We operate as an unlimited liability. We have unlimited liabilities. Not like a limited company, the partnership is an entity whereby if there are any liabilities incurred or obligations incurred, those obligations go back to the individuals, they do not stop at the corporate level.

**Deputy Michael McGrath:** Sure. Could there be significant implications for partners and for the firm if any statement was made, for example, that the financial statements during the years which are under review were not prepared, did not give a true and fair view in accordance with the international financial reporting standards or did not contain the sufficient disclosures and property risk? Could there be implications?

**Mr. Terence O'Rourke:** Obviously there could be implications if somebody was alleging that we had made mistakes or that the accounts are wrong, there could be implications for us, yes.

**Deputy Michael McGrath:** If somebody relied on the financial statements and if you had made a statement of that kind, but you certainly hadn't, just to be clear.

**Mr. Terence O'Rourke:** I mean, if we had done bad work, if we had been negligent, that is where auditors are exposed, yes.

**Deputy Michael McGrath:** Auditors would have professional indemnity insurance?

**Mr. Terence O'Rourke:** There would be a level of professional indemnity insurance.

**Deputy Michael McGrath:** Can I just raise the issue of fees? If my calculations are correct, then KPMG earned over €60 million from 2003 to 2013, between audit and non-audit fee income.

**Mr. Terence O'Rourke:** That is the aggregate of the disclosures in the AIB annual reports, that is right, including value added tax, including obviously around the world as well, yes.

**Deputy Michael McGrath:** Over that period or for any given year, what percentage of KPMG's total income would the income stream from AIB have represented?

**Mr. Terence O'Rourke:** The fees in Ireland from AIB would have never gone much above 2.5% of our total fee income.

**Deputy Michael McGrath:** 2.5%?

**Mr. Terence O'Rourke:** Yes.

**Deputy Michael McGrath:** Would it have been one of your largest clients?

**Mr. Terence O'Rourke:** It was our largest client in the last two years in that period ... not of the year in that period but lots of years it was our largest client.

**Deputy Michael McGrath:** Okay. Do you believe there was an excessive dependence on the part of KPMG on the fee income that you were deriving from that work?

**Mr. Terence O'Rourke:** No, 2.5% is not particularly large. It's a number but it's small part of our total audit ... total revenues. And the ethical guidance of auditors that was set by international standards is that, if you get more than 10% of your audit fees from a client, then you begin to get risk situations and you get to get questions about auditor's independence, but the levels at AIB was far below that.

**Deputy Michael McGrath:** Okay, but would you accept that 2.5% is still a significant element of your fee income?

**Mr. Terence O'Rourke:** Yes. It's a number, yes.

**Deputy Michael McGrath:** It was a valuable fee income.

**Mr. Terence O'Rourke:** It was a valuable fee income, absolutely.

**Deputy Michael McGrath:** Just from looking at the financial statements of AIB which were audited by KPMG and I was looking through 2007, for example. And there are 18 pages dealing with risk management and there isn't a single reference to property and construction. And if I can just put the question in some context, I suppose, for Mr. Dobey, for example, in that year, total loans and receivables to customers were €127.6 billion, of which construction and property, which we can see on ... in one of the notes of the accounts, was €46.4 billion, so about 36% of the total loans and receivables. And if you stripped out home mortgages, which were just over €30 billion, then construction and property accounted for 48% of the loans which were due to AIB. Now, do you believe it is appropriate that, in 18 pages dealing with risk management, that there wouldn't be a reference to the exposure of the bank to the construction and property sector?

**Mr. Paul Dobey:** I have to say I have the 2008 accounts with me. I don't have the 2007 accounts.

**Deputy Michael McGrath:** Okay.

**Mr. Paul Dobey:** But ... there was very detailed disclosures in the 2008 accounts that I believe would've been in the 2007 accounts, setting out its sectoral exposures-----

**Deputy Michael McGrath:** Yes.

**Mr. Paul Dobey:** -----setting out the growth in that sectoral exposure. And I believe in the note in the accounts that addresses concentrations of credit risk would've highlighted property and related construction lending. In addition, and I have an extract from the 2006 accounts ... I didn't bring 2007 as I've said ... which said:

The Irish and UK economies in particular have a significant growth in property prices and property-related lending in recent years and, while management believes this is a sensible approach to property lending and the management of related risks, any significant deterioration in Irish and/or UK property prices, could adversely affect the financial position of the group.

So I-----

**Deputy Michael McGrath:** Yes. Is that in the directors' statements-----

**Mr. Paul Dobey:** It may not be in the risk management section, but it was very, very clearly set out in the accounts and I'm ... I apologise if I don't have those accounts.

**Deputy Michael McGrath:** No, no, that's fine. And the last excerpt you read out there from 2006, where is that presented in the financial statements? Is that in the directors' report?

**Mr. Paul Dobey:** I'm sure ... that section extract is from the 20-F filing of-----

**Deputy Michael McGrath:** Okay.

**Mr. Paul Dobey:** -----of AIB, with the Securities and Exchange Commission. But I believe

the risks were set out in the financial statements and as I say, I have the 2008 financial statements and there's very extensive disclosures in there. It may not just be in the risk management section.

**Deputy Michael McGrath:** Yes. I mean, the 2008 financial statements would've been agreed and published in early 2009, so that would've been after the bank guarantee and after the crash, for want of a better phrase, in September 2008. The issue I'm raising is, you know, people who would've been relying on financial statements for 2005, 2006, 2007 ... yes, in the note dealing with loans owed to the bank, there is a breakdown by sector and you can see construction and property is there, but there is no commentary around it. And certainly on the question of risk, there isn't the reference to a specific risk that the bank faced in terms of exposure to property and construction.

**Mr. Paul Dobey:** Yes. I'm sorry, I can't disagree with you, but I ... because I don't have the accounts here, but I'm surprised at that. I would've believed that there was disclosures in the accounts setting out the property in relation to disclosures. But, I think the issue ... the big issue that AIB faced in 2007 was the valuation around its securities. Property was obviously an issue but property prices were reasonably elevated at that point also.

**Deputy Michael McGrath:** Can you just talk us through, during the course of an audit, if you as the lead auditor felt very strongly that there should be a note in the accounts? Obviously, the accounts are the preserve of the directors, but if you as the auditor felt strongly that there should be a note, what typically would happen in that situation?

**Mr. Paul Dobey:** As I mentioned, AIB were very open with us through the process. When AIB issued its interim management statement, it would send it to us. We would comment on it, that would be when it did its half-year accounts, they would send it to us, we would comment on it, we would add disclosures, if we thought they were necessary. In 2008, we added very significant going concern disclosures, so while the accounts are the preserve of the directors, our opinion is on the financial statements, and if there's something that should be in the accounts that we think is not, we will put it in. Or ask AIB to put it in.

**Deputy Michael McGrath:** Ask AIB to put it in, yes. And was there ever a situation where you as the auditor desired additional disclosure by way of a note or a statement in the accounts, but that was denied by the bank?

**Mr. Paul Dobey:** There was a particular dialogue in 2008 in relation to the going concern-----

**Deputy Michael McGrath:** Yes.

**Mr. Paul Dobey:** -----disclosure that's set out in detail in the financial statements. And it's mentioned in a number of places, but the most significant is on page 119 of those financial statements. As I mentioned to you, we had a dialogue with the Government, and with the Financial Regulator, and with the Central Bank of Ireland. Following those meetings, we input, I remember I sent a draft of a disclosure I thought I would like to go into the financial statements in relation to the going concern basic preparation, there was some discussion with AIB as to how fulsome that disclosure would be, and there was a dialogue with the Department of Finance as to how fulsome that would be, and we were satisfied in the end. We might have liked a different form of words, but we were satisfied after extensive discussions with AIB that the form of words were appropriate and set out the position and confirmed the position that had been

confirmed by the Minister for Finance at the time.

**Deputy Michael McGrath:** Okay. But prior to 2008, there weren't any examples where you wanted something in the financial statements, but-----

**Mr. Paul Dobey:** Oh no, there was ... we would have, in 2007, as I mentioned, the big issue facing AIB was the liquidity in relation to its traded credit book, and we had extensive discussions with AIB in relation to that book. And ... the credit markets froze in August 2007, as you're probably aware, and some of these securities that AIB held that were used previously as part of its liquidity now became very difficult to value. Again, we spoke to the regulator about that in late 200... sorry, early 2008, and we looked for additional disclosures in the AIB financial statements, and they were put in. I can think, going back to, on transition to IFRS, we were very involved in the dialogue around what additional disclosures should go in the financial statements, and we would have been looking at, I remember at the time we would look at the RBS financial statements, the National Australia Bank financial statements, the HBOS financial statements, and make sure that best practice was being applied by AIB -so there was an iterative process. And it isn't a case of just, we take the financial statements, we do a two-page audit opinion and we move on. There's a very detailed dialogue around what we believe should go into the financial statements, and our audit findings document with the audit committee would set out those views also.

**Deputy Michael McGrath:** Okay, and just to clarify, there was never a situation where an issue was of such seriousness that you felt it might warrant a qualification in the report?

**Mr. Paul Dobey:** No, except in ... well, we were concerned in 2007 about liquidity, and we were concerned about the disclosures, but AIB engaged with us and, in 2008, we were concerned about the going concern.

**Deputy Michael McGrath:** Another question, Chair, if I may? In terms of your communications with the AIB audit committee, and you referred to this in your opening, your witness statement, page 7, that between 2004 and 2007, those communications would have included the identification of risks relating to, or arising from, property funding and liquidity, and I assume that the extracts you read out there to Deputy Phelan a few moments ago were from those communications to the audit committee. When was the first reference made by KPMG to the AIB audit committee in respect of the concentration risk relating to exposure to property and construction? In your commentary a while ago, it appeared to be 2006 that the first specific reference to that risk, concentration risk, in property and construction.

**Mr. Paul Dobey:** Well, I think we would have had a reference to ... well, the strong credit growth in the Irish economy would probably, there was a growth in the property, at that time.

**Deputy Michael McGrath:** It is general in nature.

**Mr. Paul Dobey:** It is general nature, I agree. And I didn't read out ... I just have some extracts here. I would expect we were talking about concentrations of credit risk in 2005 also. But obviously the one ... I ... well, yes, the level of exposure to different economies and sectors, so I believe there was probably a reference to property concentrations at that time also.

**Deputy Michael McGrath:** And you were satisfied with the response of the ... the audit committee and the board, subsequently, in the presentation of the financial statements?

**Mr. Paul Dobey:** Yes. Yes.

**Deputy Michael McGrath:** Thank you.

**Chairman:** Thank you, Deputy McGrath. And, just, Mr. Dobey, in relation to your engagement with Deputy McGrath around the 2007 accounts, there does seem to be a ... maybe a divergent view there. I would invite you with the choice to come back to the committee if you want to further examine that with further information.

**Mr. Paul Dobey:** Okay.

**Deputy Michael McGrath:** Or the issue of disclosure of property-related risks, yes.

**Mr. Paul Dobey:** Yes.

**Chairman:** So, in that, I now invite Deputy Kieran O'Donnell. Deputy, you've ten minutes.

**Deputy Kieran O'Donnell:** Thanks, Chairman. I want to refer to Vol. 1, page 54 ... 53 and 54. Either of you can just advise ... the disclosure under section 27B of the Central Bank Act 1997 ... what exactly ... what are the circumstances in which ye're required to report to the ... the Financial Services Regulatory Authority on that? What are the circumstances?

**Mr. Paul Dobey:** Where the ... I believe it's where we believe the continuous functioning of the bank may be affected.

**Mr. Terence O'Rourke:** Other matters that may be of material significance for the financial regulators of supervisory functions.

**Deputy Kieran O'Donnell:** Now, you reported, in respect of the '08 accounts, which is this letter here. Did you report in respect of the '07 accounts?

**Mr. Paul Dobey:** We had a letter that would have been similar to this but ... but at this ... in this letter we highlight the dialogue we had with the Financial Regulator and the Central Bank and the Department of Finance. We didn't have such dialogues in 2007 because-----

**Deputy Kieran O'Donnell:** But when you're ... in 2007 you had issues with going concern-----

**Mr. Paul Dobey:** Yes.

**Deputy Kieran O'Donnell:** So would you have ... when you wrote to the ... to the financial services ... the regulator, would you have highlighted that you had to have going concerns? Obviously a letter would have gone in early in 2008. Did you highlight that you had going concerns in respect of the '07 accounts?

**Mr. Paul Dobey:** In 2007 there was issues in relation to the liquidity position of the ... of the bank-----

**Deputy Kieran O'Donnell:** Well, then, did you highlight ... did you highlight your concerns in respect of ... of liquidity?

**Mr. Paul Dobey:** The steps ... the steps that we took in 2007 was we asked AIB to prepared a detailed paper setting out what liquidity it had available to it. The conclusion from that paper was that AIB had some €30 billion of liquidity available to it, therefore, we got satisfied that we didn't need to go any further and we didn't.



**Mr. Terence O'Rourke:** And ... and our letter in 2007, we had also enclosed our communication with the audit committee and the audit committee-----

**Deputy Kieran O'Donnell:** No, I suppose, I accept that, I am just making ... the point, really, I ... I want to ... to clarify, is, did you report to the Financial Regulator in respect of the '07 accounts in early '08, and if you did report, did you make reference to the problems with ... with your concerns with liquidity?

**Mr. Paul Dobey:** Well, I suppose we had concerns, we made inquiries, we gathered evidence, we satisfied ourselves in relation to those concerns. We didn't believe we had to go any further because AIB had €30 billion of liquidity.

**Deputy Kieran O'Donnell:** So, therefore, when you ... when you sent in your ... your letter to the Financial Services Regulatory Authority you would have said "We've no issues"?

**Mr. Paul Dobey:** No, we would have ... well, sorry, this letter wouldn't have ... wouldn't have called out that issue. We would have enclosed all of the communications we'd had with the AIB audit committee in that ... in that period-----

**Deputy Kieran O'Donnell:** You would have drawn ... you would have drawn attention, Mr. Dobey, to the concerns you had over liquidity, even ... even though ... even though you were satisfied with the ... with the explanations given by AIB?

**Mr. Terence O'Rourke:** The regulator ... the regulator had been aware of the issues we debated with the audit committee, including liquidity, so that would have been included in the communications we shared with the regulator, so in terms of the ... while also reporting to the regulator we should have shared-----

**Deputy Kieran O'Donnell:** So your concerns in respect of liquidity and respect of the '07 accounts, the regulator would have been made aware of that in early '08?

**Mr. Paul Dobey:** Yes. We actually, we ... you raise an interesting point because we were concerned, generally, as a firm, in relation to the matters ... the financial stability matters in 2007, and in early ... on 10 January 2008 we met with the Financial Regulator. That meeting was initiated by me, through the institute-----

**Deputy Kieran O'Donnell:** For what reason, Mr. Dobey?

**Mr. Paul Dobey:** To have a discussion about the issues that the ... the issues that were arising in the environment at the time.

**Deputy Kieran O'Donnell:** And was that specifically to do with AIB?

**Mr. Paul Dobey:** No. It was generally ... as ... we wanted to have a general discussion and, actually, all the four firms went in and ... and talked to the ... to the regulator.

**Deputy Kieran O'Donnell:** And was it around liquidity?

**Mr. Paul Dobey:** It was around ... well I ... I have the note here. It was around-----

**Deputy Kieran O'Donnell:** Who did you meet, Mr. Dobey?

**Mr. Paul Dobey:** We met Billy Clarke, Mary Elizabeth-----

**Chairman:** I need to allow a bit of time for answering, Mr. Dobey?

**Deputy Kieran O'Donnell:** Yes.

**Mr. Paul Dobey:** Billy Clarke, Mary Elizabeth Donoghue, Geraldine McWeeney, and Patricia Dunne.

**Deputy Kieran O'Donnell:** Fine, you might just give us just a brief indication of what you discussed.

**Mr. Paul Dobey:** We talked about opinions, going concern and valuation issues; we talked about hard to value securities; we talked about risk management and the bank's ICAAP; we talked about what was going in relation to liquidity in the system generally; we talked about the communication of ... should be two-way if there was supervisory action being taken, so we wanted to be notified-----

**Deputy Kieran O'Donnell:** In the limited time, would you provide a copy of that to the committee, Mr. Dobey?

**Mr. Paul Dobey:** I believe it has already been provided to the committee.

**Deputy Kieran O'Donnell:** Okay. And can I ask a very quick question? So can I take it that the auditing firms had concerns around the audit of banks and, more particularly, around liquidity at the time in respect to the banks?

**Mr. Paul Dobey:** Markets were extremely uncertain. Credit markets ... the first Bear Stearns fund went down in June 2007, the capital markets froze in August 2007 for certain securities. I believe Bear Stearns was taken over by JP Morgan in late 2007. There were certain securities that were held in AIB's traded credit book that were difficult to value. We had concerns, as I've mentioned. We raised those concerns with AIB. They did the work they needed to do to get us satisfied and we were happy.

**Deputy Kieran O'Donnell:** But in terms of your discussions with the regulator, you would have highlighted you had concerns, collectively the auditing firms with liquidity and the environment in which the banks were operating in at that time?

**Mr. Paul Dobey:** Yes, the regulator had concerns, we had concerns; it was a very uncertain time.

**Deputy Kieran O'Donnell:** Okay, the second question is: if the guarantee wasn't in place in relation to 54, would you have qualified on a going concern basis your audit opinion of in respect of the 2008 accounts?

**Mr. Paul Dobey:** If I can ... I need to answer that question with a little bit more context. If we hadn't got the assurances we looked for from the Department of Finance in relation to capital, the Central Bank in relation to availability of ELA when we met them in February 2009, we would have had an emphasis of matter ... sorry, we could have because I don't know what else we would have done.

**Deputy Kieran O'Donnell:** You gave an emphasis of matter in respect of 2010 accounts when the guarantee was lapsed-----

**Mr. Paul Dobey:** No, no, no, this is in 2008.

**Deputy Kieran O'Donnell:** No, but you gave an emphasis of matter in respect of the 2010 accounts because the guarantee had lapsed, so the question I'm going back to: in the 2008 accounts, would you have qualified the accounts on a going concern basis if the taxpayers' guarantee in respect of the banks was not in place?

**Mr. Paul Dobey:** Well, I need to clarify a little bit. The reason why we qualified, sorry, gave an emphasis of matter I should say, in 2010 was not because the guarantee had lapsed but because we were unable to get assurances from the Department in relation to ... that we were looking for in relation to support for the banks.

**Deputy Kieran O'Donnell:** Well, I'm reading from Mr. Terence O'Rourke's witness statement, "In respect to financial statements for 2007, when the general bank guarantee had expired and all the previous assurances from Central Bank" - you gave an emphasis of matter.

**Mr. Paul Dobey:** And I'm referencing the assurances that we didn't get ... we didn't get in 2010 which was-----

**Deputy Kieran O'Donnell:** But, ultimately, from a going concern basis, do you think, looking back now, that you would have qualified these statements on a going concern basis for the '08 accounts?

**Mr. Paul Dobey:** If we didn't get the assurances-----

**Deputy Kieran O'Donnell:** If the guarantee wasn't in place?

**Mr. Paul Dobey:** Well, I have to consider both, right. Because what ultimately ... the availability of emergency liquidity access from ... emergency liquidity assistance from the Central Bank of Ireland and the euro system was critically important to us. My understanding, and I don't have a perfect understanding because I didn't talk to the Government at the time, was when the guarantee was given, there was a desire on the part of the various parties to avoid Ireland using emergency liquidity access ... assistance rather. When we got out to 200-----

**Deputy Kieran O'Donnell:** But it would have made your work as an auditor more uncertain ... yes. Can I just go back to IAS 39 and I just want to clarify a point? Is it ... can you just go through the procedure by which ... under IAS 39, am I correct in saying that you measured the value of the loan based on its carrying value measured against the future cash flows coming in towards it? The question I'm asking, how does that .... does that differ from basing it on not taking into account future losses?

**Mr. Paul Dobey:** Well, in assessing credit provisions, there are a couple of different steps you need to go through. The first thing you need to have is objective evidence of impairment. If you have objective evidence of impairment ... and, I'm sorry, this is a bit technical but if you have objective ... as a fellow accountant you understand this, but if you have objective evidence of impairment, you then are required to project future cash flows and reach a conclusion as to what the recoverable amount from the loan.

**Deputy Kieran O'Donnell:** I suppose the point really, in the limited time I have, Mr. Dobey, right-----

**Mr. Paul Dobey:** Yes.

**Chairman:** I'll give you a little bit of time but I just need-----

**Deputy Kieran O'Donnell:** Thank you, okay.

**Chairman:** Have you concluded your point?

**Deputy Kieran O'Donnell:** Sorry, I made ... yes.

**Chairman:** Yes, sure, yes.

**Deputy Kieran O'Donnell:** Thanks, Chairman.

**Chairman:** Okay, do you need-----

**Deputy Kieran O'Donnell:** Just really what I want-----

**Chairman:** No, no. I'll give you a bit of time there. Are you concluded on that point, Mr. Dobey, before I bring Deputy O'Donnell back in?

**Mr. Paul Dobey:** I think I've answered the-----

**Chairman:** Okay, sure.

**Deputy Kieran O'Donnell:** The question really I suppose I want to clarify is that IAS 39 is being put out that it's about ... that you could not reflect potential ... possible future losses and that there was a weakness in IAS 39. The question is, by the measurement of looking at future cash flows coming in against the carrying value of the loan and using the future cash flows based on net present value, would that not capture future losses?

**Mr. Paul Dobey:** It would if you have an impaired loan. So, if a loan has hit the trigger for ... where there's objective evidence of impairment, then you project the cash flows. Based on whatever answer ... we discount those-----

**Deputy Kieran O'Donnell:** And what would determine ... what would be the circumstances in which ... define when a loan ... when you would regard a loan as impaired under IAS 39.

**Mr. Paul Dobey:** When ... well, there's very detailed-----

**Deputy Kieran O'Donnell:** Well, just in layman's terms.

**Mr. Paul Dobey:** When there's a default by the borrower.

**Deputy Kieran O'Donnell:** And what would you classify as a default?

**Mr. Paul Dobey:** Well, non-payment of capital or interest, in accordance with the contracted terms. That's difficult, as you can understand, in relation to a loan where there's roll-up of interest so-----

**Deputy Kieran O'Donnell:** So, if you were to look into the future, we'll say, and you'd a particular loan and they were servicing the loan at that moment in time, but when you looked into the future you took the perspective, based on the environment that was coming down the tracks, that they would not be able to make the payments in a year's time-----

**Mr. Paul Dobey:** Yes.

**Deputy Kieran O'Donnell:** -----under IAS 39, could you reflect that as an impairment?

**Mr. Paul Dobeý:** I'm ... you'll have to give me a bit of time here now-----

**Chairman:** Sure.

**Mr. Paul Dobeý:** -----because I need to explain in a little bit more detail to address the question and that's a very important question, I'd like to clarify it. There's two aspects of provisioning under IAS 39. There's specific provisioning and there's IBNR and-----

**Deputy Kieran O'Donnell:** What's IBNR?

**Mr. Paul Dobeý:** And this gets technical, but bear with me. IBNR is incurred but not reported.

**Deputy Kieran O'Donnell:** Yes.

**Mr. Paul Dobeý:** So the matter you're identifying, I think, would be dealt with by the IBNR, right? So, a specific provision is where the obligor or the borrower isn't meeting interest-----

**Deputy Kieran O'Donnell:** He is in default.

**Mr. Paul Dobeý:** -----and is in default. In ... and we had huge dialogue in relation to this matter with AIB in 2008 and early 2009, as you can imagine. We were absolutely ... it was absolutely clear that the environment was becoming increasingly difficult, that there would be a further deterioration in the environment and we understand and the account ... the IAS 39 specifies that you should make an IBNR for loans that are already impaired but you don't know about it yet and IBNR is incurred but not reported, or recognised, whichever ... reported is the word. And if you have matters where somebody is about to default and I give this-----

**Deputy Kieran O'Donnell:** You haven't technically defaulted.

**Chairman:** Yes-----

**Deputy Kieran O'Donnell:** Sorry, Chairman.

**Chairman:** I'll bring you in once more. I need to have Mr. Dobeý finish.

**Deputy Kieran O'Donnell:** Yes, yes.

**Chairman:** One brief supplementary.

**Deputy Kieran O'Donnell:** Okay, thanks, Chairman.

**Chairman:** Without ... Mr. Dobeý without interruption, please.

**Mr. Paul Dobeý:** And it's hard to give this example in relation to a property, but I'll give it in relation to a business or a company, right? So, if a company is ... has borrowed from the bank and it is trading fine for a while and then it loses its biggest customer, right, the event ... that ... and the cash flows dry up, the event that drives a loss for the bank is that ... the loss is that customer, right? So, if the company has, for example, cash on its books and it can continue to pay interest and principal, it may take six months for it ... not ... it to default on the loan. That's IBNR and what you've got to work out, in IFRS terms, is what is the period in which losses have been incurred but not reported and over what period do they emerge.

The other thing that's set out in IFRS, and again this is ... IFRS is pretty complicated in this matter ... is if you have ... IFRS asks you to look at historic loss rates in relation to your IBNR,

but if you know you're in a more difficult environment now than the history reflects, you're allowed to take account of an adjustment factor. We, and it's in our detailed communications with the audit committee that ... or with the committee, we had a huge debate with AIB in relation to this matter in 2008. As we talked earlier about the paper we did on 3 November which dealt with the specific provisions and we were ... we would have ... we were encouraging AIB to take more IBNR and actually, when they got towards the end of the audit, they did take IBNR, a significant IBNR to deal with that downside risk.

**Deputy Kieran O'Donnell:** So am I-----

**Chairman:** What, Deputy?

**Deputy Kieran O'Donnell:** So am I correct in saying that ISA 39, contrary to the popular view or the popular belief, that you are actually able to make provisions for future losses? And secondly, in terms of the audits of AIB, what scale of adjustments did they ... did ye put forward and did the bank make on the basis of your audit over the provisions on loan ... on losses on loans they had already made?

**Chairman:** Answer that please, Mr. Dobey, and then I'm going moving on. Thank you.

**Mr. Paul Dobey:** Firstly, on your first point, IFRS does not allow you to take account of future losses. It allows you to take account of losses, events that have already happened which will emerge in the future, if I can put it that way. Right? And there is an emergence period, and AIB had an emergence period of nine months for most of its books, and it had a three-month emergence period for its property and construction books.

**Deputy Kieran O'Donnell:** But you had a financial crash? Surely that was a ... it's a very fundamental point.

**Chairman:** Don't use the word "surely".

**Deputy Kieran O'Donnell:** No, no-----

**Chairman:** Shirley's in *Airplane*, Shirley's a woman.

**Deputy Kieran O'Donnell:** But ... but you had a financial crash of monumental proportions, never happened before.

**Mr. Paul Dobey:** Yes.

**Deputy Kieran O'Donnell:** Sure ... sorry. Without ... that ... there's, did that not constitute a defining event for providing these losses provisions under ... you call it I ... I'm going to call it-----

**Mr. Paul Dobey:** IBNR.

**Deputy Kieran O'Donnell:** IBNR, but in essence it's losses ... a provision for losses into the future?

**Chairman:** Now, Deputy.

**Deputy Kieran O'Donnell:** Yes, I just-----

**Chairman:** Mr. Dobey, and then I'm moving on. You've been more than preferable. Mr.

Dobey?

**Mr. Paul Dobey:** You've hit on a very important point. You're allowed to account for past events that are going to give rise to problems in the future. You're not allowed to account for future events.

**Mr. Terence O'Rourke:** And one example of that would be in 2008, AIB made provisions, they substantially increased the provisions, but they also said, "We know we're going to face more losses this cycle." So in 2000 and 2009 and 2010 we expected to incur further losses, so they identified the further losses, they estimated them, the estimates turned out to be understated, but they did estimate future additional losses, which are not reflected under IAS 39 in the 2008 accounts.

**Chairman:** Thank you. Deputy Joe Higgins, ten minutes. Or a bit more.

**Deputy Joe Higgins:** Yes. Mr. Dobey, I understood you to say that auditors, and you've said it a number of times, as in my words, have no questions to answer whatsoever in relation to responsibility for the bubble and crash in Irish society?

**Mr. Paul Dobey:** Our responsibility under Irish law is to determine whether the accounts in relation to AIB gave a true and fair view. That was our responsibility and that duty is very clearly set out in law. As I've explained a number of times, we believe the AIB accounts ... excuse me ... gave a true and fair view and in that regard, we believe we've fulfilled that duty.

**Deputy Joe Higgins:** Are you aware, Mr. Dobey, that there is a view, another view, that auditors failed to alert the system to serious risks that some people felt they should have seen because of your close insight into the banks? And that that alleged failure was all the more dramatic because it cost the Irish people €64 billion, seven years of austerity, and was caused by a bubble that gave rise to unprecedented levels of lending, spending, profits in property and in speculation, etc.? There is a view that you should have seen that and you should have waved a very, very big flag years before the crash.

**Chairman:** This is your own view now, Deputy Higgins, is it? Or are you proposing that this is-----

**Deputy Joe Higgins:** No, no, I said-----

**Chairman:** -----a proposition to be tested?

**Deputy Joe Higgins:** No, I'm putting this view to Mr. Dobey. I'm not saying what my view on it is.

**Chairman:** It's a proposition to be looked at.

**Mr. Paul Dobey:** I'm aware of the view.

**Deputy Joe Higgins:** Okay. And what do you think of that view?

**Mr. Paul Dobey:** I do not believe it to be correct.

**Deputy Joe Higgins:** Okay.

**Mr. Paul Dobey:** Because our role relates to a point-in-time view of financial statements. I also would point you to some of the comments we've made earlier on in relation to the risks

we were highlighting over the period and also the dialogue we were having with the Financial Regulator, particularly in 2007 and 2008. And if you're asking me did I have a crystal ball in 2004, I'm afraid I didn't.

**Deputy Joe Higgins:** Okay. Well, let's pursue it a little bit. Maybe Mr. O'Rourke, with yourself. In your opening written statement, or ... that you provided us, you said: "One of the key steps in an audit is to assess the risks arising from the business model and strategies followed." Right? An audit is to assess the risks arising from the business model and strategies followed. You then went on and you said, "[The auditor] is required to form an opinion as to whether the consequences of those strategies and models are properly reflected in the financial statements in accordance with [regulations, essentially]. Now, you go on, "While it is now clear that the business models and property-related lending strategies of the Irish institutions led to large losses being incurred, it was only when it became likely that property prices would decrease and that the economy would contract that the consequences of these were permitted to be reflected in the financial statements." Now, does that suggest, Mr. O'Rourke, that you would ... you could have seen, and perhaps you did see, risks arising from the business models and strategies that you could have had perhaps serious concerns about those but that there was no mechanism for reporting that in a significant way?

**Mr. Terence O'Rourke:** The risks we identified in our audit of banks were ... we identified them, we talked to the audit committee about them, we evaluated them. I mean risk has got two issues. One of the elements you have to understand is what is likelihood of the risk occurring and then, secondly, what the impact of the risk occurring would be. And the risks that turned out to be occurred, as we now know from the losses which you have described, they were not seen to be as likely risks. They were seen as remote risks ... in the terms of it.

Well, the issue for me ... for us, as auditors is to make sure the banks very clearly assess those risks professionally, thoroughly, getting best information that they could as to whether ... what the likelihood of the risks occurring ... in arising out of things like property loans about concentration. All of those things were on the table. They were debated and discussed at the banks. They got the best information that they could and then we stood back and we took our independent view of whether those risks were properly evaluated and whether they took into account the likelihood of those risks occurring and whether, in terms of the financial statements whether they reflected the likelihood of the risks occurring. And we were happy with that process and happy that the likelihood was properly assessed, based on the best information. And it turns out that best information did not accurately predict the future. We had a very extreme event occurring which nobody foresaw, virtually nobody foresaw.

**Deputy Joe Higgins:** Well, I think that many people would struggle to understand the complexities here of the reporting. I was trying to come up with an analogy, perhaps. It's ... if I just put this to you and ask you to comment. That you were asked to do a mechanical audit on a juggernaut. So the engine is okay, the wheels are fine, the suspension and body work okay. The truck is overloaded a bit but the ... you tell the driver that. And the driver knows this. So you pass the vehicle. Now, you know the road ahead goes downhill, that it has precipices on each side, that the brake won't be able to check the extra weight. But you're not allowed to flag that in a significant way until the truck goes over the precipice. Is that any way of relating to the rules that you are bound by?

**Mr. Terence O'Rourke:** Well, I'm saying that our job is to make sure ... in the case of your analogy that the truck being a bit overloaded, that those issues are well known to people who are looking at that truck. So our job is in relation to financial statements - do the financial state-



ments accurately portray the way that that ... the way the financial position of that entity? So in terms of the audit of the banks, the audit of AIB, do people reading those accounts do they understand how much money they have lent to the property sector? Do they understand how much the loan book has grown? Do they understand how that's financed? Are all those issues clear on the accounts? The answer is "Yes".

So that's the main issue that those issues were clearly reported in the accounts and that everybody to make their own judgments on that. Our judgment was - have management made the right decision in terms of financial reporting as a consequence of those risks, as a consequence of the way the balance sheet is? And the management did make the right decision at the time, based on the best information they could get.

**Deputy Joe Higgins:** But, but why didn't they stop the truck before it went over the precipice then?

**Mr. Terence O'Rourke:** Because the event that occurred was not one that people foresaw.

**Deputy Joe Higgins:** And that's the question I would like to put to both of you, gentlemen, why it wasn't foreseeable. Now your organisation, for example, exists in the United States -----

**Mr. Terence O'Rourke:** Correct.

**Deputy Joe Higgins:** Correct?

**Mr. Terence O'Rourke:** Yes.

**Deputy Joe Higgins:** In Sweden -----

**Mr. Terence O'Rourke:** Yes.

**Deputy Joe Higgins:** In Norway.

**Mr. Terence O'Rourke:** In Norway and globally -----

**Deputy Joe Higgins:** And in many other countries.

**Mr. Terence O'Rourke:** And in many other countries.

**Deputy Joe Higgins:** But those three are modern, capitalist economies -----

**Mr. Terence O'Rourke:** Yes -----

**Deputy Joe Higgins:** ----- where in the 80s and 90s very, very significant bank crises, property bubbles, followed by bank crashes and disaster for the economy happened. Why did your organisation not, and other organisations, indeed, not learn from those and understand it was eminently repeatable when the same circumstances were being created in Ireland?

**Mr. Terence O'Rourke:** Well, first of all, as Mr. Dobey said before, we are very much plugged in to the global learnings of KPMG, so we were a very important part of the financial services network. In terms of the audit work, what the auditors have got to do in terms of the risk, they've got to look out for ... that was very clear. We've got the training in it on all the kind of things that can go wrong in banks. But you know ... for every a hundred times people ... and one person says this is going to happen, and 99 people say that's going to happen - you go with the 99 people, not the one, because at the end of the day you've got to go with objective

evidence of what's most likely to happen. And the evidence overwhelmingly - from ESRI, from IMF, from the financial stability report Central Bank - was that the Irish economy was facing into a soft landing. So that was the basis on which we made our judgments.

**Deputy Joe Higgins:** But if I could put it to you, Mr. O'Rourke, just to challenge what those institutions may have thought, the objective evidence from the likes of Finland, from the likes of Sweden was that these factors that were now happening with a vengeance in Ireland in the 2000s inevitably lead to a crash. Why wasn't a red flag flown high?

**Mr. Terence O'Rourke:** That's a very good question, but that very point, that those things do lead to crashes, is not ... was one that was not seen by the IMF, by the OECD, by the ESRI, by the Central Bank and by the auditors. None of us saw that. And why is it? One of the other issues of bubbles is that people always are able to rationalise it. I went to many discussions by prominent and eminent economists who told us why the Irish economy was going to go to a soft landing and would not be heading into crash because there were demographics, because of our FDI and for lots of other reasons why the Irish economy would be okay. And that was ... we looked for the best evidence, and that's our job, as auditors, to get the best evidence we can with the experts. We're not economists, we're auditors, we're applying rules and we need to take the best evidence we can and the best evidence we can was that ... that there was a risk, and everybody ... we identified the risk - if property prices decline there will be big loss in the banks. We said that and the issue for us was ... for management, have they assessed whether that risk is likely or not and, for us, have they properly reflected the likelihood of that risk. And the best evidence we had was that they had properly assessed the likelihood of that risk.

**Deputy Joe Higgins:** David McWilliams, in evidence here said: "I think the Irish property crash and the banking crash were both incredibly predictable and absolutely preventable." I haven't time to give a quote in detail, but he referred to what he himself said in October 2003, which was early enough in the process. He is referring to property but particularly to housing. "The Irish housing market is a scam ... [a] financial swindle that could potentially confine an entire generation of young Irish workers to years of bad debt ... [and it's a] confidence trick that has been foisted upon us by an alliance of banks and the landowners."

**Chairman:** A question, Deputy?

**Deputy Joe Higgins:** Yes. Alan Ahearne, in evidence told us of a study in 2005 - that he published - about 44 booms and busts internationally in many countries where you operate I've no doubt. So a view could be put that really it should have been seen and it should have been stopped in advance. And just ... my very last question, Chairman, is this. In relation to Allied Irish Banks in particular, you made the point, I think, Mr. Dobey, it was yourself, that it was very difficult to get in accurate information the extent of the exposure, etc., when you were trying to do that ... let me just finish the question because he's going to cut me off here. In your opinion, did the bank's management and board structure ... in Allied Irish Banks, impede the provision of good governance within the bank or what impact did that have, if any?

**Mr. Paul Dobey:** I think I'm ... I'm not sure if I was incorrect earlier but what I was trying to say was that trying to get a grip on the losses in 2008 was extremely difficult. I think I said in my opening statement we worked tirelessly until we got to the bottom of that and we got to the bottom of that and we were very comfortable with the loan loss provisions when we got to the end of our audit process. But it was very challenging-----

**Deputy Joe Higgins:** Was it difficult to get that information?

**Mr. Paul Dobey:** -----because the environment was contracting. I mean if you look at what happened in late 2008 and early 2009, there was a huge contraction in the economy. We had Lehman's, we had the TARP, we had the guarantee, we had foreign markets froze, we had secret loans - if I can put it that way - in the UK, we had ... there was bank mergers every ... in Europe and in the US. We were in hugely uncertain times and trying - and I could take you through the economic forecasts that were there at the time and what ultimately transpired - we were trying to assess in a very, very difficult time, the loan loss provisions for AIB. That involved a huge amount of work, and we kept going until we got to the very end, and we were absolutely comfortable when we got to the end, because if we didn't ... if we weren't absolutely comfortable, we wouldn't have signed the audit opinion.

**Deputy Joe Higgins:** In general, was good governance in any way in Allied Irish Banks affected by the management and board structures?

**Mr. Paul Dobey:** I think there's a judgment being made in that statement that there wasn't good governance in AIB. Are you asking me to comment on that?

**Deputy Joe Higgins:** Well, no, I'm just asking you to comment on the question I put, whether the management and board structures, if they - or not - impeded the provision of good governance within the bank.

**Mr. Paul Dobey:** I'm not an expert on the overall governance of the bank but I can tell you in relation to getting the financial statements right, the AIB board and directors went through all of the processes that they should go through to get the financial statements right. We did our work to get to a conclusion that those financial statements gave a true and fair view, and that was our role.

**Chairman:** All right, Deputy, I'll have to move on. Just developing on the analogy of Deputy Higgins and the red flag being waved and all of the rest of it, I don't know who was holding the flag at the time, but can I put the question to you? Are auditors like the NCT, that you go in every 12 months or two years to check out that everything's okay under the bonnet?

**Mr. Paul Dobey:** No, I don't think we're like the NCT.

**Chairman:** Okay. Would there be a lot less crashes on the road if the NCT were like auditors or not?

**Mr. Paul Dobey:** I don't know. I suppose I see us as score ... as keeping the score, right. That's our job.

**Chairman:** Okay.

**Mr. Paul Dobey:** And I don't think you can blame the scorekeeper for the performance of the team.

**Chairman:** Okay. Fair enough. Deputy Doherty.

**Deputy Pearse Doherty:** Go raibh maith agat, a Chathaoirligh, agus fáilte roimh an bheirt. I want to just pick up on where Joe was asking Mr. O'Rourke a question. And you mentioned that you failed to see the property bubble bursting. You went to conferences. Demographics and so on were given as an example of why it would be a soft landing. You're not alone and we've had many witnesses before the committee who also failed to see the property bubble bursting. They took the opportunity here to apologise to the Irish public or maybe in your re-

gard you may want to offer an apology to the shareholders of AIB, or maybe you do not, but do you want this opportunity to apologise or do you believe that you have anything to apologise for on behalf of KPMG?

**Mr. Terence O'Rourke:** Deputy, in terms of our audits, looking back on it, and it was said here on a number of occasions, that we asked: what was our job? Did we do our job properly? We did our job properly. The question then is: should the job have been different or something else and should the crash not have occurred? Of course, it's regrettable that the crash occurred. Of course, it is terrible for the Irish people that we face what we into. But I don't think it's believed as a result of our audits or the financial statements that the crash occurred.

**Deputy Pearse Doherty:** And I'm not suggesting that it did. I'm just asking-----

**Mr. Terence O'Rourke:** Well, if you're apologising, you're apologising if you've made a mistake. We don't believe we made a mistake, Deputy.

**Deputy Pearse Doherty:** Okay. And so if you had seen the crash coming, you would still have audited the accounts of AIB in exactly the same way or-----

**Mr. Terence O'Rourke:** No, if you'd seen a crash coming there would have been, obviously, implications for financial reporting unless AIB reflected ... and, again, to make changes in accounts, you need objective evidence to make changes, but if some ... if there was evidence there that the crash was coming and you could point to evidence, and we had a basis for our belief there was a crash coming, the ... if AIB did not change their accounts, of course we would have qualified them.

**Deputy Pearse Doherty:** Okay. Did the firm perform any stress testing as part of the external audit of the bank to take into account the correlation between different types of property being financed - residential, commercial, development land and speculative land banks?

**Mr. Paul Dobey:** AIB performed stress tests in 2007. I've talked earlier about the stress test that they did as part of the ... in early 2009. That did stress the property values and they came up with very significant future provisions that would be required if those stresses came true, and they were ... those were disclosed to the market in February 2009 by AIB with its results.

**Deputy Pearse Doherty:** Did the firm ... did your firm carry out any stress tests?

**Mr. Paul Dobey:** We considered the stress tests that AIB had carried out.

**Deputy Pearse Doherty:** Okay. You didn't feel it necessary to carry out your own stress tests?

**Mr. Paul Dobey:** We looked at ... we would have looked at AIB's stress tests. We didn't have the models to complete those stress tests; AIB did.

**Deputy Pearse Doherty:** Okay. In relation to unenforceable securities, in your audits of AIB, did you notice the fact that there were loans that had unenforceable securities?

**Mr. Paul Dobey:** If we noticed during the course of our loan reviews that there was unenforceable securities, we would have asked AIB to make additional provisions.

**Deputy Pearse Doherty:** Did you?

**Mr. Paul Dobey:** We did.

**Deputy Pearse Doherty:** How much?

**Mr. Paul Doherty:** All I can say is that during the course of our loan review process, we identified certain additional provisions that were required by AIB and they took those provisions. How much is difficult because, if I can talk about 2008, and this wasn't specifically in relation to loan securities, if I can put, this was generally. AIB reported to the market in its interim management statement on 4 November that it believed there would be €950 million of loan loss provisions for that year. That was ... at that time, AIB was carrying out its work, it had a criticised loan process it was going through, it had allocated... very many people from the front line into assessing the loan loss provisions. And it came up with the €950 million.

**Deputy Pearse Doherty:** Okay, I want to focus on unenforceable securities. You'd be aware in terms of the NAMA test ... NAMA testimony and what's transcribed from the transfer of known loans to NAMA, that there were €811 million of loans that were transferred to NAMA across the financial institutions that had unenforceable securities. From AIB's point of view, it made up €164.6 million and that was the price that NAMA paid for them, which was an average of 77% reduction. If you were to apply that, what the loan value would be, you'd be well over €400 million. Did KPMG come to any estimation that it was in that region that, for example NAMA, the transfer to loans from AIB to NAMA, for every €57 of loans that were transferred, one loan... €1 had an unenforced security, was not enforceable. Did KPMG recognise that, did KPMG audit those loans, audit the documentation?

**Mr. Paul Doherty:** AIB had €127 billion of loans outstanding at the end of 2008. We audited a portion of those loans to get ourselves comfortable with the processes that AIB had gone through. As I mentioned earlier, we found certain issues with those loans. And when we found issues with those loans, we extrapolated that across the whole portfolio and certain additional provisions were taken. We didn't look at every single loan, I can only imagine that that extrapolation would have dealt with some of the issues that you have mentioned but I couldn't specify for sure that it did.

**Mr. Terence O'Rourke:** I think the other issue is that a lot of that unenforceable security turned out to be solicitor's undertakings, which turned out to be, you know, not enforceable or when they went to go the solicitor to say, "Give us the perfected security", the solicitor was unable to do that. And I know the Law Society looked at this, and I know that whole system has been reformed. But, at the time, we are saying, as in terms of audit work, we could see that there were solicitor's undertakings there as good security, we relied on those solicitor's undertaking, as AIB's processes were, they had a process of getting ... top tier or second tier law firms to give those undertakings and it turns out that in retrospect that that ... those solicitor's undertakings didn't always come good. But I think it was reasonable for us at the time to say, "Solicitor's undertaking will get us there in terms of the security."

**Deputy Pearse Doherty:** Can I just push you on that there, in terms of your reason list. You believed it was reasonable in that case. NAMA paid AIB €9 billion for loans. €164.6 billion was unenforceable or they had a deduction-----

**Chairman:** Just reference that, where you are coming from.

**Deputy Pearse Doherty:** Well it's in the... it's in the NAMA documents. NAMA C4b, page 6 and it's also in the NAMA document, C4b, page 4. And it gives a breakdown of AIB. It gives a breakdown of AIB-----

**Chairman:** I'd be mindful that the witnesses haven't seen the NAMA core documents that we would be in possession of. But the figures would be NAMA records that would have been provided to this committee. So the Deputy is just testing-----

**Deputy Pearse Doherty:** NAMA, for AIB, NAMA applied a deduction of €85 million, when the transfer happened, and afterwards they subsequently found out that €79.6 million additional loans were unenforceable as well. So of the €9 billion that were transferred to NAMA, the fact that... €9 billion sorry. The fact that €164 million was unenforceable, that ... is that not a very large percentage of that loan book, and was significant focus put on that in relation to the audit? Or did you audit those loans... those tranches of loans?

**Mr. Paul Dobey:** We would have audited some of them, right. As I mentioned earlier in response to Deputy O'Donnell's question, there was a lot of issues in the system at the time. There was, obviously imperfection, imperfect security. We... there was an IBNR taken to deal with those issues in AIB. These are things that might emerge that we didn't know about yet. And that number was in the region of €800 million, so in our view that would have been caught up. These type of issues would have been caught up in that IBNR provision.

**Deputy Pearse Doherty:** The fact in 2008 your audited accounts showed AIB as a going concern. At that time, were you aware of quite significant falls in commercial prices, and also in domestic housing prices? And where did you see that it was going to end?

**Mr. Paul Dobey:** Yes, some of the documents we provided to the committee in relation to our communications with AIB set out our assessment of the declines in values. In the paper we referred to earlier, the 3 November paper, it set out the fact that there were issues we needed to face, and the loans we needed to deal with in the context of the audit. I mentioned those with Deputy Higgins as well. We looked at those loans, and we got comfortable with the recoverable amount of those loans.

**Deputy Pearse Doherty:** In relation to the concerns you had in relation to going concern; you say that you got assurances from, I think, the general secretary of the Department of Finance in relation to additional recapitalisation above the €3.5 billion that was pledged. Can you outline to the committee what ... the nature of that assurance? Was it verbal? The quantity of that assurance - was it an unlimited amount of capital that they were pledging to the bank? And also can you again shed some light on a comment that you made where you said that the 2010 accounts, you weren't able to get the assurances at that time because a Minister was not available to give the assurance?

**Mr. Paul Dobey:** Yes ... sorry I'm just looking. Oh, I have it here. The assurances we got from the ... sorry, firstly, I need to go back a bit. We were unsure, as I said in my opening statement, as to whether AIB would need additional capital or not. But there was a lot of uncertainty at the time, and to address part of your question, we were aware of the declines in values and we were estimating that there'd be a 30% or 40% decline in property values in doing our audit. We sought assurances from the Central Bank in relation to liquidity, and from the Department of Finance in relation to potentially would capital be made available. To answer your question, that was a verbal assurance that we got; it wasn't a written assurance and it confirmed the statements of support that had been given by the Minister for Finance.

**Deputy Pearse Doherty:** Was it limited?

**Mr. Paul Dobey:** No. It was, it was ... just bear with me please. The Secretary General, the

assistant Secretary General clearly noted that it was Government policy to support both AIB and Bank of Ireland. He noted that these two banks were of systemic importance to the Irish economy and, inverted commas ...

**Chairman:** What was the date of that?

**Mr. Paul Dobby:** It's a meeting with Kevin Cardiff on 27 February 2009. It's with the committee but it is misdated. It actually has a date on it of 26 February 2008 but, anyway, that's with the committee in the documents we submitted.

I .. I'll just pick up my train of thought there. He noted that these two banks were of systemic importance to the Irish economy, and this is a note, a contemporaneous note done of the meeting, "will not be allowed to fall over". That was one assurance we got.

He also noted the Government would be reluctant to step in with additional investment or to nationalise AIB unless there was *force majeure*. He noted that the Government had no interest in managing or controlling the banks but the properly functioning banking system was of critical importance to the country. He did note, however, that the Department would seek to influence credit, remuneration, and regulatory and risk policies in the bank, and that some of this was already happening under the Government's bank guarantee scheme.

There was ... I was concerned about M&T, and I had a discussion with him in relation to M&T, because we were carrying goodwill on the financial statements of AIB. And I asked whether AIB could be forced to dispose of M&T, and that would have been one of the ways that AIB could have raised capital, or they could have disposed of Poland:

KC [that's Kevin Cardiff] did note that these business interests [that's Poland and M&T] had generated good diversity and potentially growth of earnings for AIB. He noted that it was unlikely that the Government would support significant growth in AIB's overseas business or emerging businesses at the expense of providing funding to the consumer, mortgage or SME sector in Ireland [which obviously was the priority for the Government].

There was some discussion around the state of the banking system in Ireland, including some positive comments from Kevin Cardiff regarding the Government support for six banks, subject to the Government guarantee. Kevin Cardiff did not give any assurance on the extension of the Government guarantee beyond its two-year end date of September 2010 and noted this was one option open to the Government. And then we had a discussion around emergency liquidity assistance funding from the ECB. So they were the assurances we got from the Department of Finance.

**Deputy Pearse Doherty:** Maybe one reason you couldn't get the assurance, you say a Minister was not available in 2010 but there was an election in February 2011, which I presume is when you were preparing your accounts. But was there nobody in the Department that you could meet to give you similar assurances?

**Mr. Paul Dobby:** I have said I don't fully understand how the political system works, but I would imagine that in order for Kevin Cardiff to give that assurance, he would have to have had some acknowledgement from the Government, from the Minister. In 2011, as I recall, we looked for those assurances. The Government guarantee was not there any more or was about to expire. We did have the eligible securities guarantee. We looked for assurances around liquidity and we spoke to the deputy governor in the Central Bank at that time and he did give us some assurances. They weren't as fulsome as we would have liked. Then we went and spoke

to the then Secretary General of the Department of Finance at the time and she was not in a position to give us the assurance because she did not have a Minister.

**Chairman:** Can I just return to one section there with your engagement with Deputy Doherty, Mr. Dobey, where you stated that there were unenforceable securities in AIB and that you recommended to AIB to increase the loan provision.

**Mr. Paul Dobey:** No, can I just correct the record on that? I broadened out from unenforceable securities into a general dialogue on provisions and the discussion we had with AIB in 2009.

**Chairman:** Okay, because I was maybe just picking up on an incongruence there that, with your earlier questioning with Deputy O'Donnell, could this have been done under the IAS 39 if the loan was not impaired?

**Mr. Paul Dobey:** I explained to Deputy O'Donnell that there was an opportunity. Sorry, firstly, there is always room for professional judgment and for scepticism and we were exercising professional judgement and scepticism at this time. Deputy O'Donnell has quite rightly identified and importantly identified that there is room for an IBNR to be taken, and that judgment can be applied in making that IBNR. I talked about adjustment factors, so that is when the historic loss rates might not be ... that the bank was using to determine its IBNR might no longer be appropriate. That was the conclusion we reached in 2008, and we had extensive discussion with AIB in relation to taking additional provisions. They were looking at it also to deal with that issue.

**Mr. Terence O'Rourke:** But the issue is, when we said with AIB, "There is a security missing here, make an actual provision". You only make an actual provision where there is actually a loss or default, so the fact that a security might have been missing on a good loan does not make that loan bad or does not need a provision against it.

**Chairman:** Senator O'Keeffe.

**Senator Susan O'Keeffe:** Thanks, Chair. In a note that was provided to us when Mr. Gleeson was here, Mr. Gleeson described the regulator. He said he was a hopeless regulator. What was your view of the regulator?

**Mr. Paul Dobey:** We had extensive dialogue with the regulator, particularly in the latter part of the period. I have mentioned already the dialogue we had in January 2008. We had a dialogue with the regulator on 21 November 2008 as well and at that meeting, we were starting to have concerns around uncertainties in the system at that point and we spoke to the deputy governor, the deputy governor attended that meeting actually. We had a good dialogue with the regulator in that period and that dialogue was important, particularly in the latter years, the latter part of that period. However, I would say section 16 of the Central Bank Act 1942 sets out some very clear restrictions in relation to confidentiality requirements for employees of the Central Bank. I do not have all the details as to what their contracts say in relation to confidentiality but it was very difficult at that time for us to have a two-way dialogue. So we tended to go in, have a discussion, raise issues and we weren't really getting much back. Indeed, I think at that meeting, in February 2008, we were ... there seemed to be a little bit of resistance in relation to giving us assurances. Now, I understood why that was later, when we spoke to them in January 2009, because effectively it was the monetary authority we needed to speak to in relation to liquidity and not the regulator.



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**Senator Susan O’Keeffe:** You said earlier, when we were talking about the payment of the dividend, you said, “We didn’t have to form a view on the paying of a dividend.” You didn’t have to, but did you? You may not have had to, but did you actually?

**Mr. Paul Dobey:** I didn’t mean to be unclear. We didn’t form a view on whether the dividend was appropriate or not. It was not our role.

**Senator Susan O’Keeffe:** On page 25 of your ... of the ... our document ... core document Ernst & Young, there’s a note, I think it was written in relation to EBS as it happens, but the sentence under the heading, “Background”, says, “We have identified from our market knowledge that there is a potential going concern problem for EBS”-----

**Chairman:** Just to double check there, would you-----

**Mr. Paul Dobey:** That is Ernst & Young so I-----

**Senator Susan O’Keeffe:** I’m sorry. I beg your pardon.

**Chairman:** That’s okay.

**Senator Susan O’Keeffe:** I beg your pardon. I’m so sorry, I picked up the wrong document. That’s why I’m ahead of us.

**Mr. Paul Dobey:** Before we took over the audit.

**Senator Susan O’Keeffe:** Before you took over the audit ... I’m very sorry. Thank you for your correction. In fact, on the matter of correction, lots of people have come in here and given evidence and they’ve said that they have made mistakes and errors have occurred and, you know, we’ve seen in all the documentation, all kinds of errors. Human error, sometimes. But there’s been no errors offered on your part. So, in the case of, what you’ve described yourself as a very complex audit ... huge team of people obviously working on ... I assume, on a constant basis, you don’t finish the audit and go home and start again six months later ... it’s been a long process. So, I’m just wondering, have you made any mistakes at all?

**Mr. Paul Dobey:** We have layers of processes within an audit of the complexity of AIB. We have layers of reviews. It’s very important that we get these audits right.

**Senator Susan O’Keeffe:** Yes.

**Mr. Paul Dobey:** And you’ve talked earlier about ... was asked about the significance for me or for other individuals if we get those wrong. These require ... the security laws have very serious implications if we get audits wrong and we go through a process to make sure we get them right. I talked about the fact that we had a quality control reviewer from the UK firm, we had an SEC reviewer from the US firm, we did ... to put all of the processes in place to make sure we got these audits right.

**Senator Susan O’Keeffe:** So-----

**Mr. Terence O’Rourke:** Well, there’s no-----

**Senator Susan O’Keeffe:** No error.

**Mr. Terence O’Rourke:** -----such a thing as a perfect audit. Though you’ve heard ... we talked about the CARB review that said that our audit was a good audit but we ... there were

some areas of improvement. But we went through those areas of improvement. They're not significant in terms of, you know ... in terms of the truth and fairness of financial statements.

**Senator Susan O'Keefe:** It just strikes me to see that every ... that the organisations, including the banks themselves, have acknowledged mistakes that they've made but-----

**Mr. Terence O'Rourke:** The mistakes they made were lending. We were not lending. We were measuring-----

**Senator Susan O'Keefe:** I know, but you've made no mistakes-----

**Mr. Terence O'Rourke:** -----whether they properly reported the results of those lendings. And in terms of financial statements, they did report, at the point in time, the right ... So the mistakes were inherent in those balance statements of bad lending, but we weren't responsible for the bad lending.

**Senator Susan O'Keefe:** Okay. Mr. Dobey, you used the analogy a moment ago, of being ... of keeping the score.

**Mr. Paul Dobey:** Yes. Analogies always have weaknesses, I think, we demonstrated that earlier.

**Senator Susan O'Keefe:** Indeed. So you are keeping the score ... in that 2008-09 time, when things were very difficult, as you've said yourself, it was a very stressful time. And you had many negotiations. You were talking to the Financial Regulator, you were talking to Government, you were talking to all kinds of people. What status were you ... did you have then at that point? Because if you're keeping the score, you're not on the pitch, but I would ... do you see, you were obviously now involved, and you've given us some detail, for which we're grateful, but I-----

**Mr. Paul Dobey:** I mean-----

**Senator Susan O'Keefe:** -----don't understand how you can be-----

**Mr. Paul Dobey:** We're-----

**Senator Susan O'Keefe:** -----on the one hand keeping the score, and now on the other hand, on the pitch?

**Mr. Paul Dobey:** You're assuming keeping the score is easy. In our ... in what we do, keeping score is very hard. And you need lots ... to gather lots of information.

**Senator Susan O'Keefe:** You did say though, that you weren't on the pitch, and that you couldn't blame the, you know, the performance of the team.

**Mr. Paul Dobey:** No, I ... well-----

**Senator Susan O'Keefe:** No, let's not get hung up on it. I'm merely trying to establish, there was an analogy offered which you turned down, you said you were scorekeepers. But here you were, you were in the heart of those negotiations. Is that a fair and reasonable thing to say, from what you told us?

**Mr. Paul Dobey:** Yes, it is our responsibility in relation ... I should've clarified, the analogy was too simple, right. We were keeping the score in relation to historic financial statements and

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as Mr. O'Rourke said earlier, we also had a responsibility to assess whether the going concern based on preparation of financial statements was appropriate. It was in the context of the going concern based on the financial statements which was a future looking thing and maybe that's not keeping the score, right? That's assessing what the score might be at the end of the game, right? And we're only at half-time. We had to go and make an assessment and get assurances from the system, if I put it that way, the Department, the regulator, the Central Bank, around the going concern basis of preparation.

**Senator Susan O'Keefe:** In your lengthy career, was that the first time that you'd had that experience where you'd engaged with so many other people outside of a financial institution, or was that something just, that happened all the time?

**Mr. Paul Dobey:** Yes, and it wasn't done lightly. We had huge consultations in our firm. I consulted ... we had a dialogue with the regulator, which was teeing that up, in November. I had a very ... I had a dialogue within our firm, and with the managing partner at the time, which was Terence, as to how we should deal with this issue. We ... there was one very important meeting where we had the partner from the UK firm involved, and we went through the appropriate process; we were concerned, we took the appropriate steps. It was unprecedented.

**Senator Susan O'Keefe:** It was unprecedented.

**Mr. Paul Dobey:** Unprecedented.

**Senator Susan O'Keefe:** And, given that you said, for the earlier accounts, 2007, and you said that you got the contingency liquidity plans given to you by AIB when you asked for them.

**Mr. Paul Dobey:** Yes.

**Senator Susan O'Keefe:** That was all, that's where that ended. You didn't have to go ... did you go to the Financial Regulator, did you go to Government?

**Mr. Paul Dobey:** I didn't need to.

**Senator Susan O'Keefe:** You didn't need to.

**Mr. Terence O'Rourke:** We've already said that we had a meeting with the Financial Regulator in early 2008, about ... which included ... it was a meeting of the four firms with the regulator.

**Mr. Paul Dobey:** It was a general discussion.

**Senator Susan O'Keefe:** So did you think, in February-March 2008, did you think then that the trend could go anywhere other than downhill, or did you think, "Maybe things are going to recover by the end of 2008", or was it obvious then that they were on a downward trajectory?

**Mr. Paul Dobey:** To me, and I'm paid to be sceptical, right. That's my job. I didn't have a crystal ball, but I was managing the downside on behalf of my firm. It was very important; there was a lot at stake for me and for my firm, and for the bank.

**Senator Susan O'Keefe:** So you were managing it, you could see then-----

**Mr. Paul Dobey:** No, managing, it's not right - doing my job.

**Senator Susan O'Keefe:** I'm sorry, what was the expression you said, managing the

downside. I'm sorry, I'm just trying to-----

**Mr. Paul Dobey:** Thinking about the downside risk; it hadn't happened yet, but thinking about the downside risk. We made sure that our audit opinion in 2007, we were very comfortable with it, but there were issues in AIB at the time. We talked about it in relation to the traded credit book. However, if you go back, in 2007 the economy grew by 5.7%, right, so I was thinking about, this could ... there could be issues here, they haven't happened yet. I was satisfied with the 2007 financial statements. I was looking forward in relation to going concern. We got happy that AIB had €30 billion of liquidity and could have raised additional capital itself; it was still accessing the capital markets. I was happy.

**Senator Susan O'Keeffe:** Okay. So you were happy. So, when you, I'm assuming you are familiar with the Atlas report, and you'll know some of the observations that were made there at that time, in September 2008.

**Chairman:** Can you just cite it there for us in the book, Senator?

**Senator Susan O'Keeffe:** Yes, sorry it's book AIB - C2C.

**Mr. Paul Dobey:** We don't have that book.

**Chairman:** They may not have that book, now, so I need to be mindful to committee members .... that witnesses have to be given foreknowledge.

**Senator Susan O'Keeffe:** Are you familiar-----

**Mr. Paul Dobey:** I'm familiar with the report, and I can comment on it.

**Senator Susan O'Keeffe:** Okay, well, I wasn't proposing to throw everything at ... I was merely going to say that the group's criticised loans, including watch, vulnerable and impaired loans, are graded eight to ten. These are "loans which exhibit weaknesses, where payment is in jeopardy, or where there's objective evidence of impairment. In addition a portion of the group's criticised loans are included in grade seven", and it goes on then to give the detail of how much money, how many of the loans were tied up. So this was at a point, this was well before your January-February conversations with the Financial Regulator. You'd already seen in 2007, 2008, that things were not going well, and that you'd already had to ask for contingency liquidity plans. You were now in a position where you could see this, and whatever else you could see yourselves. I am finally coming to it, so I'm just concerned to know how at that point you would end up in all those negotiations, giving, if you like, the assurance, that as a going concern you could let the bank carry on, you could actually sign off on the going concern, given all the things that had gone on?

**Chairman:** The question is made. Mr. Dobey or Mr. O'Rourke, or each.

**Mr. Paul Dobey:** You're referencing the Project Atlas report-----

**Mr. Terence O'Rourke:** The issue for us was whether AIB said we'll continue in operation or existence for another year; there are lots of uncertainties out there, lots of risks, and at that stage, 2008, looked like there were losses coming down. AIB reported, "We've taken €1.8 billion this year, we've another €6 billion to come in cycle. We've got lots of losses coming, and there was a risk there could be more". That was said as well. So what we did was, we said, well, if those risks come to pass, will AIB be there? And the answer was yes, because the Government had told us they would support the pillar banks. So, on that basis, it was reasonable for

AIB to say, “That’s our accounts, we will continue in existence”. So it was a reasonable judgment for us to make, we felt.

**Senator Susan O’Keeffe:** With the support of Government?

**Mr. Terence O’Rourke:** With the support of Government, yes, absolutely.

**Chairman:** Okay.

**Senator Susan O’Keeffe:** But without that-----

**Mr. Terence O’Rourke:** Without that, exactly, that’s why we went and talked to Government.

**Chairman:** Okay. That’s it, we’re done. I just want to just ... in the opening section there of Senator O’Keeffe’s question, she made reference to Mr. Gleeson, and his comments about the regulator. I ... the ... Mr. Gleeson may have written comments with regard to the regulator, but he ... during his hearing with us he actually qualified that, in questioning from Senator D’Arcy, at which time Mr. Gleeson then says, “That was private talk between me and Eugene, an unkind phrase to use, I think, but I felt we had been let down by regulation, but we ourselves had got into trouble, so who am I to speak?” So I just ... in use of that phrase in future engagements, I think the proper context and full qualification needs to be applied. Next and last up is Senator Barrett. Senator, ten minutes.

**Senator Sean D. Barrett:** Thank you very much, Chairman, and welcome to our visitors this afternoon. Just, on the regulation of accountants, you mentioned the CARB report. I suppose there’d be two observations, one, it’s taken seven years since the ... the need for the guarantee, and two, it’s been furnished only to yourselves, and not to the public, who had to pay the €64 billion. I mean, is that the way CARB operates?

**Mr. Terence O’Rourke:** Well, first of all, I think CARB initiated the report ... 2010, I think was the time they ... they initiated the ... the work. And the ... CARB have said they will publish a public report and I expect it’ll happen in the next few months.

**Senator Sean D. Barrett:** In the next few months. I’d hope it would be able to assist this committee. The IASA, as far as I can see, has issued no report on this whole issue. Is ... is that correct?

**Mr. Terence O’Rourke:** Yes.

**Senator Sean D. Barrett:** Well, we have one watchdog which hasn’t barked at all and another watchdog that only ... that only barks in ... in private-----

**Chairman:** I’ll be barking at you now, Senator, if you make a value judgment, so, ask a question.

**Senator Sean D. Barrett:** Is the ... is this an appropriate system of regulation where one watchdog is silent and the other just works in private? The public ... who has asked us to investigate €100 million in equity from the Irish Government, then, obviously, shareholders’ equity, and inputs from the British Government ... and the two regulatory bodies operate as ... as you’ve described.

**Mr. Terence O’Rourke:** I think it’s probably a matter for them to answer that, Senator, to

be honest.

**Senator Sean D. Barrett:** But you're a member of these bodies, isn't that right?

**Mr. Terence O'Rourke:** I'm not a member of ... I'm not a member of neither body.

**Mr. Paul Doherty:** IASA is independent of the profession ... I should say IASA did review the AIB accounts and a number of other ... accounts of other banks in 2009 and '10 and on the ones I was involved in, there were no particular issues.

**Mr. Terence O'Rourke:** And, while I was a member of CARB ... I should say, I was a member of the CARB board, but again, I took no part in the ... in the discussions about this audit review.

**Senator Sean D. Barrett:** The going concern basis for the accounts, this is on page 54 of the document you sent us, for the year ended 31 December 2008. Does that correspond at all to a definition of "going concern", knowing that senior people, from the client, were in Government Buildings, you know, looking for money on the 29 September, and that it ended up 98% in public ownership? That's not a going concern, I think in the views of how most people would define "going concern". And as you say, there had to be verbal undertakings and letters of comfort, which the Committee of Public Accounts here isn't very wild about ... it's very ... it's a very elastic definition of "going concern".

**Mr. Paul Doherty:** Yes. There needs to be ... I need to put some perspective on this. The ... the reason we look at going concern is because financial statements are prepared on a basis that assumes the company, or the bank, is going to continue as a going concern. If you were assume it wasn't going to continue as a going concern, then you would record the assets at mark to market value, we record addition ... liabilities associated, wind-up ... you'd effectively account for the bank on liquidation basis. So the reason we look at going concern is to assess, one, whether going concern is appropriate, and if it's not, you ... you measure the assets and liabilities on a totally different basis, that's the first point. The second point is, if you believe there to be an uncertainty around going concern, a significant uncertainty, that may cast doubt on that basis of preparation, then you're required to put an emphasis of matter, and if you disagree with the going concern basis of preparation you ... you qualify your opinion. I think your ... I'd make a distinction between is it appropriate to ... that the financial statements be prepared on the going concern basis from ... does this entity need more capital? Which it obvious did need from the Government, but we got assurances around that. But, based on the assurances we got, the, it would not be allowed to fall over assurance, if I can put it that way, we were satisfied that it was appropriate to ... that the accounts would be prepared on a going concern basis.

**Senator Sean D. Barrett:** You mentioned your discussions with the regulator. Did he mention to you that he had attempted to have directors' compliance statements brought forward and that there had been opposition by the industry to the Department of Finance and that those would drop and they could ... and those compliance statements could have allowed to prevent excess sectoral concentration? Did you have any discussion of that aspect with the regulator?

**Mr. Terence O'Rourke:** I was a member of the auditing review group which recommended directors' compliance statements, so I was aware of the issue and I know the institute would have had dialogue with the Financial Regulator about the format of directors' compliance statement, so that issue was there. But the institute ... profession ... worked out ... said there are things you can do to make the compliance statement work better and the industry ... well the

industry of the industry took for themselves but they also made representations to the regulator and to the Department and, I mean, they're now there, they're now in the current legislation. At the time, I think there could have been a possibility of getting ... instead of compliance statements that would have worked but that process did not conclude, it just ran into the sand, as far as I remember.

**Senator Sean D. Barrett:** Is it something when we come to do our report going forward, would that be a good idea to revise that-----

**Mr. Terence O'Rourke:** It's there now, the directors' compliance statements are required now, so that's one of the changes since 2008.

**Senator Sean D. Barrett:** And the ... when you were looking at the documentation in relation to loans, the CIF were here yesterday and they were requiring that NAMA should honour verbal agreements between banks and their customers. Did you come across undocumented loans when you were doing your audit?

**Mr. Paul Dobey:** No, and I don't believe it was a feature of AIB's activity.

**Senator Sean D. Barrett:** And the high discount rate on AIB, I think 56% when it was transferred across to NAMA, was there any indication that was likely to happen when you were doing the audit?

**Mr. Paul Dobey:** Towards the end of our audit in 2009 and there was a dialogue between, I think, Government and AIB, around the concept of a NAMA-type entity. And the working assumption at that time was the discounts may be 20%, a little bit later the working assumption was that they may be as much as 35% and, ultimately, they were 56%. When you go back to the statements that AIB made to the market around the declines in value and they announced that to the market in 2009 based on their stress test, it's not terribly surprising that the NAMA losses were at the level that they were at. Because, as I said earlier, AIB would have planned to hold those loans through the cycle if it could have, but it didn't for reasons we all know and, ultimately, they were disposed of to NAMA at what, with the benefit of hindsight, was the bottom of the cycle.

**Senator Sean D. Barrett:** Lending without income statements, did that come up in the audit?

**Mr. Paul Dobey:** I think it probably did, we were ... particularly in the property construction area ... when we were doing the loan reviews, there wouldn't always have been income statements and you'll understand that in relation to a property loan, it's the cash flow ... the future cash flows that may be available from developing out that property that would give rise to income and there may not have been any income early on.

**Senator Sean D. Barrett:** Did you find regulatory compliance reluctance or reluctance to comply with the regulator in relation to sectoral concentration and in relation to loans to deposits, that the regulator's wishes were quite frequently ignored or disputed? Did you find that?

**Mr. Paul Dobey:** I didn't find that to be a feature. We've pointed out ... discussed earlier the sectoral exposures that went all the way to the AIB board, it was taken extremely seriously by AIB. It was discussed. There were reasons why they continued to breach those limits ... if I can use those words ... that was to do with their view that Basel II was coming. That was done in good faith, I believe, and I wasn't ... it wasn't a feature of our engagement with AIB that they

were non-compliant if I can put it that way. In fact, they believed compliance was an extremely important aspect of what they did.

**Senator Sean D. Barrett:** I'm sorry to interrupt you there. And the concerns of Jim O'Leary, who is a very eminent economist, as early as 2004 about the sectoral lending by the bank, was that brought to your attention?

**Mr. Paul Dobey:** Yes. We attended all of the AIB audit committee meetings and Jim would have sat on some of those meetings. He raised questions. I assume those questions went into the boardroom and I presume they got discussed and I don't know if Mr. O'Leary got satisfied in the end, but if he had concerns, it was for him to resolve those concerns with his boardroom colleagues.

**Chairman:** Okay, final question, Senator.

**Senator Sean D. Barrett:** You said you were relying on the ESRI and the IMF, the Central Bank and so on, if you like, the wrong people, as it turned out, so Mr. O'Leary's advice was bypassed in favour of the group that you did rely on.

**Chairman:** I'm sorry, if you have a document ... just before ... if you've a document there with regard to Mr. O'Leary, put it on the table, please, Senator. We're kind of having an abstract conversation about comments that somebody was actually making and I would not be inviting the witness into a kind of subjective interpretation of that unless we're dealing with direct evidence before the committee.

**Senator Sean D. Barrett:** Thank you, Chairman.

**Chairman:** Okay, thank you.

**Senator Sean D. Barrett:** That ... its merely in the context he was a board member and I won't raise it any further. Thank you.

**Chairman:** Okay, all right.

**Senator Sean D. Barrett:** And I'd like to thank our two visitors and thank you, Chairman.

**Chairman:** Thank you. Okay, I just want to tidy up with a few matters. I'm going to wrap up and then invite our two lead questioners in to finalise questions today. Just returning to the matter of the regulator and the regulation structure - and Mr. O'Rourke and Mr. Dobey, either of you can answer this - did you feel that the reports issued to the Financial Regulator provided them with enough information to enable them to discern the full regulatory position of the group?

**Mr. Paul Dobey:** By us or by the-----

**Chairman:** By you and by the bank.

**Mr. Paul Dobey:** Well-----

**Chairman:** If you can give a comment on both.

**Mr. Paul Dobey:** Yes. I think I would be making a subjective judgment in relation to the information given by the bank to the regulator. I know they gave extensive information, but if I can maybe comment more-----



**Chairman:** Sure.

**Mr. Paul Dobey:** -----in a more fulsome way on the information we gave? We prepared very detailed planning documents. We prepared very detailed findings documents from our audits. We prepared very detailed management letters in all of the years. In the more difficult years, we prepared very extensive reports. We would normally report twice a year to the audit committee. In 2008, I think we reported six times, if not seven, and all of those reports went to the regulator and I believe that was a fulsome disclosure to the regulator including ... and we also had dialogue and discussion with the regulator during that period.

**Chairman:** Okay, thank you. In layperson's terms, maybe you could explain to the committee - because I'm coming to wrap things up now - if the auditors did their job properly, according to the rules, why then did the banks fail without warning?

**Mr. Paul Dobey:** I ... at the risk of making another analogy, if ... we audit drug companies and we audit airlines, so we don't tell drug companies what drugs to develop and they don't expect us to tell them what drugs to develop as auditors. We don't have that expertise. We don't tell airlines what airlines ... what aircraft to buy-----

**Chairman:** Sure.

**Mr. Paul Dobey:** -----and what routes to fly. And we didn't tell AIB what loans to give. So I think ... the question is we did our job, which was a point-in-time financial statement ... report on financial statements. It was not our job to tell AIB what loans to give. That was the board's role.

**Chairman:** But every bank, practically, in Ireland crashed. If every airplane fell out of the sky that was over Irish jurisdiction, there would be a lot, a lot of questions. Every Irish bank failed to a certain extent, Mr. Dobey, Mr. O'Rourke.

**Mr. Paul Dobey:** Yes.

**Chairman:** Some-----

**Mr. Terence O'Rourke:** Well, if the aircraft fell out of the sky, I don't think they'd be looking at the auditors to be honest, but-----

**Chairman:** Yes, but-----

**Mr. Terence O'Rourke:** The issue-----

**Chairman:** -----we would be looking at the service engineers and the people that would be-----

**Mr. Terence O'Rourke:** Yes.

**Chairman:** -----designing the ships and all the rest of it.

**Mr. Paul Dobey:** Not the auditors.

**Mr. Terence O'Rourke:** Yes. In terms of the crash that happened, go back to what I've said earlier. What happened was ... did the accounts reflect the right numbers and the ... the accounts were accurate. They reflected the loans given, they reflected the sectoral concentration, they reflected the funding make-up. All those items were disclosed. The issue then is whether

the accounts should have provided for losses which subsequently happened and the answer is the accounts, obviously, didn't provide for those losses because they were not foreseen and the answer is because to make provisions for losses you need to be able on an objective basis for saying these losses are going to occur and there was no objective evidence, in any time we did our audits before the crash happened, that those losses were going to occur.

**Chairman:** So, in that regard, was the bank failure a surprise to you, as auditors?

**Mr. Terence O'Rourke:** Of course it is, yes. I mean ... sorry, given the economic circumstance we encountered, the fact that the banks incurred ... is not a surprise, but we didn't anticipate the economic failure, of course not.

**Chairman:** Okay. And would you concur with that view, Mr. Dobey?

**Mr. Paul Dobey:** Yes.

**Chairman:** Okay. So, maybe if ... to wrap that up again, has ... what has actually changed since the crisis period and can bank audit accounts now predict the risk of bank failure, in your opinion?

**Mr. Terence O'Rourke:** Well, there'd be a number of things, a lot of things done internationally, because it wasn't just in Ireland that banks failed, that is a global issue and there's been a lot of work done by a number of groups saying, "How can we enhance corporate reporting?" And one of the issues I said earlier that the chairman of the IASB said is that financial numbers only tell so much about a company. There's other things you need about a company, other than what its assets and liabilities are, what its income and expenditure are. You need to know its business models more, you need to know its risks. You need to be able in some way to measure the environmental impact of a company. You need to be able to measure the social impact of a company. And therefore there's a lot of work being done on can we develop corporate reporting on top of a very sound basis of the numbers being done in a certain way, can we give other information to people that'll help them better understand a business and the risks it face? That work is being done by the international integrated reporting council I talked about. It's being done by the financial stability board of the bank of international ... or the BIS in Basel, which are coming out, enhanced disclosure task force, which again has got a lot of work done on the additional disclosures that banks should make of the risks they're running. And there's now a fairly broad set of additional risk disclosures which are being developed and are being trialled with banks to see can they produce this information in an understandable and consistent manner. And that work is going ahead very well. I think in the future you'll see that banks will report a wider range of things, more than just the numbers. So that looking back on the crisis you'll say, "We believe the numbers were properly prepared in accordance with the rules that were there. The issue was: that was not enough for people to understand what was going on." We need a wider picture, which can't all be captured in numbers. They need to be captured in more narrative, telling the story in a broader sense. And what ... to have that consistent so we compare Bank A with Bank B in different countries and different situations, there needs to be a fairly comprehensive set of things that banks can and can't do, and that work is ongoing at the moment.

**Chairman:** Okay, thank you. Just a final question to both of you so, in your opinion, or in the firm's opinion, did the external audit fulfil its role or not?

**Mr. Terence O'Rourke:** We fulfilled our role in terms of the job that we were given. In

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terms of the reasonable question, which has been put to me a number of times today, should we not have foreseen it coming? Did Irish people not expect? And that goes back to that issue. I think that the information that's contained in accounts, people expect the accounts to tell the whole story, and there's probably more stories to be told than are ... than can be told in a set of financial numbers. And, therefore, the financial numbers, about which the auditors are saying, "These were properly prepared in accordance with the rules," that story, as being told by the financial numbers, was not sufficient to understand what was going on.

**Chairman:** Okay. Mr. Dobey?

**Mr. Paul Dobey:** I think that describes it well.

**Chairman:** Okay, thank you. I'm going to move to wrap up. So, Senator MacSharry?

**Senator Marc MacSharry:** Nothing further.

**Chairman:** Okay, thank you. Senator D'Arcy? Okay. With that said, I ... if there's anything further you would like to add, Mr. O'Rourke or Mr. Dobey, before matters could be closed?

**Mr. Terence O'Rourke:** No, thank you for your time today.

**Chairman:** Thank you very much. So with that said, if members can just ... in doing this I would like to thank Mr. O'Rourke and Mr. Dobey for their participation today and for their engagement with the inquiry and now to formally excuse you and also to thank you for your engagement today. With that said, I now propose that the meeting is adjourned until 2.30 p.m. on Tuesday, 19 May 2015. Is that agreed? Agreed.

The joint committee adjourned at 6.27 p.m. until 2.30 p.m. on Tuesday, 19 May 2015.