PAUL DOBEY

WITNESS STATEMENT TO THE JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS (THE "COMMITTEE") PURSUANT TO SECTION 67(1) OF THE HOUSES OF THE OIREACHTAS (INQUIRIES, PRIVILEGES AND PROCEDURES) ACT 2013

1 MAY 2015

1. Background to this Witness Statement

I refer to the Notice of Intention to issue a Direction, sent under cover of a letter from the Chairman of the Committee dated 16 April 2015, indicating that I will be directed to attend and give evidence before the Committee and provide a statement in writing pursuant to section 67(1) of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013 (the "Direction Notice").

2. Basis of Evidence

The Direction Notice indicates that my oral and written evidence to the Committee is to be provided in my capacity as a Partner of KPMG Ireland and as Lead Engagement Partner for AIB. I have been a Partner in KPMG Ireland since 1998. I was a Partner on the AIB audit from 2002 to 2008 and the Lead Engagement Partner for AIB for the period from 2005 to 2008.

This statement addresses the seven lines of inquiry (under five general themes) specified in the Direction Notice from the perspective of an external auditor and in the context of the AIB audits with which I was involved. A table setting out the relevant themes and lines of inquiry is appended to this statement at Appendix A.

I note that five of the seven lines of inquiry on which I have been directed to provide evidence overlap with those in the Direction to Mr. Terence O'Rourke (Managing Partner of KPMG Ireland from 2006 to 2013) to provide evidence to the Committee. These have been addressed in the witness statement Mr. O'Rourke provided on 16 April 2015. As Mr. O'Rourke noted in his statement, he consulted with me in the course of its preparation and I agree with the views he has expressed therein.

I intend to address, under each of the lines of inquiry identified, specific matters relating to the AIB audits, rather than repeating the more general contextual issues which have already been addressed in detail in Mr. O'Rourke's statement. These relate, for example, to the purpose and scope of a financial statement audit, the impact of the auditing and accounting standards on the financial reporting of the Irish institutions generally, and the developments in financial reporting and auditing since the crisis.

There are two additional lines of inquiry which the Committee has asked me to address which did not form part of the Direction issued to Mr. O'Rourke and which were not, therefore, covered specifically in his witness statement. Again, I will deal with these two lines of inquiry from the perspective of the external auditor to AIB, and in the context of the relevant AIB audits, rather than on any more general basis.

3. Specific Lines of Inquiry also dealt with in Mr. O'Rourke's Witness Statement

B1:b - Integrity of Financial Reporting

From 2005 onwards, AIB was required by law to comply with the set of International Financial Reporting Standards endorsed by the EU ("IFRS"). It is KPMG's opinion that AIB complied with these requirements and standards in preparing its financial statements during the relevant period.

As noted in Mr. O'Rourke's statement to the Committee, the financial reporting standard of most relevance to loan loss provisioning was IAS 39 *'Financial Instruments: Recognition and Measurement'*. This standard required the use of an incurred loss model for the reporting of loan loss provisions. Again, it is my belief that AIB complied with this standard in preparing its financial statements for all years post its adoption of IFRS in 2005.

The AIB financial statements which were filed annually with the United States Securities and Exchange Commission (the "SEC") in AIB's Form 20-F were subject to periodic reviews by the SEC. The objective of such reviews was to consider whether the financial statements of public companies like AIB, which had securities listed on the US capital markets, were in compliance with the financial reporting requirements of the applicable financial reporting standards and with securities regulations. These reviews also had the objective of promoting the consistent application of financial reporting standards. AIB dealt comprehensively with the queries that arose from these reviews (including in relation to its accounting and disclosure of loan loss provisions) and was not required to restate any published financial statements as a result of any of these reviews in the period from 2002 to 2008.

On transition to IFRS in 2005, AIB released provisions of €146m which had previously been permitted under Irish GAAP but were no longer permitted under IAS 39. Like many of its international counterparts, the 2005 AIB Form 20-F was the subject of a review by the SEC following its first-time adoption of IFRS. As part of this review, the specific objective of which was to consider the consistency of application of IFRS, the SEC requested certain clarifications from AIB regarding its financial reporting policies in relation to loan loss provisions in the transition to IFRS. These matters were responded to by AIB and did not give rise to any changes in AIB financial reporting policies.

As noted above, it is my view that AIB appropriately applied the requirements of IFRS. I am aware that there are some widely voiced concerns with aspects of IFRS, and with IAS 39 in particular. In this regard, I note that the proposed new financial reporting standard, IFRS 9, will allow for the earlier recording of provisions for loan losses.

I also note that a view has been expressed by many commentators that IAS 39 may have contributed to the banking crisis in Ireland because it did not allow the banks to build up general or unallocated loan loss provisions in a period of strong economic growth that could have been utilised to absorb some portion of the loan losses that were incurred at the beginning of the crisis.

In my view, IAS 39 was not a significant contributing factor to the property-related lending issues that gave rise to the banking crisis in Ireland. One of the objectives of financial reporting is to provide transparency to shareholders through avoiding inappropriate income smoothing or earnings management. In this regard, I believe that IAS 39 achieved the very important objective of providing transparency to shareholders.

It is worth noting that it was always acknowledged that IAS 39 would give rise to significant additional provisions in a downturn. To my knowledge, this was understood by AIB management and by its Audit Committee and its Board. In this regard, we prepared a detailed paper for the

AIB Audit Committee in September 2008, dealing with credit provisioning in a downturn, which was presented at the 6 October 2008 Audit Committee meeting. In anticipation of the challenges that would arise as part of our 2008 audit, this paper set out in some detail how loan loss provisions would be determined in a downturn in accordance with the requirements of IAS 39.

It is my view that, notwithstanding IAS 39, the Financial Regulator was in a position during that period of strong economic growth to require the banks to raise, preserve or hold additional capital to absorb losses that could arise in a downturn.

B2:a - Appropriateness of property related lending strategies and risk appetite

As noted in the statement of Mr. O'Rourke, our role as external auditor of AIB in respect of its annual financial statements was to provide an opinion as to whether those financial statements gave a true and fair view in accordance with IFRS. In forming that opinion, we were required to comply with the specified auditing standards which Mr. O'Rourke has also referred to. I was involved in the external audit of AIB from 2002 to 2008 and it is my view, and the view of the firm, that KPMG complied with these requirements and standards in carrying out the audit of AIB in that period.

It is important to note that our audit opinions on AIB related to the true and fair view given by the financial statements and did not address the effectiveness with which management or the Board of AIB conducted its affairs or the appropriateness of its risk appetite. That responsibility rested with the management and Boards of AIB.

In the context of the audits of AIB, we were aware of the Bank's strategies, including the property-related lending strategies, and also the risk appetite more broadly. We considered these matters in planning and performing our audits of AIB. In particular, we considered whether the Bank's strategies, and the risks arising from them, were appropriately reflected in the financial statements of AIB, from both a measurement and disclosure perspective, in accordance with the applicable financial reporting framework (i.e. IFRS from 2005 onwards).

AIB had an extensive risk management and monitoring infrastructure and there was extensive reporting of risk matters, including property-related concentrations of credit risk, to the AIB Board. These matters were also considered by the AIB Audit Committee from a financial reporting perspective and AIB's assessment and disclosure of these risks were set out in great detail in its annual reports, its Form 20-Fs, and in its other reporting to the market.

In our role as external auditor, we did not have responsibility for forecasting the potential future implications of these risks, other than in considering the going concern basis of preparation of the financial statements. We did note in our written communications with the Audit Committee that there were risks associated with the concentration of property-related lending and that loan loss provisions could increase significantly if property prices were to decrease or the economy to go into recession. These matters were discussed at the AIB Audit Committee meetings at which these written communications were presented and when the Chief Risk Officer presented his regular reports to the Audit Committee on risk matters. Thus, while AIB was aware that there were risks relating to its property-related lending strategies, it is clear that the Bank did not anticipate the potential scale of these risks and the ultimate losses that would arise.

B3:e - Capital structure and loss absorption capacity

The role of KPMG as external auditors to AIB was to audit the financial statements in accordance with International Standards on Auditing. The financial statements were prepared in accordance with IFRS, which required the recording only of incurred losses under IAS 39. I have dealt with the issues presented by this standard earlier in my statement and it has also been addressed by Mr. O'Rourke. As external auditor, KPMG was required to assess whether the Bank's loan loss provisions were in accordance with that standard.

As noted above, the Financial Regulator had the ability to require AIB to set aside additional capital to enable AIB to absorb losses that could arise in a downturn. As independent external auditor, we did not have, and could not have had, a role in setting the capital requirements for AIB.

C2:c - The liquidity versus solvency debate

At each year end, the directors and external auditors of AIB were required to consider, as part of the financial statements approval and sign-off process, whether the going concern basis of preparation of the financial statements of the Bank was appropriate. This going concern assessment involved considering the assumptions underpinning the funding and liquidity position of the Bank for a period of at least one year from when the financial statements were approved and signed off.

In light of the benign economic environment in Ireland from 2002 to 2006 and the sources of capital and funding which were readily available to AIB, there did not appear to be significant risks to the solvency or liquidity of the Bank during that period.

In performing our 2007 audit of AIB in early 2008, we were concerned about the effect of worsening financial markets on the liquidity and funding position. AIB prepared a detailed going concern analysis for consideration by the Audit Committee and the Board to support the basis of preparation of the financial statements. Based on this paper, and the contingency liquidity plans that AIB had in place at the time, we were satisfied in completing our 2007 audit that the going concern basis of preparation of AIB's financial statements was appropriate.

In performing our 2008 audit of AIB, we had significant concerns in relation to both the liquidity and the solvency of the Bank. We had extensive written and oral communication with the AIB Audit Committee in relation to this matter in early 2009. We communicated in writing to the Audit Committee of AIB at its meeting of 18 February 2009 that, prior to finalising our opinion on the going concern basis of preparation of AIB's financial statements for 31 December 2008, we would meet with the Financial Regulator and/or the Department of Finance to ensure that we had a full understanding of the risks to the financial system in Ireland and the actions being taken by the Financial Regulator, the Central Bank and the Irish Government to address these risks. As part of this process, we sought confirmation of our understanding of the public statements made by the Minister for Finance at the time in relation to AIB, by way of verbal representations which we received at meetings with the Head of Banking Supervision of the Financial Regulator, the Deputy Governor of the Central Bank of Ireland and the Assistant Secretary General of the Department of Finance, prior to finalising our audit opinion.

R2:c - The adequacy of the assessment and communication of both solvency and liquidity risks in the banking institution sector

I do not have very much to add in respect of this line of inquiry beyond what Mr. O'Rourke has already said in his statement, save to note that, throughout the period from 2005 to 2008, there was a significant focus within AIB on Basel II. This involved extensive dialogue between AIB and the Financial Regulator on the capital requirements of the bank under a Basel II regime in that period and a large part of the AIB deliberations in relation to its capital adequacy was informed by this dialogue and Basel II considerations generally.

4. Specific Lines of Inquiry not dealt with in Mr. O'Rourke's Witness Statement

B7:a – Impact of prevailing accounting standards in recognising risks

While this line of inquiry is not specifically referenced within Mr. O'Rourke's statement, his statement does set out the relevant financial reporting standards and requirements pursuant to which loan loss provisions were required to be estimated and recorded. I agree with what Mr. O'Rourke has said in this regard. I have also commented further above on IAS 39, the impact of the prevailing financial reporting standards on the timing of the recognition of loan loss provisions, and how this may have impacted the loss absorption capacity of AIB.

B7:b– Effectiveness of the external audit process to identify and report to the board and management, any concerns related to significant risk exposures, including property, funding and liquidity

AIB Risk Function and its reporting to the Board

Before addressing this specific line of inquiry, it might be helpful to set out some background information on the risk reporting framework within AIB during the period in question and how this related to our audit.

In the period following the Rusnak fraud in 2002, AIB reviewed and reorganised its risk function, infrastructure and reporting. This involved the hiring of a very experienced international banker as Chief Risk Officer and an extensive overhaul of the risk policies, procedures and reporting practices in AIB.

The Chief Risk Officer reported to the Chief Executive Officer and chaired the Risk Management Committee, which comprised the heads of each division. The Chief Risk Officer also attended meetings of the Audit Committee and the minutes of the Risk Management Committee were circulated to, and considered by, the Audit Committee. The Audit Committee was also briefed by the Chief Risk Officer on the activities of the Risk Management Committee and on risk matters generally. Representatives of the KPMG audit team (including myself) also attended the AIB Audit Committee meetings and therefore had a very good knowledge of the risk agenda and priorities of AIB, particularly insofar as these related to the Bank's financial reporting, the risk disclosures in its annual reports to shareholders and its Form 20-F SEC filings.

The Chief Risk Officer also prepared a risk dashboard which was designed to monitor key risks to AIB, including matters such as credit quality, concentrations of credit risk, operational risk, market risk and liquidity risk. In addition, a semi-annual detailed "bottom-up" analysis of risk was completed by the AIB risk function and a detailed report setting out the results of this analysis was prepared for the Board and presented by the Chief Risk Officer to the Audit Committee, which we attended as external auditor. This included an analysis of the environment in each of the markets in which AIB operated and of the economic and competitive landscape. This semi-annual report also set out the top ten risks for AIB, with a related analysis under the following headings:

- Risk item;
- Materiality;
- Probability and likelihood;
- Confidence in controls to mitigate the risk; and
- Whether the risk status was increasing or decreasing.

The risks relating to credit risk, liquidity and funding featured with increasing prominence in these semi-annual reports in the period from 2005 to 2008. Specifically, the risks relating to the credit and capital aspects of Basel II and credit risk generally were identified as the most significant risks for AIB in 2006. The impact of market turbulence and credit risk on the bank were identified as the most significant risks for AIB in 2007. Credit risk and the risks relating to liquidity and funding were identified as the most significant risks for AIB in 2008. These risks were also addressed in the detailed risk disclosures set out in AIB's annual reports and in its Form 20-F reporting for SEC purposes.

I believe this is useful background in understanding the internal reporting of the risk profile and exposures within the Bank to senior management and to key committees and the relatively well-evolved infrastructure in this regard.

The Role of the External Auditor

My response, from the perspective of the external auditor to AIB, to this line of inquiry must be considered in the context of a financial statement audit as described in Mr. O'Rourke's statement. In summary, the purpose of an audit is to express an opinion on the financial statements as a whole. The management and Board of AIB were responsible for the preparation of the financial statements in accordance with the underlying financial reporting and legislative framework. It was our responsibility to audit these financial statements in accordance with clearly specified auditing standards.

The financial statements of AIB and, by extension, our audit reports, were a "point in time" report on the results, financial position and disclosures of AIB in each of the relevant years.

An audit is not a forecast, nor does it direct management or business strategy. An audit is carried out within a specified scope that is reasonably well understood by the investor community. There can be misunderstandings in relation to what an audit actually is and what certain commentators think or would like it to be, particularly in relation to the strategy and risk appetite of an entity. Put simply, we did not tell AIB which counterparties to lend to, which funding markets to access, or how much capital to hold. To do so would be beyond our role and competence as external auditors and would undermine our ability to give an independent auditor's report on the financial statements of our audit clients.

Auditing Standards relating to Communications

It might be helpful for the Committee's consideration of this line of inquiry, in the context of identifying and reporting risks, for me to refer to the relevant auditing standard which sets out the communications required of an auditor to those charged with governance within an institution.

The relevant auditing standard in this regard is ISA 260 '*Communication with those charged with governance*'. This details the key principles of the auditor's responsibilities in relation to communications with those charged with governance, including the requirement for auditors to communicate in relation to matters such as the planned scope of an audit, significant findings from the audit, and issues relating to auditor independence.

It should be noted that ISA 260 does not require the auditor to design supplementary procedures to detect or communicate to those charged with governance items beyond those relevant for the purposes of the financial statement audit. However, where circumstances arise in the course of completing an audit in which the auditor comes into contact with, or possession of, other information that may be considered relevant to those charged with governance, for example, from an internal controls perspective, the auditor is required to communicate this information. In this regard, we assessed the sufficiency of the extensive risk disclosures set out in the annual financial statements of AIB and in its 20-F filings with the SEC.

The communication of KPMG with AIB, in our view, complied with each of the requirements under the auditing standard, including communications related to:

- the planning and timing of the audit;
- areas of significant risk and audit focus;
- significant findings from the audit;
- significant difficulties encountered during the audit (if any);
- significant matters discussed or subject to correspondence with management;
- other significant matters relevant to the financial reporting process; and
- auditor independence.

Communications by KPMG to the AIB Audit Committee

Mr. O'Rourke's witness statement notes, in relation to KPMG's bank audit clients generally, that, in many instances, we reported to the audit committees that there were risks associated with the concentration of property-related lending in their portfolios and that loan loss provisions could increase significantly if property prices were to decrease or if there was a downturn in the economy.

In relation to AIB specifically, we reported to the Bank's Audit Committee on various risks, identified as a result of our audit process, arising from the business model and strategies followed by the Bank. It is important to note, however, that our identification of these risks, and our reporting of them to AIB, took place in the context of our "point in time" audits and was for the purpose of ensuring that any financial reporting implications of those risks were properly reflected in the Bank's financial statements, in accordance with the applicable framework.

Our communications to the AIB Audit Committee in respect of our audits of the financial statements for the years from 2004 to 2007 included the identification of risks relating to, or arising from, property, funding and liquidity. Copies of written communications in this regard have been provided to the Committee by KPMG[1].

Based on our communications with AIB's Audit Committee during this period, it was clear that the Bank was aware of the risks inherent in its business and lending strategies but, as we now know, the potential scale of these risks, and the resulting losses that would ultimately be incurred, was not appreciated or anticipated.

Although, to a significant degree at least, the decisions which gave rise to the losses recorded by AIB in 2008 and subsequent years were taken in the 2004 to 2007 period, these losses only fell to be recorded in the financial statements (in accordance with the incurred loss model under IFRS) when there was a severe decline in property prices and rapid contraction of the Irish economy. This commenced in the last quarter of 2008 and continued in subsequent years.

Effectiveness of Communications

I consider that our communications to AIB's Audit Committee were effective in the sense that we reported on risks arising from the Bank's business strategies which we identified in the course of our audits of the financial statements. This reporting took place in compliance with the applicable frameworks and auditing standards with which we as external auditors had to comply.

The purpose of our communications with AIB in relation to risk matters was to ensure that any financial reporting implications of these risks were properly reflected in the Bank's financial

[1] Pursuant to the separate Direction to the firm to produce extensive documentation in respect of its audits of a number of financial institutions in Ireland from 2001 to 2010, including documentation relating to the AIB audits.

statements. Our communication of these matters was not to alter or influence AIB's approach to business strategy or its risk appetite. To do so would have undermined our ability to give an independent audit opinion on AIB's financial statements.

APPENDIX A

RELEVANT GENERAL THEMES AND SPECIFIC LINES OF INQUIRY

General Themes	***Specific Lines of Inquiry***
B1: Effectiveness of banks' board governance, client relationship and business models	b; Integrity of financial reporting
B2: Effectiveness of banks' credit strategies and risk management	a; Appropriateness of property-related lending strategies and risk appetite
B3: Effectiveness of banks' liquidity strategies and risk management	e; Capital structure and loss absorption capacity
C2: Role and effectiveness of the policy appraisal regime before and during the crisis	c; The liquidity versus solvency debate
R2: Effectiveness of supervisory practice (Central Bank, Financial Regulator and Department of Finance)	c; Adequacy of the assessment and communication of both solvency and liquidity risks in the banking institutions and sector.
B7: Impact of external audit process in supporting effective risk management	a; Impact of prevailing accounting standards in recognising risk.
B7: Impact of external audit process in supporting effective risk management	b; Effectiveness of the external audit process to identify and report to the board and management, any concerns relating to significant risk exposures, including property, funding and liquidity.