TERENCE O'ROURKE

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

16 APRIL 2015

1. Background to this Witness Statement

I refer to the Direction, sent under cover of a letter from the Chairman of the Committee dated 2 April 2015, that I 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").

2. Lines of Inquiry and Basis of Evidence

The Direction identifies five specific lines of inquiry under five general themes which I am required to address in my oral and written evidence to the Committee. A table setting out the relevant themes and lines of inquiry is appended to this statement at Appendix A.

The Direction indicates that my evidence is to be provided in my capacity as former Partner and former Managing Partner of KPMG Ireland. I was a Partner in KPMG from May 1988 to April 2013. I was Head of Audit for KPMG from May 2004 to December 2006. I held the role of Managing Partner from December 2006 to April 2013. The Committee has confirmed that I should consider and address the specified lines of inquiry from the perspective of the external auditor.

I have not held an active role within KPMG since retiring as Managing Partner in April 2013 but the firm has provided support and assistance to me in complying with the Direction. I am also aware that KPMG was the subject of a separate direction from the Committee to produce extensive documentation in respect of its audits of a number of financial institutions[1] in Ireland from 2001 to 2010.

The Chairman's letter of 2 April 2015 also indicated that a relevant KPMG Bank Audit Partner in relation to AIB may attend with me on the day of my public hearing. The partner in question is Mr. Paul Dobey, who was a Partner on the AIB audit for all years between 2002 and 2008 and was the Lead Engagement Partner on the AIB audit from 2005 to 2008 inclusive. In preparing this statement, I have consulted with and received input from Mr. Dobey.

3. Context of a Financial Statement Audit

In the first instance, I propose to set out the purpose of a financial statement audit and the role of the external auditor to give necessary context to my statement. In short, external auditors are

[1] To the extent that "*financial institutions*" or "*banks*" are referred to in this statement, these references also encompass, where applicable, the building societies which are also the subject of the Committee's considerations.

required to comply with certain clearly specified financial reporting and auditing standards, further details of which are provided below. As far as KPMG is concerned, the firm complied fully with these requirements and standards in carrying out the audits of the relevant institutions during the specified period. It should be noted, in this regard, that:

- The management of an entity is responsible for the preparation of its financial statements and the overall responsibility for financial statements rests with the board.

- Financial statements are a “point in time” record of financial information of an entity, including its results, financial position and cash flows. By definition, financial statements are a record of past financial performance and do not seek to forecast or predict future performance.

- Financial statements are required by statute to be prepared in accordance with a clearly defined financial reporting framework which specifies the rules and standards to be applied in their preparation.

- The role of the auditor is to perform an audit in accordance with an auditing framework which includes specified standards and rules and, following the performance of the audit, to express certain defined opinions in relation to the financial statements.

- The objective of having clearly defined financial reporting and auditing frameworks, standards and rules is to provide uniformity, consistency and transparency to the users of financial statements.

The Financial Reporting Framework

From 2005 onwards, the financial reporting framework applicable to Irish financial institutions which had securities listed on an EU regulated market was the set of International Financial Reporting Standards endorsed by the EU (“IFRS”). This applied by virtue of an EU Regulation[2] and has force of law in Ireland by way of Statutory Instrument[3], with the effect that the institutions in question are mandated by law to apply IFRS. These standards were also adopted by the Irish building societies which are the subject of the Committee’s considerations.

The IFRS are developed by the International Accounting Standards Board (“IASB”) through a formal system of due process and broad international consultation. The EU endorsed the adoption of IFRS in 2002 with an overwhelming majority vote in the European Parliament.

The IASB is an international body based in London which is committed to developing, in the public interest, a single set of high quality, global financial reporting standards that require transparent and comparable information in financial statements.

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[2] IAS Regulation – Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002.

[3] Statutory Instrument 116 of 2005 - European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005.

IFRS sets out recognition, measurement, presentation and disclosure requirements dealing with transactions and events which are important in financial statements. They seek to ensure that financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. The objective is to provide consistent information about the financial position and past performance and cash flows of an entity that is useful to those users in making economic decisions[4].

The Auditing Framework

The auditing framework applicable to the audits of the financial statements of the Irish institutions was the auditing and assurance pronouncements issued by the UK Financial Reporting Council, a body independent of the auditing profession. This framework includes the International Standards on Auditing (UK and Ireland) ("ISAs"), which are based on corresponding international standards developed and issued by the International Auditing and Assurance Standards Board ("IAASB") and published by the International Federation of Accountants.

The ISA that sets out the scope of the financial statement audit is ISA 200, entitled "*Overall objectives of an independent auditor and the conduct of an audit in accordance with International Standards on Auditing (UK and Ireland)*". This deals with the purpose and framework of the audit, the overall objectives of the auditor, and provides guidance on what an audit opinion is required to address in relation to the financial statements of the audited entity.

ISA 200 further states that the purpose of an audit is to enhance the degree of confidence, of intended users, in the financial statements. For the years since 2005, for entities with securities listed in the EU, this is achieved by the expression of an opinion by the auditor on whether the financial statements give a true and fair view in accordance with IFRS as adopted by the EU.

ISA 200 also deals with the overall objectives of an auditor[5] and the purpose of an audit opinion[6].

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[4] An important principle of IFRS is that "*an entity whose financial statements comply with IFRS shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with IFRSs unless they comply with all the requirements of IFRS*".

[5] These are described as: "*(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether caused by fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework*" and "*(b) To report on the financial statements and communicate as required by International Standards on Auditing (UK and Ireland) in accordance with the auditor's findings*".

[6] This is described as dealing "*with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of an entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.*"

4. Specific Lines of Inquiry

B1:b - Integrity of Financial Reporting

As set out above, the directors of the financial institutions which KPMG audited had responsibility for the preparation of financial statements in accordance with the specified financial reporting framework which is embodied in law, i.e. IFRS from 2005 onwards. It was, and remains, KPMG's view that the financial reporting of the relevant institutions was conducted in accordance with the requirements of IFRS and that those institutions had in place the necessary governance to allow this to happen.

The KPMG teams performing bank audits during the relevant period were experienced in the application of ISAs and the relevant financial reporting frameworks (IFRS from 2005 onwards) and had an in-depth understanding of the banking sector. These teams monitored emerging best practice financial reporting through their connection with fellow KPMG firms in Europe and the US. These audit teams had particularly close ties with our UK firm and were, therefore, familiar with best practice financial reporting and auditing standards in the UK market.

As appropriate, the teams in Ireland were supplemented with input from our UK firm, with, for example, an experienced partner from the UK acting as Engagement Quality Control Reviewer. This partner was the lead partner on one of the large UK clearing banks and was consulted extensively, particularly in 2007 and 2008 as the crisis took hold. In addition, one of our bank audit clients was US-listed at the time and the US Securities Exchange Commission ("SEC") rules required KPMG to use an SEC-accredited specialist partner to support the audit team. This individual was an experienced banking partner based in the New York office of KPMG's US firm and was also consulted extensively. The involvement of UK and US banking partners and their international perspectives were reflected in the conduct of, and positions taken, in our bank audits at the time.

The financial statements of the listed banks were also subject to reviews by independent accounting regulators over the period from 2002 to 2010, including reviews by the Irish Auditing and Accounting Supervisory Authority and the SEC. These included consideration of the first time adoption of IFRS post-2005 and also included a review of the application of accounting policies and certain financial statements disclosures in the post-crisis period. None of these institutions were required to restate any of their published financial information as a result of these regulatory reviews.

IAS 39 - Fair Value Accounting and the Incurred Loss Model

One of the most significant accounting standards impacting the Irish institutions was IAS 39, entitled "*Financial Instruments: Recognition and Measurement*", and, in particular, its requirements regarding the recognition of provisions for loan losses.

After the adoption of IFRS in the EU in 2005, the financial reporting framework in both the EU and the US (under the equivalent standards issued by the FASB) required banks to apply an incurred loss (as opposed to an expected loss) model. This was arrived at after extensive deliberations by standard setters and other parties. It was believed that this was preferable to other models which were considered to be potentially less transparent and much more subjective, which would make it more difficult to achieve consistent application between entities. Notwithstanding this, one of the inevitable effects of the incurred loss model is to delay the recording of loan loss provisions in a downturn.

IAS 39 requires the preparers of financial statements to use this incurred loss model in respect of the recording of loan loss provisions by financial institutions, with the objective (and result) that loan losses are recorded when there is objective evidence that they have been incurred and not before. The incurred loss model prohibits entities from:

- marking to market financial instruments accounted for as loans and receivables;
- anticipating increases or decreases in asset values that are not based on available information at the time of making the provision; and
- providing for the impact of forecast economic or employment conditions.

<u>The post crisis debate on enhancing the Financial Reporting Framework</u>

a) Changes in Financial Reporting Standards

As noted above, the objective of financial statements is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions concerning the entity.

In this context, it is interesting to consider the review of, and wide consultation on, standards undertaken by the IASB in the wake of the global financial crisis. It is also interesting that the IASB has noted that the challenges relating to the effectiveness of its standards were similar in many of the more than 100 jurisdictions in which they were being used at the time of the global financial crisis.

In a speech in March 2014, the Chair of the IASB noted that their response to the global financial crisis was guided largely by the recommendations of the Financial Crisis Advisory Group ("FCAG"), which was formed in 2009 to advise the IASB and the FASB in the wake of the financial crisis. The FCAG consisted of senior leaders with broad international experience in the financial markets, standard-setting and regulation.

The Chair of the IASB noted that "*One of the key findings of the FCAG was to emphasise the role of financial reporting in providing unbiased, transparent and relevant information. However, the FCAG also recognised that only so much can be expected of accounting. Yes, accounting standards could contribute to financial stability by providing transparency. But, no, we should not expect accounting standards to provide a veneer of stability by ignoring volatility when it is really there*."

He further noted that:

"*The FCAG also made more specific recommendations with regard to our standards. The most important were the following:*

1 improving the accounting for what is on or off balance sheet and the related disclosures;

2 *fixing the so called 'own-credit'-problem: the counterintuitive result of entities booking gains when the value of their own liabilities fall as they become more likely to default; and*

3 *devising a more forward-looking impairment model for loan loss provisions.*

4 *finally, the FCAG urged the FASB and IASB to come to converged solutions."*

The first, second and fourth points of the FCAG's specific recommendations are of limited relevance to the Committee's considerations and do not relate to the accounting implications of the risk and business strategies that resulted in the large losses incurred by the Irish institutions.

The third point, relating to a more forward looking impairment model for loan loss provisions, was perhaps the accounting issue most commented on in Ireland, and related to the fact that banks were not permitted to factor likely future events into their assessment of loan loss provisions unless there was objective evidence of impairment.

This limitation only really came to prominence when the extent of the unfolding financial crisis had become apparent in late 2008. At that point, the banks were not permitted to provide for the losses that were then foreseeable given the expected future decline in the value of property collateral on which the loans were secured. Indeed, the Irish banks reported in early 2009 that they expected that their losses to be incurred over the downturn would be some multiples of the actual provisions they were able to make in their 2008 financial statements under the financial reporting standards in place at the time. Notwithstanding this, it is also worth noting that even in early 2009, when the institutions made their projections, neither they nor many commentators were able to quantify with any degree of accuracy the actual scale of the losses that were ultimately incurred.

It is only recently that the IASB has agreed a revised loan loss provisioning model. This revision follows the extensive debate and research involved in attempting to arrive at a better model which harmonised, to the extent possible, the approach to be used for such provisioning between the proposals of the IASB and those of the FASB in the US.

The new IFRS provisioning standard specifies an expected, rather than an incurred, loss model for loan loss provisioning. While this, by its nature, is more subjective and more difficult to apply consistently than the incurred loss model, the current view is that this standard will permit the earlier recognition of loan losses. As a result, it will be possible to recognise expected losses in a downturn when there is evidence of impairment.

This new standard cannot currently be applied by an EU-listed institution as it has not yet been endorsed by the EU but this is expected to occur in the relatively near future. The new standard is expected to be applied by EU-listed Irish banks from 1 January 2018, although early adoption will be permitted following endorsement by the EU.

b) Possible changes in other aspects of Corporate Reporting

A more wide-ranging debate is also underway globally regarding how corporate reporting can be improved. The limitations of the formal aspect of corporate reporting are being reviewed, including whether the current regime is serving the needs of shareholders and whether it is appropriate that so much important information is communicated outside of the annual report, e.g. in investor presentations, on websites, etc.

The International Integrated Reporting Council ("IIRC")[7] has considered the possible future direction of financial reporting and is examining ways in which to better set out, in an integrated report, what is happening in a business in more than just financial terms.

Such an integrated report would be a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, is intended to lead to the creation of value in the short, medium and long term[8]. This principles-based approach would provide a structure for describing the performance and value of the business from an operational rather than a compliance perspective.

c) Possible changes in the reporting framework in the UK

Within the reporting framework which is applied in the UK, there has been a significant development along these lines with the publication of the Financial Reporting Council's Guidance on the Strategic Report introduced in June 2014 (the "Guidance"). This is the latest in a series of regulatory initiatives aimed at improving the relevance of narrative reporting. Again, the Guidance adopts a principles-based approach, with the emphasis on business 'telling its story', rather than making a series of disconnected compliance disclosures[9].

The above initiatives are not currently effective in Ireland but, if implemented, would improve financial reporting so that, over time, there would be a more coherent framework for integrated financial and strategic business reporting.

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7 The IIRC comprises a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs.

8 The aims of such integrated reporting are to: (i) improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital; (ii) promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time; (iii) enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social, and natural) and promote understanding of their interdependencies; and (iv) support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.

9 Key areas of change that the new Guidance is expected to drive include: (i) more rigorous descriptions of business model and strategy that provide shareholders with an understanding of the processes, relationships and resources that the business is dependent on, together with the strategy for developing and preserving business capability over the longer term; (ii) renewed focus on the Strategic Report complementing the financial statements by evaluating past performance and supporting readers' assessment of future prospects; (iii) greater use of non-financial performance measures that are relevant to an understanding of business prospects and how business prospects and capabilities have been developed and protected; and (iv) better linkage between elements of the report, including performance measures that relate to identified risks and opportunities to shareholder value.

The responses of the audit profession since 2008

The auditing profession has been conscious of the views expressed by regulators, politicians and commentators of the role played by it prior to and during the financial crisis. Some have questioned the role of auditors and the value of an audit, while others have questioned the appropriateness of the incurred loss model under IAS 39 referred to above.

Substantive new guidance has been issued and changes have occurred since 2008, including in relation to the increased consideration by directors and auditors of the going concern basis of preparation of financial statements, auditors reporting to regulators, and the format and content of audit reporting.

In 2009, the IAASB issued a complete new set of International Standards on Auditing with a view to developing a better focused audit. The Financial Reporting Council ("FRC"), through its work on the Audit Quality Framework, has also been active in identifying ways in which the practical application of high standards can be supported. It has also been acknowledged that while there may be robust challenge and dialogue between the auditor, management and audit committees, the audit findings reports may show only the final conclusions in the areas which were the subject of debate.

The FRC reviewed the reporting of going concern issues towards the end of 2008 and issued comprehensive guidance to directors on how to fulfil their responsibilities. The Auditing Practices Board also released a related bulletin in 2008 to support auditors in dealing with going concern issues. The FRC later updated its material, issuing its "*Revised Guidance on Going Concern and Liquidity Risk*" in October 2009. The topic of going concern has remained high on the agenda, primarily through the 2012 Sharman report and related activity, with directors and auditors now looking at the implementation of significantly more demanding requirements for assessing and reporting on going concern and liquidity.

The auditor's right and duty to report to regulators in certain instances was also addressed in a clarified version of ISA 250 (UK and Ireland)[10] issued in 2009. While this did not change the overall nature of the auditor's responsibilities to communicate matters 'of material significance' to regulators, it includes a number of clarifications of requirements that bring the 'when' and 'how' of such reporting into sharper focus. This matter has also been dealt with through additional guidance issued by the Central Bank of Ireland.

The format and content of the auditor's report was also addressed in the FRC's UK and Irish version of clarified ISA 700 on auditor reporting. This set more demanding parameters than the international version and has been underpinned with work on the concept of 'true and fair'. The revision of ISA 700 in 2012[11] has increased focus on meeting investor needs. Similarly, the parallel reporting now required by the audit committee in the annual report provides more clarity on critical areas of judgment.

[10] Entitled "*The Auditor's right and duty to report to regulators in the financial sector*".

[11] This now requires auditors of entities applying the UK Corporate Governance Code to provide a long form commentary on key audit areas.

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

The auditor's opinion on the financial statements deals with whether they give a true and fair view in accordance with IFRS. The opinion does not assure, for example, the future viability of an entity nor the effectiveness with which management has conducted its affairs. This responsibility rests with the management and boards of the entity.

One of the key steps in an audit is to assess the risks arising from the business model and strategies followed and then to ensure that any accounting implications of those risks are properly reflected in the "point in time" financial statements. The auditor is not tasked with assessing the appropriateness of the strategies or business models; rather, it is required to form an opinion as to whether the consequences of those strategies and models are properly reflected in the financial statements in accordance with the applicable financial reporting framework.

While it is now clear that the business models and property-related lending strategies of the Irish institutions led to large losses being incurred, it was only when it became likely that property prices would decrease and that the economy would contract that the consequences of these were permitted to be reflected in the financial statements. At this point, the auditor was required to form an opinion as to whether the financial consequences were being adequately reflected in the financial statements.

For much of the period being considered by the Committee, virtually all of the economic forecasts were for the continuing stability of the property market and a benign economic outlook. During this period, a very low level of losses was required to be reported in the financial statements, in accordance with the applicable financial reporting and legislative frameworks.

While an auditor does not have responsibility for the strategies or business models of the banks or for assessing the potential future implications of the risks associated with same, it may report to those responsible for management and governance of the banks, if it is aware of possible adverse financial reporting implications of the strategies that have been adopted. In many instances, KPMG noted in our communications with 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 the economy to go into recession. Based on our communications with our bank audit clients at the time, it was clear that they were aware of these risks and their assessment of same was set out in the risk disclosures and in their financial statements. It is also clear that they did not anticipate the potential scale of these risks and the resulting losses that would ultimately arise.

B3:e - Capital structure and loss absorption capacity

KPMG's role as external auditors was to audit the financial statements of the institutions in accordance with ISAs. While many commentators have observed that it would have been preferable, in hindsight, for the institutions to have general reserves to absorb the losses when the crisis emerged, the financial reporting and legislative framework after 2005 was such that holding such provisions was not permitted.

It is worth noting that, while the banks are not permitted to hold general unallocated loss absorption provisions in their financial statements, it was possible for a financial regulator to specify capital ratios that incorporated additional loss absorption reserves. For example, this step was taken by the Canadian regulator and these additional capital buffers assisted in protecting the Canadian banks from the worst effects of the financial crisis. The Irish Central Bank also specified additional capital requirements for Irish banks in 2010 and 2011 in order to restore confidence but this was after the collapse of those banks and the State bailout.

Prior to approving its financial statements each year, the board of a bank is required to assess whether the going concern basis of preparation on which the financial statements have been prepared by management is appropriate. This includes an assessment of the assumptions relating to the bank's capital and liquidity, the future business plans of the bank and their impact on the bank's ability to continue as a going concern for a period of at least one year from when the financial statements are approved. In forming an audit opinion, the auditor is also required to consider whether the going concern basis of preparation is appropriate.

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

C2:c - The liquidity versus solvency debate

In the period from 2002 to 2006, the economic environment in Ireland was extremely benign. During this period, there was significant economic growth, almost full employment and the government financing position was healthy. There was also a significant increase in property prices in this period although it now appears that property prices peaked in late 2006 or early 2007.

Commencing in mid-2007, financial institutions began to face liquidity challenges arising from a loss of confidence in the securities issued by banks and the issuers of structured and asset backed securities. The global capital markets and the interbank lending markets became increasingly unstable and illiquid, leading to significant pressure on the business models of many of the world's banks.

These difficulties escalated in 2008 and this ultimately culminated in an extreme loss of confidence in the banking system globally, the collapse of Lehman Brothers, and in regulatory and governmental action being taken to support a number of other international banks in September and October 2008.

At the same time, there was a marked acceleration in late 2008 of the fall in property prices in Ireland. The loss of confidence in the Irish banking system, due to concerns relating to access to funding and the impact on property and construction lending portfolios of this fall in property prices, led the Irish Government to take the unprecedented step of guaranteeing the liabilities of the covered Irish banks on 30 September 2008. These issues continued throughout 2009 and 2010, leading to the IMF/EU bailout in November 2010.

In light of these unprecedented circumstances and the fundamental property lending and funding challenges that faced the Irish banking system, KPMG reviewed and revised the scope of our banking audit work and the manner in which these audits were planned, resourced, directed, executed and completed. During this period, the firm also consulted regularly and extensively with our UK and US counterparts in relation to market developments and the conduct of bank audits in other jurisdictions.

The KPMG audit teams also took certain additional steps in conducting their audits in respect of these years, having regard to the significant issues which required to be addressed, including:

(i) Requesting the management of bank audit clients to present “going concern” papers to their audit committees which were considered by those committees and the boards of directors; and

(ii) Engaging with management, the audit committees and the boards of our bank audit clients and seeking assurances from the Financial Regulator, Central Bank of Ireland and Department of Finance regarding the availability of capital and liquidity funding to support these entities should it be required.

In respect of the financial year 2010, when the general bank guarantee had expired and all of the previous assurances from the Central Bank and Department of Finance in relation to the continued support of the banks were no longer available to us, KPMG modified our audit opinions in respect of four of our bank audits to include an “emphasis of matter” paragraph drawing attention to the disclosures in the financial statements in respect of the material economic, political and market uncertainties that impacted the Irish banking system and which cast significant doubt in respect of the going concern basis of preparation of the financial statements.

For all four of these banks, the issues referenced in our audit opinion included uncertainties relating to the ability of these banks to access funding from the Eurosystem and the Irish Central Bank to meet their liquidity requirements. In addition, for three of these banks, our audit opinion was also modified in respect of a further uncertainty in relation to the ability of these banks to raise additional capital to meet their required capital ratios.

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

The consequences of the focus on solvency as well as liquidity, as part of the financial statements preparation process and the associated audits, were fully disclosed in the published financial statements of the institutions. These disclosures were increased by the boards of the institutions in 2007 as a result of the dislocation and instability in financial markets in the aftermath of the failure of certain Bear Stearns hedge funds and Northern Rock. The nature and extent of these disclosures was revised significantly in 2008 when it became apparent that the decline in property values and in economic activity in Ireland would have a very significant negative impact on the liquidity and solvency of the Irish banks.

I do not believe that, in the pre-crisis period, any of the various arms of the regulatory oversight framework or any of the boards of banks had significant concerns in relation to the solvency and liquidity of the Irish banking system.

In the absence of any major indications of a decrease in property prices or of recessionary trends prior to 2007, the banks' own assessments were that they had sufficient liquidity and capital. As has been stated in the evidence of other witnesses to the Committee, this assessment was also made by a number of bodies looking at Irish banks in 2006 and prior years, including the auditors, the supervisory organs (Central Bank and Financial Regulator), the Department of Finance, and overseas oversight bodies such as the IMF or the EU.

I also note that, immediately after KPMG's annual audits of each of our credit institution clients, we were required to forward a statutory duty confirmation letter to the Financial Regulator. We appended to this letter all of our extensive and detailed communications with the audit committees of the relevant institution, including our audit planning and strategy documentation, our audit findings reports and our management letters.

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.