Independent Auditors’ Report

Independent Auditors’ Report to the members of Allied Irish Banks, p.l.c.

Opinion on the financial statements of Allied Irish Banks, p.l.c.

In our opinion:

- **the financial statements give a true and fair view of the state of the Group’s and of the Parent Company’s affairs as at 31 December 2016 and of the Group’s profit for the financial year then ended;**
- **the Group and Parent Company financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and**
- **the financial statements have been prepared in accordance with the requirements of the Companies Act 2014 and, as regards the Group financial statements, Article 4 of the IAS Regulation.**

The financial statements that we have audited comprise:

- the consolidated income statement;
- the consolidated statement of comprehensive income;
- the consolidated and Parent Company statement of financial position;
- the consolidated and Parent Company statement of cash flows;
- the consolidated and Parent Company statement of changes in equity; and
- the related notes 1 to 59 and a to ak.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2014.

Summary of our audit approach

Key risks	The key risks that we identified in the current year were: – Loan impairment and restructuring; – Deferred tax; – IT controls; – Retirement benefit obligations; and – Conduct risk provisions. Our key risks are consistent with our prior year assessment.
Materiality	The materiality that we used in the current year was €66 million which was determined on the basis of a range of 4-8% of profit before tax (“PBT”). Materiality is 4% of the Group’s 2016 PBT.
Scoping	We focused our group audit scope primarily on the audit work in four legal entities all of which were subject to individual statutory audit work, whilst the other legal entities were subject to specified audit procedures, where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group’s operations in those entities. These audits and specified audit procedures covered over 95% of the Group’s net assets.
Significant changes in our approach	In the prior year we used shareholders’ equity as our basis for determining materiality. This was due to the high levels of volatility in the income statement. With the income statement volatility reducing we have determined, in our professional judgement, Group PBT to be one of the principal benchmarks within the financial statements relevant to members of the Parent Company in assessing financial performance.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the Group financial statements, in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, the Group has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

Going concern and the Directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

We have reviewed the Directors' statement regarding the appropriateness of the going concern basis of accounting contained within note 1 to the financial statements.

We are required to state whether we have anything material to add or draw attention to in relation to:

- the Directors' confirmation on page 180 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 50 to 58 that describe those risks and explain how they are being managed or mitigated;
- the Directors' statement in note 1 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and their identification in note 2 of any material uncertainties to the Group's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and
- the Director's explanation on page 208 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We agreed with the Directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

Loan impairment and restructuring

Risk description

The risk that provisions for impairment of loans and receivables do not represent an appropriate estimate of the losses incurred. This includes the risk that the estimate of cash flows on restructuring cases is not appropriately measured. The determination of appropriate provisions requires a significant amount of management judgment and relies on available data.

Please also refer to page 190 (Board Audit Committee Report), page 243 (Accounting Policy – Impairment of financial assets), Note 2 – Critical accounting judgements and estimates and Note 25 – Provisions for impairment on loans and receivables.

Loan impairment and restructuring *(continued)*

How the scope of our audit responded to the risk

We undertook an assessment of the provisioning practices to compare them with the requirements of IFRS.

We have evaluated the design and tested the operating effectiveness of controls over impairment identification and calculation.

We have evaluated the design and tested the operating effectiveness of controls over credit management processes, new lending, restructuring transactions and front line credit monitoring and assessment. Furthermore, we have evaluated the design and tested the operating effectiveness of controls in the operations over collective and latent models, including source data and calculations, and the work of the credit review function.

In examining both the sample loan cases and the models we challenged management on the judgments made regarding the application of triggers, status of restructures, collateral valuation and realisation time frames; and examined the credit risk functions analysis of data at a portfolio level. We tested samples of the data used in the models, management adjustments, together with the calculations involved and the output from the models.

Where appropriate, this work involved assessing third party valuations of collateral, internal valuation guidelines derived from benchmark data, external expert reports on borrowers’ business plans and enterprise valuations. This allowed us to determine whether appropriate valuation methodologies were employed and assess the objectivity of the external experts used.

Deferred tax

Risk description

The risk relates to the incorrect recognition or measurement of deferred taxation. Deferred tax assets are recognised for unused tax losses to the extent that it is probable that there will be sufficient future taxable profits against which the losses can be used. The assessment of the conditions for the recognition of a deferred tax asset is a critical judgment, given the inherent uncertainties associated with projecting profitability over a long time period.

Please refer to page 190 (Board Audit Committee Report), page 236 (Accounting Policy – Deferred taxation), Note 2 – Critical accounting judgements and estimates and Note 32 - Deferred taxation.

How the scope of our audit responded to the risk

We have evaluated the design of controls over the preparation of financial plans and budgets. We reviewed the financial plans and the model used by management to assess the likelihood of future profitability and challenged management’s assessment of a range of positive and negative evidence for the projection of long-term future profitability. We compared management’s assumptions to industry norms and other economic metrics. We reviewed management’s analysis of their consideration of the “more likely than not” test and reviewed the sensitivity analysis disclosed.

IT controls

Risk description

The Group’s IT environment is complex, with financial accounting systems dependent on IT. Financial reporting processes and controls are dependent on the Group’s IT environment and related controls. There is a risk that if controls are not operating as designed in respect of IT security, change management and user access over significant IT applications, this could lead to failure of other controls or errors within the financial reporting process.

Please refer to page 190 (Board Audit Committee Report) and page 185 (Corporate Governance report).

How the scope of our audit responded to the risk

We have evaluated the design and tested the operating effectiveness of IT controls that are critical to financial reporting, including those relating to system access, IT operations and program change, including other controls that mitigate deficiencies, where relevant.

Retirement benefit obligations

Risk description	The risk is that the recognition and measurement of retirement benefit liabilities are inappropriate. There is a high degree of estimation and judgement in the calculation of retirement benefit liabilities. Material change in the liability can result from small movements in the underlying actuarial assumptions, specifically the discount rates, pensions in payment increases and inflation rates. Please refer to page190 (Board Audit Committee Report), page 235 (Accounting Policy – Employee benefits), Note 2 – Critical accounting judgements and estimates and Note 12 Retirement benefits.
How the scope of our audit responded to the risk	We have utilised Deloitte pension actuaries as part of our team to assist us in evaluating the appropriateness of actuarial assumptions with particular focus on discount rates, pensions in payment increases and inflation rates. Our work included discussions with Management and their advisors to understand the processes and assumptions used in calculating retirement benefit liabilities. We benchmarked assumptions used against market data where available.

Conduct risk provisions

Risk description	The risk that the recognition, measurement and disclosure of provisions in respect of allegations of mis-selling of financial products, allegations of overcharging and breach of contract and/or regulation are inappropriate. Please refer to page 190 (Board Audit Committee Report), page 248 (Accounting Policy – Non-credit risk provisions), Note 2 – Critical accounting judgements and estimates and Note 38 – Provisions for liabilities and commitments.
How the scope of our audit responded to the risk	We have evaluated the design and tested operating effectiveness of the Group's controls over the identification and measurement of the provision and the disclosure of exposures. We challenged the assumptions, regarding the interpretation of contract terms, the numbers of customers affected and the costs arising from the issue, used in the provisioning models. We met with Group General Counsel and Group compliance and reviewed the correspondence with regulators and legal advice.

The description of risks above should be read in conjunction with the significant issues considered by the Audit Committee, which is discussed on page 190.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

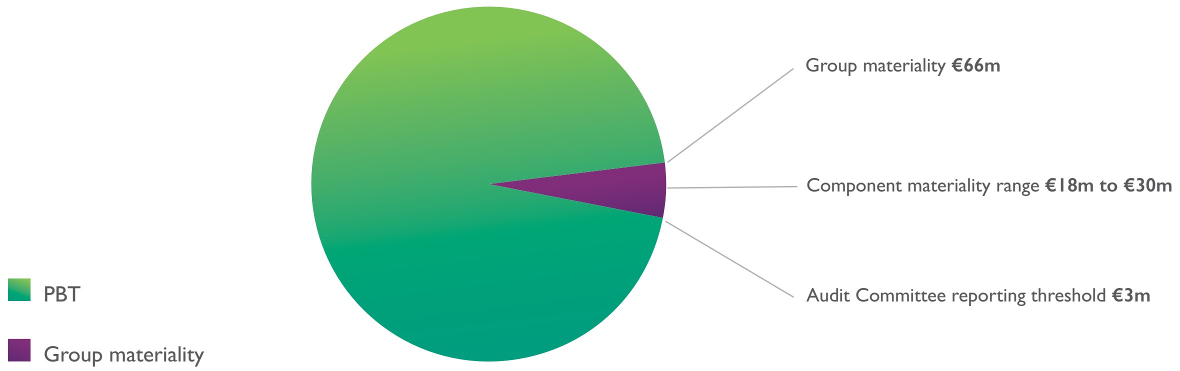
Independent Auditors' Report

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Group materiality	€ 66 million (2015: € 60 million)
Basis for determining materiality	Group materiality is set within a range of 4-8% of Group PBT. Materiality is 4% of the Group's 2016 PBT. For each component, we allocated a materiality that is less than 50% of group materiality.
Rationale for the benchmark applied	In the prior year we used a measure of shareholders' equity as our basis for determining materiality. This was due to the high levels of volatility in the income statement. With the income statement volatility reducing we have determined, in our professional judgement, Group PBT to be one of the principal benchmarks within the financial statements relevant to members of the Parent Company in assessing financial performance.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of € 3 million as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Board Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed by us, as the group engagement team, or auditors within Deloitte network firms operating under our instruction ('component auditors'). Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those components to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the consolidated financial statements as a whole.

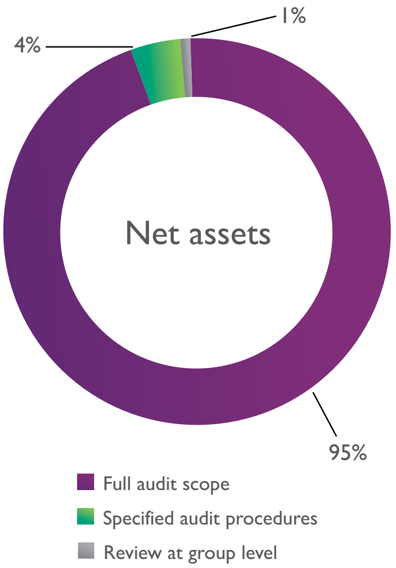
Based on that assessment, we focused our group audit scope primarily on the audit work in the four legal entities as disclosed in note 46 to the consolidated financial statements, all of which are subject to individual statutory audits, whilst the other legal entities were subject to specified audit procedures, where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations in those entities. These audits and specified audit procedures covered over 95% of the Group's net assets.

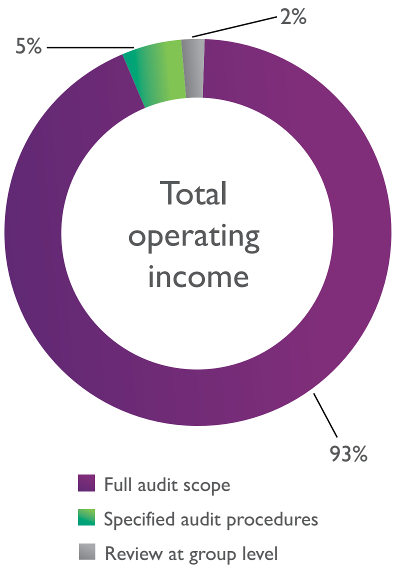
We also tested the consolidation process and carried out analytical procedures to assess there were no additional significant risks of material misstatement arising from the aggregated financial information of the remaining entities not subject to audit or specified audit procedures.

An overview of the scope of our audit *(continued)*

The group audit team sent component auditors detailed instructions on audit procedures to be undertaken and the information to be reported back to the group audit team. Regular contact was maintained throughout the course of the audit with key component auditors which included holding group planning meetings, maintaining communications on the status of the audits and continuing with a programme of planned visits designed so that the group audit team met each significant component audit team during the year.

The levels of coverage of key financial aspects of the Group by type of audit procedures as set out below:





Opinion on other matters prescribed by the Companies Act 2014

Directors' Report and Corporate Governance Statement

In our opinion, the information given in the Directors' Report is consistent with the financial statements. Based on the work undertaken in the course of the audit the description in the Corporate Governance Statement of the main features of the internal control and risk management systems in relation to the financial reporting is consistent with the financial statements and has been prepared in accordance with section 1373 Companies Act 2014. Based on our knowledge and understanding of the Group and its environment obtained in the course of the audit, we have not identified any material misstatements in this information. In our opinion, the information required pursuant to section 1373(2) (a), (b), (e) and (f) of the Companies Act 2014 is contained in the Corporate Governance Statement.

Adequacy of explanations received and accounting records

Under the Companies Act 2014 we are required to report to you if, in our opinion:

– we have not received all the information and explanations we require for our audit; or
– adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
– the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Matters on which we are required to report by exception

Directors' remuneration

Under the Companies Act 2014 we are required to report to you if, in our opinion, the disclosures of Directors' remuneration and transactions specified by law are not made.

Corporate Governance Statement

We agreed to review the parts of the Corporate Governance Statement for compliance with the following provisions of Section C "Accountability" of the UK Corporate Governance Code: C1.1; C.2.1 and C3.1 – C3.7.

Independent Auditors' Report

Matters on which we are required to report by exception *(continued)*

Our duty to read other information in the Annual Financial Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Financial Report is:

– materially inconsistent with the information in the audited financial statements;
– apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
– otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between the knowledge acquired during our audit and the Directors' statement that they consider the Annual Financial Report is fair, balanced and understandable and whether the Annual Financial Report appropriately discloses those matters that we communicated to the Board Audit Committee which we consider should have been disclosed.

We have nothing to report arising from these matters.

Respective responsibilities of Directors and Auditor

As detailed in the Statement of Directors' Responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and otherwise comply with the Companies Act 2014. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report is made solely to the Parent Company's members, as a body, in accordance with section 391 of the Companies Act 2014. Our audit work has been undertaken so that we might state to the Parent Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Parent Company and the Parent Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, as a result of fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Financial Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies with our audit of the financial statements, we consider the implications for our report.

Gerard Fitzpatrick
For and on behalf of Deloitte
Chartered Accountants and Statutory Audit Firm
Dublin

1 March 2017

Deloitte.

Consolidated statement of financial position

as at 31 December 2016

	Notes	2016 € m	2015 € m
Assets			
Cash and balances at central banks	50	**6,519**	4,950
Items in course of collection		**134**	153
Disposal groups and non-current assets held for sale	20	**11**	8
Trading portfolio financial assets	21	**1**	1
Derivative financial instruments	22	**1,814**	1,698
Loans and receivables to banks	23	**1,399**	2,339
Loans and receivables to customers	24	**60,639**	63,240
NAMA senior bonds	26	**1,799**	5,616
Financial investments available for sale	27	**15,437**	16,489
Financial investments held to maturity	28	**3,356**	3,483
Interests in associated undertakings	29	**65**	70
Intangible assets	30	**392**	289
Property, plant and equipment	31	**357**	344
Other assets		**248**	785
Current taxation		**13**	35
Deferred tax assets	32	**2,828**	2,897
Prepayments and accrued income		**444**	503
Retirement benefit assets	12	**166**	222
Total assets		**95,622**	103,122
Liabilities			
Deposits by central banks and banks	33	**7,732**	13,863
Customer accounts	34	**63,502**	63,383
Trading portfolio financial liabilities	35	**–**	86
Derivative financial instruments	22	**1,609**	1,781
Debt securities in issue	36	**6,880**	7,001
Current taxation		**18**	31
Deferred tax liabilities	32	**81**	–
Other liabilities	37	**973**	1,108
Accruals and deferred income		**484**	653
Retirement benefit liabilities	12	**158**	368
Provisions for liabilities and commitments	38	**246**	382
Subordinated liabilities and other capital instruments	39	**791**	2,318
Total liabilities		**82,474**	90,974
Equity			
Share capital	40	**1,696**	1,696
Share premium	40	**1,386**	1,386
Reserves		**9,572**	8,572
Total shareholders' equity		**12,654**	11,654
Other equity interests	42	**494**	494
Total equity		**13,148**	12,148
Total liabilities and equity		**95,622**	103,122

Richard Pym
Chairman
1 March 2017

Bernard Byrne
Chief Executive Officer

Mark Bourke
Chief Financial Officer

Sarah McLaughlin
Company Secretary

2 Critical accounting judgements and estimates *(continued)*

Specific provisions *(continued)*

collectively for assets that are not individually significant.

The amount of specific provision required on an individually assessed loan is highly dependent on estimates of the amount of future cash flows and their timing. Individually insignificant impaired loans are collectively evaluated for impairment provisions. As this process is model driven, the total amount of the Group's impairment provisions on these loans is somewhat uncertain as it may not totally reflect the impact of the prevailing market conditions. For further details please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on pages 81 and 82 of the Risk management section of this report.

The property and construction loan portfolio continues to have a high level of provisions following the downturn in both the Irish and UK economies. While collateral values have stabilised and recovered somewhat, market activity remains low relative to normalised levels. Accordingly, the estimation of cash flows likely to arise from the realisation of such collateral is subject to a high degree of uncertainty.

Incurred but not reported provisions

Incurred but not reported ("IBNR") provisions are also maintained to cover loans which are impaired at the reporting date and, while not specifically identified, are known from experience to be present in any portfolio of loans. IBNR provisions are maintained at levels that are deemed appropriate by management having considered: credit grading profiles and grading movements; historic loan loss rates; changes in credit management; procedures, processes and policies; levels of credit management skills; local and international economic climates; portfolio sector profiles/industry conditions; and current estimates of loss in the portfolio.

The total amount of impairment loss in the Group's non-impaired portfolio, and therefore, the adequacy of the IBNR allowance, is inherently uncertain. There may be factors in the portfolio that have not been a feature of the past and changes in credit grading profiles and grading movements may lag the change in the credit profile of the customer. In addition, current estimates of loss within the non-impaired portfolio and the period of time it takes following a loss event for an individual loan to be recognised as impaired ('emergence period') are subject to a greater element of estimation due to the speed of change in the economies in which the Group operates. For further details of the potential impact of an increase in the emergence period, please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on pages 81 and 82 of the Risk management section of this report.

Forbearance

The Group's accounting policy for forbearance is set out in accounting policy (t) 'Impairment of financial assets' in note 1 which incorporates forbearance.

The Group has developed a number of forbearance strategies for both short-term and longer-term solutions to assist customers experiencing financial difficulties. The forbearance strategies involve modifications to contractual repayment terms in order to improve the collectability of outstanding debt, to avoid default, and where relevant, to avoid repossessions. Forbearance strategies take place in both retail and business portfolios, particularly, residential mortgages. Where levels of forbearance are significant, higher levels of uncertainty with regard to judgement and estimation are involved in determining their effects on impairment provisions and on the future cash flows arising from restructured loans. Further information on forbearance strategies is set out in the 'Risk management' section of this report.

Deferred taxation

The Group's accounting policy for deferred tax is set out in accounting policy (l) in note 1. Details of the Group's deferred tax assets and liabilities are set out in note 32.

Deferred tax assets are recognised for unused tax losses to the extent that it is probable (defined for this purpose as more likely than not) that there will be sufficient future taxable profits against which the losses can be used. For a company with a history of recent losses, there must be convincing other evidence to underpin this assessment. The recognition of the deferred tax asset relies on the assessment of future profitability and the sufficiency of those profits to absorb losses carried forward. It requires significant judgements to be made about the projection of long-term future profitability because of the period over which recovery extends.

2 Critical accounting judgements and estimates *(continued)*

Deferred taxation *(continued)*

In assessing the future profitability of the Group, the Board has considered a range of positive and negative evidence for this purpose. Among this evidence, the principal positive factors include:

- the financial support provided to the Irish State under the EU/IMF programme and the fact that Ireland successfully exited the three-year bailout programme in December 2013;
- the financial support provided by the Irish Government to AIB as agreed with the EU/IMF from 2009 to 2011;
- the Irish Government's committed support to AIB and its nomination of the Group as one of two pillar banks in the smaller reconstructed Irish banking sector;
- the absence of any expiry dates for Irish and UK tax losses;
- the non-enduring nature of the loan impairments at levels which resulted in losses in prior years; and
- external forecasts for Ireland, and the UK economies which indicate continued economic recovery through the period of the medium-term financial plan. This is evident in a levelling off of bad debts growth, reductions in unemployment and increased spending.

The Board considered negative evidence and the inherent uncertainties in any long-term financial assumptions and projections, including:

- the absolute level of deferred tax assets compared to the Group's equity;
- the reduced size of the Group's operations following re-structuring;
- the quantum of profits required to be earned and the extended period over which it is projected that the tax losses will be utilised;
- the challenge of forecasting over a long period, taking account of the level of competition, market dynamics and resultant margin and funding pressures;
- potential instability in the eurozone and global economies over an extended period; and
- recent taxation changes (including Bank Levy and changes to the UK tax rates and the utilisation of deferred tax assets) and the likelihood of future developments and their impact on profitability and utilisation.

The Group's strategy and its medium term financial plan targeted a return to profitability by 2014 and growth in profitability thereafter. The return to profitability objective was realised in 2014 and has continued to date. Growth thereafter has been reaffirmed in the annual planning exercise covering the period 2017 to 2019 undertaken by the Group in the second half of 2016. Growth assumptions and profitability levels underpinning the plan are within market norms.

Taking account of all relevant factors, and in the absence of any expiry date for tax losses in Ireland, the Group further believes that it is more likely than not that there will be future profits in the medium term, and beyond, in the relevant Irish Group companies against which to use the tax losses. In this regard, the Group has carried out an exercise to determine the likely number of years required to utilise the deferred tax asset under the following scenario based on the financial planning outturn 2017 to 2019. Assuming a sustainable market return on equity (c.8.5%) over the long term for future profitability levels in Ireland and a GDP growth in Ireland of 2.5%, based on this scenario, it will take in excess of 20 years for the deferred tax asset (€ 3 billion) to be utilised. Furthermore, under this scenario, it is expected that 52% (2015: 60%) of the deferred tax asset will be utilised within 15 years with 83% (2015: 92%) utilised within 20 years.

In a more stressed scenario with a return on equity of 8% and GDP growth of 1.5%, the utilisation period increases by a further 4 years. The Group's analysis of the results of the scenarios examined would not alter the basis of recognition or the current carrying value.

Notwithstanding the absence of any expiry date for tax losses in the UK, AIB has concluded that the recognition of deferred tax assets in its UK subsidiary be limited to the amount projected to be realised within a time period of 15 years. This is the timescale within which the Group believes that it can assess the likelihood of its UK profits arising as being more likely than not.

Furthermore, legislation enacted in the UK in the past two years affected both the quantum of carried forward tax losses that could be utilised against future profits and the tax rate at which they will reverse. This legislation has resulted in the deferred tax asset reducing by € 92 million.

However, for certain other subsidiaries and branches, the Group has also concluded that it is more likely than not that there will be insufficient profits to support the recognition of deferred tax assets. The amount of recognised deferred tax assets arising from unused tax losses amounts to € 3,050 million of which € 2,928 million relates to Irish tax losses and € 122 million relates to UK tax losses. IAS 12 does not permit a company to apply present value discounting to its deferred tax assets or liabilities, regardless of the estimated

2 Critical accounting judgements and estimates *(continued)*

Deferred taxation *(continued)*

timescales over which those assets or liabilities are projected to be realised. The Group's deferred tax assets are projected to be realised over a long timescale, benefiting from the absence of any expiry date for Irish or UK tax losses. As a result, the carrying value of the deferred tax assets on the statement of financial position does not reflect the economic value of those assets.

Determination of fair value of financial instruments

The Group's accounting policy for the determination of fair value of financial instruments is set out in accounting policy (p) in note 1. The best evidence of fair value is quoted prices in an active market. The absence of quoted prices increases reliance on valuation techniques and requires the use of judgement in the estimation of fair value. This judgement includes but is not limited to: evaluating available market information; determining the cash flows for the instruments; identifying a risk free discount rate and applying an appropriate credit spread.

Valuation techniques that rely to a greater extent on non-observable data require a higher level of management judgement to calculate a fair value than those based wholly on observable data.

The choice of contributors, the quality of market data used for pricing, and the valuation techniques used are all subject to internal review and approval procedures. Given the uncertainty and subjective nature of valuing financial instruments at fair value, any change in these variables could give rise to the financial instruments being carried at a different valuation, with a consequent impact on shareholders' equity and, in the case of derivatives and contingent capital instruments, the income statement.

NAMA senior bonds designation and valuation

The Group's accounting policy for NAMA senior bonds is set out in accounting policy (r) in note 1. These bonds are separately disclosed in the statement of financial position.

NAMA senior bonds are designated as loans and receivables as they meet the criteria to be so designated.

The bases for measurement, interest recognition and impairment for NAMA senior bonds are the same as those for loans and receivables (see accounting policy numbers (m). (f) and (t) in note 1). There is no active market for the NAMA senior bonds, accordingly, the fair value at initial recognition was determined using a valuation technique.

The absence of quoted prices in an active market required an increased use of management judgement in the estimation of fair value. This judgement included, but was not limited to: evaluating available market information; determining the cash flows generated by the instruments and their expected timing; identifying a risk free discount rate and applying an appropriate credit spread.

The valuation technique and critical assumptions used were subject to internal review and approval procedures. While the Group believes its estimates of fair value are appropriate, the use of different measurements, valuation techniques or assumptions could have given rise to the NAMA senior bonds being measured at a different valuation at initial recognition, with a consequent impact on the income statement.

AIB continually reviews its assumptions as to the expected timing of future cash flows based on its experience of repayments to date, as required by IAS 39, AG8. If the revised assumptions when reassessed prove to be different, this will impact the carrying value and income statement in future periods.

NAMA senior bonds are subject to the same credit review processes and procedures as for loans and receivables (accounting policy (t) in note 1).

Retirement benefit obligations

The Group's accounting policy for retirement benefit schemes is set out in accounting policy (j) in note 1.

The Group provides a number of defined benefit and defined contribution retirement benefit schemes in various geographic locations, the majority of which are funded. All defined benefit schemes were closed to future accrual with effect from 31 December 2013.

Scheme assets are valued at fair value. Scheme liabilities are measured on an actuarial basis, using the projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Actuarial gains and losses are recognised immediately in the statement of comprehensive income.

32 Deferred taxation

	2016 € m	2015 € m
Deferred tax assets:		
Provision for impairment on loans and receivables	–	1
Retirement benefits	27	15
Assets leased to customers	6	9
Unutilised tax losses	3,050	3,201
Other	22	50
Total gross deferred tax assets	**3,105**	3,276
Deferred tax liabilities:		
Cash flow hedges	(67)	(54)
Retirement benefits	(40)	–
Amortised income on loans	(12)	(18)
Assets used in business	(12)	(14)
Available for sale securities	(161)	(280)
Other	(66)	(13)
Total gross deferred tax liabilities	**(358)**	(379)
Net deferred tax assets	**2,747**	2,897
Represented on the statement of financial position as follows:		
Deferred tax assets	2,828	2,897
Deferred tax liabilities	(81)	–
	2,747	2,897

For each of the years ended 31 December 2016 and 2015, full provision has been made for capital allowances and other temporary differences.

Analysis of movements in deferred taxation	2016 € m	2015 € m
At 1 January	2,897	3,576
Exchange translation and other adjustments	(19)	20
Deferred tax through other comprehensive income	81	(186)
Income statement – Continuing operations *(note 17)*	(212)	(513)
At 31 December	**2,747**	2,897

Comments on the basis of recognition of deferred tax assets on unused tax losses are included in note 2 'Critical accounting judgements and estimates' on pages 257 to 259. Information on the regulatory capital treatment of deferred tax assets is included in 'Principal risks and uncertainties' on page 58.

At 31 December 2016, recognised deferred tax assets on tax losses and other temporary differences, net of deferred tax liabilities, totalled € 2,747 million (2015: € 2,897 million). The most significant tax losses arise in the Irish tax jurisdiction and their utilisation is dependent on future taxable profits.

Temporary differences recognised in other comprehensive income consist of deferred tax on available for sale securities, cash flow hedges and actuarial gains/losses on retirement benefit schemes. Temporary differences recognised in the income statement consist of provisions for impairment on loans and receivables, amortised income, assets leased to customers, and assets used in the course of the business.

Net deferred tax assets at 31 December 2016 of € 2,651 million (2015: € 2,722 million) are expected to be recovered after more than 12 months.

For AIB's principal UK subsidiary, the Group has concluded that the recognition of deferred tax assets be limited to the amount projected to be realised within a time period of 15 years. This is the timescale within which the Group believes that it can assess the likelihood of its profits arising as being more likely than not.

32 Deferred taxation *(continued)*

With effect from 1 April 2015, legislation was introduced in the UK whereby only 50% of a bank's annual trading profits can be sheltered by unused tax losses arising before that date, accordingly, the Group's UK deferred tax asset was reduced by € 242 million in 2015.

Furthermore, in November 2015, UK legislation was enacted to reduce the UK corporation tax rate to 19% from April 2017 with a further reduction to 18% from April 2020.

In addition, an 8% corporation tax surcharge was introduced which applies to banking profits from January 2016, subject to an annual exemption for the first £ 25 million of profits. Taxable profits for the purpose of the surcharge cannot be reduced by pre-2016 tax losses.

Effective from 1 April 2016, UK legislation further reduced the amount of annual taxable profits a bank can shelter with unused tax losses arising before 1 April 2015 from 50% to 25% and resulted in a reduction of € 92 million in the UK deferred tax asset. In addition, the legislation provided that the UK corporation tax rate will reduce to 17% from 1 April 2020.

These changes have been reflected in the carrying value of deferred tax assets and liabilities at 31 December 2016 and 2015.

For certain other subsidiaries and branches, the Group has concluded that it is more likely than not that there will be insufficient profits to support full recognition of deferred tax assets.

The Group has not recognised deferred tax assets in respect of; Irish tax on unused tax losses of € 122 million (2015: € 305 million); overseas tax (UK and USA) on unused tax losses of € 3,315 million (2015: € 3,475 million); and foreign tax credits for Irish tax purposes of € 3 million (2015: € 3 million). Of these tax losses totalling € 3,437 million for which no deferred tax is recognised: € 33 million expire in 2032; € 42 million in 2033; € 27 million in 2034; and € 5 million in 2035.

The aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates for which deferred tax liabilities have not been recognised amounted to Nil (31 December 2015: Nil).

Deferred tax recognised directly in equity amounted to Nil (31 December 2015: Nil).

Analysis of income tax relating to total comprehensive income

	2016			
	Gross	Tax	Net of tax	Net amount attributable to owners of the parent
	€ m	€ m	€ m	€ m
Profit for the year	1,682	(326)	1,356	1,356
Exchange translation adjustments	(168)	–	(168)	(168)
Net change in cash flow hedge reserves	119	(13)	106	106
Net change in fair value of available for sale securities	(478)	119	(359)	(359)
Net actuarial gains in retirement benefit schemes	127	(24)	103	103
Net change in property revaluation reserves	–	(1)	(1)	(1)
Total comprehensive income for the year	1,282	(245)	1,037	1,037
Attributable to:				
Owners of the parent	1,282	(245)	1,037	1,037

32 Deferred taxation *(continued)*

Analysis of income tax relating to total comprehensive income

				2015
	Gross € m	Tax € m	Net of tax € m	Net amount attributable to owners of the parent € m
Profit for the year	1,914	(534)	1,380	1,380
Exchange translation adjustments	31	–	31	31
Net change in cash flow hedge reserves	(29)	–	(29)	(29)
Net change in fair value of available for sale securities	186	(83)	103	103
Net actuarial gains in retirement benefit schemes	846	(103)	743	743
Total comprehensive income for the year	2,948	(720)	2,228	2,228
Attributable to:				
Owners of the parent	2,948	(720)	2,228	2,228