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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 20 Bealtaine 2015

Wednesday, 20 May 2015

The Committee met at 9.30 a.m.

MEMBERS PRESENT:

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

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Nexus Phase

PricewaterhouseCoopers - Mr. Ronan Murphy and Mr. John McDonnell

Chairman: As we've a quorum, the Joint Committee of Inquiry into the Banking Crisis is now in public session, is that agreed? Agreed. Can I ask members and those in the public Gallery to ensure that their mobile devices are switched off? We now commence session 1 today which is a public hearing discussion with Mr. Ronan Murphy, senior partner, PwC, and Mr. John McDonnell, partner, PwC.

In doing so we would like to welcome everyone to the 27th public hearing of the Joint Committee of Inquiry into the Banking Crisis. Today we continue our hearings with senior auditors who had roles before and during the crisis. At this morning's session we will hear from witnesses from PwC, Mr. Ronan Murphy, senior partner, and Mr. John McDonnell, partner.

Ronan Murphy joined PwC in 1980 and was admitted to the partnership in 1992. He has been a senior partner at PwC since 2007. Mr. John McDonnell is a partner in PwC's banking and capital markets group. He is the Bank of Ireland audit partner in PwC. Mr. Murphy and Mr. McDonnell, you're both very welcome before the committee this morning.

Mr. Ronan Murphy: Thank you, Chairman.

Chairman: Before I hear from the witnesses, I wish to advise the witnesses that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you're directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you're 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 a smooth running of the inquiry, we will display certain documents on the screens here in the committee room. For those sitting in the Gallery, these documents will be displayed on the screens to your left and right. Members of the public and journalists are reminded that these documents are confidential and they should not publish any of the documents so displayed.

The witnesses have been directed to attend this 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 both Mr. McDonnell and Mr. Murphy.

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

Mr. Ronan Murphy, Senior Partner, PwC.

Mr. John McDonnell, Partner, PwC.

Chairman: Thank you again, Mr. McDonnell and Mr. Murphy, and I believe, Mr. Murphy, you'll be going first with your opening statement this morning ... yes?

Mr. Ronan Murphy: That's correct, Chair.

Chairman: Okay. So, if I can invite you to make your opening statement please.

Mr. Ronan Murphy: Yes, thank you, Chairman, good morning and good morning also to the members of the committee of inquiry. Can I firstly say that I and my colleague here on my right, John McDonnell, welcome this opportunity on behalf of PwC to meet with the committee this morning and to assist you in your work. Chairman, in your letter to me of 6 May you allocated a time period for me to read my opening statement. I don't anticipate that I will require all of that time but I would nonetheless like to make some opening remarks.

Chairman, in your introductory remarks you outlined a brief biography of my career and I won't repeat this. However, I would like to make some comments around my role and function as senior partner of PwC. My main role is to act as the CEO of the firm on behalf of the partners. This is a role I've held since 1 July 2007, as you've mentioned, and from which I will step down on 30 June next. We currently have 95 partners in the Republic of Ireland firm, over 2,000 staff and revenue in the Republic of Ireland of €230 million for the year ended 31 December 2014. In terms of clients, my principal role is to ensure we have appropriate systems in place to make sure that we deploy suitably experienced and senior partners to carry out specific client assignments. On the risk and quality side, the senior partner has a very key role to ensure we have effective client acceptance and retention controls in place and also that there is adequate support in place for partners dealing with higher risk situations and making critical professional judgments.

PwC Ireland is a member of the PwC global network and in that context the senior partner's role is to ensure that new practices and procedures-----

Chairman: Sorry, Mr. Murphy, if I could just slightly disrupt you, I think you may have a box on the speaker there that's actually-----

Mr. Ronan Murphy: Oh, I'm sorry. I'll take it off.

Chairman: Thank you very much.

Mr. Ronan Murphy: Sorry. Will I continue Chairman or-----

Chairman: Please ... yes.

Mr. Ronan Murphy: PwC Ireland is a member of the PwC global network and in that context the senior partner's role is to ensure that new practices and procedures developed in centres of excellence in other parts of our network are effectively rolled out in the Irish firm.

Chairman, I was directed by you on 12 March to attend this meeting of the committee this morning. I responded to you on 27 March and I think it's appropriate that I read out a paragraph from that letter as follows:

Further to your letter of 12 March ... directing me to attend before the Joint Committee, I would like to point out to the Joint Committee that I have not practiced as an auditor since my appointment as Senior Partner on 1 July 2007 and, furthermore, prior to that date, I acted [almost entirely] on non-financial services entities. Accordingly, as I have never been an auditor to a bank, I request that I be granted the option of being accompanied by one of my financial services partners so that I can fully respond to the key themes and lines of inquiry when I attend before the Joint Committee on 20 May.

Chairman, the firm appreciates your consent to this and accordingly I'm accompanied by John McDonnell this morning and I will shortly pass over to him to permit him to make his opening remarks.

As requested, Chairman, I submitted my written statement on behalf of the firm on 22 April. The statement addresses the five key themes which I was directed by the committee to cover. In summary, these themes are: integrity of financial reporting; appropriateness of property-related lending strategies and risk appetite; the liquidity versus solvency debate; the adequacy of the assessment and communication of both solvency and liquidity risks in banking situations, institutions and sectors; and capital structure and loss absorption capacity. Chairman, I'm happy that if you wish, that this statement can be taken as read. However I think it's appropriate that I read the short conclusion included in the statement. Our conclusion is that audits in the period from the start of the financial crisis were clearly challenging due to the inherent uncertainty facing the Irish and global economies and the particular issues faced by Irish banks. The loan loss provisions were clearly a material estimate in the overall set of financial statements on which we expressed an opinion. We stand over the quality of the audits of the financial statements of Bank of Ireland and the robustness of the audit opinions issued on the respective reporting dates.

Chairman, my colleague John McDonnell and I would be happy to answer questions from the committee and to explain to the committee how we arrived at this conclusion and why we believe this conclusion was appropriate.

Chairman: Thank you very much Mr. Murphy ... sorry -----

Mr. Ronan Murphy: I'm just almost there, Chairman.

Chairman: Sure yes, take your time.

Mr. Ronan Murphy: We would also be happy to explore with the committee how bank accounting and bank auditing could be enhanced so as to help avoid a similar financial crisis recurring. Before I conclude, Chairman, could I say that in relation to Bank of Ireland, that it has been and continues to be a significant client of the Irish firm of PwC. We were joint auditors to Bank of Ireland along with Deloitte of London up to 1990 and since then have been the sole auditors. We believe we had, and continue to have, a very strong working relationship with the executives, the audit committee and the court of the bank and provided appropriate challenge and support to the bank in an unprecedented period of turmoil starting in the middle of the last decade. Can I also say Chairman that, in accordance with the new rules currently being introduced on mandatory auditor rotation, we will step down as the bank's auditors no later than the required date of 2020.

In conclusion Chairman, our objective today is to assist the committee as best we can. As you'll be aware we have already provided the committee over 5,300 pages documenting our work over the period and this highlights the extensive communication we had with Bank of

Ireland throughout this critical period. Thank you Chairman.

Chairman: Thank you, Mr. Murphy. Your opening statement, which you provide to the committee will be published as well this morning in full, just so it's put into the record. And also just in terms of notification that was given to both yourself and Mr. McDonnell, you would be here representing yourself, along with the activities of your firm. So Mr. McDonnell, if I can invite you to make your opening statement please.

Mr. John McDonnell: Thank you Chairman, thank you Ronan. Good morning Chairman and members of the committee of inquiry. Like Ronan, I welcome the opportunity on behalf of PwC to meet with the committee this morning and to assist you in your work. I am here today in my capacity as lead audit partner on Bank of Ireland from 2010 to date. Whilst not directly involved in the Bank of Ireland audits from 2001 to 2009, I am familiar with the audit procedures adopted by PwC in the audits of banks in the period in question and like Ronan, I will do my best to answer the committee's questions.

Chairman, I submitted my written statement on 6 May 2015. I'm happy to take the statement as read but I would like to make a few introductory remarks on two aspects: (a) the role of audit, what it is and what it is not, and (b), the impact of prevailing accounting standards in recognising risks. So moving to the role of the audit, there is and has been a lot of discussion about the role of an audit, including what it is, what people think it is and what they might like it to be. So I think it's important at the outset to set out what the role of an audit is, where it begins and ends, and what it is not. In doing this I'm drawing from the requirements of company law in Ireland and auditing standards. The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, that's IFRS in the case of Irish banks for 2005. Although an auditor's opinion enhances the credibility of financial statements, the user cannot assume that the audit opinion is an assurance as to the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In other words, the primary purpose of an audit is to provide independent assurance to the shareholders that the directors have prepared the financial statements properly in accordance with the rules of IFRS. An audit does not exist to provide comment or opinion on a company's business model. That is not the purpose of an audit, nor is there any means for an auditor to express such views in the audit opinion. The prescribed format and somewhat binary nature of an audit opinion does not allow for commentary on an entity's business model. In fact, the content and set of financial ... the content of a set of financial statements is prescribed by the accounting and regulatory framework. There is nothing in this framework which allows an auditor an avenue to express a view in the financial statements on a company's business model. In the context of regulatory returns, there is no requirement for auditors to audit or review, and nor did we audit or review, any regulatory turn of the bank, be it solvency, liquidity or otherwise.

I move on to the second item - impact of prevailing accounting standards and recognising risks. The objective of financial statements is to provide information about the financial position, the performance and changes in financial position of an entity. Accounting standards set the rules for the preparation of financial statements and, as I said, IFRS are the accounting standards that applied to listed entities in Ireland, including the banks, from 2005 or March 2006 in the context of Bank of Ireland.

Financial statements portray the effects of past transactions or events. They're not intended to provide all the information that users need to make economic decisions. The aim of accounting standards is to faithfully represent past transactions or events in financial statements. Matters such as stability, capital adequacy and future prospects are outside the remit of accounting standards. The requirement to focus on past transactions and events means that IFRS prohibits the recognition of future events. By way of example:

1) There is a general rule in IAS 39, which deals with accounting for financial instruments and impairment, that losses expected as a result of future events, no matter how likely, are not recognised as impairment on loans and receivables - this is called the incurred loss approach.

By way of example, the date a borrower became unemployed would be an impairment trigger in many retail books. What I mean by an impairment trigger is the first point at which impairment is allowed to be recognised. But banks cannot take into account an ... expected increase in unemployment in the following year, say 2016, in their year-end, say 2015, assessment of impairment, no matter how likely, because this unemployment has not yet happened. There is a second example. There's a general rule in IAS 37 and that deals with provisions contingent liabilities and contingent assets, that provisions cannot be recognised for future operating losses. And my third example deals with events after the balance sheet period, IAS 10, and this standard does not allow an entity to recognise the financial impact of events that arise after the balance sheet date concerning conditions which did not exist at the balance sheet date.

IFRS set the rules which had to be applied in financial statements of Irish banks during the financial crisis. The financial crisis tested some of these rules and found some of them wanting. Changes have now been made but, nonetheless, they were the prevailing rules. Therefore, they were required to be applied. The accounting rules of the time did not allow for the recognition of future events or risks. There have been changes since the crisis to accounting auditing and corporate governance standards. We've engaged heavily in the process and welcome the opportunity to engage further with the various stakeholders in the overall debate on improving financial reporting. Thank you, Chairman.

Chairman: Thank you very much, Mr. McDonnell, and thank you again, Mr. Murphy. We'll commence this morning's opening questions with Senator Susan O'Keeffe. Senator, you've 25 minutes.

Senator Susan O'Keeffe: Thank you, Chair. Good morning. Mr. Murphy, in the seven years between 2004 and 2010, your firm would have earned a total of €66 million for the work that you did at Bank of Ireland. Obviously, that is split between the audit and the other work. So while I appreciate we're here largely to talk about the audit, I'd just ... I'd like some clarity, maybe, on ... because the other work appears to have earned quite a lot of income, and given that you are the chief executive of the company, you might be able to throw some light on that.

Mr. Ronan Murphy: Okay. Senator, included in the figure you've quoted there are the audit fees.

Senator Susan O'Keeffe: Yes.

Mr. Ronan Murphy: There are a significant amount of non ... of audit-related fees, and that would be where we supported the bank in terms of IFRS transition. We supported the bank in terms of providing accountant's report where there was capital raising. We were involved in Sarb-Ox implementation. And then there's an element of non-audit fees, which would be for tax and some consulting fees.

Senator Susan O'Keeffe: For clarity, Mr. Murphy, would the people concerned in the non-audit activity be completely separate to the audit team or would there be a crossover?

Mr. Ronan Murphy: They would be completely separate, Senator. So the ... we have three divisions in our practice - audit, tax and consulting. John McDonnell works in the audit practice. Those working on the audit were solely in the audit practice. Anyone providing tax advice would work in the tax practice, and those providing consulting advice would be in the consulting practice. They're three separate divisions.

Senator Susan O'Keeffe: In any way, would the people involved ever have had a conversation or been invited to have a conversation with the bank where, if you like, there'd be a joined-up presentation by PwC to the bank, you know, saying, "Well, we found all of this and here you go, here's a clear picture"?

Mr. Ronan Murphy: Yes, I think where that would most happen, Senator, would be where our tax colleagues were preparing tax returns or looking at certain tax planning aspects, and they would link in with the auditors as part of that. That's where it would mostly happen.

Senator Susan O'Keeffe: Okay. So they weren't ... there wasn't a Chinese wall environment going on.

Mr. Ronan Murphy: There wasn't a total Chinese wall, but, as I say, it wouldn't be the norm that you would have discussions. It would mainly happen around the tax and audit linkages to make sure that the auditors were fully aware of the consequences of tax planning and tax returns.

Senator Susan O'Keeffe: Given the scale of the earning, was Bank of Ireland one of your biggest or, indeed, perhaps your biggest - perhaps you could tell us - client?

Mr. Ronan Murphy: Certainly, Senator. The Bank of Ireland is ... was and is our largest financial services client and throughout the period it would have been one of our largest ... three largest clients.

Senator Susan O'Keeffe: Did I hear you correctly to say that you'd been auditing Bank of Ireland since 1990? Is that correct?

Mr. Ronan Murphy: Correct. Sorry ... yes, what I said was that we were joint auditors up to 1990 with another firm and then we became sole auditors in 1990 and we've been sole auditors since that date.

Senator Susan O'Keeffe: And I think you talked about the quality of the relationship between yourselves and the bank being a good one.

Mr. Ronan Murphy: It was a very good professional working relationship and, as I say, we provided appropriate challenge and support to the executives on the board in what was a very difficult period.

Senator Susan O'Keeffe: Do you believe that the longevity of your relationship could be perceived to have an implication of closeness? Do you see why people might observe that and say, "They've been the auditors for such a long time; they must know each other very well"?

Mr. Ronan Murphy: I think that's a reasonable question to ask, Senator. We were auditors, as I say, solely for 25 years, but there are some very key safeguards in place to make sure that we don't become any less independent than we should be and that we don't provide appropriate challenge and robustness and rigour and, I mean, just to very quickly enumerate those, Senator ... I mean, John McDonnell said he has been partner on the Bank of Ireland for the last five years. We've a new partner taking over. His predecessor did five audits, as did his predecessor. So every five years we're required to rotate the partner. We also have, in the case of Bank of Ireland, a quality review partner. He's not involved in the relationship but he does review the planning documentation. He reviews the papers and, critically, he reviews all of the judgments. So he, again, would be making sure that we applied appropriate rigour and independence and we arrived at the right decision. And I think, thirdly, Senator, it's important to realise that in our engagement with the audit committee of the Bank of Ireland, every number of years they would do a formal review of the quality of our service, and that would have happened on every, probably, third anniversary, where they would look to make sure that we were providing the services that they thought were appropriate. So those safeguards would ensure that we have, and we continue to apply, the right level of independence.

Senator Susan O'Keeffe: In your view, did the firm's audit team have sufficient banking and, particularly, I suppose, property experience, given what we saw in the growth of property-related investments by the bank over that period of time?

Mr. Ronan Murphy: Senator, we're happy that we had the absolute level of experience we needed. John can explain that we have within the firm a banking group where the ... in our audit practice, a banking group where all of the staff are almost exclusively working on bank clients. There's about 100 people in that group. We have five partners. The core team supporting ... auditing the Bank of Ireland would have been drawn from that. John ... if that's okay?

Senator Susan O'Keeffe: Sure, of course, yes. Mr. McDonnell?

Mr. John McDonnell: Senator, we're the only firm in Ireland that have a dedicated banking practice as opposed to a dedicated financial services practice. So when you arrive into PwC on day 1 and you join the banking practice, you only work on banking audits, so the full audit team that we would have directed to Bank of Ireland was from our banking practice and they would have all had banking experience commensurate with the period of time they were in the firm. Secondly, we were very conscious that Bank of Ireland is organised on a divisional basis, so we would have taken our retail banking specialists to audit the retail part of Bank of Ireland, we would have taken our corporate banking specialists to audit the corporate side of Bank of Ireland and our treasury specialist to audit the treasury side of Bank of Ireland. In terms of mobilising for the audit, we would have had specific Bank of Ireland structured training at the start of every year where we would look at the key risks and significant risks with Bank of Ireland and ensure the team were up to speed on those.

But also, as a banking practice, we would have detailed, banking-specific training over and above the training everybody else in the firm gets before we enter into a cycle of banking audits. That training would deal with three aspects. The first aspect would be accounting training: any changes in the accounting that has particular relevance to banking and that would have been very heavily focused on accounting for financial instruments and impairment. Two, any auditing training and that would have had two focuses, Senator. The first is any changes in auditing standards that we need to take into account but also re-emphasising aspects of auditing standards that maybe ... that we need to focus in on as the business environment changes and particularly in that aspect, it would have been how one audits impairment and how one audits an incurred loss model on impairment, and thirdly, particular training around the current business environment in which the financial institutions are operating. And that would have been, as you would expect, a heavy focus on training around credit, accounting for credit, the auditing of credit and as part of that training, we would have been discussing the impact of the credit crisis on the property markets and we would have had auctioneers coming into us to give us their perspectives on the property crisis etc.

Senator Susan O'Keeffe: You might ... because there is such, I think, a mixed perception of what auditors do, could you just indicate what size of a team you might have had in place over the average year and whether or not that team was working constantly or for a period of time, you know, very hard and then there is a gap, or how does it function and how often are they in and out of the bank, the actual physical bank?

Mr. Ronan Murphy: Maybe, Senator, I will just give an overall perspective on the audit team and ask John then to comment in relation to the bank. Is that okay?

Senator Susan O'Keeffe: Yes.

Mr. Ronan Murphy: In terms of the audit teams, it has been a very consistent model over many years and it is applied consistently throughout the profession. There are really four levels. There is the partner and as I say, in our firm we have 95 partners. Their job is to make the critical judgments. They consult as widely as they need internally, they have the support of the quality review partner, but they are the ones who can commit the firm. The next level below the partner are the directors, senior managers and managers, who are very experienced accountants who are in charge of the project management of the audit. Below them are the qualified seniors. These would generally be qualified chartered accountants. They would be on-site on clients throughout the period of the audit and they would be supported by unqualified staff. These would be trainees, who are training to become chartered accountants.

Senator Susan O'Keeffe: What is the period of the audit, Mr. Murphy? When you say, "for the period of the audit", what is the period of the audit?

Mr. Ronan Murphy: You say how long would the audit take?

Senator Susan O'Keeffe: Yes.

Mr. Ronan Murphy: The audit of the Bank of Ireland would generally have taken about four or five months. John, do you want to-----

Senator Susan O'Keeffe: Okay.

Mr. John McDonnell: Just to answer, the audit cycle of Bank of Ireland, Senator, would operate throughout the full year. We wouldn't be with the bank throughout the full year but would operate throughout the full year. We would be engaged in a degree of planning and conversation with the bank - if I take it December-December, it's probably easiest - in the early part of the year, discussing with the bank key matters that are impacting their financial statements, discussing changes in accounting standards, changes in auditing standards and they would always seek our views on accounting for particular matters. That would happen, if you like, throughout the first half of the year. We would then enter into our review of the half-year financial statements, and that would take place, if it was a December year-end, generally we would plan for that in June and we would be operating in July and into August. Then we move into the planning of our audit and we would determine our audit plan and present that to the audit committee, generally in September time, and then we would start full-scale on the audit in October and that would run through until we sign the financial statements, which would be usually the end of February in a December year-end, then we would move into signing and finalising the form 20-F, which is the equivalent of financial statements we would have filed with the SEC. We'd finish that in March and we'd start the cycle again. The main bulk of our time would be probably, it changes every year but October to February, coming into March. In terms of the resources that we would have mobilised at the peak of the crisis, probably in and around 200 people, of which 25%, give or take, would be the senior management team, which would be partners and senior managers.

Senator Susan O'Keeffe: So in the previous year, for 2008, you would complete and sign off the audit in March 2009?

Mr. John McDonnell: Yes, 2008 was a March year-end, apologies, but for December it's similar-----

Senator Susan O'Keeffe: It's usually after three months the actual end of the ... year-end

Mr. John McDonnell: Yes, usually two months after the end of the period, and then the 20-F follows a month after that, usually. That's usually the way it works.

Senator Susan O'Keeffe: Now, you've talked a little bit about, and I'm sure other colleagues will talk about, the changes and some of the things that have happened in terms of the changing of rules for auditors and for auditing in the future. But did your firm ever call for a change of rules prior to 2008? Were you out there banging the drum saying, "Audit rules are not strong enough", or were you satisfied up until then that the audit rules were strong enough and robust enough for the work that you were doing?

Mr. John McDonnell: I think, Senator, in the context of the audit rules and the rules that were applicable to allow us to formulate an opinion, I think the rules that were in place were appropriate for the time, and I think the substance of those rules is still in place in the canon of accounting standards. I would say that we stand over the audit opinions on Bank of Ireland, we did a very robust and thorough audit, and we are satisfied that those opinions were appropriate.

The main changes, though, in auditing standards since the crisis have been predominantly focused in on the role of the auditor and the role of management, and trying to strengthen an understanding in the marketplace as to what an auditor does and what an auditor doesn't do, and what management do and what management do not do, and the interaction between the two. And what we've seen is, we have seen a development - for an example, Senator - we've seen a development in the audit report, whereas the audit report previously would have been a two-page report, now it's about a six-page report. Previously we would've just, effectively, said what our responsibility is and what our opinion was; now we will specify how we, how we determined the focus of our audit, so, in other words, what entities were in scope and what were not in scope, what was the materiality that we would have applied to our audit, and what were the key areas of audit focus, so, in other words, the significant risk and, clearly, impairment would have been one of them, and what tests we undertook to audit those areas of focus, and then how that brought us to our opinion. So it's much more discursive around the opinion, and the second part of the change was that management through ... the directors, through the auspices of the audit committee, would outline what they considered were the significant issues that they took into account in the context of the finalisation of the financial statements, and how they interacted with the auditors in that regard. And, lastly, the directors would then say why they believed the accounts were fair, balanced and understandable. All that was being done in the past; it is just now more, it is communicated in a more detailed manner to the marketplace.

Senator Susan O'Keeffe: But you weren't calling for that change, you weren't, among your colleagues and your international partners and so on, you weren't saying to each other or to yourselves, "Do you know, guys, we need to change, we need to make these rules more robust"?

Mr. John McDonnell: We would have always been involved in debate in the markets around auditing standards, we would be constantly in debate with the body who sets auditing standards, the body who set accounting standards, we would always have been involved in the debate about good corporate reporting and, I don't have examples, but I'm sure that we were involved in saying that, you know, we would always be promoters and supporters of better communication to the marketplace. And we would have always been supporters in, since well before the banking crisis, about, you know, auditors looking at a better way to communicate what they do because there has always been an expectation gap between what we do and what people perceive that we do. But I can't pinpoint a specific and say that as a result of the crisis we did X, Y and Z; we would have been constantly involved in that debate.

Senator Susan O'Keeffe: No, actually, I was asking particularly, prior to the crisis, in fact, but-----

Mr. John McDonnell: Well, we would have been involved in the debate prior to the crisis. There was a number of, and this is going back a long way, there was a number of documents and debates done in the Institute of Chartered Accountants. I think one of our partners, Niall Deasy, was involved around the expectation gap, so we would have been involved in that debate, but it's been a long-standing debate, Senator.

Senator Susan O'Keeffe: When the loans, when you would examine ... the auditing team would examine loans that the bank had, would the bank provide the sample of loans, or would you go in and seek a sample of loans?

Mr. John McDonnell: No, Senator, the bank would not provide the sample of loans, we would select the sample of loans; we would not notify the bank as to what our sample was until we went in to seek that sample, and we would select that sample ourselves.

Senator Susan O'Keeffe: And would you seek the sample from across all loans, or would you concentrate more on the top end or the bigger loans, or did you give equal parity to-----

Mr. John McDonnell: We would seek ... we would apply two types of testing. We would apply targeted-type testing and then we would test the balance that ... the remaining balance. We would focus our audit approach on the risks inherent in the book so while we wouldn't necessarily go for big loans but we would focus our sample, if we're testing for impairment, on loans that are more likely to have risk factors, thereby they could be impaired, but we would also look at other loans. So, it would be across the whole, the whole population, focused in on where we perceive the more material risk. And the reason we do this is because the purpose of an audit is to focus in on risks and material misstatements, so all our auditing focus is always focused on where there is more likely to be a risk of material misstatement.

Senator Susan O'Keeffe: Would you know, for example, if the bank had interest free loans being given to any body or any organisation? Would that be something a bank ... an auditor would know or would that just simply not arise?

Mr. John McDonnell: I'm not sure it would be something that I could say an auditor would know. It would be a focus of our work to look at whether the, whether an institution gave interest free loans for a number of reasons, and I'll articulate. The first reason is if a loan is issued at an interest-free rate. Then that loan would need to be fair valued under IAS 39, and at day 1, to determine what the actual interest is. So if you issue a loan of €100 at an interest-free rate, in reality what that would be booked at in the accounts would be €95 and then the interest would be accumulated. IFRS always assumes there's an interest in it. Secondly and more importantly, the reason we would look at interest-free loans would be in the context of our requirements to consider related party transactions and there would be a risk that if an institution gave a loan at an interest-free rate that there may be a related party aspect to it. It's not necessarily saying that the loan would not be appropriate, but there would be disclosures that would need to follow from that and our audit would heavily focus in on that.

Senator Susan O'Keeffe: When you're ... when the auditors for AIB were here with us, they said that they had had a meeting in 2000 ... early 2008 with the Financial Regulator. It was a meeting of the four firms with the regulator. And this arose in the context of contingency for ... for the going concern for AIB. I appreciate you're the auditors for Bank of Ireland, you can't speak for AIB, but I'm wondering whether you're aware and attended this meeting that AIB refers to with the regulator.

Mr. John McDonnell: Senator, yes, I am aware of the meeting. I personally didn't attend. We did attend the meeting, but I think the meeting ... I think the meeting that KPMG referred to last week was the meeting that the accounting firms had with the regulator in the context of accounting for financial instruments as a result of the liquidity crisis. And what happened at the time was that we had the subprime crisis in late 2007 and, as a result of that, there was a number of issues around how one would value securitisation vehicles, but, in particular, the credit aspect of financial ... of financial instruments. And we, indeed, and it's in the book of evidence, would have written to Bank of Ireland in that context in September 2007, highlighting the issues that people were considering. And that was the meeting that the four firms had along with the institute with the Central Bank I believe, and it was really to discuss valuation-type aspects of ... arising from the subprime crisis and liquidity crunch resulting from then.

Senator Susan O'Keeffe: But was there any questioning on the part of the auditors for Bank of Ireland at that point yourselves, at that point with the bank in relation to the bank as a going concern and whether you would ... whether there was any concern on the part of the auditors about the bank as a going concern?

Mr. John McDonnell: Us questioning the bank as a going concern ... oh, yes, there was-----

Senator Susan O'Keeffe: Can you tell me about that please?

Mr. John McDonnell: Oh yes. Our ... we always have responsibility to consider and audit the going concern concept and we would do that every year.

Senator Susan O'Keeffe: Yes. I'm specifically concentrating now on your observations at the end of 2007.

Mr. John McDonnell: Yes. We would always have a, as I said, a responsibility and, in 2007, Bank of Ireland was still on the March year-end, so our year was 31 March 2008. And maybe just before I just get into it what we did there, I might just stand back and say what-----

Senator Susan O'Keeffe: Sorry, I'm just conscious of the time, Mr. McDonnell.

Mr. John McDonnell: Okay, sorry. Fine.

Senator Susan O'Keeffe: I'm sorry, it's just if you can concentrate just on what you-----

Mr. John McDonnell: We focused in on going concern considerably with Bank of Ireland in March 2008 as a result of the effective freezing of the securitisation market. That had a knock-on impact on liquidity in the marketplace. Bank of Ireland were a small player in the securitisation market and they didn't have any of the valuation issues I discussed earlier on, or a very small number of them. We would've focused very heavily with Bank of Ireland and they would have increased the amount of work they would have done themselves to assess the going concern aspect. And we would have considerably ramped up the work we did in terms of going concern.

And we would've particularly focused in on liquidity and we particularly focused in on a number of things. And we took reliance from a number of things. One, Bank of Ireland's deposit base had grown by 19% that year. They were still growing deposits. Two, they had access to the wholesale money markets and they had considerable access to the wholesale money markets and they had no issues accessing those markets, albeit that the cost of funds was a little higher. And, three - and this, we had taken considerable comfort from this - they had a huge amount of liquid assets, about €30 billion, which they had not sought to access the ECB with. So that's ... we would have focused on that and done a lot of work around that.

Senator Susan O'Keeffe: And Mr. Boucher in his document, exhibit B3, said that, "Many aspects of normal financial market operations-----

Chairman: What reference?

Senator Susan O'Keeffe: Exhibit B3:

> Many aspects of normal financial market operations have ceased or been curtailed or else done under radically different conditions. Liquidity conditions were very difficult in the period leading up to 31 December 2007, with a brief rally in January-February-----

Chairman: I just need you to clarify that document, Senator.

Senator Susan O'Keeffe: -----a rally, however, that was not sustained.

Chairman: Sorry, Senator, I need you-----

Senator Susan O'Keeffe: I don't know what else to tell you except it's exhibit B3, RB001 - B0I.

Chairman: It's a Bank of Ireland document, is it?

Senator Susan O'Keeffe: It is. Mr. Boucher … I said at the start.

Basically Mr. Boucher was saying that things ... it was very difficult and liquidity conditions were very difficult. And I'm just trying to establish what ... were the auditors ... the auditors were clearly aware that they were very difficult is what he's saying. I'm just wondering did you agree or-----

Mr. John McDonnell: Liquidity issues were difficult, were very difficult, were difficult at that point in time and the difficulty was caused as a result of the liquidity crunch which had come from the subprime market.

Senator Susan O'Keeffe: Yes.

Mr. John McDonnell: What had actually happened was that the wholesale money markets had become more expensive to raise funds. We would have had detailed conversations with Bank of Ireland as to their ability to access those markets. They were able to access the markets and they continued to access those liquidity markets, albeit at a higher cost of funds. Secondly, and this is the very important thing we would have looked at is were Bank of Ireland still being able to draw funds from depositors and they were. Their deposit base grew by 19% up to March 2008.

But the most important focus of our audit and the most important focus of management's audit was the level of collateral that they had that they were not using at that aspect. They had about €30 billion in liquid assets which they could have repoed with the ECB. My recollection is that they had not drawn down any ECB funds at that point in time. And at that point in time, liquidity markets were a lot tougher than they had been heretofore but they were not as tough as they became when Lehman's collapsed.

Senator Susan O'Keeffe: If I can move you to the going concern position for the end of 2008. And again, KPMG referred to ... that this was a completely different experience. They had to consult with the regulator, with the Department of Finance, with the Central Bank, with everybody. That it was an "unprecedented" was the word they used. And that's pages 125 to 126 of KPMG's evidence from last week.

And, again, I want to know whether that was a similar experience with Bank of Ireland. Was it unprecedented? Was there any change in the way that you signed off on the going concern issues in relation to Bank of Ireland for 2008?

Chairman: The witness may not be familiar now with the evidence of last week, okay, just to flag that.

Senator Susan O'Keeffe: No, but he'll be familiar, I hope, with what happened in Bank of Ireland.

Mr. John McDonnell: Chairman, I think I can answer the question.

Chairman: Sure, indeed. You've plenty of time.

Mr. John McDonnell: Bank of Ireland's year-end was 31 March 2009. We would have been very heavily focused in on the audit of going concern in Bank of Ireland. Bank of Ireland were in a slightly different position than AIB because it was three months later. At that point in time, the bank had been recapitalised through the preference shares from the State. The bank had ... the Government guarantee was in place. And, lastly, the Bank had had a number of conversations with the Central Bank with regard to the availability of emergency liquidity, although I will say that the bank had not drawn down any emergency liquidity at that point in time. The bank, I believe, although I'm not certain, had started ... may have started to use some of its securities to repo them with the ECB in terms of raising money from the ECB. We would have focused very heavily in on capital. The capital was in place. The Government undertakings were in place. Liquidity - the bank had detailed conversations with the Central Bank as to the availability of funds.

Chairman: Okay, final question and supplementary then.

Senator Susan O'Keeffe: Was it unprecedented at the time?

Mr. John McDonnell: Was it? Sorry, no I ... sorry, Senator. It was wholly unprecedented. There was absolutely no expectation in the marketplace that someone of the size of Lehmans would collapse. There was no ... the market was stunned with the actual immediacy of the impact of that on wholesale markets and the interbank markets closed down at that point in time, so there was ... and therefore there was a heavy dependency on funding from the ECB and the banks were aware of that and the discussions ... they would have had ongoing discussions with the Central Bank and we were well aware of that. We would have been heavily involved in that and, as part of our audit procedures, we would have sought to have detailed discussions with the banks. We would have overlooked the collateral, over the full period, now, because this runs on into 2010 and 2011. We would have had detailed debates with our head of risk. When I got involved, I would have been discussing with our global head of risk how other banks were looking at going concern. We would have detailed conversations with the directors, the head of treasury, the person responsible for ensuring the collateral is in place, the head of deposits, the audit committee, the court. We would have discussions with ... We would have had a technical panel and that technical panel ... so, in terms of, for the audit partner to make a decision, because the serious in this, we would have had a technical panel so we would have had a conversation with our peers and that would have included our head of risk, our head of audit, some senior partners who are very good and versed in business risks, our head of accounting technical. I would have met with the Financial Regulator, the NTMA, the Department of Finance, the Central Bank. So we took this very, very seriously as did the bank, took it very, very seriously.

Senator Susan O'Keeffe: You were very involved.

Mr. John McDonnell: Very.

Chairman: Okay, thank you very much. I just want to stay with one aspect of that, Senator, before I bring in Senator Barrett. If I can bring up core document page 55, group audit findings report, year ended 31 March 2008 and what this is is an audit findings carried out by your firm, Mr. Murphy and Mr. McDonnell, with significant audit risks and other areas of focus. Maybe if I can draw your attention to the very last section of the page, which relates to your dialogue with Senator O'Keeffe:

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

Now, Mr. McDonnell and Mr. Murphy, this is about five months before the guarantee, when Bank of Ireland, from earlier evidence here, were in a very crisis position. The comment there, "in common with other banks", can you please explain to me what that actually means? Is this or is it not a suggestion that there was some open dialogue amongst those in the wider financial community as to a general liquidity concern right across the financial sector?

Mr. John McDonnell: There was at that point in time, Chairman. As I mentioned earlier on, there had been impacts on liquidity as a result of the US subprime market and the securitisation market had effectively frozen and liquidity was becoming, I suppose ... wholesale liquidity was becoming more short term and was becoming more expensive and it was recognised in the global markets that liquidity had become more difficult. That is what we meant by "in common with other banks". It wasn't just Irish banks. It was right across-----

Chairman: Maybe you could elaborate upon that dialogue so that was taking place in terms of the "in common with other banks".

Mr. John McDonnell: In terms of-----

Chairman: Was there a discussion taking place in your firm at the time that there is a potential for a significant liquidity crisis coming down the tracks here?

Mr. John McDonnell: There was discussion in our firm at the time around the impact of what had happened in the subprime market on liquidity. We would, as a regular ... regularly, Chairman, we would discuss, banking partners, both in Ireland and across the firm, would discuss the impacts on markets of various things happening and we would have discussed within our firm, and as I am sure the other firms were discussing, the impacts of the matters I just discussed earlier on liquidity in the marketplace and we would have had those detailed conversations within our firm and we would have had conversations with Bank of Ireland in that regard. And also, as I mentioned, I believe the meeting in February with the ... with the institute and the Central Bank was around ... was around the impacts of that crisis.

Chairman: Okay, and you advised the group audit committee. What was the advice you gave them? You said, "Accordingly, we will update the Group Audit Committee ..." - that's the Bank of Ireland group audit committee, I presume, you're talking about there.

Mr. John McDonnell: Yes, well, what happened was that the Bank of Ireland had considerably ramped up their approach to going concern and the going concern detail paper was not available ... was only just made available to us at the time of writing that audit committee report. So, what we did at ... verbally at the audit committee was bring, with management ... bring the audit committee through what the bank did to ensure itself that the going concern concept was appropriate to be applied in the bank. And the work that we did and we would've articulated - and I think it's in the minutes ... and management would have said why they were satisfied with the going concern concept ... we would've brought the audit committee through the work that we did, which I've mentioned to the Senator, and lastly, management would have concluded that they felt it was appropriate for the bank to continue as a going concern. We would've said that we were comfortable with that and the audit committee would've recommended to the board that they adopt the going concern concept.

Chairman: Earlier in your engagement, I think it was Mr. Murphy or it could have been yourself, Mr. McDonnell, when Senator O'Keeffe was speaking to you about the banking experience held within your firm ... what was the extent of the property experience?

Mr. John McDonnell: Our banking partners and staff are banking experts, what I mean by that is we're experts in the auditing of banks, we're experts in accounting for banks. We are not property experts but we would have ensured that our staff got appropriate training in what they needed to understand in the context of the auditing standards and the accounting standards and what they would need to understand to audit impairment of financial instruments. It's audit impairment as opposed to credit risk.

Chairman: But isn't it a case that, at the time ... that there was significant loan concentrations in the bank into the property sector and that that was going to ... that that had a relationship with the liquidity difficulties that the bank may actually encounter into the future? Would that have been seen, or even seen now, on reflection, as a necessary skillset or a deficit of skills, given the situation that was going to arise, or did it not?

Mr. John McDonnell: Chairman, the concentration of credit risk is as a consequence of the bank's business model. The bank's business model is the responsibility of the bank's management and directors. Our responsibility, as auditors, is to consider material misstatement in the financial statements ... the risks of material misstatement in financial statements and that's the boundary of what we do. So, the fact that the bank had a concentration credit risk, we would've been aware of that, we would've discussed concentration and credit risk, we would've discussed property prices with the bank over various stages but in the context of their impairments models. And we would have identified to the bank that it was very important to keep their impairment models up to date. We would've also discussed with the bank the difficulties of keeping those impairment models up to date when property prices are under stress. We would've also discussed the growing loan book ... and the growing loan book in the context of impairment models. But, Chairman, our focus of our work, as prescribed by the rules, was on the approach that the bank took to determine impairment in accordance with IAS 39.

Chairman: Just to clarify for the committee, before I bring in Senator Barrett, did your firm have the relevant property experience or are you saying to the committee this morning that property experience wasn't a required prerequisite of the skillset of your audit team?

Mr. John McDonnell: We had the appropriate ... appropriate experience in property-related matters to conduct our audit and to be able to determine the appropriateness of the bank's impairment charges. I can say that.

Chairman: Thank you. Senator Barrett.

Senator Sean D. Barrett: Thank you, Chairman, and welcome to our visitors this morning. Could I start with the PwC document on page 25, if I may, please? It deals with the transfers to NAMA which, from the Bank of Ireland, went at a 43% discount. Was that a surprise to the auditors?

Mr. John McDonnell: No, Senator, it wasn't. That there was a difference between what NAMA paid for the assets and what the ... and the nominal amount of the loans that were issued ... it wasn't.

I'll just make a couple of comments around that, Senator. The first is that there was always going to be a difference between what NAMA paid for the loans and what the banks carry the loans at because they're calculated in two very different ways. Second point I'd make is that the 43% discount is a haircut against the amount that was lent. It is not a haircut against the carrying value in Bank of Ireland because the carrying value in Bank of Ireland would've included impairment provisions. Impairment provisions, as I indicated, are accounted for in accordance with the incurred loss model. And that means that you need, first off, an impairment indicator, so you need to have objective evidence of impairment. When you have objective evidence of impairment, you can book an impairment loss. Secondly, how you book an impairment loss is you take the expected cash flows from the loan, not taking into account future impairment indicators, and you discount them at the interest rate implicit in the loan. What was-----

Senator Sean D. Barrett: Could I refer-----

Mr. John McDonnell: The amount that was sold to NAMA was at effectively fair value, and that's a very different value. And as we know now that, when the loans were sold to NAMA, it was at the effective ... it was at the bottom end of the cycle, so therefore the fair value of those loans was a very different amount to the impaired value of those loans. They're calculated very differently.

And lastly, under IAS 39, the bank were not allowed to account for these loans at fair value, so they couldn't write them down to fair value and they could only book the additional loss when the loans were transferred to NAMA. Bank of Ireland were very aware of that and, in their December 2009 accounts, disclosed that they expected to take quite a substantial additional losses on the loans transferred to NAMA as a result of this calculation difference.

Senator Sean D. Barrett: Thank you. Could I have core document BOI - RBU & LCR at page 14 displayed, please?

Chairman: Is it a Bank of Ireland document now you're talking about here?

Senator Sean D. Barrett: It's a Bank of Ireland document, Chairman, and-----

Chairman: That hasn't been provided with the witness. And I've said this to members already, if they're going to be introducing other questions that are outside the core book ... the core documents we have this morning, they need to be notifying the secretariat and the witnesses beforehand. Okay? Now, the witness may be ... I'll give you a bit of latitude here, Senator. The witness may or may not be familiar with it, but if they're not familiar with it, you're not going to press a question on it, but you can address generally to the theme. Go on.

Senator Sean D. Barrett: Thank you, Chairman. The statement was made by Mr. Laurence Crowley, the governor of the Bank of Ireland, and his successor endorsed it - Richard Burrows - that, on both of their times as governor, "In particular, I do not recall any issues of imprudent lending being brought to a Board by the Executives of the Bank, the internal auditors or the external auditors."

Chairman: On that.

Senator Sean D. Barrett: Does that tally with your own experience? Did you ever have these discussions with governor Burrows or governor Crowley?

Mr. John McDonnell: I personally didn't because I only came on in 2010, but I am conscious of the reporting that we gave to the bank. We would have discussed, as I said earlier, discussed the bank's business strategy only in the context of impairment of loans in the context of our audit work, so I'm not surprised that we wouldn't have had a detailed discussion about the bank's strategy to lending, because the bank's strategy of lending is for the role of management, the role of directors. Our role is bounded by the risk of material misstatement in the financial statements, and we would've had detailed conversations with the audit committee around the impact of their lending on their impairment and the controls over impairment, and that's where the focus of our work was. I can't discuss as to what the audit committee would've said to the court or not.

Senator Sean D. Barrett: There is a statement in the *Financial Times* of 27 February this year by Caroline Binham. In the UK, critics "of the big four accountancy firms will point to the fact that they gave [the] banks a clean bill of health only months before the onset of the worst financial crisis in a generation." It looks like Mr. Burrows and Mr. Crowley were given the same complacency from their auditors.

Chairman: You can't ask that question, okay? That's a leading question. Could you care to comment upon that as a proposition, that the advice that was given to Bank of Ireland would have maybe given a more benign position to what the true health of the situation was?

Mr. John McDonnell: I think, Chairman, you have to look at what our role is. Our role ... and I know I'm repeating myself, but it's really important. Our role is to give an opinion on the financial statements. The financial statements ... the purpose of financial statements is to faithfully represent the past. A set of financial statements ... the bank enter into transactions, those transactions have an impact on the balance sheet, we give an opinion as to whether those transactions have been properly accounted for. It is not our role ... and there's been a lot of debate about this through the crisis and after the crisis. It's accepted that it was not our role at that point in time to give an opinion on the business model of the bank. That's the role of management. And very importantly here, our role as auditors are governed by the independence rules, and the independence rules say that we cannot get involved in management activities. So, we're not ... we can't get involved in the setting of the bank's business strategy. We can't get involved in the determination of whether it's right or wrong. That's for the purpose of management. Even the monitoring of the lending strategy is a management role. We have to be very, very careful that we don't cross that line or we cease to be independent. So thereby we focus in on what we were asked to do, and what we were asked to do under legislation and our letter of engagement with Bank of Ireland was to talk about whether transactions had been properly accounted for in the financial statements and whether impairment on those transactions were properly reflected in the accounting statement.

The impact of business model on future risks and the impact of business model on the future profitability of the bank is something for management, and I think ... that expectation gap I know is there, but that's what we did.

Senator Sean D. Barrett: You were also auditing Northern Rock. Wasn't that correct?

Chairman: Hold on a second, now. We're drifting outside the terms of reference of this morning. Unless you've something germane and that's relevant to this morning's line of inquiry, Senator, I just have to ask you to move on.

Senator Sean D. Barrett: Would the collapse of Northern Rock in 2007, including an Irish branch it had here in Dublin ... would that have been the topic of discussion between you and Mr. Burrows and Mr. Crowley?

Mr. John McDonnell: I can't answer that because I wasn't there. I can say, as a firm, we would've discussed the collapse of Northern Rock. It was in the public domain. People were talking about it. People were talking about why it happened, but I just ... I don't know.

Senator Sean D. Barrett: But PwC weren't just people. They were the auditors of Northern Rock.

Chairman: Sorry, sorry. Senator, I'm going to have to ask you to kind of ... you're moving into a leading line of questioning, now, this morning. So, if you can ask questions rather than just make a series of statements, or else I'll have to move on because we've a particular line of questioning we do have to pursue this morning and I don't want to be taking up members' time by taking the questions myself, so I would ask them to-----

Senator Sean D. Barrett: Thanks.

Chairman: -----concentrate now on the programme of work that we have ahead of us.

Senator Sean D. Barrett: Thank you, Chairman. The core document pages 59 and 60. No. That states on page 60, "No circumstances have come to our attention, in our capacities described in the schedule attached to this letter, that give rise to a statutory duty on us to report to you under section [s.]47 of the Central Bank Act, 1989." And that document is dated 18 June 2008. Now, under section 47 of the Central Bank Act, if I might quote it:

> If the auditor of [the] holder of a licence [that's the bank]--
>
> (*a*) has reason to believe that there exist circumstances which are likely to affect materially the holder's ability to fulfil his obligations to persons maintaining deposits with him or meet any of his financial obligations ... or
>
> (*b*) has reason to believe that there are material defects in the financial systems and controls or accounting records of the holder ...
>
> he shall report the matter to the Bank [that's the Central Bank] in writing without delay.

Was that how you found the bank on ... in June 2008, I think, as the Chairman has said earlier, within months of requiring rescue ... that there was nothing to report under section 47 of the Central Bank Act ... that you found in the audit?

Mr. John McDonnell: Senator, under our obligations under law ... we have an obligation to report certain matters to the Financial Regulator. We do not have the right to report any other matters to the Financial Regulator. We just have an obligation to report some things ... certain matters. And that obligation arises solely out of our work as auditors. So it's only if something comes to our attention as ... when we are completing our work as auditors and, as I explained, our work on auditors looking at risks of material misstatement in the financial statements. Our audit approach is not about considering the bank's business model. And nothing arose from our audit that gave us an obligation to report to the regulator. We are required to, when nothing comes from our work that gives us an obligation to report to the regulator ... to give a negative ... a ... a ... statement that nothing has come to our attention and that is what we included in our annual report to our Financial Regulator at that point in time. And we would have also included with that annual report, a copy of our audit findings document for that point in time. And that audit findings document would have when into ... into detail about our identification of significant risks, our commentary on those significant risks and our commentary on the audit procedures we adopted to conclude our opinion on financial statements.

Senator Sean D. Barrett: And is it a matter of any regret at this stage that you didn't send a report to the Central Bank under that section 47? Or do you still think that the deposits were entirely safe in June 2008?

Mr. John McDonnell: No-----

Chairman: Just ask the ... Mr. McDonnell for his opinion. Whether it's a matter of regret or not, Mr. opinion ... or Mr. McDonnell will inform us.

Mr. John McDonnell: Pardon, Chairman?

Chairman: I'm encouraging the Senator just to ask the question. Whether it is a matter of regret or not is something that you ... you can disclose, Mr. McDonnell.

Mr. John McDonnell: I stand ... we, as a firm stand, over our report to the Central Bank. It was an appropriate report to the Central Bank under the terms of our requirements under ... under the ... section 47 of the Central Bank Act. And it was an appropriate report to the Central Bank under that and PN 19. And it ... it was appropriate.

Senator Sean D. Barrett: Would describing the bank at that stage ... and having the dialogue with the regulator, have improved our understanding of what was going on in Irish banking at that time?

Mr. John McDonnell: We always welcome engagement with the regulator but, as I said, we hadn't ... we did not have the right to raise matters with the regulator. We would have met with the regulator where the regulator asked us to meet ... to meet ... asked to meet with us. We had interaction with the staff of the regulator but we did not meet the regulator himself over that period. I don't believe the staff of the regulator sought to meet with us in the context of our audit of Bank of Ireland.

Subsequent to the financial crisis there is a ... now an auditor protocol and we would meet with the regulator on a very ... a very regular basis - at the start of our audit, during the ... during the execution of our audit and at the end of our audit. And we welcome that engagement with the regulator and it's working very well. And also, the regulator has now started to ask us to ... to do specific work for them current ... around GL44 and that work allows the regulator to direct us to do certain work which might be of benefit to their role. The one thing I would say is the regulator is a very different role to the audit firms'. The regulator's role is about the safety and soundness of the banks, whereas a set of financial statements is around whether the financial statements give a true and fair view of past transactions and events. As I said in my opening remarks ... you know ... financial ... a set of financial statements are not about stability, they're not about capital adequacy and they're ... they're the primary concerns of the regulator. So they ... we've different objectives. But I do think it's good that we have engagement.

Senator Sean D. Barrett: Yes, but could you expand on that engagement which we have now? Because the committee has to look at what we do going forward. So we'd be most interested-----

Mr. John McDonnell: Under the-----

Senator Sean D. Barrett: Do you meet? How frequently and what do you discuss?

Mr. John McDonnell: Under the auditor protocol the auditors have engagement with the Central Bank and in the context of Bank of Ireland, that's all I can talk ... what .... what would happen is at the start of our ... our audit, the Central Bank would ask us to come in and for us to bring them through our audit plan ... which we would present to the audit committee. And I would go through that plan in detail with the Central Bank. I would bring them through what we consider to be the significant audit risks, why we consider them to be the significant ... significant audit risks and the type of testing we plan to undertake.

Secondly, we would bring them through our ... our assessment of materiality. And lastly, we would bring them through the ... our timetable and our ... our expected communications with management and the audit committee. We would discuss that in a degree of detail and we'd take comment from the regulator. Secondly, then, probably it could be early December, early January, we would have a meeting with the regulator where they ... that ... where we would bring them through where we are in the context of our work and anything that has arisen from that. And lastly, then we would have a meeting with the regulator after we had concluded our work and that might ... would probably be after we signed the financial statements ... whereby we would discuss with the regulator the final ... the final outcome of our work. But as I ... as I would point out, the regulator would ... would also get access to our audit plan documents and our audit findings documents.

Senator Sean D. Barrett: Chairman, could I ask for BOI B1 to be displayed please?

Chairman: Bank of Ireland booklet ... you'd have to give notification prior to the ... if it's just a statement from it you want to use Senator Barrett, I can allow you to read it out and maybe ask Mr. Murphy or Mr. McDonnell to comment upon it.

Senator Sean D. Barrett: Thank you, Chairman. I'm just wondering - and thank you very much, Mr. McDonnell - if these are the kinds of discussed ... it's from a Bank of Ireland document at that ... "ANALYSIS OF THE REASONS WHY THE INSTITUTION RAN INTO DIFFICULTY", and it lists the following items at the end of page 17:

> [The B of I] issues ... revolved around the:-
>
> - the absolute quantum of property lending ...
>
> - ... greater dependence on-----

Chairman: Senator, I'm going to have to .... you need to reference the document in full for me. But I would advise members very, very strongly that if they are going to be introducing documents that are not on the core listing for this that there is plenty of notification to be given to witnesses in advance because the full context of what is actually being delivered is not being given to the witness. So, can you just reference the document for me in case I have to go and find this and produce this to the witness?

Senator Sean D. Barrett: It ... it lists issues that are felt to be important in discussing the Bank of Ireland in relation to its rescue - property lending, wholesale markets for funding, greater reliance on securitisation and going into some businesses that they weren't equipped to ... were ... are property lending and wholesale funding ... are they part of the discussions you have with the regulator under the new dispensation?

Mr. John McDonnell: The discussions we have with the regulator would be on our approach to the audit of impairment and we would articulate where we would see risks ... where we would see risk in the context of our audit of impairment and how we plan to execute our work to address those risks. Again, I have to say that our audit work is purely around the risk of material misstatement. It's not around the business model. So that's what we discuss. We discuss our approach of the audit of Bank of Ireland.

Senator Sean D. Barrett: But would risk include the risk of excessive concentration of lending into the property sector, for example?

Mr. John McDonnell: The risk would take into account the impact of what the bank has done on its loan book, its loan stock, and its loan provisions. And we would consider that in the context of how the bank goes about determining its provisioning and in the context of the audit procedures we need to adopt to audit that provisioning. That's where it begins and ends. We're concentrated on what has happened in the past, we're concentrated on how that is reflected in the financial statements and we're concentrated on the risk that it may not be properly reflected in the financial statements. And that's what we do. It is ... you know, business model, sustainability, capital adequacy - all that is a matter for management and a matter for the regulator in the context of their work on safety and soundness. Our work is to give an audit opinion in accordance with the rules on which we are guided by.

Senator Sean D. Barrett: Does risk include reliance unduly on wholesale funding rather than deposits?

Chairman: Okay ... if that's when your ... we're moving in now to an operational matter ... for the bank as opposed to what are actually operational procedures and auditing measures for the firm that's actually before us. Mr. McDonnell is already on record as saying that he ... clearing ... making a clear distinction between what are bank operations and what are auditing operations. So, Senator, I'll have to push you back into that space or else I'll just take the questions myself.

Senator Sean D. Barrett: Thank you Chairman. The signing of the documents by the names PricewaterhouseCoopers, is that anachronism these days? We have had people saying that, perhaps, the individual partners and auditors should be the people responsible. I suppose we don't sign ourselves as Seanad Éireann or Dáil Éireann or Trinity College Dublin. I mean, are we moving towards an area where auditors will be expected to take responsibility for the work that they conduct rather than the corporation?

Mr. Ronan Murphy: Maybe, Senator, I might just answer that. The historical background is that as partners in the firm you're signing the firm's name so you are committing the firm, so therefore, it is being signed on behalf of all of the partners in the firm. The practice nowadays is that partners do sign in their own name but John can give you more details in terms of when that came into play but it is ... it has been always the practice in the past that you are committing the firm and the firm is standing behind the opinion.

Mr. John McDonnell: Yes, and Ronan is correct. I think that from 2013 you now sign in your name so that the market now knows the partner personally who signed the opinion but it is also for and on behalf of PricewaterhouseCoopers, so when I sign a set of accounts for Bank of Ireland I'm signing on behalf of myself and I'm signing on behalf of the firm. And I would take that ... I'd take the signing of that opinion very very seriously because it has significant impact on the firm and it also has significant impact on me personally.

Senator Sean D. Barrett: Should there be a disciplinary action against individual auditors?

Chairman: On the basis of what, Senator?

Senator Sean D. Barrett: On the basis that they are taking more responsibility rather than signing in as PricewaterhouseCoopers, for example.

Mr. John McDonnell: I don't think there's any distinction between signing as PricewaterhouseCoopers or signing as John McDonnell on behalf of PricewaterhouseCoopers, Senator, because as I explained when I sign an opinion or when a partner signs an opinion it binds the firm. It is the firm's opinion signed by a partner acting on behalf of the firm but that partner is the partner who has done the work and that partner takes that role very very seriously.

Mr. Ronan Murphy: And we are subject, Senator, to the investigation and disciplinary procedures of the Chartered Accountants Regulatory Body and that has not changed given the change in protocols regarding the signing of opinion. So, we are still subject to those very intense regulatory and investigative procedures.

Senator Sean D. Barrett: Is the regulation of accountants less strict in Ireland than in the United Kingdom or the United States, where fines have certainly been substantially larger in both jurisdictions?

Mr. Ronan Murphy: I don't believe so, Senator. As I say, we are subject to CARB, which is the short name for the Chartered Accountants Regulatory Body. They are subject to oversight by IAASA, so we have a very proactive regulatory regime, which would be similar to the situation in the UK and the US.

Senator Sean D. Barrett: And has that proactive regime been-----

Chairman: Final question Senator.

Senator Sean D. Barrett: Yes. Has it reacted appropriately to what is a bigger bank collapse in Ireland than in the other two countries?

Mr. Ronan Murphy: Senator, it's hard ... I mean, has it reacted appropriately? It has reacted to circumstances, not only in terms of the financial crisis but also previous circumstances. It is a very proactive regulatory regime that we operate under.

Chairman: Okay. Thank you very much. I want to turn to one matter there, please, before I bring in Deputy O'Donnell and that's in regard to the NAMA-acquired loan portfolios from Bank of Ireland. This is in the core document, page 25 - annual report and financial statement. So, in there when NAMA acquired the loan portfolios from Bank of Ireland, NAMA imposed a haircut of over 43% on the nominal loan on the value of assets at that particular time and Senator Barrett touched upon this with you. Can I maybe just ask, were you satisfied with the valuation methodology used by Bank of Ireland assessing the value of Bank of Ireland's land and development loan book and the potential impact upon the subsequent provisioning?

Mr. John McDonnell: Sorry, Chairman, just so I understand ... the valuation in the context of what NAMA paid or in the-----

Chairman: Yes, the 43% haircut.

Mr. John McDonnell: What NAMA paid, Chairman-----

Chairman: I'll take you to the acquired loans asset document that's in front of you there.

Mr. John McDonnell: I can see ... yes.

Chairman: If you look at it ... on table 3 on the right-hand top corner of it, there is the Bank of Ireland loan balance transferred, a €9.9, I presume these are billions, consideration paid €5.6 billion, discount 43%.

Mr. John McDonnell: Yes, okay. So, is it the calculation of the €5.6-----

Chairman: I'm asking you were you satisfied with the valuation methodology used by Bank of Ireland in assessing the value of their land and development loan book before it went into the haircut?

Mr. John McDonnell: First off, the amount that NAMA paid was a matter that was driven by the legislation which brought in NAMA. The bank had no ability to impact that at all. NAMA just paid them what they paid them. That amount was a close to a fair value-type calculation. The nominal value is before provisions so that's not the carrying value at Bank of Ireland at the time that it was transferred, it's the amount that was actually lent and Bank of Ireland would have determined the carrying value of that, taking into account that loan balance and appropriate impairment provision, calculated in accordance with the incurred loss approach. And, as I said, Chairman, as part of our audit work, we would have focused very heavily in on the audit of impairment and we were satisfied to give a clean audit opinion at that point in time. So, we had no issue in terms of the calculation of the carrying amount of the loans at the balance sheet date prior to when they were sold to NAMA and, as I said, the bank couldn't influence the amount that NAMA paid because that was set by legislation. They're two very different calculations. They will always be different.

Chairman: But, can you provide any explanation to the committee this morning as to why the NAMA high cut, rather than NAMA haircut, was so high, Mr. McDonnell?

Mr. John McDonnell: Yes, because the NAMA haircut was a close to a current fair value for the loan and given the very depressed state of property prices, fair values were always going to be lower than in an incurred loss value. And, as I said earlier on, Chairman, the bank had no ability to fair-value its loans in its financial statements. It was required to account for them at amortised cost, which is basically what you lent less your incurred loss impairment. The two numbers are calculated differently and because we were at, as we now know, the bottom of the cycle, fair value was always going to be below the amortised cost amounts, so it was always going to be different. And, as I said, Bank of Ireland were critically aware of that and that's why they disclosed in the financial statements 31 December 2009 that they were going to make substantial losses on the disposal of loans to NAMA and they also would have, I believe, explained why those losses could not be recorded in accounting standards until the loans actually transferred to NAMA.

Chairman: Okay, so can I just check for the record so Mr. McDonnell, were PwC aware of the fair value of these loans when signing off on the account?

Mr. John McDonnell: We would not have audited the fair value of those loans because the bank were not allowed ... the bank had accounted for these as loans in receivables, they were not allowed to fair-value them. That's the first point. Secondly, when we audited the 2010 accounts we would have had to audit the gain or loss on the disposal to NAMA and as part of that audit procedures, we would have looked at the amount of which NAMA paid the bank for the transfer. But, as I said, NAMA dictated that. The bank did not have any real influence in determining what that price was. It was set by legislation. So, in this instance NAMA would say we're paying €5.6 billion for the loans and that's what NAMA paid and we would have ensured that that's what NAMA paid. We wouldn't have audited the NAMA calculation because there was no ... we didn't have the basis first off for the NAMA calculation, that was what NAMA did and, secondly, it wasn't particularly relevant because NAMA was going to pay what NAMA was going to pay and they paid €5.6 billion. And, we would have ensured they paid €5.6 billion.

Chairman: So, what was the difference between the fair value and the IAS 39 valuation when it all panned out?

Mr. John McDonnell: I don't have the numbers ... I don't have the numbers, Chairman, but it was-----

Chairman: Was there a difference?

Mr. John McDonnell: Oh, yes there was ... it would've been disclosed in the accounts. I can give you the December '10 number if that's of help.

Chairman: Yes.

Mr. John McDonnell: It wouldn't be the total amount. I think it was ... I think the bank would have booked a loss on the disposal to NAMA of about €2.2 billion but I just need to check it ... yes, loss on sale of assets to NAMA and associated costs, €2.2.

Chairman: €2.2. Thank you very much. Deputy Kieran O'Donnell.

Deputy Kieran O'Donnell: Thanks, Chairman. Mr. McDonnell, for a layman, we have a lot of technical terms here ... how would you define true and fair ... "true and fair view"?

Mr. John McDonnell: That the accounts had been properly prepared in accordance with the appropriate accounting framework, which is IFRS.

Deputy Kieran O'Donnell: What about reflecting the actual financial position of the state of the bank at that particular moment in time?

Mr. John McDonnell: The purpose of the set of financial statements is to faithfully represent the past transactions and events ... the accounting standards are brought in to direct management as to how to do ... how to measure their assets and liabilities in the context of reflecting past transactions and events. And, where a financial statement ... sorry, where an accounting standard is prescriptive in how one must measure and recognise an asset or liability and it is specifically directed at the measurement or recognition of an asset or liability, you must apply that accounting standard to that measurement and recognition, otherwise the accounts will not give a true and fair view. Once an accounting standard says this is what you do, you have to follow that otherwise you could not say the accounts give a true and fair view. That's the way it works. The accounting standards come in, they set the rules and they set the boundary, if you like, on true and fair.

Deputy Kieran O'Donnell: The 2000 ... year ... the year end for Bank of Ireland is 31 March every year ... was back then. So the year 31 March 2007 and the year 31 March 2008, you would've audited the company's accounts and you gave technically ... which was an unqualified audit opinion ... an independent audit opinion. In layman's terms ... someone reading the accounts, you did not criticise the accounts in any way. So the question, I suppose, I want to ask is in light of the fact ... you signed your audit report for 31 March '08 accounts on 20 May '08 and within literally four months of that date a bank guarantee had to be brought in to effectively secure the deposits and liabilities of Bank of Ireland, which was from the taxpayer. And within a short period of time of that again, within another what ... four months, the taxpayer had put €3.5 billion of their money into Bank of Ireland. Now looking at that in hindsight, did the accounts show a true and fair view or not?

Mr. John McDonnell: Yes, the accounts did throw ... show a true and fair view. As I said-----

Deputy Kieran O'Donnell: Why?

Mr. John McDonnell: -----financial statements are a point in time representation of the assets and liabilities in accordance with accounting standards.

Deputy Kieran O'Donnell: But, Mr. McDonnell, you have said here that there was a liquidity crisis from late 2007 onwards. You had discussions with the regulator amongst the four big firms in Ireland, including PricewaterhouseCoopers, on 10 January 2008, around the whole area about how you'd value securities. That was once again around liquidity. So the question I'm asking here is, to the layman looking in, how did you not in any way criticise the accounts? You wrote to the regulator on ... document Vol. 1 PwC, Chairman, page 59 and 63 ... and you were required to report to the Financial Regulator ... and once again you drew reference to nothing to do with liquidity, not one mention of solvency-----

Chairman: You have to give time to respond because otherwise you'll run out of time for your questions.

Deputy Kieran O'Donnell: The question I am asking once again, Mr. McDonnell, to the ordinary person looking in ... how could you give a report that was in no way critical of '07 or '08 accounts in respect of Bank of Ireland?

Chairman: The question's made. Mr. McDonnell and Mr. Murphy, whichever.

Mr. John McDonnell: As I said in my opening remarks, financial statements are about giving a faithful representation of past transactions and events. No, that's important-----

Deputy Kieran O'Donnell: I know that-----

Chairman: Sorry, Deputy, now I will have to interject. If you are going to take a couple of minutes asking a question, you at least have to accommodate the same amount of time for a response. Mr. McDonnell, please, without interruption now.

Mr. John McDonnell: -----and the auditor's job is to give an opinion as to whether those accounts give a true and fair view in accordance with the requirements of accounting standards. That's what we did. We did that work very thoroughly, very robustly and we stand over our opinion. As I said in my opening remarks, there is no ... avenue in either the wording ... the prescribed wording of an audit opinion, or indeed in the accounting and regulatory framework which sets out what goes into a set of financial statements to allow an auditor to give a subjective view on an entity's business model. That is not what we were asked to do, it is not ... there is no ... we are not allowed to-----

Deputy Kieran O'Donnell: Yes, but Mr.-----

Chairman: Deputy, I'll bring you back in when Mr. McDonnell is finished, yes?

Deputy Kieran O'Donnell: Chairman-----

Chairman: No, and keep your questions short, Deputy, if you want plenty of time. Mr. McDonnell.

Mr. John McDonnell: From an independence perspective, we have to be very careful that we don't get into the role of what management do. What we were asked to do was say whether the accounts gave a true and fair view at that point in time. We conducted our work appropriately, we conducted our work with the proper due diligence and we were satisfied that our opinions were appropriate.

Deputy Kieran O'Donnell: But the question I have, Mr. McDonnell, is based on the fact that €3.5 billion of taxpayers' money went in to Bank of Ireland within a relatively short few months, in hindsight now do you believe the accounts showed a true and fair view at 31 March

'08?

Mr. John McDonnell: Yes I do.

Deputy Kieran O'Donnell: Okay. Can I move on from that? In terms of your analysis of risk, the issue in terms of auditing is materiality. So how do you define "materiality" Mr. McDonnell?

Mr. John McDonnell: Materiality is both a qualitative and quantitative aspect, we would look at a number of things when we're talking about it. Quantitatively, we'd look at key drivers in the financial statements. They would be the net banking revenue line, we'd look at PBT, etc., and maybe to cut-----

Deputy Kieran O'Donnell: Mr. McDonnell, in the limited time I have, what-----

Mr. John McDonnell: Okay. Our materiality would-----

Deputy Kieran O'Donnell: -----what would be the percentage of materiality based on ... give a benchmark, what ... did you change-----

Chairman: Question today, Deputy, so please don't be using up your time.

Mr. John McDonnell: Our materiality over that period would have been in and around ... in and around maybe €70 million to €50 million, depending.

Deputy Kieran O'Donnell: €70 million to €50 million?

Mr. John McDonnell: Depending.

Deputy Kieran O'Donnell: On a particular item?

Mr. John McDonnell: Yes, depending on a number of items and our-----

Deputy Kieran O'Donnell: Did you adjust that materiality when the crisis hit in '07 and '08, to take account of risk?

Chairman: Question is made.

Mr. John McDonnell: We would set our materiality the same way taking into account the likely ... taking into account the result ... the expected results of a bank.

Deputy Kieran O'Donnell: Did you change your materiality when the risk period came?

Mr. John McDonnell: We did not change our approach to materiality.

Deputy Kieran O'Donnell: At all?

Mr. John McDonnell: No, but-----

Deputy Kieran O'Donnell: Why not, considering the risks?

Chairman: The question was made, a bit of time to respond.

Mr. John McDonnell: Materiality is looking at the disclosed performance in a set of financial statements so if a bank loses, let's say ... a large number of ... let's say a bank loses €10 billion, let's say they do - your materiality is prescribed around that number. So it's not driven by ... necessarily by the risk, it's driven by the performance in the financial statements and the numbers in the financial statements.

Deputy Kieran O'Donnell: Can I move on to the item? The level of audit fees that you would have earned from the audit, Mr. McDonnell ... was the ... in 2008 you got €4.9 million and overall you got €10.8 million from Bank of Ireland. Was that your highest audit fee?

Mr. Ronan Murphy: Senator ... or Deputy, I don't recognise that figure. Could you just quote it again please?

Chairman: Where is it coming from please?

Deputy Kieran O'Donnell: In 2008 PwC received €10.8 million-----

Chairman: Deputy, if you are referencing it you can just give the inquiry ... inform the inquiry-----

Deputy Kieran O'Donnell: It's the external auditors' fees by institution 2004 to 2010.

Chairman: Okay. What's the reference?

Deputy Kieran O'Donnell: We were provided with it by ... it's a sheet given to us by the secretariat, Chairman.

Chairman: Okay.

Deputy Kieran O'Donnell: So the question really I have is twofold. Number one - in 2008 the €10.8 million, which was the total fee - €4.9 million for the audit and €5.9 for the non-audit - was that your highest single fee? And, secondly, from a ten-year period up to 2009 it's reported that, between audit and non-audit income, you got over €100 million for Bank of Ireland and about ... you could take it that €56 million of that was non-audit and about €50 million of it was audit. Did that in any way conflict you ... to have that level of fees coming in from one single client?

Chairman: Or not.

Deputy Kieran O'Donnell: Or not.

Chairman: Please, Deputy. I'll be calling members in when we go to recess to actually have a private meeting with you when we go to a break at the recess please.

Deputy Kieran O'Donnell: Or not.

Mr. Ronan Murphy: Chairman, can I answer that question just in relation to the fees and ... the schedule which we have here is extracted from the statutory accounts-----

Deputy Kieran O'Donnell: Yes.

Mr. Ronan Murphy: -----and the period you are talking about Deputy is the year to 31 March 2008.

Deputy Kieran O'Donnell: Correct.

Mr. Ronan Murphy: Fees in that year were €9 million, of which €8.1 million were audit and audit related and €900,000 were non-audit fees. So in relation to your question regarding independence, the non-audit fees were just about 10% of the total fees. So, therefore, it would be wrong to say there was any potential impairment of our independence given that small percentage.

Deputy Kieran O'Donnell: How does this relate to being-----

Chairman: Final question, Deputy.

Deputy Kieran O'Donnell: ---being the ... was it your largest fee, combined?

Mr. Ronan Murphy: In that year it was certainly one of our three largest fees. I can't be certain whether it was the largest fee in that year. Some years the Bank of Ireland fees were the largest but throughout that period it was one of our three largest fees.

Deputy Kieran O'Donnell: How did you ensure that couldn't be-----

Chairman: Sorry, the question's made and I'm moving on.

Deputy Kieran O'Donnell: Final question, Chairman, just one final question. How did you ensure that there wasn't conflict of interest where you had one client, Bank of Ireland, having ... commanding such a large level of fee?

Mr. Ronan Murphy: Well, I think, when you look at that figure of €9 million in terms of total fees ... the fees for Ireland in that year were €6.7 million. Chairman, our revenue is not in the public domain ... sorry, it is now because of the requirement on transparency reports, but I will disclose that our revenue in that year, the total firm fees was €231 million. So the quantum of fees that we received from Bank of Ireland was less than 3% of our total fee income. There's a requirement under the Auditing Practices Board ethical standards that no client should pay you more than 10%. We were well short of that in terms of the quantum of fees.

Chairman: Okay, thank you very much. I'm now proposing that we take a break. We'll return at 11.30 a.m. but I would ask the committee just to remain in the committee room for a couple of moments before we suspend. During the suspension, I'd like to remind the witnesses ... remind them that once they begin giving evidence to the committee, they should not confer with any other person other than their legal team in relation to their evidence or matters that're been discussed before the committee. With that in mind, I now suspend the meeting until 11.30 a.m. and remind the witnesses that they are still under oath until we resume.

Sitting suspended at 11.11 a.m. and resumed at 11.43 a.m.

Chairman: I am going returning to public session, is that agreed? And just to thank Mr. McDonnell and Mr. Murphy for joining us again this morning, and, in doing so, I invite Deputy Joe Higgins. Deputy, you've ten minutes.

Deputy Joe Higgins: Yes ... Mr. McDonnell, you've said that the audit process goes on over the year and you said about 200 employees would be involved in the Bank of Ireland audit, but just very, very briefly, for people out there and ourselves, could you just physically tell us how is the audit done? Like, does a small army of 200 leave Spencer Dock, march to the headquarters, or do they fan out around the country, or how does it work? How do you get the information and so on?

Mr. John McDonnell: We start off, Deputy, at the start we design our audit plan, and, as part of that audit plan, we determine what we would consider to be the significant risks of material misstatement, and then we also would look at the other risks of material misstatement. Then we would design the tests that we need to apply to get appropriate audit evidence for each of those. We have a detailed audit methodology designed by the firm and we would apply that. We would sit down at the start and have a mobilisation meeting with our team, bring our team through where we want them to focus and what we want them to do, and, as I said earlier on, Deputy, we would have a retail team for the retail audit, we'd have an insurance team for the insurance audit, a treasury team for the treasury audit, a UK banking team for the UK banking audit. I would issue instructions to all of the teams. We would then mobilise the teams and the teams would then set about testing the various transactions in line with the instructions issued by the audit partner and in line with our audit methodology. We apply a consistent approach across the patch so that-----

Deputy Joe Higgins: Yes, but how do they do that? Do they go into all the branches or to the headquarters, or-----

Mr. John McDonnell: They would go into the ... they would go into various headquarters of the group, so various buildings, the insurance building, the treasury building, the head office building, etc.

Deputy Joe Higgins: And Bank of Ireland will have compiled what happens in a range of branches-----

Mr. John McDonnell: Bank of Ireland would have detailed systems and controls over all the processes and transactions which arise in the various branches and arise in the various operations.

Deputy Joe Higgins: And then they have access, what, to computers, to information networks or to paper, or-----

Mr. John McDonnell: Our teams would have access to the Bank of Ireland systems, their computers, their controls, their books and documents, and we would also have our own computer processes that we bring with us to allow us to audit, so we'd audit both physically and we'd also audit by computer, computer auditing.

Deputy Joe Higgins: Okay. Now Bank of Ireland was organised along divisional lines and different divisions had separate management information systems. And there was issues arising with difficult-to-manage credit and risk groupwide ... in the Oliver Wyman report, 20 May 2015, it says, summarises, that in relation to information available to the board on the credit risk, and I quote "Incomplete heterogeneous'-----

Chairman: Page 9 and 10, Joe, is it? Page 9 and 10?

Deputy Joe Higgins: Page 10, yes - "incomplete, heterogeneous and difficult to collate". Now, were you satisfied that you had full access to the, and accurate information to discern the full financial position of Bank of Ireland, considering these issues?

Mr. John McDonnell: Yes, we were satisfied that we had access to the bank's systems and their operations and the books and records to allow us to formulate our opinion. Two things I would say, in the context of their having a load of disparate systems, that's not unusual in the audit of a financial institution, or, indeed, any entity. Any entity would have a lot of different computer systems. The important thing is is that there are controls over how those computer systems talk to each other, and also there are controls over any manual interventions. So while it would be ideal to have one platform, you'll rarely see that platform; so it wasn't unusual that Bank of Ireland would have a disparate set of systems in their divisions, but what was important is they had appropriate controls over how those systems rolled up together. In the context of the Oliver Wyman report, the Oliver Wyman report was around credit governance, whereas, as I said, our role is solely on the focus on material misstatement in the financial statements, so, in that regard, our role was around the audit of impairment, and impairment is a small subset of the overall credit risk methodologies.

Deputy Joe Higgins: And when it comes to risk, what is the legal role of the auditor? For example, as you know there have been issues with concentration in property and construction, and then there has been the concentration around a small number of developers in the case of some banks. Do you have a role in advising on the wisdom of lending, let's say, tens of millions to buy a field just for speculative reasons? Do you have a role in that?

Mr. John McDonnell: No, Deputy, we do not have a role in that. Our ... the beginning and ending of what we look at, in terms of risk, is the risk of material misstatement in the financial statements, that is, that impairment is properly calculated in accordance with accounting standards. We do not have a role in determining the bank's lending strategy, or in the appropriateness of lending strategy, and, as I mentioned earlier on, we have very strict independence rules, which means that we cannot stray into management decisions or management responsibility. So we are actually prohibited from being involved in the decisions of how an entity sets its business model or how it runs its business; that's for management. What our role in ... is, is to report at the end of the year on the transactions which fell out of that business model, that they were properly accounted for. That is where our role ends.

Deputy Joe Higgins: So if PwC representatives came across in a situation where they saw a €50 million loan for a few fields west of Mullingar, and €40 million for a few more fields in west Cork, which is on the basis of value to be realised, on the basis of speculation that the property that will be built on those will go up, etc., etc., the auditor might think, "This really is unwise". Would the auditor, you, tell me, or do you, that has no role in that?

Mr. John McDonnell: We have no role in determining the ... in advising management on the wisdom of their business model or, indeed, of the wisdom of entering into particular lending strategies. What we do do is we select a sample of loans and we, on foot of our audit work on those loans, we would look at the collateral supporting those loans, but only in the context of the determination of impairment.

Deputy Joe Higgins: So you do have a role in examining the security that would be put up to guarantee those loans, is that correct?

Mr. John McDonnell: In terms of when we would select a sample of loans to do our audit work, as part of that sample we would look at the collateral supporting those loans, yes.

Deputy Joe Higgins: Yes, then, I notice Mr. McDonnell, in your PwC half-year review, which is in the documents, page 19, there is grave concern expressed here in relation to that very point, the valuation of loans, of financial instruments. For example, in the middle of page 19, your people say, "In cases where prices are obtained in the market, but these prices are not based on actual trades, consideration needs to be given to the appropriateness of the prices." In the middle or to the latter end of 2007, isn't that raising a very, very serious question? And is there an implication here that there is a fear that there isn't adequate collateral for large loans?

Mr. John McDonnell: This part of this document, and as I would have referred to Senator O'Keeffe, this was the document we issued in response to the impact, the first impact on the liquidity crisis as a result of the subprime in the US. We would have issued this to all of our banking, and, indeed, non-banking, clients. But this paragraph, this is the first page, on page 19, is around financial instruments accounted for fair value and loans and audit account for fair value and it is really around how one values holdings in securitisation vehicles, how one values credit derivatives, because the level of trade in the securitisation market had decreased quite substantially and, therefore, it was difficult. Markets were thin and it was difficult to determine whether a trade in the market was actually a fair price or whether there was no trades in an active market. And that is what this is focusing on. It is not focusing ... page 19 is not focusing on impairment of assets which are not carried at fair value, which are normal loans and advances.

Deputy Joe Higgins: But, in general, did you ever perform a review on the valuations received for assets offered as security?

Mr. John McDonnell: We would have selected a sample of loans. As part of the testing of the sample of loans, we would have looked at the security and we would have looked at the valuations of the banking-----

Deputy Joe Higgins: And was PwC satisfied with the valuation policy in Bank of Ireland?

Mr. John McDonnell: The bank ... the policy for valuation in Bank of Ireland was appropriate policy for the determination of impairment and we would've looked at that. We would've looked at the valuations that Bank of Ireland would've had for its collateral in our sample of loans.

Deputy Joe Higgins: How do you explain then that the bank was left so disastrously exposed in the crash a few months after this document, for example?

Mr. John McDonnell: The bank would have had a strategy to lend in certain sectors and as a result of that strategy, they would've built up exposure in certain centres, certain sectors, and as we moved into the credit crisis, the property values collapsed and as a result of property values collapsing, they would've experienced impairment, which is consistent with what we would've seen in the ... elsewhere in the marketplace and consistent with what we would've seen across the globe. The actual impact of the credit crisis is that stock markets, property markets, all sort of other markets collapse in the prices. And people did not expect such an unprecedented collapse.

Deputy Joe Higgins: Yes, but Mr. McDonnell, the evidence given by NAMA chairman and chief executive here was damning, I would say, by ... in what they wrote in relation to issues of the security and the non-examination of security for very large loans who were left out. You didn't come across this in your audits in Bank of Ireland?

Mr. John McDonnell: Sorry, Chairman, in the context of Bank of Ireland ... I am not sure what-----

Deputy Joe Higgins: No, I didn't say this. They didn't specifically refer to Bank of Ireland. They were speaking in general in relation to the banks whose loans finished up in NAMA.

Mr. John McDonnell: I can't comment for any of the banks that we obviously didn't audit. In terms of Bank of Ireland, Bank of Ireland would've had very detailed procedures around the perfection of the security. We would've looked at those procedures and they would've had very detailed controls around ensuring that they perfected security, and we looked at those controls. And, certainly, when a loan moved into an impaired category, the level of control and the level of scrutiny would've increased quite substantially.

Chairman: Thank you Deputy Higgins. Deputy Doherty.

Deputy Pearse Doherty: Go raibh maith agat, a Chathaoirligh, agus fáilte roimh an bheirt agaibh chuig an coiste fiosrúcháin. Can I ask you by asking you first of all, can you recall any issue which may have warranted a qualified report, which was discussed with the bank but did not feature in the management letter, the final year-end report?

Mr. John McDonnell: No, I am not aware of any such matter.

Deputy Pearse Doherty: So, is it the case or not that for the years PwC audited the bank, no issue arose during the audit that necessitated a qualified report?

Mr. John McDonnell: No, no such issues arose.

Deputy Pearse Doherty: No such issues arose. Mr. Murphy, on page 10 of your opening statement, you referred to the practice note 19(1), and this can be answered by either of you, and you state and I quote: "...there may be circumstances where the auditor concludes that a matter does not give rise to a statutory duty to report but nevertheless feels that in the public interest it should be brought to the attention of the Financial Regulator". To your knowledge, were there any cases where this happened?

Mr. Ronan Murphy: Deputy, in the case of Bank of Ireland, there were no cases.

Deputy Pearse Doherty: There were cases?

Mr. Ronan Murphy: There were no cases.

Deputy Pearse Doherty: There were no cases?

Mr. Ronan Murphy: Correct.

Deputy Pearse Doherty: So, to your knowledge, there were no cases when the auditor came across something on the book of the bank that, while within the rules, was, nevertheless, a cause of concern?

Mr. Ronan Murphy: Deputy, what we're saying here is that in the context of our requirements to report to the regulator, and John covered it in the earlier part of the ... of our evidence, nothing came to our attention under the requirements from the Financial Regulator to report to them on any matters.

Deputy Pearse Doherty: Yes. The question that I am asking is not in relation to what you're required to report, which is in ... again, in your opening statement, you talk about the statutory duty to report, but you go on to say but "nevertheless feels that in the public interest it should be brought to the attention of the Financial Regulator," that it allows an auditor ... and I will read it again: "where the auditor concludes that a matter does not give rise to a statutory duty to report but nevertheless feels that in the public interest it should be brought to the attention of the Financial Regulator". So there was, and correct me if I am wrong, but from your statement, my reading is that there was an ability to report issues that were not statutory and an obligation on you to report, if you felt it was in the public interest?

Mr. Ronan Murphy: Correct.

Deputy Pearse Doherty: Correct. So, again, back to my question, were there any cases where the auditor came across something on the books of the bank that, while within the rules were, nevertheless, a cause of concern for the auditor?

Mr. Ronan Murphy: No.

Deputy Pearse Doherty: No. So ... okay. So during the auditing process of Bank of Ireland, you have never identified any issue that was a cause of concern?

Mr. Ronan Murphy: No, that it was a cause of such public concern that we should bring to the attention of the regulator. That's correct. We haven't.

Deputy Pearse Doherty: Okay. How do you ... where is the tipping point in terms of such a concern that it was of the public interest?

Mr. Ronan Murphy: I mean, Deputy, that's a question of professional judgment. It would be very much a decision reached by the audit partner, being John in the case of the last five years, supported by the quality review partner and our internal processes. So it would not be a decision that we would arrive at lightly.

Deputy Pearse Doherty: Okay.

Mr. John McDonnell: And, you know, our right to report is prescribed in PN 19 and prescribed by law. So while we would be able to report matters, as Ronan said, if we believe they're appropriate under common law, it is only in the context of the output of our audit procedures that that arises too. So it's only in the boundaries of our audit.

Deputy Pearse Doherty: Okay. But it did go beyond the statutory requirement to report certain matters; it allowed you to report additional issues that you observed during the audits.

Mr. Ronan Murphy: Correct, yes.

Deputy Pearse Doherty: Okay. When Brian Goggin, the former group chief executive of Bank of Ireland gave evidence before the committee, he said in relation to commercial property exposure, and I quote him: "€13 billion was in land and development and even again I think you'd need to look behind that, €5.4 billion of that €13 billion was in land bank. I think that is where the real problem was, in land bank." I want to refer you to page 16 of the PwC group audit findings report on 31 March 2008. This page is not in the core booklets, but it has been given to you and the reference number for the screen is PwC 00047-016. There is a brief mention of commercial property and land bank and I am going to quote that. It says: "BB UK [which is Business Banking UK] has exposure to some higher risk areas, such as land bank, commercial property and other less secure types of lending and as a result the risk of latent bad debt is on an upward curve." Can I ask you: did PwC observe a similar exposure with regard to the Irish operation of Bank of Ireland?

Mr. John McDonnell: This is I believe our reporting on the UK operations. We would have looked at impairment on all of the property books and we would've seen and would've reported to the audit committees in various stages. We would have seen the increase in property across Bank of Ireland and we would have also discussed with the audit committee the impact of the growing loan book and the impact of that on their impairment models. We would have also discussed at various stages the impact of the falling of property prices on and, particularly the speed which with, with which, apologies, property prices fell at certain stages and we would've reported that to the audit committee. And the last thing we would have reported to the audit committee was around how incurred loss was reported and how there was a market, how there was a lag between ... in the reporting of incurred loss and expected loss. We would've discussed all of that with the audit committee and with management out of the process of our work.

Deputy Pearse Doherty: Okay. Can you explain to me why, in relation to the audit of the UK division of Bank of Ireland, that you felt it necessary to make that point in terms of commercial property and less secure types of lending and the result of the risk of latent bad debt is on an upward curve but that same type of statement did not find its way into the audit of the Irish division of that bank?

Mr. John McDonnell: I'd need to look at our audit findings report for the Irish division. I'm sure we made comments on property in the Irish division. I can look, I have it here.

Deputy Pearse Doherty: Okay.

Mr. John McDonnell: It might take me a minute to find that.

Deputy Pearse Doherty: Okay. Well. If you want to-----

Mr. John McDonnell: In May 2008, retail, which is Ireland, key concerns centre on residential, developmental, landbank, finance ... distressed activity has resulted in a number of mid-tier developers coming under pressure to service a debt and result in significant increase in provisions within the business lending book. Reduction in activity in the construction sector is also implied on personal lending to those involved in construction and construction-related activities.

Mr. Ronan Murphy: That is page 14 of the report.

Mr. John McDonnell: That is page 14 of the group audit findings report on 12 May 2008. And that retail is the Irish operations.

Deputy Pearse Doherty: Okay, and that covered a range of areas. It didn't specifically identify commercial property as an individual area as ... which was identified in the UK division.

Mr. John McDonnell: Well, it ... yes, but it did mention landbank property.

Deputy Pearse Doherty: Okay. Okay.

Can I ask you in relation to financial reporting, the same report and this is on page 29, section B, the reference on the screen is PWC00047–029. It makes the following observation with regard to:

> The high level of aggregation in the choice of loan types used to disclose credit risk information. Only 3 classes of loan exposure are disclosed being mortgages, personal and commercial. This choice assumes that loans in each class share sufficiently common credit risk characteristics. In particular this could be open to challenge in the single "commercial" class. Management note that their approach is generally consistent with market practice.

So, the managers made the point that this was market practice yet PwC still felt the need to highlight this issue. Why would PwC have seen the aggregation of commercial loans into one class as an issue?

Mr. John McDonnell: This, if my recollection is correct, was around the time IFRS 7 first came out. IFRS 7 was around the disclosure of financial ... of risks of financial instruments. This was particularly directed around the disclosure of credit risk. IFRS 7 said that banks were required to disclose credit risk in the context of what it calls “through the eyes of management” and at that point in time, Bank of Ireland would have looked at their loans in line with these categories. And the thing that was being raised is to whether Bank of Ireland should consider, when they move forward, disclosing a greater breakdown in their loans in advance, if you like. But the bank would’ve come back to us and they would’ve said that they disclosed their ... all their sectorial and geographic disclosures in another disclosure in the IFRS 7 notes, which you will see in the financial statements.

Deputy Pearse Doherty: The Nyberg report on page 6 referred to the auditors as the silent observers. On page 51 of the Nyberg report, he asked a direct question, “why did the banks require State support in 2008 so soon after all of them had received unqualified audit reports from various auditing firms?” Can I ask you, could you answer that question and do you believe that the categorisation or the portrayal of auditors as the silent observers in the Nyberg report is a fair one or an unfair comment?

Mr. John McDonnell: I think Nyberg found that the auditors, and I quote from page 5 of the executive summary, “The auditors clearly fulfilled this narrow function [in accordance with] existing rules and regulations.” As I’ve said, our role ... the role of an audit is very prescribed in accounting standards and in law and we conducted our audits and the auditors conducted their audits in line with those rules and regulations. That is what an audit does. We fulfilled our function appropriately under those rules. And Nyberg agreed with that. They’re the rules that are applied and we have to operate within those rules.

Deputy Pearse Doherty: Okay. Final question is this here. You mention in the opening statement the changes that have taken place and the changes that are about to kick in in 2018. Bearing in mind those changes with all of them in place, including the one that will come in in 2018, if those were applied at the point of your audit of 2008, would the bank have still received the same type of audit? Or, what in your view would have been the difference to the type of audit that you would have provided Bank of Ireland at that time?

Mr. John McDonnell: The bank would have received in substance the exact same type of audit in terms of our methodology. The one thing you cannot say the change in 2018 is the change from moving from an incurred loss model to an expected loss model. So that comparison isn’t relevant. You had to apply an incurred loss model at the periods in which we conducted our audit and we stand and still stand over our opinions.

The last thing I’d say is that in terms of disclosure, in terms of corporate governance and in terms of auditing standards, all the debate after the credit crisis has really come down to two things. Is a better disclosure from management and the directors as to what their role is in the set of financial statements and better disclosure from auditors as to what their role is in the audit of a set of financial statements? Through all of that, nothing has changed the role of the auditor, which is to give an opinion on whether the financial statements have been properly prepared in accordance with the rules of IFRS. And the disclosure has been around getting better communication on the interaction between management and the audit firms.

Chairman: Thank you. Deputy Phelan.

Deputy John Paul Phelan: Thank you Chairman. You caught me a bit by surprise there. I thought there was somebody before me.

Can I ask actually at the start ... Mr. McDonnell ... I think you referenced shareholders in several of your answers and, indeed, in your opening comments. And you said that the responsibility of an auditor is primarily to the shareholders to ensure that the accounts of the company being audited are correct. In light of the fact that in Bank of Ireland, so many of those shareholders have virtually lost everything, do you believe you fulfilled your duty completely to those shareholders in the carrying out of the audit of Bank of Ireland?

Mr. John McDonnell: Yes, we fulfilled our duty completely to those shareholders in the audit of Bank of Ireland because the role of the auditor in Bank of Ireland is to give an opinion on the financial statements. And our opinion stated that those financial statements were properly prepared in accordance with IFRS. That is where our role starts and where our role ends. We don't give investment advice or anything to shareholders. It's just around the historical information. It's not about the business model etc.

Deputy John Paul Phelan: Is it your view or not that shareholders when they make investment decisions tend, or not, to study the audited accounts of the companies that they're thinking of investing in? Or, do you think that audited accounts really should be part of the decision-making process of shareholders before they make an investment?

Mr. John McDonnell: I am not an expert in investment advice but I would assume that shareholders would look at financial statements and people would look at financial statements because they are available in the marketplace. I would assume they are looked at.

Deputy John Paul Phelan: To touch on what my colleague Deputy O'Donnell was asking earlier, how do you reconcile the signing off of the 2007 accounts for Bank of Ireland in May 2008 with the fact that in January-February 2009, €3.5 billion worth of taxpayers' money had to be invested into the bank to rescue it? How do you reconcile the fact that the audited accounts from PwC gave Bank of Ireland a clean bill of health, that it was a true and fair view and that it was a going concern, and the going concern prospect, I suppose, is the one that I am really focusing on, and the fact that eight months later it really wasn't a going concern to the extent, at least, that €3.5 billion at the time, and subsequently somewhat more, had to be invested by the taxpayers of the country, some of whom were shareholders who lost virtually everything, into Bank of Ireland?

Mr. John McDonnell: The financial statements, as I've said, are ... the role of, say, the financial statements is to faithfully represent the past, represent the transactions and the financial statements at that period appropriately represented the transactions which the bank had entered into at that period. In the context of going concern, "going concern" is an accounting concept which is around the measurement basis and at, when we signed those financial statements, it was appropriate for the bank to apply a going concern ... to apply the going concern concept, because it was not in liquidation nor was liquidation expected. And that's the only reason that you do not apply the going concern. There is a misapprehension is that you can have a choice between going concern and non-going concern. Under accounting standards, you must apply the going concern concept unless the company is about to be liquidated and that was not the case. The last point I would make is, when those financial statements were signed, no one had ... no one expected that Lehmans were going to go bust and no one expected a knock-on impact on the liquidity markets and, indeed, then the knock-on impact on the credit market.

Deputy John Paul Phelan: Was ... sorry, five minutes? Yeah, sorry, I don't ... I can't ... Was a post-balance sheet review conducted just prior to the signing off the accounts in May 2008 and did that indicate any of the difficulties that Bank of Ireland was about to enter into?

Mr. John McDonnell: In terms of our audit of that period, we would have taken into account all developments right up to the date on which we signed the financial statements and you will find that the audit committee meeting, I would say but I just can't recall, was probably two or three days before the financial statements were signed and at that meeting there was a very fulsome discussion around the going concern, a very detailed paper produced by management, a very fulsome discussion between ourselves, management, the audit committee around the appropriateness of the going concern concept.

Deputy John Paul Phelan: And didn't ... when you say fulsome discussion, like, what did it throw up or are you at liberty to it?

Mr. John McDonnell: At that ... well, as I've said earlier, earlier on, at that point in time, a number of things were discussed, was the bank's success in raising, in increasing its deposits by 19%, the bank's continued access to the wholesale funding markets albeit that those markets were more short term and albeit that it was more expensive. Thirdly, the fact that the bank had considerable amounts of liquid assets and also the bank had considerable amounts of other assets which it had not repoed in the ECB funding, which we'd also looked at, the fact that the bank had not got involved in using the ECB for funding. So, all in all, there was no indications at that point in time that the bank could not access the retail funding market and there was no discussion around a Lehman-type event because it was not, not expected.

Deputy John Paul Phelan: Can I turn to page 31 of the core document? It's a group audit committee minute from Bank of Ireland and in the minutes, it's at the bottom of page 31, I think it is under the heading "Non Audit Fees", it is noted that approximately, and this is a quote, "approximately €6 [million] has been paid in Statutory Audit fees, including SOx, and €15.2 [million] on Non-Audit work". In the financial statement for the year ending 2009, the amount accounted for under auditors' remuneration comes in at €8.2 million. Can you reconcile the €8.4 million figure stated in the financial statement against the €21 million as per the minutes of the group audit committee?

Mr. Ronan Murphy: I'd get onto that, if I may. The fees for the period we are talking about here, which is 31 March 2009, as disclosed in the statutory accounts, are €8.4 million. That is the correct figure. The figure that is included here includes a number of fees that were not directly related to our audit of Bank of Ireland and there were two major elements there and I'll just take a moment to explain it if I may.

In situations where the bank is a participant in bank syndicates, there is sometimes a requirement, if the loan is impaired or if there is issues around the loan, to carry out independent business reviews. That is a decision for the syndicate. It is not a decision for the Bank of Ireland. It is a decision for the syndicate or it may well be a decision for the directors. Approximately €7.2 million of that €15.2 million was in respect of these independent business reviews. They were not contingent, they were not part of our audit fees and they were not ... it was not dependent on us being auditors to Bank of Ireland. They are entirely independent and separate.

There is a second element of it, Deputy, which is €4.4 million of fees, where the Bank of Ireland acted as asset manager for some very big international funds. Examples would be Guggenheim; BIAM. Those fees were paid by those funds to PwC but they were not dependent on a relationship with the Bank of Ireland. The decision to appoint PwC was a decision for the boards and the trustees of those funds. So, the vast majority of that €15.2 million is not ... is totally unrelated to our role as Bank of Ireland auditors. The correct fee for non-audit fees is as disclosed in the accounts, which is €700,000, which is €400,000 for tax fees in Ireland and €300,000 for tax fees in ... outside of Ireland, which was mainly in the UK.

Deputy John Paul Phelan: Okay, okay. I want to turn briefly before I finish to ... Chair ... to the issue-----

Chairman: This is coming to the final question now, Senator, or Deputy.

Deputy John Paul Phelan: ----- yes, of necessary professional scepticism from the Nyberg report, which I am sure you are familiar with. It has been quoted several times at hearings to other auditors and other witnesses. Mr. Nyberg, at paragraph 3.6.2, stated, "Commission would have expected a bank auditor exercising necessary professional scepticism to have concerns where they were growing property and funding exposures combined with material governance failings." Do you accept, gentlemen, the findings of the Nyberg report in relation to PwC's auditing of Bank of Ireland?

Mr. John McDonnell: The first thing I will say in response to your question is that we showed appropriate and detailed professional scepticism. We carried out a very robust audit of Bank of Ireland and we gave an appropriate opinion and we still stand over those opinions and I would say, as I said earlier on, Nyberg's clearly said the auditors clearly fulfilled this narrow function in accordance with the existing rules and regulations. We're a set of ... we're an audit firm. There are a set of rules. Those rules dictate what we do. We applied by those rules in giving, in giving, the opinion.

Deputy John Paul Phelan: In your view, what was he ... what was he expressing when he said that, you know, he would have expected a bank auditor exercising necessary professional scepticism to have concerns where they were growing property and funding exposure? I mean, is that not a direct statement about all auditors of all Irish banks, including PwC of Bank of Ireland?

Mr. John McDonnell: I can ... I can read it. I didn't have a detailed conversation with Nyberg. I could assume what was in his mind when he read it but I can only really comment in the context of the work we did at Bank of Ireland and I can assure you we took our role very, very seriously. We did a very robust audit and we applied appropriate scepticism and we came to an opinion in accordance with the rules which we stand over. That's all I can say to that, Deputy.

Deputy John Paul Phelan: Very good.

Chairman: Deputy Eoghan Murphy. Deputy, you have ten minutes.

Deputy Eoghan Murphy: Thank you, Chairman, and thank you to both the witnesses. The reference for my question, Chairman, is at pages 37 to 40 in the core booklet. But before I come to that I just wanted to go back, Mr. McDonnell, to something you were speaking about earlier in relation to PwC and the dedicated banking unit that you have. Was this unique amongst audit firms at the time?

Mr. John McDonnell: I believe we were the only firm in Ireland that had a dedicated banking practice. That's my belief.

Deputy Eoghan Murphy: Is that still the case?

Mr. John McDonnell: That would be my belief, yes.

Deputy Eoghan Murphy: Okay. And within that unit you had, you said, the specialist banking, retail banking, treasury teams. But did you ever consider a specialist property lending team?

Mr. John McDonnell: We would have had specialist credit teams and those specialist credit teams in, if you like, if you take our corporate team, for want of a better word, we would have had specialist credits ... credit specialists, who would be used to auditing corporate credits, and we would have had retail credit experience in our retail teams.

Deputy Eoghan Murphy: But no one with a particular focus on, say, property?

Mr. John McDonnell: Property would have been a component of those----

Deputy Eoghan Murphy: Component.

Mr. John McDonnell: ----- and they would have had a specialism, they would have had an expertise in the audit of credit arising from the types of exposures that fall in those and property would be one of those exposures but it would not be the only exposure, but we are looking ... we are talking about the expertise to audit credit because that's what our job is.

Deputy Eoghan Murphy: Okay. And when the bank began to change its internal structures at the beginning of 2001, specialist property financing units, and then in 2004, a dedicated property unit, was there a discussion in PwC about changing how you might audit the bank's activities?

Mr. John McDonnell: I ... I don't know, to be honest, but what ... what I would, what I do know is is, and the reason I don't ... I wasn't involved in Bank of Ireland in 2000. What I do know is is that we would always and we do always at the start of any audit sit down and talk about the risk that apply to that audit, so, therefore, when a bank starts to build up as Bank of Ireland started to build up considerable exposures in various areas, we would have ensured that our banking expertise was appropriate to audit the bits that we were required to audit arising from that, and that would have been impairment.

Deputy Eoghan Murphy: So your concern would have been that you have the necessary expertise to audit what the bank was doing - not necessarily a concern with the additional risk the bank may or may not been taking on?

Mr. John McDonnell: No, I have said before, it's not our job to comment on the risk that the bank is taking on. It's our job to complete our audit to ensure that we appropriately audit risks of material misstatement in the financial statement which we look back rather than looking forward.

Deputy Eoghan Murphy: So it wouldn't have been your responsibility to comment to the bank itself but would people ... in your ... inside your expert team looking at banks and looking at Bank of Ireland, would they have been commenting to themselves or to senior partners about what was happening in the bank ... and the changes that were happening, the increases in ... say ... concentration in property lending?

Mr. John McDonnell: I can't comment on what people were thinking in themselves ... I mean ... all I can really comment here is on the audit of Bank of Ireland and on the audit of Bank of Ireland we would have discussed at the start of every year, we set our audit plan, we would have discussed the risks in the context of what we were required to do and that's what we would have done.

Deputy Eoghan Murphy: Okay but in terms of ... have you looked at documentation from the time internal to PwC?

Mr. John McDonnell: Yes I have, yes-----

Deputy Eoghan Murphy: And would there be documentation, e-mails for example, of people on the bank team discussing their own concerns as to strategies being pursued by the banks, separate to their role as an auditor to the bank and the risk that they might be concerned with in terms of auditing?

Mr. John McDonnell: I haven't looked at all the documents over the period. I have looked at documents on the file. Basically what is on the Bank of Ireland audit file is work directed towards the audit of Bank of Ireland and that work is directed towards the risks and it's directed towards the audit of those material risks. We don't have a role in determining the bank's business model and we do not do a critique on our audit file of those business models. And the reason I say this, and this is important, we're an independent set of auditors, it's not our job to get involved in the management of the running of the bank and, therefore, we need to be very careful that we look at what we are required to look at and that's what we do and that's what our staff would be trying to do and that's what we would see on our files.

Deputy Eoghan Murphy: Okay. The document I cited is a document from the group risk office to the group risk policy committee on 13 December 2007 and it's talking about property concentration in the group's loan book. So as part of your audit, does it concern itself with these types of documents?

Mr. John McDonnell: This is the ... I think it's a GRPC minute, we would have seen the minutes of the GRPC ... GRPC is a very important risk committee within Bank of Ireland and as part of our audit of Bank of Ireland, we would consider the governance in place and the context of the financial statements. One of the key risk committee, as I said, is the GRPC, so we would look at the minutes of GRPC, yes.

Deputy Eoghan Murphy: Right, but to what purpose did you look at the minutes, say, for example, in these minutes, where it expresses a number of concerns about exposures?

Mr. John McDonnell: We would look at the minutes in the context ... in two contexts: one, to ensure that there was appropriate governance, and it's governance in the context of the audit of set of financial statements, to ensure that there are appropriate committees and those committees are looking at aspects of the accounting statements and, secondly, and another prime focus of our look, would be to consider any impacts that these have on impairment. So where these minutes have detailed application to the calculation of impairment, then we would look at them and they would direct our work.

Deputy Eoghan Murphy: Impairment at that point in time, not in future impairment risks?

Mr. John McDonnell: Yes ... we're not ... we're in an incurred loss model and an incurred loss model is the loss event has to happen and then it is of consequence for the accounts. Sorry, if it hasn't happened, it's not of consequence for the accounts because we're not in an expected loss model, so we ... we're doing an audit and we have to focus on what we're asked do and what we're asked to do is look at impairment from an incurred loss perspective.

Deputy Eoghan Murphy: Okay. This document then from the group risk policy committee or to the group risk policy committee, it's the end of 2007, and it's noting that 44% of all non-mortgage lending is to property. And when you combine mortgage lending with property construction lending, it's 70% of the bank's entire loans. So did PwC ever analyse the risk level associated with the percentage share of the property-related lending?

Mr. John McDonnell: I think the 70% includes both property and mortgage, if I am correct-----

Deputy Eoghan Murphy: Yes ... it's the two figures together.

Mr. John McDonnell: -----so there two ... so they'd be two separate risk factors. What we would look at is the risk of material statement. What we would look at is the impairment calculations from the bank and ensure that the impairment calculation of the bank are appropriate to give them their impairment charge and are appropriate to allow us to give a clean opinion on the bank's financial statements and that's very important. But our reporting in the context of property concentration, in the context of property prices, in the context of an expectation gap between incurred loss and expected loss, we would have reported on that to the audit committee, quite regularly during this period, but always in the context of the calculation of impairment because that's what we were asked to do. So when we look at ... our pure focus is "What does that mean in the context of the calculation of a loss, an incurred loss for the period that we are asked to cite our audited opinion?" That's what we look at it.

Deputy Eoghan Murphy: What about the wider concern, though, that's been expressed internally about this exposure ... this concentration exposure? I mean, if you go to page 40, half-way down the page it states, "If the GRPC [Group Risk Policy Committee] is of the view that the level of property exposure in the Group's balance sheet is too high, there are relatively few realistic options that could be considered", and it points out a few. That's a warning from one part of the bank to the other over its concentration exposure.

Mr. John McDonnell: What it is is it's a minute from a risk committee documenting the risk that exists as a result of the bank's lending strategy. What we have to do is audit the balance sheet that arose as a result of the strategy. So the balance sheet is there, we audit the transactions and we audit the transactions in the context of whether they've been properly measured and recognised in the balance sheet. So we are always looking in the context of an impaired loss calculation.

Deputy Eoghan Murphy: But as it says here, if the exposure is too high and there are relatively few realistic options that could be considered. You as PwC cannot take a view on that in terms of your assessment of the bank's position.

Mr. John McDonnell: No, because it's not our assessment, as I said, it's not our role to talk about what the bank's strategy was, what its policies were, what options are available to the management if it's a business. What our job is "What loans have they entered into at the year end?", "Are those loans properly accounted for?" In the context of are they are properly accounted for, "Has impairment on those loans, as they exist at the balance sheet, has that been properly calculated?" That is our role - that's where it begins and ends, Deputy.

Deputy Eoghan Murphy: In finalising your accounts, then, for 2007 and this report came in December 2007, you could make no regard to this particular risk being identified and you could have no concern for the future, based on this risk?

Mr. John McDonnell: What I would say is, is that we considered all risk documents, we consider all evidence available to us in the context of formulating an opinion on the financial statements. Secondly, we would have considered all these documents in terms of the required disclosures and we look in the financial statement, the sector risk was properly disclosed in the bank's financial sectors ... in the bank's financial statements and indeed, the funding model to fund those sector risks was also disclosed in the bank's financial statements. That's where our role begins and ends, Deputy.

Deputy Eoghan Murphy: Okay, thank you. Thank you, Chairman.

Chairman: Thanks very much, Deputy. Just before I move on to the next member, if I can just ... one of our lines of inquiry is the integrity of financial reporting, Mr. McDonnell and Mr. Murphy. In around 2005, most banks adopted the IAS 39 in relation to the calculation of the provision of bad debts. Within the industry, was there any discussion or opinion about this standard and particular in regard to the adoption of the standard as to how it would relate to profit and loss in accounts and the provision for bad debt?

Mr. John McDonnell: There was considerable discussion around, even prior to that, if you just look at who the ISB are, the ISB are an independent objective standard setter, that's why people apply their rules because they're independent and objective. When the ISB set IAS 39, they would have a very long consultation period and as part of that consultation period, they would have got a lot of comments back from users of the financial statements around what was right or wrong. Sorry, what they believed was appropriate or not appropriate ... sorry, that's the right way to say it ... and they would have taken that into account and then they made their deliberation. And it's important to understand where the ISB are coming from with this. They were concerned at that point in time because a lot of market participants were concerned that people were making what was called "big bath provisions" or as Deputy Levitt in the SEC "cookie jar provisions". There was concern that people were making provisions when times were good and then they were releasing those provisions when times were bad and smoothing their profits to ensure that they had an appropriate trend. That was the concern ... so that was at the forepoint of the ISB's mind. So the ISB's intention on IAS 39, would be that it was pro-cyclical, their intention was that when there was a significant downturn, you would have greater losses than in benign times. That was the intention to meet that obligation. So clearly, when financial institutions and people were moving from old GAAP ... what we called old Irish GAAP (IFRS), there was a lot of debate about what would IAS 39 mean in the context of provisions. And it would generally mean that provisions would be lower. There was some debate about the appropriateness or not ... the appropriateness or not of that, but it kind of all became a little bit irrelevant because, when the EU adopted IAS 39, it had to be applied. So, once personal views as to whether it was right ... once personal views as to whether you felt it was the most appropriate standard became not of a consequence, it was the standard, it was the rules and, therefore, you needed to apply ... apply those rules. And that's what financial institutions and, indeed, other financial institutions did. They just moved on and they applied the rules and they kept going.

Chairman: So, upon the commencement then, Mr. McDonnell, of the adoption of the international auditing standard, IAS 39, did this mean that the audited financial statements no longer had to comply with the true and fair standard that ... of the previously accepted standard?

Mr. John McDonnell: Chairman, I'd actually say the opposite. Once IAS 39 was adopted by EU law, it became part of the financial framework which had to be applied. If you have material lending transactions, you must apply the incurred loss approach, and I would believe if you did not apply the incurred loss approach, you could not say the financial statements gave a true and fair view. If you did comply the incurred loss approach, then you could give such a view. And the true and fair view, as it applies to accounting standards, where, as I said earlier on ... where an accounting standard specifically deals with a matter and deals with it in the level of detail which IAS 39 dealt with it and deals with its eyes open, knowing that it's going ... with a view that it should be pro-cyclical, then they're the rules as set down. When those rules are in law, you must apply those rules to give a true and fair view. If you don't apply them, you cannot say the accounts give a true and fair view.

Chairman: And in your firm-----

Mr. John McDonnell: That would be my view.

Chairman: In your opinion, Mr. McDonnell, do you believe that ... did you feel that it was right for the firm to adopt the standard?

Mr. John McDonnell: The firm being-----

Chairman: In your opinion, did the firm feel it was right to adopt the standard?

Mr. John McDonnell: PwC would've been involved in all of the consultation periods on all financial accounting standards. We give our views. In some instances, we agree. In some instances, we disagree but, as I said, once the standard becomes part of IFRS, we, as a firm, are required to apply it as are our clients are required to apply it. So, it became GAAP and, therefore, we had to apply it. So, we ensured that we were proficient, expert and that we could apply it appropriately.

Chairman: Okay. And-----

Mr. John McDonnell: And that's all we can say we do.

Chairman: Yes, and we accept that the rule had to be applied, but, I suppose, the question I'm putting to you this morning is ... during PwC's interaction with the bank, did either party express concerns regarding the adoption of IAS 39?

Mr. John McDonnell: We had very detailed debate with the bank about the impact of IAS 39 across a whole range of assets and liabilities, particularly impairment. We would've discussed with the bank the impact of IAS 39 and how it compared and contrast with the previous accounting framework. We would've also looked at it in the context of US GAAP. Directors and management would've had views. We would've discussed all of those views. But at the end of the day, the rules were the rules and we would ... and Bank of Ireland needed to apply those rules. They ensured that they'd the appropriate controls to apply the rules and we ensured that our audit and our accounting expertise was appropriate so we could actually audit those rules.

Chairman: But in a general capacity, Mr. McDonnell, when a rule is being applied, I'm sure you, as the auditor, and the firm that you're auditing would talk about how the rule gets rolled out and all the rest. But what I'm asking you here is, was there concerns being expressed by either your firm or by the bank or were you in discussions that there were going to be concerns with regard to how this rule was going to be adopted and the implications of adopting it?

Mr. John McDonnell: The primary debates we would have had, Chairman, were around the differences between this GAAP ... IFRS and where we previously came from and how those differences might manifest themselves and to ensure that the employees and the directors and management staff understood the rules of IFRS, because they were the new rules of the game, and to understand that they were being properly prepared. Because personal views were not particularly relevant. The accounting standard was what it was and it was designed to do something and it had to be applied.

Chairman: Thank you.

Mr. John McDonnell: And, therefore, the focus of the management and directors of Bank of Ireland was, "We have to apply this properly. Let's get on and make sure that we do apply it properly and we understand it in all its minutiae." And our primary concern was to ensure that our staff, our managers and our directors understood it in all its minutiae so, therefore, it could be applied properly. So, we could stand back at the end of the day and say, "We understand IAS 39 and we understand it's been properly applied", because that's our role in this.

Chairman: Okay. I understand that and I'm going to move on now to the next questioner, but I just want to ask that question again to you. I understand what you're saying with regard to any new accountancy rule that comes down, people have to be trained up, people have to be familiarised with it and so forth, but, specifically in regard to IAS 39, was there any concern held by either your firm or by the bank or was there at any time an engagement between you and the bank that there was a concern as to how this rule would roll out? I'm not asking about the operational aspects of it-----

Mr. John McDonnell: I-----

Chairman: -----I'm asking was there a concern.

Mr. John McDonnell: Chairman, I can only answer the way I've answered the question. I've tried to answer the question. We would've had a detailed debate about how it was applied.

Chairman: Yes.

Mr. John McDonnell: It was the rule. We would've engaged in the consultative process to get to the rule. We would've engaged in the consultative process to get to the rule, but once the rule was made, personal views were irrelevant. It needed to be applied.

Chairman: I'm sorry, Mr. McDonnell, but I'm going to have to press this with you. I understand how rules get applied, but in the ... what I'm asking you was, in all of that process, was there a concern about the rule? Now, I'm not asking for a "Yes" or "No" question, I'm just asking you was there a concern about the rule.

Mr. John McDonnell: I think there was an understand ... Chairman, the way I can answer this, there was an understanding of how the rule operated. There was an understanding of how and what it might mean to financial reporting,-----

Chairman: I-----

Mr. John McDonnell: -----but I can't say we-----

Chairman: I can go into legislation that I have here now that would've forced you to answer a question if I wished, but I'm asking you was there concern about the rule in your firm or in the bank or were there discussions with regard to a concern around it?

Mr. John McDonnell: I don't believe there was a concern about the impact IAS 39 would've had on a financial crisis. I don't believe there was a concern discussed in that manner. I think what we were trying to ascertain was how the accounting standard worked, the basis for which the accounting standard was brought in, which was to address other issues in the marketplace, and ... and that's what we looked at.

Chairman: Okay. Thank you. Deputy Michael D'Arcy.

Senator Michael D'Arcy: Thanks for the upgrade, Chairman. You're welcome, gentlemen. Can I ask you, in relation to the policy exceptions, did PwC ever review the loans that were outside of the policy exceptions? And the booklet is the PwC booklet, Vol. 1, page 43 to 48. The policy exceptions place.

Mr. John McDonnell: Yes. I mean, we would've reviewed a sample of loans and I'm sure that the sample of loans ... we would've identified a number of these policy exceptions. The way the policy worked in Bank of Ireland was that the credit policy was drawn very tightly. And, therefore, if there was an exception to that credit policy, it went up to the next level-----

Senator Michael D'Arcy: Yes.

Mr. John McDonnell: -----and if the next level approved it, then it was approved, and we would've ensured that that happened when we went through our ... our ... our review of loan samples.

Senator Michael D'Arcy: And each year there was a number of exceptions to the policy. And would you have reviewed a sample batch on each?

Mr. John McDonnell: No. We would've reviewed a sample of loans and, coming from that sample, I'm sure there would've been exceptions to the policy as expressed in those papers, and then we would've ensured that the next layer of approval was in place. And if the next ... the way it worked is if there was to be a tight policy drawn, if it came to an individual discretion level, the person had the discretion to approve it if it was in that policy. If it wasn't, it went up to the next level and the next level could approve it. And then once it was approved, it was within the total policy.

Senator Michael D'Arcy: Sorry. What I'm trying to get at is, the following year there's another ... percentage of exceptions. When exceptions went through the process and were sanctioned by the bank, did PwC pursue another sample each calendar year as there were exceptions flowing?

Mr. John McDonnell: We would have reviewed a sample of loans every year and-----

Senator Michael D'Arcy: Every year.

Mr. John McDonnell: -----I would've ... I haven't looked at all the samples, but I would assume that there would've been these type of exceptions in each of the samples. I would've assumed, yes.

Senator Michael D'Arcy: Okay. Page 47 of the ... of your booklet: "Bank of Ireland transferred 191 connections to NAMA with [an] aggregate ... value of [€9.76 billion] ... Cases including policy exceptions [were] identified [of] 139 out of 191 ... [or] ... (73%) with aggregated exposure of [€8.78 billion]". That seems like a very, very high figure for exceptions ... for a huge quantum of money. Were any of those cases reviewed to your knowledge?

Mr. John McDonnell: I honestly don't know. As I said, we would have reviewed a sample of loans and there was a fair chance that ... that some of those loans ... those loans would have been in the sample. But I can't be conclusive to that. But we would have reviewed them and there would have been ... I'm sure those exceptions would have arose.

Senator Michael D'Arcy: And can you comment on the level of exceptions, 72%, please?

Mr. John McDonnell: No. I mean it was the bank's policy and I understand this from speaking to the bank, you know, when I got involved, their policy was to draw their loan policy very, very tight and if there was an exception to that policy, it went to the next level. And part of the reason they would have said to me they had a tight policy is they wanted full ... they wanted greater transparency around individual loans and exceptions. And what really ... what they wanted was a ''two eye'' principle. So you've got a discretion within a tight policy ... you've got a discretion, it goes up to the next level. So two people looked at it - the person at that discretion level and the next discretion level and they wanted ... one of the things that they did say to me ... and this was just after the fact ... they thought about widening the policy but they felt that that wasn't an appropriate decision. This is a better rule. And that's why they would say they got a lot of exceptions at the first level. But, therefore ... but it's not an overall exception because it can be approved at the next level.

Senator Michael D'Arcy: The ... we know the NAMA numbers were ... people who were transferred were people with €20 million plus. I just want to take the comparison between that and the policy exceptions for owner-occupiers and the policy exceptions for buy-to-let mortgages. The policy ... on page 47 ... on ... in 2005 we have the policy exceptions for owner-occupiers at 10% and for buy-to-lets at 20% ... at 19%; 2006, 9% for mortgage, buy-to-lets, 17%; 2007, 7% versus buy-to-lets, 16%; and then, finally, in 2008, 5% owner-occupier exceptions and 13% mortgage buy-to-lets. The difference, Mr. McDonnell, is two times and three times owner-occupier versus mortgage buy-to-lets. And then the only percentage figure that we have for NAMA is 73%. Can I ask you did the exception become the rule and the rule become the exception?

Mr. John McDonnell: No, the policy was that if a loan had an exception, it went up to the next level and it could be approved. That was the policy-----

Senator Michael D'Arcy: I understand that.

Mr. John McDonnell: That policy was applied. That was the rule, if you like. A number of these exceptions could be for ... for technical-type breaches or .. or exceptions. Maybe one of the ... an example would be where you needed to have an income statement for a company and the company had only started trading so there was no income statement. There was all sorts of reasons for the exceptions. A whole plethora of them ... but I would have ... I ... this is the first time I ... when we got the evidence ... this is the first time I've seen this so we wouldn't have been doing comparisons between the exceptions ... between various categories of loans. We wouldn't have seen this before.

Senator Michael D'Arcy: And can you comment on the ... on the percentage difference between owner-occupier exceptions and the buy-to-let exceptions? -----

Mr. John McDonnell: Without -----

Senator Michael D'Arcy: -----two times or three times the difference.

Mr. John McDonnell: Without having the detailed analysis as to why the exceptions arose, I don't know. I mean I could ... it would only be supposition as to why one is ... is different to another. I mean, I haven't seen the make up of it .... I ... I really ... I don't know.

Senator Michael D'Arcy: Could you offer an opinion, please?

Mr. John McDonnell: I don't ... maybe there was more technical-type breaches in the buy-to-let but I don't know. It's only supposition. I honestly don't know. I don't have the ... the material. If I had the material backing it up, I could tell you because I'd have all the material; I just don't have it.

Chairman: Are you finished? Okay. Just a ... further on Deputy or Senator D'Arcy's questions there. Did PwC have any concerns with the exceptions to the lending policies and the level of exceptions?

Mr. John McDonnell: We understood the policy in detail and we would have .... we would have identified ... that we would have seen exceptions of policies that we weren't sure ... our detailed testing. In the context of the ... you know, our opinion on the financial statements and whether the financial statements gave a true and fair view, we wouldn't have had a concern as to the impact on our opinion on the financial statements.

Chairman: Okay, and were these concerns sent along then and addressed?

Mr. John McDonnell: No, we would ... we wouldn't have ... we would have ... they would have arose ... the policy was in place. We understood the operation of the policy, Chairman. And where there was an exception to one ... one part of the policy, we would have ensured that it was approved at the next level. If it was approved at the next level we wouldn't have raised that ... that higher because it was in line with the rules of Bank of Ireland at that point in time.

Chairman: Okay, thank you. Deputy Michael McGrath.

Deputy Michael McGrath: Thank you very much, Chair. You are very welcome Mr. McDonnell and Mr. Murphy. If I can start by asking if PwC performed any stress testing as part of the external audit of Bank of Ireland to take into account the correlation between different types of property being financed- residential, commercial, development land and speculative land banks - and if you did, what conclusions were drawn? And if not, why not?

Mr. John McDonnell: We didn't produce our own stress tests around those concentrations. The bank would have produced detailed stress tests as part of their processes. And the bank, I think, the bank would have got Oliver Wyman to help them, to assist them in terms of their impairment analysis. We would have reviewed those stress tests and we would have considered the outcome of those stress tests. But the one thing I will say is under IAS 39, you need to look at each individual loan separately or groups of similar loans separately. You can't, when you are looking at impairment, mix a land loan with a business loan. They have got a different risk profile. You consider impairment on those separately. That's the way IAS 39 works. So, the bank would have done stress tests, we would have looked at the stress tests as part of the overall bank's governance but we would not have done our own stress tests.

Deputy Michael McGrath: Okay. Are you happy enough to take some questions on the financial statements prior to the years-----

Mr. John McDonnell: Oh yes ------

Deputy Michael McGrath: -----that you became the auditor in charge,

Mr. John McDonnell: I am but ------

Deputy Michael McGrath: -----which was a -----

Mr. John McDonnell: Oh, I am. That's why I am here -----

Deputy Michael McGrath: -----2005, 06, 07? Okay.

Mr. John McDonnell: That's why I am here.

Deputy Michael McGrath: Can I ask why the financial statements for Bank of Ireland for 2005, 2006 and 2007, for example, would not have provided a breakdown by sector of the loans owed to the bank by customers? So I'm talking about the notes to the accounts, the disclosures by the bank in the financial statements for 2005, 6 and 7, for example, there is no breakdown by sector whereas we have looked at the accounts of other banks for example, AIB and Ulster Bank, and they would have been providing a breakdown by sector.

Mr. John McDonnell: The Bank of Ireland IFRS 7 came in for financial periods ending 31 December 2007, which for Bank of Ireland was 2008. And IFRS 7 was the accounting standard for which prescribed the disclosure of sectoral concentrations and disclosures around credit risk and they .... considerably increased the required disclosures of credit risk. I haven't actually done an analysis of what was there -----

Deputy Michael McGrath: Sure, yes-----

Mr. John McDonnell: -----before '08 but I suspect that that's why you see from March 2008 onwards, you see much greater disclosure around market risk, credit risk, etc., because that's was driven by IFRS 7, which is the accounting standard that came in to promote and require greater disclosure and require greater-----

Deputy Michael McGrath: Okay-----

Mr. John McDonnell: ----- disclosure and that------

Deputy Michael McGrath: And that came into effect-----

Mr. John McDonnell: -----I suspect ..... I suspect that's the reason-----

Deputy Michael McGrath: -----at the end of '07 is it?

Mr. John McDonnell: I suspect that's why you will ... you will see a difference-----

Deputy Michael McGrath: Yes -----

Mr. John McDonnell: ------between the March '07 accounts and the March '08. It hit everybody else for December because Bank of Ireland is March ... they were ... March ... March '08. All the other banks were December '07. So if you're comparing the December '07 for, let's say, AIB and Ulster Bank, you would need to compare it with the March '08 because that's

... there is the comparator-----

Deputy Michael McGrath: Okay. And prior to then, the level of disclosure was dictated by what?

Mr. John McDonnell: It was dictated by IAS 39.

Deputy Michael McGrath: Okay. And did that set a minimum standard? Was it open to the directors of the bank, for example, to go beyond that and provide additional disclosure in the notes to the accounts?

Mr. John McDonnell: It's always open to the director of financial statements to provide additional disclosures to the extent that I think that disclosure is reasonable and to the extent that that disclosure accords with financial ... with accounting standards. Now, you -----

Deputy Michael McGrath: Yes -----

Mr. John McDonnell: -----you have to ... the disclosure has to be sensible in the context of the accounting framework, if you know what I mean. And has to be in the context of the historical numbers.

Deputy Michael McGrath: Okay. For example, the account to the end of March 2005 in the relevant note, which was 15, dealing with loans and advances to customers, subsection C, there was a reference of concentration of exposure to credit risk. It said: ''Group's exposure to credit risk from its lending activities does not exceed 10% of loans and advances to customers after provision in any individual sector or industry with the exception of residential mortgages''. Now that was repeated again then in 2006. But at that point, property and construction was added into residential mortgages as being an exception to the ... to the 10% rule. But it wasn't until 2008 that you had a specific note on credit risk exposures and you're saying that arose from-----

Mr. John McDonnell: That arose from-----

Deputy Michael McGrath: -----the new IFRS-----

Mr. John McDonnell: ----the new IFRS 7. I think there would have been market disclosures around ... and I just can't recall whether that 10%, whether you have to disclose, whether you have something over and above 10%. I don't recall where that comes from-----

Deputy Michael McGrath: Yes.

Mr. John McDonnell: -----it may have been a market standard or it may have come from one of the accounting standards; I just can't remember that.

Deputy Michael McGrath: Okay. I suppose, the point I am getting at is that it wasn't until the financial statements for the year ended 31 March 2008 were published, which was May 2008, that a reader of the Bank of Ireland financial statements would have realised the extent of that bank's dependence on the property and construction sector. None of the accounts prior to that gave any information on the bank's reliance and the concentration of risk in property and construction.

Mr. John McDonnell: They don't ... I mean, I just don't have the 2007 accounts ... the March 2007 accounts to hand so I just don't ... can't do a comparison as such.

Deputy Michael McGrath: But, as you said, the '07 was not prepared in accordance with the IFRS.

Mr. John McDonnell: Well, I-----

Deputy Michael McGrath: -----though the directors could have made additional disclosures if they had so wished.

Mr. John McDonnell: They're ... in the bank's form 20F there was a requirement, which is called the guide 3 requirements, and in the March '07 accounts for the guide 3 accounts, the accounts disclosed property and construction of property for 2007, 2006 and 2005.

Deputy Michael McGrath: And that is published, is it?

Mr. John McDonnell: That's publish, yes. And, it says property and construction: €16 billion, '07; €10.7 billion, '06; and €8 billion, '05 under IFRS.

Deputy Michael McGrath: And that's published by the bank.

Mr. John McDonnell: That's published by the bank, yes. Just bear with me a second.

Deputy Michael McGrath: Sure, yes.

Mr. John McDonnell: Yes.

Deputy Michael McGrath: What we're dealing with here essentially is the financial statements which were audited by PwC and it wasn't until the 2008 financial statements that somebody would have seen, for example, that Bank of Ireland had lent over €35 billion to property and construction, which accounted for 26% of all loans made by the bank. Anyone relying on the financial statements prior to 2008 would not have had any sense of the level of dependence that the bank was placing on property and construction. That's what I'm putting to you.

Mr. John McDonnell: Property and construction lending in 2007 was €16 billion. The requirements of the financial-----

Deputy Michael McGrath: Where are you taking that from?

Mr. John McDonnell: I'm taking that form the form 20F.

Deputy Michael McGrath: Okay but that's not the financial statements.

Mr. John McDonnell: That says ... sorry, Ireland €10 billion and the UK €26 billion.

Deputy Michael McGrath: Yes, but I'm talking about the financial statements which are prepared by the directors and audited by yourselves.

Mr. John McDonnell: We do audit the 20F. The financial statements prepared by the directors need to be prepared in accordance with relevant accounting standards and the 2007 financial statements would have accorded with the relevant accounting standards. The accounting standards were changed and IFRS 7 came in in 2007. So, if you look at the financial ... if you look at the financial statements of any financial institution between ... in 2007 or in the context of the bank's accounts in 2008, you will see substantial increase in disclosure because IFRS 7 came in and IFRS 7 required the banks to give substantial disclosure. Prior to the adoption of IFRS 7 that ... other standards applied and Bank of Ireland's accounts prior to that accorded with those financial ... those accounting standards and that's why we could give an opinion on those financial statements.

Deputy Michael McGrath: But would it have been open to the directors prior to that new IFRS coming into play in 2007 to disclose in the financial statements the information which was in form 20F, sectoral concentration, essentially? Could the directors have included that information in the notes to the financial statements prior to the 31 March 2008?

Mr. John McDonnell: The directors ... yes, the directors could put that disclosure in the financial statements.

Deputy Michael McGrath: And to your knowledge was there any discussion between the PwC team and the bank about providing that additional disclosure above and beyond the minimum level required in the standards, but in the interests of giving the reader of the financial statements the maximum amount of possible information?

Mr. John McDonnell: We would've always discussed with the bank their approach to disclosures in the financial statements but I don't know what was actually discussed at that point. We would always discuss ... we would've always ensured that the bank ... and the bank would've always themselves ensured that they complied with appropriate accounting standards and they did apply with appropriate accounting standards. There was a big move, as I said, in the marketplace to increase disclosure and that arose from IFRS 7. The banks had just come through the adoption of ... the Bank of Ireland had just adopted IAS 39 in 2006 ... in 2005 and IFRS 7 came in as part of that accounting standard so people were still getting to grips with the overall requirements of IFRS. That's the only way I can answer it.

Deputy Michael McGrath: I think you said earlier on, Mr. Murphy, that PwC became the sole auditor in 1990-----

Mr. Ronan Murphy: That's right.

Deputy Michael McGrath: -----of Bank of Ireland.

Mr. Ronan Murphy: Yes, that's right.

Deputy Michael McGrath: And under the mandatory rotation rules you have to depart that job as such by 2020, is it?

Mr. Ronan Murphy: That's correct, yes.

Deputy Michael McGrath: Can you clarify what those rules state at the moment?

Mr. Ronan Murphy: There are new rules coming in for public interest entities, which are large corporations regulated ... regulated entities that require us ... the auditors to retire after a period of ten years.

Deputy Michael McGrath: Ten years. And, prior to that rule coming into play, was there any rule about-----

Mr. Ronan Murphy: There was no requirement.

Deputy Michael McGrath: No term limit.

Mr. Ronan Murphy: There was no term limit.

Deputy Michael McGrath: Whatsoever.

Mr. Ronan Murphy: No, Deputy, there was no term limit.

Deputy Michael McGrath: Okay. If I can finally raise the issue of ... of practice note 19, which Deputy Doherty raised as well. So, this is where it goes beyond the statutory requirement laid down in the Central Bank Act 1989 but where the auditor may in circumstances where it concludes that the matter doesn't give rise to a statutory duty to report but nevertheless feels that in the public interest it should be brought to the attention of the regulator, to use your own words, Mr. Murphy. The group risk policy committee that Deputy Eoghan Murphy referred to on 13 December 2007, which is on page 37 of the core booklet, highlighted in pretty stark terms the concentration risk that Bank of Ireland was facing at that time. Was any consideration given by PwC to making a disclosure to the Financial Regulator under practice note 19, an additional voluntary disclosure about the level of concentration risk that Bank of Ireland was facing at that time in respect of lending to property and construction?

Mr. Ronan Murphy: Deputy, I don't believe so.

Deputy Michael McGrath: Not considered at all or-----

Mr. Ronan Murphy: Not considered ... not considered in terms of reporting to the Financial Regulator.

Deputy Michael McGrath: Was there any consideration to the fact that it may be an issue of interest to the regulator that one of the main banks in Ireland had, for example, 44% of its non-mortgage related lending in the basket of property and construction?

Mr. Ronan Murphy: There may have been discussion but I'm not aware of it.

Mr. John McDonnell: Our ability to report to the regulator, as I said, is set out by obligations to report and we can, in certain circumstances, report over and above those obligations but it's only in the context of the work we do from ... arising from our audit work. That's the first point I'd say. The second point I'd say is that the regulator has its own regular ... returns which the bank need to issue to the regulator and those returns deal with various concentrations risk. So, the regulator has its own mechanism to be well aware of the what the bank do and they had their own reporting regime. So, the fact that we see something in our work which as part of our audit doesn't lead us to report *per se* to a regulator in that situation because the regulator has its own framework-----

Deputy Michael McGrath: Sure, but you could've decided to.

Mr. John McDonnell: I'm not sure that we would have the ability just to say that we saw a report and report that to the regulator. I'm not sure of the basis on which you would be reporting to the regulator.

Deputy Michael McGrath: Well, if you felt it was in the public interest to bring a matter to the attention of the Financial Regulator ... you could argue that it was in the public interest, and certainly of interest to the regulator, to know that at that time Bank of Ireland's exposure to property and construction was so high. That could, at least, have been considered.

Mr. John McDonnell: I think what's in the public interest is around the continuing functioning of the financial institution and that's where-----

Deputy Michael McGrath: That's what's laid out in the Act. They're your mandatory requirements.

Mr. John McDonnell: It is in the context ... our ability to report in that really flows from what we look at as part of our audit. We don't ... I don't believe we really have the ability to report to the regulator on various things that we see. It would have to be something which we would consider, arising from our audit, that we should report in and around that type of thing.

Deputy Michael McGrath: This was a key element of your audit ... looking at the loan exposures, looking at the adequacy of the provisions being made, the application of the accounting standards and their impact on the true and fair view of the financial statements. I mean, that's the very essence of the audit that you were doing.

Mr. John McDonnell: As I explained, we looked at that report in the context of our overall governance and looked at risk management and the governance over risk, the GRPC being a key risk committee. We reviewed that report solely in the context of how it impacts on our calculations ... on the bank's calculation of impairment and our audit of that calculation of impairment. We would've looked at that. I don't believe we had any obligation, be it under the rules of section 47 of the bank or indeed any other way to report to the bank ... I don't think we had any obligation to report that at all.

Deputy Michael McGrath: I never suggested it was an obligation. It is a "may". So, the question I put was, was it open to the auditors to bring those matters to the attention of the regulator?

Mr. John McDonnell: Yes.

Deputy Michael McGrath: Yes it was. Thank you.

Chairman: I'm going to move to wrap up. I'm going to invite both leads in for five minutes. Before I do, if maybe I could just put a general question to both Mr. Murphy and Mr. McDonnell. In the firm's opinion, did the external audit fulfil its role or not?

Mr. John McDonnell: Chairman, could you repeat that, sorry?

Chairman: In the firm's opinion, did the external audit fulfil its role or not?

Mr. John McDonnell: Yes it did.

Chairman: It did indeed. In that regard, if I can maybe just move things towards a wrap-up, can you explain, in layperson's terms, if the auditors did their job properly according to the rules why did every bank in the Republic of Ireland fail without warning?

Mr. John McDonnell: As I said Chairman, an audit is a set of financial statements, is a representation of what happened in the past, past transactions and events. It is not a representation of stability, capital adequacy or future prospects of an entity and we gave our opinion on the ... on the transactions that occurred in the past in the financial statements and we stand over those opinions.

Chairman: Mr. Murphy?

Mr. Ronan Murphy: I agree with what Mr. McDonnell has said. We carried out our work. I think we've spent the last three and a half hours here outlining in detail the work we did, how it was in line with auditing practice accounting standards and we believe we did the best possible professional job in the context of the Bank of Ireland audits.

Chairman: Was the bank failure, to both of you, a surprise or not?

Mr. Ronan Murphy: Yes, when you say the bank failure, I think what happened and what transpired was a huge surprise. Nobody could have anticipated ... I mean, we spoke about a period of unprecedented turmoil, nobody could have anticipated what happened. Chairman, I've been in public accounting for 35 years. I've seen recessions, I've seen economic cycles, I've seen the downturns in the '80s and the '90s - nothing prepared us for what we saw from September 2008 onwards.

Chairman: Mr. McDonnell?

Mr. John McDonnell: I would agree with that. It was totally unprecedented and ... I share exactly what Ronan said. I've been through other downturns but I've never experienced anything like the one we've gone through.

Chairman: In view of that, can bank audited accounts predict a risk of a bank failure, in your opinion, into the future?

Mr. John McDonnell: I think the accounting standards have been developed to allow ... if you look at impairment, we're moving from an incurred loss to an expected loss model. That will mean that accounting standards will recognise loss quicker than in the past. I think that the disclosures and likely future disclosure ... there's much better disclosure around risk, etc., so I think there's a better chance that financial statements will alert to crisis moving into the future. But I would say that a set of financial statements are always going to be about a representation of the past and the past is not always going to be representative of future shocks, and a set of financial statements will never capture ... they might capture expected loss and that's the new model we're going to, but they won't capture unexpected loss. And even if a full set of financial statements were accounted for at fair value, if the market ... if there's a sudden shock in the markets, fair values can drop and they can drop very, very quickly and that can have a ... that can have a very difficult effect on a set of financial statements. Financial statements are always looking backwards, they are not looking forwards and they need to be viewed in that context. But there's been a couple of changes around going concern and the directors in ... the change around going concern is the going concern concept still remains but there's going to be a directors' viability statement into a set of financial statements going forward where the directors will have to give some disclosure around the viability of the business model over an horizon greater than ... greater than one year. And that obviously will have some impact.

Chairman: Mr. Murphy?

Mr. Ronan Murphy: Chairman, could you repeat the question?

Chairman: Can I ask you, in terms of audited accounts, can they predict the bank failure or a risk of a bank failure going into the future?

Mr. Ronan Murphy: I think the changes that have been brought in that we've spoken about this morning will certainly help in terms of being able to predict, but at the end of the day we're talking about a set of historical information so it is limited in terms of what it can do.

Chairman: Thank you. Deputy ... or Senator Susan O'Keeffe, five minutes, and then I will move on to Senator Barrett.

Senator Susan O'Keeffe: Thanks Chair, I have a couple of shorter questions and then a longer one. When you were saying there to Deputy McGrath that it was ... it would have been open to you potentially to disclose the level of property concentration at any time, did the bank ever ask you not to make such a disclosure?

Mr. Ronan Murphy: No Senator.

Mr. John McDonnell: No.

Senator Susan O'Keeffe: Did the Financial Regulator or the Central Bank ever ask you not to?

Mr. John McDonnell: No Senator.

Senator Susan O'Keeffe: In terms of the dealings, did you have any dealings with the Minister for Finance, the Department of Finance, the Taoiseach or the Taoiseach's office prior to 2008?

Mr. Ronan Murphy: When you say dealings Senator, could you just-----

Senator Susan O'Keeffe: Phone calls, conversations, meetings.

Mr. Ronan Murphy: In relation to the Bank of Ireland, no.

Senator Susan O'Keeffe: Yes, in relation to your role here as Bank of Ireland auditor.

Mr. Ronan Murphy: No, in relation to the Bank of Ireland, the answer is no.

Senator Susan O'Keeffe: Were you involved with Bank of Ireland on the night of the guarantee, were you standing by or taking phone calls?

Mr. Ronan Murphy: No, Senator, we were not ... we did some work in advance of the guarantee. That work was completed on the Friday evening - Saturday morning, where we reported in relation to the liquidity concerns on three of the institutions that subsequently became covered institutions but our work effectively ceased that weekend. So we never advised nor were we asked to give any advice on nor did we give any view on, the options being considered by the Government at that point in time.

Senator Susan O'Keeffe: So can you just give me some clarity about the work that you did do that you've just explained, the kind of timeline for that?

Mr. Ronan Murphy: I can Senator. I can give some high-level comments in relation to ... and I know you're talking about Project Atlas ... and I can give some -----

Senator Susan O'Keeffe: Sorry, I didn't realise ... I wasn't trying to go in to that.

Chairman: No, we are not talking about Project Atlas.

Senator Susan O'Keeffe: No, I wasn't trying to go there. I am sorry, I didn't mean to.

Mr. Ronan Murphy: Okay, well that was the approach, the work we did in advance of the guarantee is Project Atlas phase one, Senator so-----

Senator Susan O'Keeffe: Okay, there was no ... sorry Chair, I wasn't asking.

Chairman: We'll deal with Project Atlas at another entirely different time.

Senator Susan O'Keeffe: No that's fine, I was trying to establish whether there was any other work that you might have done, with your Bank of Ireland-only hat on?

Mr. Ronan Murphy: No, Senator, there wasn't, no.

Senator Susan O'Keeffe: Thank you, that's what I mean to say, I beg your pardon. In terms of your team of 200 people that worked with you, did you have to ... did you go abroad to recruit or were all those people recruited in Ireland or did you have a mix of people?

Mr. John McDonnell: I haven't looked but it's a mix of people we would recruit. Predominantly we recruit in Ireland but we would recruit across Europe and we'd recruit across the world. We'd also have, if you like, a PwC secondment-type programme where we take people in from other PwC offices and we'd give people to other PwC offices. And when we get engaged in recruitment or in the secondment programme, we're always focused in on people with banking-type expertise to fulfil what we need in our banking group.

Senator Susan O'Keeffe: So for some of them, they would have needed training about the Irish property market, about Ireland, about the way in which we ... you know the businesses day to day, if they were coming from abroad?

Mr. John McDonnell: Everyone needs training and we'd always ensure that people get the appropriate type training. As I said earlier on Senator, we have a very detailed training programme both in the context of the Bank of Ireland audit and in the context of the banking group.

Senator Susan O'Keeffe: Did you ... did your audit team audit Bank of Ireland understanding that the bank was too big to fail?

Mr. John McDonnell: That was not a concept that we would have ... been discussed in terms of the audit of Bank of Ireland. We would have audited Bank of Ireland in the context of the auditing standards and in the context of the risks that we saw and the context of our requirements. And we would also review it in the context of the ... the environment in which it operated in, the regulatory environment in which it operated in, the Central Bank environment it operated in and the business environment in which it operated.

Senator Susan O'Keeffe: So it was never discussed with the bank management, you know, look we're-----

Mr. John McDonnell: No, we never would have had a discussion with bank management at Bank of Ireland to ... too big to fail. What we did is we looked at the risks. We looked at them in the context of our requirements and we ensured that they were properly audited and we never would have taken that into account.

Senator Susan O'Keeffe: On several occasions you have referred to the idea of financial statements faithfully representing the past at a particular time, you've talked about never getting involved in the running of the bank. Can you then clarify for me the role that you did have prior ... I'm sorry, post-September 2008, when it was all, as you said yourselves, in a completely unprecedented situation, you were now talking to the Financial Regulator much more, the Central Bank, and all kinds of ... you were now, I would say if it's fair to say, you were now involved much more. So how did that square, that involvement directly with having meetings with people who were not the bank, outside your audit, I don't understand that?

Mr. John McDonnell: We were seeking to ... at that point in time we had come through the Lehman collapse and we were seek ... and the Government guarantee ... we were seeking to ensure that the bank would be able to continue in ... in operating in existence and as part of that we had to ensure that (a), the bank had proper access to liquidity and (b), the bank had proper access to capital.

Senator Susan O'Keeffe: But that wasn't part of your audit function.

Mr. John McDonnell: It's part of ... part of our audit is we have to look at ... we have to consider the applicability of the going concern concept over the next 12 months and as part of that, as I said, we would have very heavily looked at liquidity. And when we got into the credit crisis and then the sovereign debt crisis, we would have been looking at liquidity and at that point in time the bank, and indeed all the banks, were very heavily dependent on the EU in the terms of their liquidity, and we had conversations with the Central Bank in the context of the Central Bank's policies to provide liquidity to the ... to the sector. And we would have had conversations with the Department in the context of the systemic importance of Bank of Ireland and the Department's support for Bank of Ireland in the context of both capital and-----

Senator Susan O'Keeffe: Just to clarify, Chair.

Chairman: Supplementary now.

Senator Susan O'Keeffe: Absolutely. So you were ... would you use the word negotiating or assisting ... what is the word that you would use there?

Mr. John McDonnell: No, no. We were not negotiating, we were seeking to understand the level of support which the Central Bank were giving Bank of Ireland in the context of liquidity. We were seeking to understand the level of support which the Department of Finance and the Government were giving the bank in the context of capital.

Senator Susan O'Keeffe: But you were allowed to talk at the meetings that you attended. You were allowed to be participants in them. You weren't sitting passively at the-----

Mr. John McDonnell: No, we ... we were seeking to get audit evidence. So, we're sitting doing audit opinion on a set of financial statements and we are looking at the applicability, the going concern concept, we are looking at disclosure in the financial statements and we're looking at the bank's ability to have appropriate liquidity. The bank was very, very dependent on the ECB and we needed to ensure that that dependency ... that the ECB would provide liquidity to the bank over the horizon that we were meant to look at for going concern, which is a year. And, therefore, we asked the ECB would ... would they confirm that and they confirmed that to us. It was us gathering audit evidence. That was our role.

Chairman: Okay, thank you very much. Senator Barrett.

Senator Sean D. Barrett: Thank you very much, Chairman, and thank you, gentlemen. Did the bank's management and board structure impede the provision of good governance within the banks or what impact, if any, did it have?

Mr. John McDonnell: No, Senator, the bank ... the bank's management and governance structure ... the bank were always very open with us. They always shared things with us very early. They always took our counsel and they always reflected our counsel in the preparation of the financial statements, so we'd a very open relationship with them. But look at their governance ... the banks ... the bank had to apply Sarbanes-Oxley and Sarbanes-Oxley arose as a result of a corporate failure in the US, and it is taken as probably one of the best-in-class corporate governance-type arrangements for the production of financial statements. And the bank would have very detailed processes around the governance ... its governance over financial statements and around detailed controls around the production of financial statements. The bank would test those controls and we'd test those controls. So we took considerable comfort from the fact that the bank applied a Sarbanes-Oxley model.

Senator Sean D. Barrett: Just that ... it has 20 years imprisonment and criminal penalties of $5 million. Is that a model that this committee might look at, Sarbanes-Oxley?

Chairman: Sarbanes-Oxley?

Mr. John McDonnell: Sarbanes-Oxley is a model which is applied in the US.

Senator Sean D. Barrett: Yes.

Mr. John McDonnell: It's a model which entities apply for reporting on financial controls. The ... the ... the CEO and chief executive report under Sarbanes-Oxley and the auditors have to give an opinion under Sarbanes-Oxley.

Senator Sean D. Barrett: You were talking about the regulator now. Have you any observations on the regulator in the period 2003 to 2008 and in the period leading up to the crisis?

Mr. John McDonnell: I ... we've had a ... Senator, as I said earlier, we had very limited engagement with the regulator and we would've reported the regulatory requirements in accordance with our requirements under PN 19. And, you know, that engagement would've been quite limited. We now have much greater engagement with the regulator.

Senator Sean D. Barrett: Did you encounter, in doing the sample of loans, any problems of income verification?

Mr. John McDonnell: What do you mean by income verification? Sorry.

Senator Sean D. Barrett: Verifying the income of the borrower.

Mr. John McDonnell: The bank would have had detailed procedures around its collateral and around the information that it gets from its loans. It would've detailed controls in place and we would've looked at a sample of loans. We looked at the operation of those controls. I can't say in all the sample loans that we see ... what we would've seen. But anything that we would've seen, we would've reported up. But I can say the bank had very, very detailed checklists and controls over collateral.

Senator Sean D. Barrett: Were there concerns ... just two, if I may, in the wrap-up, Chairman ... were there concerns about Bank of Ireland's loss of market share? Were there concerns when you were doing the audits that a lot of power had been moved from local branches and regions to the centre?

Mr. John McDonnell: They were ... they were ... the bank had a business model where it was trying to co-ordinate its ... its ... its ... the operation of its controls so it would get a much better effective control and it would get consistency and control across its models. So the banks would always change and verify ... change their business models and we would have discussions with the banks about those business models solely in the context of how it impacts on our audit or the financial statements. I don't ... I don't ... that's where it would begin and end in terms of our interaction with that.

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

Chairman: Thanks very much. Okay, that brings me to wrapping matters up. And, in doing so, I would like to thank Mr. Murphy and Mr. McDonnell for their participation today and for their engagement with the inquiry. The witnesses are now excused and I just want to take a brief suspension because there's some lines of inquiry, notification stuff that ... we just need to have a quick sit-down before we go to lunch. So with that said, I'll just suspend for two or three minutes to excuse the witnesses and we'll just resume in private session to deal with those matters promptly then. So Mr. McDonnell and Mr. Murphy, you are excused.

Mr. John McDonnell: Thank you, Chairman.

Sitting suspended at 1.15 p.m., resumed in private session at 1.17 p.m. and suspended again at 1.30 p.m. until 2.30 p.m.

Ernst and Young - Mr. Paul Smith and Mr. Dargan Fitzgerald

Chairman: I now propose that we go back into public session for this afternoon's engagement, is that agreed? Okay, and the committee is now back in public session for session 2. This is a public hearing with Mr. Paul Smith, former managing partner at Ernst and Young, and Mr. Dargan Fitzgerald, audit partner, Ernst and Young. 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 Ernst and Young, Mr. Paul Smith, former managing partner, and Mr. Dargan Fitzgerald, audit partner. Mr. Paul Smith is a former managing partner with Ernst and Young. He held this position from 2000 to July 2009, having been re-elected on three consecutive occasions.

Dargan Fitzgerald is head of Ernst and Young's insurance and audit practice in Ireland. He is a partner in Ernst and Young since 2000, and within Ernst and Young is the EBS's auditing partner. Mr. Smith and Mr. Fitzgerald are both very welcome here this afternoon.

Before I start hearing from the witnesses, I wish to advise the witnesses that by virtue of section 17(2)(*l*) 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 in 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, and in this regard, I remind members and those present, that Mr. Paul Smith and Mr. Dargan Fitzgerald are here today to discuss their roles as auditors with