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Ms Fiona Cashin
Committee Secretariat
Clerk of the Committee of Public Accounts
Leinster House
Dublin 2



Wednesday, 4 July 2012

Dear Ms Cashin,

I refer to your letter of 13th June 2012 concerning matters arising from my appearance before the Committee on 7th June 2012 and about which they wished to have further information. Apologies for the tardy reply but I was travelling in Europe and only returned today. The following sets out the position in relation to those matters.

1. Selection process for auditors in banks

Details regarding the selection of auditors in banks (Irish Life and Permanent, AIB, Bank of Ireland and the Irish Bank Resolution Corporation (IBRC) is set out at Appendix 1.

We intend writing to the Chairs of the Audit Committees of each of the above banks to advise them of the concerns raised by the Public Accounts committee regarding auditor selection and to invite their views in that regard. During our meeting, I made mention of a prior speech I made on the subject of auditors. I attach a copy for circulation to the members of the Committee.

2. The interest rate from the ESM:

This question was raised by the committee in the context of support drawn down to date and remaining available funding. If the Committee is referring to the funding drawn down to date, then the interest rate applicable varies for each drawdown but the estimated all-in fixed euro equivalent cost of loans received under the EU/IMF financial assistance programme was 3.46% at 30th April 2012. A recent PQ setting out the details of the various drawdowns and the interest rates applicable is set out at Appendix 2.

If the committee is referring to the interest rate for the new ESM funding mechanism then the committee should note that the rate has not yet been agreed. Article 20 of the ESM



Treaty (which has yet to come into force – it is expected that this will happen by early July 2012) sets out the pricing policy:

- When granting stability support, the **ESM shall aim to fully cover its financing and operating costs and shall include an appropriate margin.**
- For all financial assistance instruments, pricing shall be detailed in a pricing guideline, which shall be adopted by the Board of Governors.
- The pricing policy may be reviewed by the Board of Governors.

The pricing guideline is still under discussion. Following these discussions, the guidelines will be put to the Board of Governors for consideration and adoption.

3. The amount of the debt repayment to be made in 2014

Based on the latest information available from the NTMA some €8.2 billion worth of outstanding Irish Government bonds is due to mature in mid-January 2014.

4. A copy of the Department's guidelines on 'Whistleblowers'

A copy of the Department's guidelines on 'Whistleblowers' is attached in Appendix 3.

5. A note outlining the selection process involved in appointing Deloitte to perform the external review of the €3.6bn error and whether a procurement exercise was followed

The Deputy will recall that when the €3.6bn statistical error was discussed in the Dáil on 2nd November of last year, the Minister for Finance indicated that an external review of systems in the Department of Finance, the National Treasury Management Agency and the Central Statistics Office would be undertaken. At that stage, it was envisaged that this external review would be separate, but related, to a review of the issue to be conducted internally by the Department of Finance.

Given the urgency of this investigation, combined with the specialised nature of the matters to be covered by the review, the Department did not publicly advertise by tender. Instead, as provided under the 2004 *National Procurement Guidelines - Competitive Process*, the *direct invitation to tender* approach was used where an invitation is made directly to suppliers deemed appropriately qualified for a particular project.

As provided under the direct invitation to tender approach, contact was made with a number of individuals who were deemed to have the necessary expertise to conduct the work covered by the Terms of Reference on an urgent basis. None of these individuals would agree to provide a quotation other than the person contacted in Deloitte who indicated that their preference would be to undertake the work on foot of a contract with the firm. Accordingly, Deloitte submitted an initial estimate for the work at a fee of

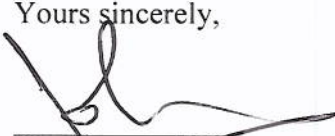
€135,050 (excluding expenses and VAT) which was subsequently reduced through negotiations to €50,000, excluding expenses and VAT.

Deloitte undertook the work in accordance with Terms of Reference which are set out in Appendix 4.

Update meeting with the Public Accounts Committee

At the end of the meeting we invited the Public Accounts Committee to attend an update briefing in the Department of Finance later in then year. Suitable dates for this can be arranged and we will liaise with the secretariat in due course to arrange this.

Yours sincerely,



John A. Moran
Secretary General

Appendix 1 – Selection process for auditors in banks:

Irish Life and Permanent:

At present External Auditors in ILP are automatically reappointed annually unless a resolution to the contrary is brought to shareholders at the AGM. In order to address the issue of the independence of the Auditor, the senior audit partner is rotated every three years.

The ILP Audit Committee conducts a review of the performance of the External Auditor on an annual basis and reports on this to the Board.

AIB:

The AIB Audit Committee makes a recommendation to the Board on the appointment of Auditors. This recommendation is based on their assessment of the performance of the existing firm, the level of fees charged, the outcome of an audit tender process if undertaken and other relevant information such as, the rotation frequency of the lead partner, the engagement of other auditor firms and the level of professional services provided by them to AIB Group. This is an annual process.

As part of discussions in arriving at a recommendation to the Board, the Audit Committee considers the merit of conducting an Audit tender. AIB has conducted two Audit tenders in the past, in 1999 when PwC were reappointed and in 2002 when KPMG were appointed Group Auditors.

The Group had originally intended to undertake a tender process earlier this year but, given the proposed timing of communication of the organisation strategy, and the expected disruption of the severance programme and exit of departing employees, details of which would be relevant to all potential applicants, it was decided not to proceed at this time. The Group expects this process to be revisited shortly with regard to the 2013 audit.

Bank of Ireland (BOI):

Bank of Ireland's Group Audit Committee formally reviews the performance of its external auditors on an annual basis. The most recent review, including an assessment as to whether a tender process was appropriate, was conducted in November 2011. Relevant stakeholders including the Central Bank of Ireland were notified of the outcome.

At the recent AGM in April 2012, the stockholders voted overwhelmingly in favour of the 2 resolutions relevant to the external auditors as follows:

- To receive the Report and Accounts – 99.98% of stockholders voted in favour of this resolution
- To authorise the Directors to determine the remuneration of the auditors - 99.97% of stockholders voted in favour of this resolution

Irish Bank Resolution Corporation:

The IBRC external auditor is selected following the successful completion of a competitive tender process in compliance with the Bank's Procurement Policy. IBRC last appointed external auditors in 2009. An overview of the selection process is set out below

- A request for tender was sent to six audit firms in 2009. Three of the firms in turn submitted tenders.
- A detailed review of each tender was performed and an initial summary evaluation was prepared and provided for further consideration by the Bank's Audit Committee and senior management.
- The review considered the following areas:
 - Overall capabilities of the firm;
 - Banking expertise;
 - Skills of the professional team assigned to the engagement;
 - Proposed service offering (capability to add value);
 - Proposed methodology;
 - Understanding the assignment; and
 - Cost
- Each of the three firms was then invited to make a presentation to representatives of the Bank's Audit Committee and senior management.
- Based on detailed consideration of the tender documents and the presentations delivered, the Audit Committee recommended to the Board of the Bank that Deloitte be appointed as the Bank's external auditors.

Note: The above process for appointing an external auditor has been updated in order to comply with the current IBRC Procurement Policy. The request for tender would now not be issued directly to any firms, it would be advertised, and the tender response process managed, through both the eTenders & OJEU procurement websites.

Appendix 2

Table 1: Liabilities outstanding at 15th June 2012 under the EU/IMF Financial Assistance Programme

Lender	Nominal Loan Amount ¹	Date of Draw Down	Maturity Date	Term from Date of Drawdown	Interest Rate
European Financial Stabilisation Mechanism (EFSM)	€5.00 billion	12-Jan-11	04-Dec-15	4.9 yrs	2.50%
	€3.40 billion	24-Mar-11	04-Apr-18	7 yrs	3.25%
	€3.00 billion	31-May-11	04-Jun-21	10 yrs	3.50%
	€2.00 billion	29-Sep-11	04-Sep-26	14.9 yrs	3.00%
	€0.50 billion	06-Oct-11	04-Oct-18	7yrs	2.38%
	€1.50 billion	16-Jan-12	04-Apr-42	30.2yrs	3.75%
	€3.00 billion	05-Mar-12	04-Apr-32	20.1yrs	3.38%
EFSM Total	€18.40 billion			11.8yrs weighted average life	
European Financial Stability Facility (EFSF)	€4.19 billion ²	01-Feb-11	18-Jul-16	5.5 yrs	2.75%
	€3.00 billion	14-Nov-11	04-Feb-22	10.2yrs	3.60%
	€1.27 billion	12-Jan-12	04-Feb-15	3.1yrs	1.73% ³
	€0.48 billion	19-Jan-12	19-Jul-12	0.5yrs	0.37% ³
	€1.00 billion	15-Mar-12	23-Aug-12	0.4yrs	0.29% ³
	€2.80 billion	03-Apr-12	03-Apr-37	25yrs	Floating Rate ⁴
EFSF Total	€12.74 billion			10.1yr weighted average life	
United Kingdom Bilateral Loan ⁵	€0.50 billion	14-Oct-11	14-Apr-19	7.5yrs	4.72%
	€0.50 billion	30-Jan-12	30-Jul-19	7.5yrs	4.29%
	€0.50 billion	28-Mar-12	28-Sep-19	7.5yrs	4.44%
UK Total	€1.50 billion			7.5yrs weighted average life	
Sweden Bilateral loan ⁶	€0.15 billion	15-Jun-12	15-Dec-19	7.5yrs	Floating 3 mths Euribor +1%
Sweden Total	€0.15 billion			7.5yrs weighted average life	
Denmark Bilateral Loan ⁶	€0.10 billion	30-Mar-12	30-Sep-19	7.5yrs	Floating 3 mths Euribor +1%
Denmark Total	€0.10 billion			7.5yrs weighted average life	
International Monetary Fund ⁷	€6.040 billion	18-Jan-11	Amortising: 18 Jul 2015-18 Jan 2021	4.5 - 10 yrs	Floating Rate
	€1.699 billion	18-May-11	Amortising: 18 Nov 2015-18 May 2021		
	€1.589 billion	07-Sep-11	Amortising: 07 Mar 2016-07 Sep 2021		
	€3.987 billion	16-Dec-11	Amortising: 16 Jun 2016-16 Dec 2021		
	€3.357 billion	29-Feb-12	Amortising: 31 Aug 2016-28 Feb 2022		
	€1.435 billion	15-Jun-12	Amortising: 15 Dec 2016-15 Jun 2022		
IMF Total	€18.11 billion			4.5 - 10yrs	
Overall Total	€51.0 billion²			9.7yrs weighted average life	

Notes

- Non-euro liabilities are translated into euro at the rates of exchange at 15th June 2012. The net euro amount received by the Exchequer was €49.4 billion: after adjustment for below par issuance and deduction of a prepaid margin (Note 2), and also reflect the effect of foreign exchange transactions. Non-euro liabilities have been locked-in, as appropriate, in order to remove exchange rate risk.
- A prepaid margin of €0.53 billion was deducted from the loan of €4.19 billion drawdown on 1 February 2011 giving a net liability of €3.67 billion. This margin prepayment will be refunded to Ireland in 2016. The total liability of €50.46 billion included in the National Debt (€130.1 billion at 15th June 2012) takes account of this reduction.
- Short Term EFSF Funding of €1.48 billion maturing in 2012 is due to be replaced by longer term funding at a floating interest rate. The EFSF loan of €1.27bn maturing in 2015 is also subject to rollover at a floating rate.
- The EFSF funding provided to Ireland under pooled issuance comes from a variety of fundings, and the EFSF will confirm the interest rate cost related to each loan coming from the pool on every interest payment date.
- The interest rates on the UK bilateral loans are subject to a reduction pending the signing of an amendment to the legal agreement. The reduction is estimated, at this stage, to be about 1.5%. Rate shown is an annualised rate.
- The current rate on the Denmark bilateral loan is 1.787%. This rate resets every 3 months and is due to do so on 29th June 2012. Similarly, the Sweden bilateral loan is a floating rate loan which resets every 3 months. The current rate of 1.337% applies for a 2 week initial period.
- The interest rate charged by the IMF is variable. It is composed of a weekly setting of the IMF SDR interest rate and surcharges which are volume and time dependent. As of 25 June 2012 the SDR interest rate accruing on Ireland's IMF loans is 0.12% and the surcharges are 2.50% making a total of 2.62%.

Appendix 3 - Good Faith Reporting Policy

This document will be reviewed on a 6 monthly basis and will be amended if required, taking into account the Whistle-blower Legislation currently being prepared by the Department of Public Expenditure and Reform.

Department of Finance Office Notice 1/2012

Introduction:

The purpose of this document is to set out the Department's policy on Good Faith /Concerned Employee Reporting. It should be considered together with, and does not supersede, the Civil Service Code of Standards and Behaviours and the Department's Fraud Policy.

Under the Civil Service Code of Standards and Behaviour civil servants must:

(a) Maintain high standards in service delivery by:

- conscientiously, honestly and impartially serving the Government of the day, the
- other institutions of State and the public;
- always acting within the law and
- performing their duties with efficiency, diligence and courtesy.

(b) Observe appropriate behaviour at work by:

- dealing with the public sympathetically, fairly and promptly and
- treating their colleagues with respect.

(c) Maintain the highest standards of probity by:

- conducting themselves with honesty, impartiality and integrity;
- never seeking to use improper influence, in particular, never seeking to use
- political influence to affect decisions concerning their official positions;
- abiding by guidelines in respect of offers of gifts or hospitality; and
- avoiding conflicts of interest.

All staff are encouraged to speak openly and express their opinions freely during the course of the conduct of the business of the Department, in accordance with our principles of Challenge and Integrity as articulated in the Department's Statement of Strategy, 2011 – 2014. These principles are not altered by this policy statement.

Policy

All staff are encouraged to raise genuine concerns regarding improprieties in the conduct of the Department's activities, whether in matters of financial reporting or other malpractices, at the earliest opportunity and in an appropriate way.

The Department recognises and supports staff who raise genuine concerns. An individual who raises concerns mistakenly will not suffer any form of retribution. However, appropriate disciplinary action will be taken in the case of bad faith (including malicious) reporting. All concerns will be treated fairly and properly.

Scope

This policy is designed to ensure staff can raise concerns without fear of retribution and provide a transparent and confidential process for dealing with concerns.

Areas within the scope of the policy are:

- Possible improprieties in matters of financial reporting
- Fraud
- Corruption, bribery or blackmail
- Criminal offences
- Failure to comply with a legal or regulatory obligation
- Miscarriage of justice
- Breaches of the Civil Service Code of Standards and Behaviour or any other policy relating to the business of the Department or the Civil Service
- Endangering the health and safety of staff
- Concealment of any of the above

Personal grievances should be raised directly with line managers or the Human Resource Manager.

Procedures

1. If any staff member (the reportee) has concerns regarding the areas set out above, then he or she should normally report that fact to their line manager. However, if the reportee is reluctant to do so for any reason he or she should report their concerns to one of the following (i) Head of Division, (ii) Head of Finance Office or (iii) Head of Internal Audit.
2. Once a report has been received the recipient will undertake an initial evaluation.
3. Following the initial evaluation the reportee will normally be informed as to whether the report requires a full investigation

4. Where a full investigation is required the full investigation will be undertaken either by the Head of Internal Audit or the Head of the Finance Office, or where required an appropriate senior official. This investigation will include a determination of any action necessary to address the issue of concern.
5. Staff who have raised concerns will be informed of who is handling the matter, how they can make contact with that person and if there is any further assistance required.
6. The reportee will be informed of the results of any full investigation where possible – see below.
7. All investigations will be reported to the Secretary General and Chief Risk Officer. It should be noted that it may not be possible to inform the staff member reporting the Violation, or suspected violation, of the precise action to be taken, where this would infringe a duty of confidence owed to someone else. The process will be as open as possible subject to these constraints. Any matter reported under this policy will be promptly investigated, with due regard to the dignity of all concerned, and appropriate corrective action or disciplinary action, in line with the Department's disciplinary procedures, if warranted, will be taken following the investigation. It is not possible to lay down precise timescales or steps required for investigations, as this will depend on the nature of the issue. However, the Department will ensure that the investigators will use all reasonable speed as soon as possible without affecting the quality or depth of the investigation.

All concerns raised will be treated in confidence where possible. Where concerns cannot evidence is required in a court or Tribunal), the Department will enter in to a dialogue with the staff member concerned as to whether and how it can proceed.

Protection for Staff members

This Policy is intended to encourage and enable staff members and others to raise serious concerns within the Department. Under this policy, the Department will ensure that no staff member, who in good faith reports a violation, shall suffer harassment, penalisation, retaliation or adverse employment consequence, as a result of raising the concern. Provided the report is made in good faith, and the staff member reasonably believes that the information he/she has disclosed shows malpractice or impropriety or intent towards malpractice or impropriety, and he/she has made the disclosure to the appropriate person (in accordance with the procedures set out above), no action will be taken that affects the staff member to his or her detriment with respect to any term or condition of his or her employment because he/she has raised the concern.

A manager or staff member, who retaliates, in any way, against someone who has reported a violation in good faith, will be subject to appropriate disciplinary proceedings. If a colleague believes that an individual, who has made a good faith report of a violation or who has, in good faith, cooperated in the investigation of a reported violation, is suffering harassment, retaliation or adverse employment consequences, he/she should inform (i) Head of Division, (ii) Head of Finance Office or (iii) Head of Internal Audit, as appropriate.

If an individual makes an allegation in good faith, which is not confirmed by subsequent investigation, no action will be taken against the individual. However, if the investigation shows, or it subsequently becomes clear, that the allegation has been made maliciously, appropriate disciplinary action will be taken against the individual making the allegation.

Appendix 4 – Terms of Reference for External Review

- review the respective roles of the Department of Finance, the CSO and the NTMA in the compilation of the General Government Debt figures;
- review the inter-action between all three organisations, including communications;
- drawing on the findings of the Internal Review, this process should summarise the reasons for the error with regard to processes, systems, staffing, and control issues; (Individual personal performance is excluded from scope), and
- making recommendations, if any, to (*for example*):
 - improve the inter-action between the three organisations, including the development of a communications protocol for all three organisations;
 - clarify and, if appropriate, reallocate the responsibilities for the compilation and reporting of the General Government Debt;
 - restructure the systems and work flows/responsibilities within the relevant areas of each of the three organisations;
 - identify system wide issues in this regard for more general applicability; and
 - recommend appropriate checks and balances to enable mistakes to be picked up in the system.



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

**Address by John Moran,
Head of Wholesale Banking Supervision, Central Bank of Ireland
to Chartered Accountants Ireland**

2 December 2010

As EU Internal Market Commission Barnier has said:

"The veracity of financial statements is central to confidence in the marketplace The crisis highlighted failings in the audit sector. These need to be explored and we need to see what improvements can be made."

As Ireland is a highly open economy, this global backdrop is important and should inform discussions locally. A note of caution, though: we should not delay action in Ireland just because international initiatives are likely to wash ashore at some point. There is much to be done to restore the credibility of the domestic banking system, and taking a firm lead in improving audit practices can only help.

Two questions are frequently asked when considering the role of auditors before and during the banking crisis in Ireland:

- a. Could auditors have done more to mitigate the risks associated with the rapid, and in some cases reckless, growth in banks' balance sheets in the 2000s?
- b. Latterly, could auditors have been quicker to bring to light the very rapid decline in asset quality which has occurred?

The answer to both questions is a qualified **Yes**. In practice, there are probably unrealistic expectations about what auditors could have achieved, at least through the external audit process, to mitigate the build-up, and uncover the subsequent crystallisation of risks in the banking sector. But there *is* more that can be done; and what I would like to do today is to address these issues, and in particular to explore some realistic and practicable solutions from the perspective of a prudential supervisor.

I suspect there will be some disagreement between what the public in general consider 'realistic' and how the audit profession would define this term; but perhaps not as much as we might suppose, and any point of friction will itself perhaps be an indicator that we are focused on the right issue. I know from discussions with the profession to date that there is some impetus for change. I'll describe later the steps we consider can be taken.

The international context

Before doing so, I'd like to consider what has been, and is, happening internationally as this is relevant to the steps we take as prudential supervisors in Ireland in respect of a dialogue with the audit profession.

Audit, of course, is a global business. Most audits of any size include a major cross-border component because that reflects the international nature of most business today, in Ireland as much as anywhere. And larger businesses tend to be audited by one of the four global audit networks, the quality of whose work is critical.

The shortcomings in audit practice uncovered in the early part of this century in Enron and other cases led to the establishment of public bodies charged with the oversight of audit firms. The Public Company Accounting Oversight Board in the US, the most prominent of such audit oversight bodies, has now been joined by similar regulators all over the world, including IAASA here in Ireland. These bodies have started to engage in the direct inspection of the conduct of audit firms and IFIAR, the International Forum of Independent Audit Regulators, the international committee which brings them together, recently reported on examples of inspection findings. These included concerns with the exercise of professional scepticism, the audit of impairments, the firm's own internal quality control processes and threats to auditor independence. The lack of scepticism found internationally may identify itself in a number of ways: over-reliance on management

representations; failure to investigate conflicting explanations; failure to obtain appropriate third-party confirmation or seeking to obtain evidence that merely corroborates, rather than challenges, judgements made by management.

Such concerns about adherence to higher standards are important in the light of emerging debate about the value of audit. This debate is being pursued within Europe as a whole, where the European Commission has embarked on a consultation on how the European audit market can be improved, looking at the role of statutory audit as well as the wider environment within which audits are conducted. In the UK, the House of Lords has embarked on a major inquiry into market concentration and the role of auditors. The issues being addressed also include how to ensure auditors are truly detached and critical when examining the financial statements of a company where that same company is an existing or potential client for non-audit services, and clarification of the reliance stakeholders, such as investors or regulators can place on audited financial statements.

Audit quality is, of course, difficult to define and there is no internationally agreed definition of audit quality that can be used as a standard against which actual performance can be assessed. Nevertheless, recent events suggest that there is room for improvement. Furthermore, even where accounting and auditing standards have literally been met, it is difficult not to feel that here, and in many jurisdictions, information that could

have helped anticipate, or at least mitigate, the crisis was available within the audit firms and could with benefit have been transferred to those in a position to influence the emergence of the risks that have subsequently crystallised.

Power to appoint independent experts

The remainder of my remarks are devoted to exploring ways in which such improvements might be made; and I would mainly like to steer away from external audit of public financial statements and focus on other areas where the audit profession might contribute to a sounder prudential framework in Ireland.

A key role for the profession, and one it undertakes already in Ireland, is to review, outside the external audit process, how financial institutions conduct business, and in particular the adequacy of controls.

In the UK, Section 166 of the Financial Services and Markets Act 2000 gives the FSA the power to require firms to provide reports by skilled persons. This often involves auditors, for example, testing the veracity of financial statements on behalf of regulators. To give you a sense of the importance of this power, the FSA commissioned 88 S166 reports in the period 2009–2010.

We are seeking an equivalent power here in Ireland; and its importance to the completeness of our regulatory regime cannot be overstated. It enables the regulator to access where necessary the important detail of a

financial institution's business without diverting scarce regulatory resources from other critical responsibilities.

It is an essential, core power, not one that is merely nice to have...

A better dialogue with auditors

This legal power would lead to a very defined, and issue specific, sharing of information. As supervisors, we think there is also a case for re-invigorating the frequency and quality of the three-way dialogue between the Central Bank, regulated firm and its auditor. We also think there needs to be a more fulsome bilateral dialogue between the Central Bank and auditors...

What do I mean by this?

The Central Bank and the auditor profession are, to a greater or lesser degree, in privileged positions in that we both see different information which, by its nature, is relevant to our respective statutory duties. From time to time this information is automatically exchanged – for example, when an audit report is qualified. What we are less good at doing is sharing our *interpretations* of this information. In other words, we do not spend enough time discussing what we know of risks within financial institutions, either within individual firms or across the financial markets generally.

This, we think, can easily be resolved.

To this end we will be meeting representatives of the major audit firms next week to discuss how we promote an enhanced, regular dialogue between auditors and supervisors. We do not want to invent new rules or processes to make this a reality, but we do think there is a good case for defining, in writing, what this dialogue should encompass and how it can be organised. In essence, such a document would establish the basis on which the Central Bank can engage in substantive discussions with auditors on areas of interest to prudential and conduct of business supervision.

We hope the profession will respond positively to this initiative.

Auditor appointment and rotation

But is this sufficient?

In addition to promoting a better dialogue between auditors and supervisors, there could be further own-initiative measures.

For example, should there be more frequent rotation of audit firms or partners for financial institutions than for corporations generally?

Should there be a pre-approval regime for the audit partners of those financial institutions classified as major under our new corporate governance regime?

Should IAASA and the Central Bank work more closely together on issues of audit quality as they arise in the financial sector?

I do not propose to answer these questions today; but we do think it is entirely legitimate that, as a prudential supervisor, we should consider whether further safeguards need to be built into the prudential regime for major financial institutions.

Quicker Identification of Asset Quality Deterioration

At the start of my speech I asked whether auditors have been slow to recognise the rapid deterioration in asset quality which has occurred on the balance sheets of Irish banks.

I ask this question because a material gap emerged earlier this year between banks' own estimates of losses in their financial statements, and thus their capital requirements, and those estimates of losses and capital resulting from our Prudential Capital Assessment Review – the PCAR.

The PCAR, of course, has a different objective in being forward-looking, and makes use of different measures of loss to those which determine the construction of financial statements. As such, a simple like-for-like comparison is not possible. However, it is far from clear that banks would have commenced a re-capitalisation process on anywhere near the scale required to cover losses, if at all, had the Central Bank not initiated a process to assess expected future losses.

This is not a moot point: the Irish banking system has had, as this week's announcements remind us, to be re-capitalised to absorb quite staggering losses. Against this backdrop, the incomprehension which has been

expressed at the production of unqualified audit reports so close to major re-capitalisation is understandable.

The audit profession is not, of course, deaf to these issues. We noted with interest the recent IASB-FASB exchange on the estimation of expected losses. Our position on these issues is clear: only last week - in this auditorium, in fact - the Governor criticised the backward-looking loan-loss provisioning methods linked to current International Financial Reporting Standards. The limitations of this approach are well understood, so I won't repeat them here. Suffice to say that changes in accounting standards which might follow the IASB-FASB discussions would be welcome.

But experience in Ireland suggests that, even if there were to be changes in accounting standards, a close look at audit *practice* is required.

I mentioned earlier the international concern about the degree of scepticism exercised by auditors. In that connection doubts are expressed as to whether firms employ auditors of sufficient experience adequately to challenge the views of management.

The profession also needs to overcome a significant (and self-imposed) assumption: it is simply not sufficient to have a view on a control that is silent on the context within which that control operates, especially the organisational culture at work and the behaviour of key individuals. The statement "culture eats strategy" can fairly be re-worked to make

"controls" its object. I have no doubt that some auditors in Ireland failed either to realise this, or, worse perhaps, recognise it in their dealings with clients and the regulator.

There are solutions, though. The Management Letter gives auditors a vehicle to make these wider points. Similarly, the Audit Committee is a forum in which auditors can raise issues they consider material to the soundness of a financial institution's operations. The construction of financial statements should not, in other words, be considered a sealed channel in which auditors must operate; and I suspect most auditors would agree with this statement.

But what am I really talking about here? Well, the central issue is undoubtedly the exercise of professional scepticism - in the same way that supervisors at the Central Bank need to operate with an independent and sceptical disposition, so I think the same is true of auditors. For all of us here today, institutionalising such a mindset is work in progress. I hope my remarks today provide a foundation for us to make progress.

Thank you.