

NATIONAL AUSTRALIA BANK LTD  
Form 20-F  
December 21, 2006

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended 30 September, 2006

Commission file number 1-9945

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## National Australia Bank Limited

ABN 12 004 044 937

(Exact name of Registrant as specified in its charter)

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Victoria, Australia

(Jurisdiction of incorporation)

500 Bourke Street, Melbourne, VICTORIA, 3000 Australia

(Address of principal executive offices)

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Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares	New York Stock Exchange
American Depositary Shares, each representing five Ordinary Shares	New York Stock Exchange
Exchangeable Capital units consisting of 7 7/8% Perpetual Capital Securities and Purchase Contracts	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: NONE

Indicate the number of outstanding shares of each of the registrant's classes of capital or common stock as of the close of the period covered by the annual report.

<b>Ordinary Shares</b>	<b>1,609,897,524</b>
<b>Staff Share Scheme shares (partly paid shares)</b>	<b>390,259 paid to 25 Australian cents</b>
<b>National Income Securities</b>	<b>20,000,000</b>
<b>Trust Preferred Securities</b>	<b>400,000</b>
<b>Trust Preferred Securities II</b>	<b>800,000</b>

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:

Yes  No

If this is an annual report or transition report, indicated by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934:

Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

This Report on Form 20-F shall be deemed to be incorporated by reference in the prospectus included in the Registration Statement on Form F-3 (No. 333-6632) of National Australia Bank Limited and to be part thereof from the date on which this Report, is filed, to the extent not superseded by documents or reports subsequently filed or furnished.

(APPLICABLE ONLY TO ISSERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS) Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes  No

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**Chairman's message**

I am pleased to report that your Company achieved good growth in profitability and steady progress in its business improvement program in the 2006 year.

Net profit attributable to members of the Company increased 10.0% to \$4,392 million and cash earnings before significant items rose 21.9% to \$3,967 million.

These results were achieved despite an increasingly competitive lending environment and a substantial amount of management time being devoted to improving the Bank's internal systems and complying with the requirements of new international regulatory frameworks and standards.

The Company's culture change program, initiated in 2005, is achieving early success, especially at senior levels. The program seeks to clarify individual accountability and empower employees at every level to take initiative in their day-to-day decisions and interactions.

The success of these efforts is evidenced by numerous positive developments across the Group – from a recovery in the Australian bank's market share in business lending, to the growth of the Integrated Financial Solutions Centre (FSC) business in the UK, the rebuilding of nabCapital and the success of the 'Unbeatable' home loan campaign in New Zealand.

In Australia, our efforts were recognised via Money Magazine's Bank of the Year Award, CFO Magazine's Business Bank of the Year Award and Australian Banking and Finance Magazine's Life Insurance Company of the Year Award for MLC.

Much, however, remains to be done. The principal message being conveyed by the Board to senior management, and through them to employees, is that the Company's goal of providing sustainable satisfactory shareholder returns will only be achieved through an unwavering focus on our customers' needs, ethical behaviour at all levels and recognition in the community of our operating companies as good corporate citizens.

The investment of time and money by the Company in developing its systems to meet regulatory requirements is substantial. These investments will ultimately result in an even sharper appreciation of risk across the business.

In the meantime, such demands do result in a lesser focus on market-oriented initiatives than would otherwise be the case.

Increasingly in the markets in which we operate there is strong competition from non-traditional sources, which are not required to meet the same regulatory standards.

The tilting of the playing field in this way works to the detriment of banks, a development that is not in the interest of either our shareholders or our economy. At a time when governments are beginning to recognise the costly burden being placed on companies by regulation generally, this is a trend that needs to be monitored closely.

During the year, the directors declared dividends totalling 167 cents per share, a small increase on that paid in 2005. As a result of the increase in net profit attributable to members of the Company, the Company's dividend payout ratio fell from 79.6% to 67.4% which is closer to the board's target range of 60% to 65%.

In July 2006, Mr Robert Elstone resigned from the Board as a result of his appointment as Chief Executive of the Australian Stock Exchange. Rob's departure is a real loss to the Company, in particular given his keen appreciation of risk across all parts of the finance sector. Rob made a significant contribution during his two years on the Board and we are indebted to him for that.

Fortunately the Board is well placed in respect of finance industry expertise and Mr Paul Rizzo was able to assume the role of Chair of the Risk Committee seamlessly upon Rob's departure.

In closing, I would like to thank my fellow directors and the Company's employees for their dedication and effort over the past year.

/s/ Michael A Chaney AO  
Michael A Chaney AO  
Chairman



**Group Chief Executive Officer's message**

**2006 at a glance**

Net profit attributable to members of the Company increased 10.0% to \$4,392 million;

Business portfolio aligned to core capabilities;

Share buy back; and

Improving customer satisfaction.

National Australia Bank is about to commence the next phase of its development focused on creating sustainable satisfactory shareholder value.

The progress made in all parts of the Group during the past year was very pleasing. All of our key businesses are gaining momentum. Our portfolio is now well suited to our core capabilities and has the ability to produce sustainable growth in shareholder value.

Net profit attributable to members of the Company was up 10.0% to \$4,392 million. This was affected by significant items, largely in respect of the UK pension reforms in 2006 and profit on the sale of the Irish Banks and restructuring provisions in 2005. This was all a part of getting the National Australia Bank match fit .

In 2006, net profit attributable to members of the Company before significant items was up 25.3% to \$4,154 million. This is a better reflection of the underlying performance of the Group, but was also affected by the introduction of the Australian equivalents to International Financial Reporting Standards.

In line with our commitment to active capital management we will undertake a \$500 million on-market share buy back to commence in the first half of 2007. We intend to neutralise the capital impact of shares issued under the dividend reinvestment plan and various employee share plans by either buying back shares issued or purchasing shares on market to satisfy our obligations rather than issuing new shares.

We have carefully managed margins, asset quality remains sound overall and we continued to strive to improve customer satisfaction levels throughout the Group.

The Corporate Centre was reduced in size and is focused on creating value for shareholders, strategic development of our portfolio of businesses, financial and risk performance and governance, developing and retaining talent and capital and balance sheet management.

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The establishment of a regional business model has created a more nimble, customer-focused organisation in the regions in which we operate.

In the Australian business, we developed and launched new products, built market share in target areas and managed expenses.

As the major business within our portfolio, Australia also faced the largest challenge in the turnaround and made progress on all fronts.

This was reflected in the increase of 27.0% in net profit attributable to members of the Company to \$2,515 million and excluding significant items, was up 10.9%.

In New Zealand, despite challenging economic conditions and fierce competition, our Bank of New Zealand operation performed well. Using the 'Unbeatable' home loan campaign to position itself in a crowded market, net profit attributable to members of the Company increased 26.7% to \$389 million and excluding significant items, was up 22.7%.

The United Kingdom operation differentiates National Australia Bank from other Australian banks. The net profit attributable to members of the Company of \$868 million, a decrease of 46.7% (largely related to the profit on sale of the Irish Banks in 2005), represents 19.8% of overall Group net profit. Net profit attributable to members of the Company, excluding significant items, was up 15.7% to \$618 million.

We successfully worked to rejuvenate the existing branch network, and expand into the southeast of England with Financial Solutions Centres targeting small to medium enterprises, and the mass affluent personal sector.

nabCapital, formerly Institutional Markets and Services increased net profit attributable to members of the Company by 22.9% to \$618 million and excluding significant items was up 8.0%, while reducing the amount of capital deployed in the business. nabCapital further evolved its originate warehouse and distribute business model to provide greater linkage between the various parts of its business, and both borrowers and investors.

During the year we continued to develop the Corporate Social Responsibility (CSR) program within our businesses. Paying attention to broader social and environmental issues helps manage risks and identify new opportunities that add value to our business for shareholders and the communities in which we operate. This year we will produce our third CSR Report to outline our progress in this area.

I would like to thank the Board for its support, especially in leading the culture change program. A great deal of practical work has been completed to support the new Corporate Principles and measure behaviours. Over time, I am confident this will result in a fundamental and lasting shift in the culture.

And finally, thank you to all of our staff who worked very hard to contribute towards the National Australia Bank's success in 2006.

/s/ John Stewart

John Stewart  
Group Chief Executive Officer

*Refer to non-GAAP measures on page 56 for an explanation of the Group's non-GAAP measures, including significant items, and reconciliations of non-GAAP financial measures, including significant items on page 7.*

**Presentation of information**

*Basis of presentation*

References in this document to this annual financial report refer to this 2006 annual report on Form 20-F filed with the US Securities and Exchange Commission. This annual financial report contains financial information in respect of the Group's parent entity, National Australia Bank Limited, as well as consolidated financial information in respect of the Group. Parent entity financial information is prepared solely to meet Australian reporting requirements.

**This annual financial report is prepared in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS) which differ in some respects from US GAAP (as set out in note 57 in the financial report). Comparative amounts have been reclassified to accord with changes in presentation made in 2006, except where otherwise stated.**



**This is the Group's first annual financial report prepared in accordance with AIFRS. The 2005 annual financial report was prepared in accordance with previous Australian Generally Accepted Accounting Principles (GAAP), which differs from AIFRS in certain respects (as set out in note 1 in the financial report).**





*Currency of presentation*



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All currency amounts are expressed in Australian dollars unless otherwise stated. Merely for the convenience of the reader, this annual financial report contains translations of certain Australian dollar amounts into US dollars at specified rates. These translations should not be construed as representations that the Australian dollar amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated. Unless otherwise stated, the translations of Australian dollars into US dollars have been made at the rate of US\$0.7461 = A\$1.00, the noon buying rate in New York City for cable transfers in Australian dollars as certified for customs purposes by the Federal Reserve Bank of New York (noon buying rate) on September 30, 2006.

### *Certain definitions and glossary*



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The Company's fiscal year ends on September 30. The fiscal year ended September 30, 2006 is referred to as 2006 and other fiscal years are referred to in a corresponding manner. The abbreviations \$m and \$bn represent millions and thousands of millions (ie. billions) of Australian dollars respectively. Any discrepancies between total and sums of components in tables contained in this annual financial report are due to rounding.

A glossary of some of the key terms used in this annual financial report is contained at page 285. In addition, non-GAAP financial measures have been defined at page 56.

### **Forward-looking statements**



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This annual financial report contains certain forward-looking statements within the meaning of section 21E of the United States *Securities Exchange Act of 1934*. The United States *Private Securities Litigation Reform Act of 1995* provides a safe harbour for forward-looking information to encourage companies to provide prospective information about themselves without fear of litigation, so long as the information is identified as forward-looking and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the information.

Accordingly, the words anticipate, believe, expect, project, estimate, intend, should, could, may, target, goal, objective, plan, outlook and other similar expressions are used in connection with forward-looking statements.

In this annual financial report, forward-looking statements may, without limitation, relate to statements regarding:

economic and financial forecasts, including but not limited to statements in the financial review and the report on the directors and officers;

anticipated implementation of certain control systems and programs, including, but not limited to those described in risk management; and

certain plans, strategies and objectives of management.

Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of the Group, that may cause actual results to differ materially from those expressed in the statements contained in this annual financial report. For example:

the economic and financial forecasts contained in this annual financial report will be affected by movements in interest and foreign currency exchange rates, which may vary significantly from current levels, as well as by general economic conditions in each of the Group's major markets. Such variations may materially impact the Group's financial condition and results of operations;

the implementation of control systems and programs will be dependent on such factors as the Group's ability to acquire or develop necessary technology or systems, its ability to attract and retain qualified personnel and the response of customers and third parties such as vendors; and

the plans, strategies and objectives of management will be subject to, among other things, government regulation, which may change at any time and over which the Group has no control. In addition, the Group will continue to be affected by general economic conditions in Australia and worldwide, movements and conditions in capital markets, the competitive environment in each of its markets and political and regulatory policies.

There can be no assurance that actual outcomes will not differ materially from the forward-looking statements contained in this annual financial report.





**Selected financial data**

The information hereunder has been derived from the audited financial report of the Group, or where certain items are not shown in the Group's financial report, it has been prepared for the purpose of this annual financial report. Accordingly, this information should be read in conjunction with and is qualified in its entirety by reference to the financial report.

	2006 \$m	Group 2006 (1) US\$m	2005 \$m
<b>Income statement summary</b>			
Net interest income	8,686	6,481	6,944
Net life insurance income	1,417	1,057	1,505
Gains less losses on financial instruments at fair value	471	351	639
Other income (2)	4,615	3,443	5,251
Significant revenue	334	249	1,354
Operating expenses (3)	(7,642)	(5,702)	(7,995)
Charge to provide for doubtful debts	(606)	(452)	(534)
Significant expenses			(748)
<b>Profit before income tax expense</b>	<b>7,275</b>	<b>5,428</b>	<b>6,416</b>
Income tax expense	(2,134)	(1,592)	(1,814)
<b>Net profit</b>	<b>5,141</b>	<b>3,836</b>	<b>4,602</b>
Net profit attributable to minority interest	(749)	(559)	(610)
<b>Net profit attributable to members of the Company</b>	<b>4,392</b>	<b>3,277</b>	<b>3,992</b>
Dividends paid/payable (4)	2,554	1,905	2,454

	2006 \$m	Group 2006 (1) US\$m	2005 \$m
<b>Balance sheet summary</b>			
Investments relating to life insurance business	54,784	40,874	49,783
Loans and advances	283,777	211,726	264,674
Total assets	484,785	361,698	422,598
Total risk-weighted assets (5)	318,323	237,501	289,833
Deposits and other borrowings	222,277	165,841	212,557
Life policy liabilities	46,475	34,675	42,123
Bonds, notes and subordinated debt	65,006	48,501	41,490
Other debt issues	2,274	1,697	1,559
Net assets	27,972	20,870	31,547
Contributed equity	12,279	9,161	10,828
Ordinary shares	7,948	5,930	6,894
Other equity instruments (6)	4,331	3,231	3,934
Total equity (excludes minority interest)	27,804	20,745	25,323

	2006 \$	Group 2006 (1) US\$	2005 \$
<b>Shareholder information</b>			
Earnings per share (7)			
Basic	2.63	1.96	2.46
Diluted	2.62	1.95	2.42
Dividends per share (4)	1.67	1.25	1.66
Dividends per American depository share (ADS) (4)	8.35	6.23	8.30
Dividend payout ratio (%) (4)	67.35	67.35	79.56
Net assets per share	17.38	12.97	20.13
Share price at year end	36.70	27.38	33.05
Number of ordinary shares at year end (No. 000)	1,610,288	n/a	1,567,654

	2006 %	Group 2006 (1) %	2005 %
<b>Selected financial ratios</b>			
Average equity (ordinary shareholder funds) to average total assets (excluding statutory funds) (8) (9)		5.4	5.5
Return on average assets (10)		0.9	0.9
Return on average equity (ordinary shareholder funds) (9) (10)		18.8	18.0
Average net interest spread		1.88	1.69
Average net interest margin		2.31	2.13
Gross impaired assets to gross loans and acceptances (11)		0.30	0.35
Net impaired assets to equity (parent entity interest)		3.1	2.8
Total provisions for doubtful debts to gross impaired assets		191.3	235.8
<b>Capital risk asset ratios (12)</b>			
Tier 1		7.3	7.9
Tier 2		3.9	3.6
Deductions		(0.4)	(1.0)
Total		10.8	10.5

**US GAAP measures**

	2006 \$m	2006 (1) US\$m	2005 \$m	Group 2004 \$m	2003 \$m	2002 \$m
<b>Selected financial data in accordance with US GAAP</b>						
Net income	4,232	3,157	3,891	2,781	3,667	3,455
Total assets	485,728	362,402	424,628	417,758	398,448	380,280
Total equity	25,911	19,332	23,385	23,311	22,297	24,005

	2006 \$	2006 (1) US\$	2005 \$	2004 \$	2003 \$	2002 \$
<b>Selected shareholder information in accordance with US GAAP</b>						
Net income per share (7)						
Basic	2.60	1.94	2.44	1.71	2.30	2.11
Diluted	2.57	1.92	2.40	1.71	2.22	2.06
Dividends per ADS (US\$) (4) (13)	n/a	6.38	6.09	6.13	6.03	4.12
Dividends as percentage of net income (%)	63.48	63.48	67.45	89.78	64.14	65.59

	2006 %	2005 %	2004 %	2003 %	2002 %
<b>Selected financial ratios in accordance with US GAAP</b>					
Net income as a percentage of					
Average total assets (excluding statutory funds) (8)	<b>1.1</b>	1.0	0.8	1.0	1.0
Average equity	<b>17.2</b>	16.7	12.2	15.8	14.5
Total equity as percentage of total assets (excluding statutory funds) (8)	<b>6.0</b>	6.3	6.2	6.2	6.9

	2006 \$m	Group	2005 \$m
<b>Reconciliations of non-GAAP measures (14)</b>			
<b>Net profit attributable to members of the Company</b>	<b>4,392</b>		3,992
Adjusted for			
Significant revenue	(334)		(1,354)
Significant expenses			748
Income tax expense/(benefit) on significant items	96		(72)
<b>Net profit attributable to members of the Company before significant items</b>	<b>4,154</b>		3,314
<b>Net profit to cash earnings before significant items reconciliation</b>			
Net profit attributable to members of the Company	4,392		3,992
Adjusted for			
Net profit/(loss) attributable to minority interest	749		610
Net profit	5,141		4,602
Adjusted for			
Net (profit)/loss attributable to minority interest	(749)		(610)
Distributions on other equity instruments	(254)		(204)
Treasury shares (after-tax)	126		143
Investment earnings on shareholders' retained profits and capital from life businesses discount rate variation	6		
Revaluation gains/(losses) on exchangeable capital units (after-tax)	112		
Net (profit)/loss on sale of controlled entities (after-tax)	(108)		
Economic hedge (gain) on proceeds from sale of controlled entities (after-tax)	(22)		
<b>Cash earnings</b>	<b>4,252</b>		3,931
Adjusted for			
Significant revenue	(402)		(1,354)
Significant expenses			748
Income tax expense/(benefit) on significant items	117		(72)
<b>Cash earnings before significant items</b>	<b>3,967</b>		3,253
<b>Average ordinary shareholder funds reconciliation</b>			
Total average equity (refer to note 42 in the financial report)	26,016		28,806
Adjusted for			
National Income Securities (average)	(1,945)		(1,945)
Trust Preferred Securities (average)	(975)		(975)
Trust Preferred Securities II (average)	(1,014)		(531)
National Capital Instruments (average)	(13)		
Minority interest (average)	(50)		(4,281)
<b>Average ordinary shareholder funds</b>	<b>22,019</b>		21,074

	2006	2005	Group 2004	2003	2002
<b>Employees</b>					
Full-time equivalent (15)	38,433	38,933	43,517	42,540	43,202

	2006	2005	Group 2004	2003	2002
<b>Exchange rates (average and closing per A\$1.00)</b>					
Average					
British pound	<b>0.4150</b>	0.4141	0.4055	0.3824	0.3622
United States dollar	<b>0.7467</b>	0.7654	0.7265	0.6125	0.5324
New Zealand dollar	<b>1.1432</b>	1.0847	1.1254	1.1142	1.1992
Closing					
British pound	<b>0.3991</b>	0.4326	0.3973	0.4072	0.3474
United States dollar	<b>0.7478</b>	0.7617	0.7149	0.6804	0.5440
New Zealand dollar	<b>1.1439</b>	1.0991	1.0682	1.1446	1.1565

	2006	2005	Group 2004	2003	2002
<b>United States dollar (per A\$1.00)</b>					
Average (16)	<b>0.7468</b>	0.7655	0.7263	0.6167	0.5329
September 30	<b>0.7461</b>	0.7643	0.7244	0.6797	0.5628

On November 10, 2006 the noon buying rate was US\$0.7673 per A\$1.00.

	Group 2006					
United States dollar (per A\$1.00)	November	October	September	August	July	June
High	0.7889	0.7738	0.7713	0.7677	0.7675	0.7522
Low	0.7619	0.7421	0.7459	0.7573	0.7419	0.7293

- (1) *Translated at the noon buying rate on September 30, 2006 of US\$0.7461 = A\$1.00.*
- (2) *In 2006, other income includes the net profit (before-tax) from the sale of the Custom Fleet business.*
- (3) *In 2006, operating expenses includes the net loss (before-tax) from the sale of the MLC Asia businesses.*
- (4) *Dividend amounts for a year represent the final and interim dividend in respect of that year, irrespective of when they are declared, determined and publicly recommended and includes issues under the bonus share plan in lieu of cash and the dividend reinvestment plan. Dividends and book value per ordinary share and per American depositary share (ADS) calculations are based on year-end fully paid equivalent ordinary shares, adjusted for loans and rights issues as appropriate. Dividend payout ratio is the dividend amounts for a year divided by cash earnings before significant items. Refer to page 7 for a reconciliation of cash earnings before significant items and page 56 for an explanation of non-GAAP financial measures .*
- (5) *The calculation to determine the market risk capital component of risk-weighted assets at September 30, 2006 and September 30, 2005 was carried out under the Standard Method as directed by APRA. The Standard Method as prescribed by the APRA Prudential Standard (APS 113), limits recognition of portfolio effects on outstanding positions and is substantially more restrictive on the rules regarding the matching of positions.*
- (6) *Equity instruments comprise preference shares, National Income Securities, Trust Preferred Securities, Trust Preferred Securities II and National Capital Instruments.*
- (7) *Refer to notes 8 and 57 in the financial report for an explanation of earnings per share.*
- (8) *Statutory funds are excluded given the significant restrictions imposed on these assets by life insurance legislation, regulations and the regulators thereunder. However, current Australian accounting requirements do not allow for these assets and liabilities to be separated and disclosed separately on the balance sheet.*

- (9) *Refer to page 7 for a reconciliation of average ordinary shareholder funds.*
- (10) *Return represents net profit attributable to members of the Company after deducting distributions on other equity instruments.*
- (11) *In 2006, this includes loans accounted for at fair value.*
- (12) *As defined by APRA (refer to liquidity, funding and capital resources on page 27).*
- (13) *Dividend amounts are translated into US dollars per ADS (representing five fully paid ordinary shares) at the exchange rate on each of the respective payment dates for interim and final dividends.*
- (14) *Refer to page 56 for explanations of non-GAAP financial measures .*
- (15) *Full-time equivalent employees (FTEs) includes part-time staff (pro-rated) and non-payroll FTEs (ie. contractors).*
- (16) *The daily average of the noon buying rates.*

**Business overview**

**Introduction**





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The Group is an international financial services group that provides a comprehensive and integrated range of financial products and services.

The Company traces its history back to the establishment of The National Bank of Australasia in 1858. National Australia Bank Limited is a public limited company, incorporated on June 23, 1893 in Australia, which is the Company's main domicile. Its registered office is 35 floor, 500 Bourke Street, Melbourne Victoria 3000, Australia. The Company operates under the requirements of the *Banking Act 1959* (Cth) and the *Corporations Act 2001* (Cth).

In 1981 the National Bank of Australasia merged with the Commercial Banking Corporation of Sydney which was established in 1834.

Globally, as at September 30, 2006, the Group had:

total assets of \$485 billion;

\$97 billion in assets under management and administration;

\$474 billion in funds under custody and investment administration; and

8.0 million banking and 2.3 million wealth management customers.

### **Strategy and corporate principles**



The Group's corporate purpose is to generate sustainable satisfactory returns to shareholders.

The Group's strategies are focused on the turnaround of the Group and building new avenues for growth. There has been, and continues to be a focus on:

- re-invigorating the Group's franchise and brand;
- improving the Group's core infrastructure;
- accelerating cultural change around the Group's corporate principles;
- enhancing the Group's disciplined approach to performance improvement;
- improved regulatory and key stakeholder engagement;
- strengthening risk and capital management; and
- leveraging our distinctive capabilities to create new and differentiated growth opportunities.

The Group's corporate principles will continue to be embedded in the Group's culture to ensure that thinking and actions are aligned with the Group's strategic direction.

The five principles are:

- we will be open and honest;
- we take ownership and hold ourselves accountable (for all our actions);
- we expect teamwork and collaboration across our organisation for the benefit of all stakeholders;
- we treat everyone with fairness and respect; and
- we value speed, simplicity and efficient execution of our promises.

#### **Organisational structure and operating model**



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National Australia Bank Limited is the holding company for the Group, as well as the main operating company. During 2006, the Company had four wholly-owned main operating subsidiaries: Bank of New Zealand, Clydesdale Bank PLC, MLC Limited and National Australia Financial Management Limited.

The Company continues to consider a range of options to optimise its domestic and international operations, including a non-operating holding company. The Company is participating in industry-wide consultation with regulators in the relation to the matter. Consideration of various structural options which involves a range of complex issues, the analysis and subsequent decision on a particular path are expected to take some time to complete.

During the 2006 year, two divestments occurred, the Custom Fleet and MLC Asia businesses. *For further information on these divestments refer to page 45 and page 46 respectively).*

In 2005, one significant divestment occurred. In February 2005, the Group sold the shares of National Europe Holdings (Ireland) Limited, the immediate parent entity of Northern Bank Limited and National Irish Bank Limited. *For further information on this divestment, refer to page 45.*

The business operating model is run along regional lines of business as follows:

Australia Region comprises Australian Banking and Wealth Management Australia;

United Kingdom Region comprises United Kingdom Banking and Wealth Management United Kingdom;

New Zealand Region comprises New Zealand Banking and Wealth Management New Zealand; and

nabCapital (global).

This is supported by the Group's Other business segment, which includes streamlined functions that support all the regional businesses and comprises Group Funding and Corporate Centre activities.

At September 30, 2006 the Group operated around 1,715 outlets and offices worldwide, of which 58% are in Australia, with the largest proportion of the remainder being in the UK. Approximately 12% of the 1,715 outlets and offices are owned directly by the Group, with the remainder being held under commercial leases.

*Refer to note 45 in the financial report for details of the principal controlled entities of the Group and note 21 for details of the Group's property, plant and equipment.*

### **Australia Region**



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The Australia Region of the Group provides a broad range of banking and wealth management products and services. As well as lending and deposit taking, Australia Region includes the Australian cards, custody and other transactional banking operations, as well as its wealth management activities including insurance, investments and superannuation, in both Australia and Asia. It does not include nabCapital's operations in Australia and Asia.

The Australia Region incorporates an extensive distribution network to service customers. At September 30, 2006, there were 85 integrated financial service centres (catering for customers' financial advice needs), 186 business banking centres, 110 agribusiness locations, 27 private banking suites, 787 branches and agencies, and over 3,200 Australia Post GiroPost outlets.

Electronic distribution also provides customers with the choice to meet their financial needs via the internet, over the telephone, through more than 1,290 automatic teller machines (ATM) as at September 30, 2006, or through an extensive network of electronic funds transfer point of sale (EFTPOS) terminals. There were over 1.1 million registered internet banking customers at September 30, 2006.

At September 30, 2006, Australia Region had 22,411 full-time equivalent employees.

In 2005, four key strategies were focused upon:

- customer and employee satisfaction;
- simplifying our business through productivity, efficiency and quality gains;
- re-investing in our critical infrastructure; and
- managing our business units for performance.

Key achievements and actions taken during the 2006 year include:

- awarded Bank of the Year in Money Magazine's 2006 Consumer Finance Awards;
- MLC Insurance Limited awarded Insurance Company of the Year 2006 at the Australian and New Zealand Industry Awards;
- updated its brand in February 2006, supported by significant internal and external communications and sponsorship of the 2006 Commonwealth Games, the Socceroos and the Australian Football League;
- Customer First program - a reconfiguration of the business and retail network - with rollout in Queensland completed;
- new and enhanced product offerings, which have delivered substantial revenue growth;
- stable net interest margin and overall risk quality;
- cross-selling of Wealth Management products in bank channels up 31% (investments), up 35% (insurance) and up 22% (debt products) in Wealth Management channels on the 2005 year;



sale of MLC Asia businesses and Custom Fleet business; and

the final review by an independent expert, PricewaterhouseCoopers, was conducted, following which APRA and ASIC jointly considered that all actions under the MLC enforceable undertakings and directions issued to the relevant MLC group companies are now complete.

Management also continues to drive significant cultural and behavioural change within Australia Region. Recent internal surveys have highlighted improvement in employees sharing a common vision and having clarity about what they need to do to help the region meet its goals and objectives. Importantly customer satisfaction improved significantly this year due to the region's commitment to improving the customer experience in the front line through branch refurbishment, service improvement and product innovation.

Five key themes will guide effort over the next few years:

improving process quality to increase customer satisfaction and lower costs;

reducing enterprise costs;

extending customer relationships, to grow revenue, especially cross-selling;

renewing infrastructure; and

creating a distinctive NAB way of working and leading.

Commentary on each of the divisions of the Australia Region is provided below.

### **Business and Private Banking**

The Business and Private Banking operation provides lending, deposit, transaction and specialist services to over 1 million customers, including businesses and high net worth individuals in Australia.

During the 2006 year Business and Private Banking implemented a new operating model bringing together both the product management and distribution management aspects of the business. This change has been instrumental in ensuring a consolidation of the turnaround performance of last year and has enabled a continuation of focused sales campaigns, improved product offerings (eg, Business Options, Business Cash Maximiser and the Portfolio Facility) and increased capacity for our people.

The Company continues to be Australia's largest business lender with a market share of 19.0% (source: RBA financial system, company data, September 2006), and largest business deposit-taker with a market share of over 24.9% (source: APRA banking system, company data, September 2006). The business is underpinned by an extensive distribution network and excellent business bankers. Improvement in processes has led to improved client service and the capacity release for future growth. Emphasis has been on training to ensure the business has strong

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credit skills and are able to provide value to clients. Growth has also been underpinned by an embedded performance management framework aligned to the Group's corporate principles.

Management are continuing to improve the service and support offered to business customers with the ongoing development of a new business internet banking platform - the foundation release is currently in use with upcoming releases in the first quarter of 2007.

Other key focus areas include the ongoing refinement of the relationship management model, reinforcing sales capability, customer retention, growing deposits, cross-sales and industry specialisation.

### **Retail Banking**



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Retail Banking provides lending, deposit and transaction services to approximately 3.2 million retail customers through extensive physical and virtual distribution networks.

The key areas of focus for Retail Banking during the year have been the re-invigoration of the sales channel and product innovation.

The re-invigoration of the retail distribution sales channel has resulted in significant change at the front line. These efforts have concentrated on improving branch sales capability, empowering front line staff and enhancing the customer experience.

A local market operating model was established during the year, with newly appointed regional executives having financial accountability for their local area. Other key initiatives included a realignment of the mobile banker channel, rollout of a new customer segmentation model and branch refurbishment program. This has increased branch home loan sales capability. The refurbishment of 198 branches was completed by September 30, 2006.

As competitive pressure has continued to characterise the external operating environment, product innovation has been another important area of focus. New products launched during the year have included the Velocity Card, Low Rate Visa Card, Custom Home Loan and the NAB Investment Cash Manager. Coupled with new products launched toward the end of the 2005 year (high-yield internet savings account and the Personal Project Loan), these product developments continue to enhance the Group's product offerings and improve sales through targeted campaigns.

### **Wealth Management**



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Under the MLC brand, Wealth Management provides investment, superannuation and insurance solutions to 1.9 million retail and corporate customers. As at September 30, 2006, Wealth Management managed approximately \$94 billion on behalf of its customers.

Wealth Management's Financial Planning and Third Party division manages relationships with its network of salaried, self-employed aligned and external financial planners, as well as mortgage brokers. The division provides a range of tools and support services to financial planners and mortgage brokers including practice management support, financial planning software, and business growth and efficiency support.

Wealth Management has more than 1,300 aligned and salaried advisers and relationships with more than 1,200 external advisers at September 30, 2006. At the same time, it has relationships with approximately 12,200 brokers.

In its core Australian market, as at June 30, 2006, MLC held the largest share of total individual risk business with a 15.0% share of inforce annual premiums (source: DEXX&R Life Analysis Report, date: June 30, 2006). At the same time, it was ranked number one in market share of master trusts, with a 15.5% market share of funds under management (source: Plan for Life Australian Retail & Wholesale Investments Market Share & Dynamics Report, date: June 30, 2006).

Focus on the utilisation of the regional model to promote business strategies and deliver improved outcomes for customers continued throughout 2006. Product initiatives in 2006 included:

Masterkey Fundamentals, a no commission version of our MasterKey platform, supporting a growing number of advisers operating under a fee for service model;

MLC Long Term Absolute Return (LTAR) Fund, which is an unconventional investment strategy explicitly designed to maximise the long term net real return to investors over rolling 20-year time frames;

two JANA retail investment trusts; and

MLC EasyCover, a debt insurance solution purpose-built for mortgage brokers.

Wealth Management completed its regulatory undertakings to the Australian Securities and Investments Commission (ASIC) and Australian Prudential Regulation Authority (APRA) and also completed the compensation program for investors in a number of products that were adversely affected by October 2001 unit pricing reductions, as well as two associated historical unit pricing errors.

### Asia





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The Australia Region is also responsible for the Group's banking and wealth management activities in Asia. In May 2006, the Wealth businesses in Hong Kong and Indonesia were sold to AXA Asia Pacific. The remaining businesses have been consolidated with Hong Kong as the primary base supporting both the Tokyo and Singapore branches. The business commenced a strategic alliance with China Union Pay which claims to have up to 99% of the credit and debit card market in China. Chinese visitors to Australia will have access at NAB ATMs and EFTPOS terminals.

*Refer to page 35 for detailed information of the financial performance of the Australia Region.*

### **United Kingdom Region**



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United Kingdom Region (UK), consists of banking and wealth management activities in the UK that provide financial solutions to approximately 3.1 million customers in the UK. It includes nabCapital's operations in the UK. At September 30, 2006, UK had 8,822 full-time equivalent employees.

The Group's activities in the UK operate under two brands, Clydesdale Bank and Yorkshire Bank, within one legal entity, Clydesdale Bank PLC.

Clydesdale Bank was established in 1838 in Glasgow, has a long history of support for Scottish industries and communities, and has been part of the Group since 1987. Clydesdale Bank is one of Scotland's largest retail banks, as well as one of the country's leading business banks. In the 2006 year, Clydesdale Bank has continued to expand its network of Financial Solutions Centres in the south of England.

Yorkshire Bank was founded in 1859 in Halifax, West Yorkshire, and today maintains a strong regional focus in the north of England and the Midlands. Yorkshire Bank has a strong personal customer base and business capability, and has been part of the Group since 1990.

Each bank offers a broad range of financial products and services to both retail and business customers. Products and services provided by Wealth Management and nabCapital offer customers a further range of financial solutions.

Following the sale of Northern Bank Limited and National Irish Bank Limited to Danske Bank A/S in February 2005, the Group provided transitional services to Danske Bank A/S in respect of the Northern Bank Limited and National Irish Bank Limited operations to assist in the transition of ownership of those businesses. These transitional services were provided at cost and ended in April 2006. Subsequently, any ongoing services provided to Danske Bank A/S have been on commercial business terms.

In the 2005 year, the Group recorded a provision of \$266 million to cover costs of restructuring initiatives including the streamlining of operations,

reductions in staffing levels and the reconfiguration of its distribution networks. It was anticipated that the restructuring would lead to a total reduction of approximately 1,700 positions across the UK over a 12-to-18 month period, together with the closure of approximately 60 Clydesdale Bank branches and 40 Yorkshire Bank branches. This decision reflected the changing needs of customers and the different ways in which they are banking. The branch closure programme was completed in March 2006, six months ahead of schedule, with a total of 105 branches closed and 99% of the reduced staffing positions being achieved by September 30, 2006.

At September 30, 2006, the Group's UK distribution network comprised 153 Clydesdale Bank branches, 190 Yorkshire Bank branches and 74 Financial Solutions Centres, supported by 2 customer contact centres, internet banking, telephone banking and 921 ATMs.

During the 2006 year, a further 6 Financial Solutions Centres were opened in the south and, as at September 30, 2006, there were 38 centres operating in Scotland and the north of England and 36 centres operating in the south of England. Financial Solutions Centres offer integrated business and private banking services to small-medium sized business customers.

In the retail distribution network, the branch network rationalisation has been completed and other locations with potential have been reinforced with investment in flagship branches, which handle micro businesses as well as retail customers.

Further expansion into the mortgage intermediary market continued with the marketing of Clydesdale Bank branded mortgage products through third party distributors. As at September 30, 2006, more than 450 broker relationships have been established.

In July 2006, Clydesdale Bank established an offshore branch banking operation in Guernsey, initially taking deposits with plans to expand the range of services offered.

Further progress has been made toward centralising, streamlining and simplifying technology and operations. Customer Connect, which is the Bank's sales and service illustration tool, has been rolled out to all Yorkshire branches and a new teller system is now successfully operating in over half of those branches. The programme of process simplification and workload removal has continued with greater process and transaction centralisation. In addition, the processing of third party originated mortgages and procurement was outsourced during the year.

Rationalisation of products continues with a planned reduction in product numbers over the next 12-18 months. New base rate tracker mortgage and savings products and offshore deposit products have been launched to enhance our product offerings.

Major pension reforms were implemented during the 2006 year following consultations with staff, unions and pension fund trustees, including a ballot of employees to seek their agreement to the revised benefits. This has resulted in the three defined benefit schemes moving from final salary to a career average structure for benefits accrued from April 1, 2006. As part of the reforms, the Group made a one-off contribution across the defined benefit schemes during the 2006 year and improvements were made to the defined contribution scheme.

Attention has also been directed to further develop talent and the quality of leadership. A branch development programme has been undertaken with more than 200 senior retail staff to enhance leadership skills in areas such as coaching, mentoring and performance management.

*Refer to page 36 for detailed information of the financial performance of United Kingdom Region.*

**New Zealand Region**



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New Zealand (NZ) Region consists of NZ Banking and Wealth Management activities, and at September 30, 2006 had 4,505 full-time equivalent employees. It does not include nabCapital's operations in New Zealand.

NZ Banking represents the retail and business banking arm of the Group in NZ, which together with nabCapital operates under the Bank of New Zealand (BNZ) brand. Custom Fleet's operations in NZ were also part of NZ Banking until they were sold on July 31, 2006. NZ Banking provides financial solutions for 1.1 million customers at September 30, 2006 and is the primary contributor of the NZ financial result. The Investment Management arm of the Wealth Management operations was sold during January 2006.

BNZ, acquired by the Group in 1992, is one of the largest financial service providers in NZ and has a strong brand position with comprehensive coverage in a very competitive market.

BNZ has strong market share positions in business, corporate, agribusiness and cards. A major component of BNZ's longer-term strategy is also to drive growth in key personal market segments of housing, small-medium enterprises and youth.

BNZ continued its strong programme of re-investing in its people, products and infrastructure which is reflected in gains in customer satisfaction and brand awareness, and BNZ winning domestic and international awards for its Customer Contact Centres.

Focus on people development, performance and customers, and the ongoing enhancement of the physical distribution network, coupled with improved technology, automation and functionality through electronic and remote channels, continue to be core to the strategy. This, together with the strategic decision to discontinue the mortgage broker distribution channel, reflects BNZ's vision to empower its customers with a range of convenient and cost-effective channels.

The distribution network at September 30, 2006 comprised of 180 outlets, 402 ATMs, and shared access to an extensive nationwide EFTPOS network. BNZ also has well-established telephone banking capabilities, in addition to its internet banking service catering for more than 310,000 registered users as at September 30, 2006.

*Refer to page 37 for detailed information of the financial performance of New Zealand Region.*

**nabCapital (formerly Institutional Markets & Services)**





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nabCapital is a global business with operations in Australia, the United Kingdom, New Zealand, United States and Asia. At September 30, 2006, it had 2,075 full-time equivalent employees. nabCapital provides debt financing, financial risk management and investor services and products to the Group's customers, and trades financial risk management products. It is also responsible for the management of relationships with top tier corporate clients and financial institutions.

In July 2006, the business was reorganised to establish two global business lines - Global Markets and Structuring & Investments - and three regionally focused businesses, Australia (including Asia and the US), the United Kingdom and New Zealand.

Global Markets is focused on traded products and financial risk management solutions. It provides foreign exchange, money market, commodities and derivatives products globally through a dedicated 24-hour dealing capability. Structuring & Investments is responsible for manufacturing investment products and managing nabCapital's assets. The three regions are responsible for managing the franchise and customer relationships, including the provision of corporate finance products and services such as project finance and leveraged finance.

The reorganisation of the business ensures nabCapital's structure aligns to its operating model of originating a more diverse mix of funding and risk management products, repackaging or warehousing the risk around those products, and distributing them to a larger pool of investors. This has helped nabCapital maintain its strong position in Australian bonds, loan syndications and project finance league tables (source: Thomson Financial and Dealogic), and saw positive movement in client satisfaction measures.

A strong emphasis on remediation work remains. The cultural change agenda continues with two-thirds of nabCapital employees participating in a cultural diagnostic which is helping to shape the next steps in the cultural development of nabCapital. In addition, nabCapital has initiated a three year Strategic Investment Program aimed at delivering a simplified, flexible, and cost effective business and technology platform to support its growth initiatives.

The move during the year to a new name and a distinct brand identity reflects more accurately the nature of the business. The new branding applies to nabCapital's global operations except in New Zealand, where it continues to operate under the Bank of New Zealand brand.

*Refer to page 38 for detailed information of the financial performance of nabCapital.*

**Other**



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The Group's Other business segment includes streamlined functions that support all the regional businesses and comprises Group Funding and Corporate Centre activities. Group Funding acts as the central vehicle for movements of capital and structural funding to support the Group's operations. Corporate Centre activities include strategic development of the portfolio of businesses, financial and risk governance, developing and retaining talent, capital and balance sheet management.

### **Employees**



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The following tables summarise the Group's staffing position as at September 30:

	2006 Number	2005 Number	2004 Number
<b>By geographic region</b>			
Australia	24,263	23,554	24,567
Europe	9,197	9,868	13,324
New Zealand	4,686	4,814	4,766
United States	93	114	141
Asia	194	583	719
Total full-time equivalents (1)	38,433	38,933	43,517

	2006 Number	2005 Number	2004 Number
<b>By line of business</b>			
Australia Region	22,411	22,136	23,128
United Kingdom Region	8,822	9,480	12,865
New Zealand Region	4,505	4,645	4,596
nabCapital	2,075	1,993	2,073
Other	620	679	855
Total full-time equivalents (1)	38,433	38,933	43,517

(1) *Full-time equivalent employees (FTEs) includes part-time (pro-rated) and non-payroll FTEs (ie. contractors).*

The Group's full-time equivalent (FTE) employee numbers decreased by 500 or 1.3% to 38,433 during the 2006 year. This decrease primarily reflects the following:

- the sale of the Group's Custom Fleet and MLC Asia businesses which reduced FTE by 923;
- restructuring activities, particularly in Australia and the United Kingdom, which decreased FTE by 1,654; partly offset by
- the uplift associated with projects and business initiatives, which increased FTE by 1,815.

The Group's FTE employee numbers decreased by 4,584 or 10.5% to 38,933 during the 2005 year. This decrease primarily reflected the following:

- the sale of Northern Bank Limited and National Irish Bank Limited, which had 2,712 FTE at September 30, 2004; and
- the significant restructure, reorganisation and integration of all of the Group's businesses, particularly in the Australia, United Kingdom and nabCapital segments, amounting to a reduction of 1,964 FTE.

*Refer to page 47 for further information on the Group's restructuring expenses and provisions recorded by the Company during the 2005 year.*

The Group continues to work professionally and constructively with the unions in Australia, United Kingdom, New Zealand and in other countries where the Group operates, recognising their members as key stakeholders in the organisation. The Group utilises a number of industrial instruments including individually negotiated contracts and collective agreements.

In Australia, there is a single enterprise agreement, which comprises the terms and conditions for all employees. This agreement was developed and negotiated with the Finance Sector Union and was certified in

February 2006. The agreement replaced all previous agreements and some site agreements to provide a single consolidated version for Australian employees. The agreement runs from 2006 to 2009 and provides for a total of 4% pay increase each year for all employees, excluding those on management levels.

Bank of New Zealand has a collective agreement covering the branch network, contact centres and back-office locations. This collective agreement was renegotiated with FinSec late in calendar 2005 and runs from November 2005 to October 2007. A pay increase of 4.35% was paid to these employees in November 2005, with a further 4% paid in November 2006.

Pay negotiations commenced with the UK union, Amicus, during November 2005. A single negotiation process replaced the three separate pay negotiations previously conducted annually. A pool of 3.3% was paid to these employees with a further 0.1% available for lower paid employees.

*For further information on the remuneration and reward policies offered by the Group, refer to the remuneration report on pages 78 to 93 of this annual financial report and note 41 shares, performance options and performance rights and note 52 equity instrument holdings of key management personnel in the financial report.*

#### **Economic outlook**





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This section contains forward-looking statements. *Refer to forward-looking statements on page 4.*

Global economic conditions remained strong in 2006. While the US expansion has begun to moderate, China and more generally developing economies performed very strongly. In addition Japanese activity picked up significantly and the Euro area has improved.

Business conditions in the countries that contain the bulk of the Group's assets remained solid but varied by regions and sectors. In New Zealand, slow growth emerged as households adjusted to higher interest rates and cooling property markets. Australian activity remained strong and unemployment levels continue to fall. Resource and related sectors and regions were boosted by high commodity prices, while conditions moderated in retail and manufacturing sectors. UK activity picked up with contributions from both household spending and business investment.

The global growth outlook is for a moderation in activity in 2007. The normalising of interest rates and continued high oil prices are expected to continue to slow the pace of the current global expansion. Growth is also expected to be sustained in the Group's main operating regions. In Australia, some moderation in domestic spending is expected. The drought and slower domestic demand is expected to impact growth. Faced with capacity and inflationary pressures, New Zealand looks set to sustain slow growth in domestic spending. In the UK, growth is expected to remain reasonable with a strong services sector but a weak manufacturing sector.

The Group's main areas of operation continue to face similar economic risks and vulnerabilities. External imbalances and already stretched fiscal positions especially in the US and Europe might limit any response to any increased geopolitical tensions. Any disruption to the current strong growth in China and other emerging economies would also be expected to lead to a marked revaluation of global income growth and asset prices. On the other hand, overly aggressive action by central banks in response to inflation pressures could also trigger negative wealth effects and a marked slowdown in household spending.

### **Competition**



The Australian financial system is characterised by intense competition from a large number of traditional and new players, and well-developed equity and corporate bond markets. There are four major national banks and many other financial conglomerates with national operations offering a complete range of financial services, as well as a number of smaller regional institutions and niche players. Non-bank financial institutions are a force in the Australian financial system, although many have demutualised over the past decade to capture capital-related and other competitive advantages. Non-bank financial institutions offer a wide portfolio of products and services including insurance, investments and superannuation (pensions).

Competition also comes from numerous Australian and, in many cases, international non-bank financial intermediaries including investment and merchant banks, specialist retail and wholesale fund managers, building societies, credit unions and finance companies. Product and functional specialists operate and are important players in the household and business mortgage, credit card deposit and other payment services markets. The rapid development and acceptance of the internet and other technologies have increased competition in the financial services market and improved choice and convenience for customers.

These forces are evident across all of the Group's businesses in each of its geographic markets. Within the broader financial services industry, increased competition has led to a reduction in operating margin, partly offset by fees and other non-interest income and increased efficiencies. The latter has been largely achieved through greater investment in new technologies for processing, manufacturing and retailing products and services. These trends towards increasingly contestable markets offering improved access, wider choice and lower prices for customers are expected to continue in the future.

## **Risk management**

### **Introduction**

Effective management of risk is a key capability for a successful financial services provider, and is fundamental to the Group's strategy. A key component of the Group's risk management strategy is the establishment by the Board of a formal risk appetite statement for the Group.

This places an overall limit on the total amount of risk that the Group is prepared to take. That position is set with respect to the returns that the Group is seeking to provide to shareholders, the credit rating that the Group is seeking to maintain, and the Group's capital position and desired capital ratios.

This position informs the Group's risk, capital and business management limits and policies. It is periodically reviewed by the Board as a part of the strategic planning process, or as the commercial circumstances of the Group change.

The Group manages risk within an established three lines of defence framework. The first line of defence comprises the business units managing the risks associated with their activities. The second line encompasses dedicated risk functions at both a Group and regional level, which are accountable for independent monitoring and oversight. The third line of defence relates to Internal Audit independently reviewing, monitoring, and testing business unit compliance with risk policies and procedures, and regularly assessing the overall effectiveness of the risk management framework. Control is exercised through clearly defined delegation of authority, with clear communication and escalation channels throughout the organisation.

The Group Risk Management Committee, chaired by the Group Chief Executive Officer, serves as the principal risk strategy and risk policy decision making management body within the Group, and provides the Board with assurance in the performance of the overall risk management framework. This committee is supported by five sub-committees - Group Credit Risk Committee, Group Market Risk Committee, Group Operational Risk and Compliance Committee, Group Asset and Liability Committee, and Group Economic Capital Committee - each with a specialised focus.

Each of the four major regions also has a regional Risk Management Committee comprised of senior regional executives, which serves to provide a leadership focus on key risk issues within the region.

*Refer to page 61 for Risk Committee members, responsibilities and charter.*

In response to the March 2004 APRA report on the foreign currency options trading losses, significant progress has been made to improve market risk systems, governance processes, and organisational culture although the organisation continues to invest in further development of systems and culture. Key outcomes include the reopening in May 2005 of the foreign currency options trading desk, closure of all governance and culture related remedial actions in April 2006 and in December 2006, APRA approved the return to the use of the internal model for the calculation of the market risk component of risk weighted assets, from January 1, 2007.

**Risk factors**



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The following are certain risk factors that may impact the Group's future results. The factors discussed below should not be considered to be the complete list of all potential risks.

*For a discussion of the Group's risk mitigation procedures, refer to risk mitigation on pages 16 to 20.*

### **Credit risk**

As a financial institution, the Group is exposed to the risks arising from changes in credit quality and the ability of the borrowers or counterparties to fulfil their contractual obligations under loan agreements or other credit facilities. The Group's provision for doubtful debts provides for loan losses incurred in loans and advances. Estimating losses incurred in the loan portfolio is of its very nature uncertain and the accuracy of those estimates depends on many factors, including general economic conditions, rating changes, structural changes within industries that alter competitive positions, and other external factors such as legal and regulatory requirements.

### **Market risk**

The Group's earnings are also subject to a range of market risks, principally changes in market interest and foreign exchange rates, equity and commodity prices, and associated financial derivatives.

### **Liquidity and funding risk**

The Group is exposed to liquidity and funding risk and its banking entities must comply with the relevant regulatory liquidity requirements of the banking and other regulators in the countries they operate in.

### **Operational risk**

As a financial services group, the Group is exposed to operational risks, being the risk of loss resulting from inadequate or failed processes, people or systems or from external events.

### **Pension risk**

Pension risk is the risk that, at any point in time, there are insufficient funds available to meet the pension obligations due now and in the future. There are a number of factors that underpin pension risk, each with differing characteristics. Broadly, pension risk can be described as being the aggregation of asset risk, liability risk and accounting risk. The Pension Group's principal exposure to pension risk is in the UK business.



**Regulatory risk**

The Group is subject to substantial regulation in the countries where it operates. The Group's businesses and earnings may be affected by fiscal or other policies that are adopted by various regulatory authorities, or the failure to meet the requirements of those regulators.

Changes or developments in regulations, including accounting standards, could impact the earnings performance of the Group. The nature and impact of future changes in such policies are not predictable and are beyond the Group's control.

Regulatory agencies have broad administrative power over many aspects of the Group's business, including liquidity, capital adequacy and permitted investments, money laundering, privacy and record keeping. Financial services laws and regulations currently governing the Group, the Group's branches and subsidiaries may change in ways that could have an adverse impact on the Group's business. Also, bank regulators and other supervisory authorities in Australia, the United Kingdom, the US and elsewhere continue to examine payment processing and transactions under regulations governing such matters as money laundering, prohibited transactions with countries subject to sanctions and other anti-corruption matters. If the Group fails to respond appropriately to regulatory developments, actions or measures, the Group's reputation could be harmed and could be subject to additional legal risk, such as fines or penalties.

**Strategic risk**



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Strategic risk is the current or prospective risk to earnings and capital arising from poor business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. These include the quality of the strategic planning process, the achievability of the strategy, the implications of the strategy on risk appetite and the nature of products, services and customers targeted.

### **Business conditions and general economy risk**



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As an international financial services group, the Group's businesses are affected by conditions in the markets in which it operates. The profitability of the Group's businesses could be adversely affected by a worsening of general economic conditions in Australia, New Zealand, the UK, the US, or elsewhere, as well as by foreign and domestic trading market conditions.

### **Legal risk**

The Group may be and is subject to legal proceedings, including tax disputes with the taxation authorities in Australia and New Zealand. The outcome of these proceedings could affect earnings.

*Refer to note 46 in the financial report for further information on the Group's contingent liabilities, including the tax disputes.*

### **Fluctuations in currency exchange rates**

As the Group prepares its annual financial report in Australian dollars, changes in currency exchange rates, particularly between the Australian dollar and the British pound, NZ dollar or US dollar, may have an adverse effect on the earnings that it reports.

### **Other**

Many other types of risks such as those pertaining to payment systems, computer systems fraud, legislative compliance, business continuity, disaster recovery and e-commerce risks exist and are managed throughout the Group.

### **Risk mitigation**



For the major areas of risk, the processes for managing these risks is discussed below:

*Credit risk*





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The Group's credit risk management infrastructure is designed to provide sound management principles and practices to maintain appropriate asset quality across the Group.

The Group has dedicated divisions within Group Risk Management, responsible for the development and maintenance of credit policies, large counterparties' credit approvals, and the development and maintenance of key credit risk systems.

### *Establishing an appropriate credit risk environment*



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Significant credit risk strategies and policies are reviewed and approved annually by the Risk Committee of the Board, and ultimately the Board. Through such policies, the Board establishes the Group's tolerance for risk. These policies are delegated to management and administered under their guidance and control.

Single large exposure policies and industry concentration limits are in place across the Group. Overall composition and quality of credit portfolio exposures are monitored and periodically reported to the regional boards and the Board, and, where required, to the relevant supervisory authorities.

*Operating under a sound credit granting process*



The Group has established processes for the origination of credit. Key considerations include:

establishment of overall credit limits at the level of both individual counterparties and groups of connected counterparties for on- and off-balance sheet exposures;

satisfaction with repayment capacity and integrity of the counterparty;

use of financial covenants;

use of collateral;

consideration of economic and industry conditions; and

an objective customer risk rating assessment system.

Supporting these considerations are defined and documented policies and processes for the origination of credit. The key elements of the process include:

clearly defined authorities for the approving of credit; and

a system of overview of credit approvals by a higher level of authority to ensure adherence to policies and good credit practice.

The delegated authorities are aligned to the counterparty risk by the inclusion of customer risk ratings in the authority matrix. The Group's credit rating system is based on probability of default of a counterparty and provides differentiation of credit risk and focus in pricing for risk.

For consumer credit, scoring systems are in place and are supported by appropriate monitoring tools. These tools provide the essential continual review of data integrity, scorecard performance and decision strategies.

Software to validate and verify input data is used globally to support data integrity and counteract fraudulent activity.

**Maintaining adequate controls over credit risk**

Monitoring the condition of individual credit exposures in the business units principally rests with the customer-facing relationship managers, with overview by Risk Management credit executives.

There is a formal process, undertaken by specialist units, of independent oversight of credit in each region across the Group. Periodic reporting is submitted to management and the Risk Committee of the Board.

Credit processes and policy compliance are subject to internal auditing. In addition, targeted credit reviews of specific business units or regions are undertaken by Risk Asset Review teams. Credit exposures identified by this team to be outside agreed parameters are reported to the appropriate levels of authority for attention.

Credit exposures showing adverse trends are passed to specialist units that undertake the collections and recovery processes. The Group utilises skilled internal resources supported by external resources. Through the use of due diligence techniques, the Group regularly targets areas of interest or concern within its credit portfolio to review and maintain the quality of the credit portfolio.

The Group also provides quarterly information to APRA, detailing large exposures to individual customers or groups of related customers in excess of 10% of total Tier 1 and Tier 2 capital. APRA applies restrictions on the Group's ability to accept large credit exposures.

***Market risk***





The management of market risk is segregated between risk derived in the Group's trading activities and risk resulting from mainstream banking activities.

**Traded market risk**



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Traded market risk is mainly due to the trading activity undertaken by the Group through its dealing desks, which focus on traded products and risk management solutions for customers. The Group currently provides foreign exchange, money markets, commodities, credit products and associated derivatives products globally through a dedicated 24 hour dealing capability.

Traded market risk is managed and controlled in accordance with policy approved by the Risk Committee of the Board. Trading is conducted on the basis of specific purpose profit centres authorised to deal in certain instruments approved by a management committee.

Traded market risk is primarily managed and controlled using Value at Risk (VaR) which is a standard measure used in the industry. The global VaR limit is approved by the Board and delegated at the discretion of the Group Chief Executive Officer.

### **VaR methodology**

VaR is an estimate of potential losses resulting from shifts in interest rates, currency exchange rates, traded credit spreads, option volatility, equity prices and commodity prices. The estimate is calculated on an entire trading portfolio basis, including both physical and derivative positions. The Group's VaR is predominantly calculated using historical simulation. This method involves multiple revaluations of the trading books using two years of historical pricing shifts. The pricing data is rolled monthly so as to have the most recent two year history of prices. The results are ranked and the loss at the 99th percentile confidence interval identified. The calculation and rate shifts used assume a one-day holding period for all positions.

In the case of small number of products such as commodities and equities, an alternate contingent loss matrix approach is used. While risk positions in these asset classes are small, efforts are continuing to bring them within the scope of the VaR methodology described above.

The use of a VaR methodology has limitations, which include:

the historical data used to calculate VaR is not always an appropriate proxy for current market conditions. If market volatility or correlation conditions change significantly, losses may occur more frequently and to a greater magnitude than in the VaR measure;

VaR methodology assumes that positions are held for one day and may underestimate losses on positions that cannot be hedged or reversed inside that timeframe;

VaR is calculated on positions at the close of each trading day, and does not measure risk on positions taken and closed before the end of each trading session; and

VaR measure does not describe the directional bias or size of the positions generating the risk.

VaR estimates are checked via backtesting for reasonableness and continued relevance of the model assumptions.

The Group employs other risk measures to supplement VaR, with appropriate limits to manage and control risks, and communicate the specific nature of market exposures to executive management, the Risk Committee of the Board and ultimately the Board. These supplementary measures include stress testing, stop loss, position and sensitivity limits.

**Relationship between risk measures**

Given the variance in the levels of detail and differing valuation shifts used to calculate these measures, the Group harmonises the specific desk controls with VaR. Market Risk conducts a calibration program supported by ongoing portfolio analysis, to maintain consistency across different risk controls. With the introduction of an Economic Capital framework, the various measures will be linked and derived from the economic capital allocated and used by each of the profit centres within traded market risk.

During the year, the Group's VaR exposure has been maintained within the Board approved limit. The following table shows the Group's VaR for all controlled banking entities' trading portfolios, including both physical and derivative positions:

Value at risk at 99% confidence interval	2006 \$m	2005 \$m
<b>Average value for year</b>		
Foreign exchange risk	1	3
Interest rate risk	9	13
Volatility risk	1	1
Commodities risk	1	
Credit risk (1)	1	
Diversification benefit	(3)	(3)
Total	10	14
<b>Minimum value for year (2)</b>		
Foreign exchange risk	1	1
Interest rate risk	5	9
Volatility risk	1	1
Commodities risk		
Credit risk (1)	1	
Diversification benefit	(1)	
Total	7	11
<b>Maximum value for year (2)</b>		
Foreign exchange risk	4	7
Interest rate risk	14	18
Volatility risk	1	3
Commodities risk	2	1
Credit risk (1)	4	1
Diversification benefit	(10)	(10)
Total	15	20

(1) As of June 1, 2005, market risk included credit VaR as part of the internal model calculation.

(2) VaR is measured individually according to foreign exchange risk, interest rate risk, volatility risk, commodities risk and credit risk. The individual risk categories do not sum up to the total risk number due to diversification benefit.

#### Non-traded market risk



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Non-traded market risk includes structural interest rate risk, structured foreign exchange risk, liquidity and funding risk.

The primary objective for the management and oversight of the risk is to maintain the risk profile within approved risk appetite and limits, while implementing strategies that optimise stable current and future earnings from the impact of market volatility.

Policies, inclusive of risk appetite and limits, are approved by the Board, with Group authority delegated to the Group Asset and Liability Management Committee (Group ALCO) and Regional Asset and Liability Management Committees (Regional ALCOs) for their subsequent implementation and monitoring.

Interest rate risk management across the Group is directed by Group Treasury, with execution on a regional basis.

Risk oversight is the responsibility of the Group Non-Traded Market Risk team which reports directly to the Deputy Group Chief Risk Officer. This team maintains standards of independence and control resilience consistent with traded market risk, with teams in place across the regional businesses.

### **Structural interest rate risk**





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Structural interest rate risk is the risk to the Group's earnings and capital that arises out of customers' demands for interest rate-related products with various re-pricing profiles. As interest rates and yield curves change over time the Group may be exposed to a loss in earnings and capital due to the re-pricing structure of the balance sheet. It includes:

re-pricing risk – the risk of loss of earnings or economic value caused by the differential timing of the re-pricing of assets and liabilities in the banking book;

basis risk – the risk of loss of earnings or economic value due to the repricing of assets and liabilities in the banking book relative to different wholesale market rates;

yield curve risk – the risk of loss of earnings or economic value due to a change in the slope or shape of the yield curve; and

optionality – the risk of loss of earnings or economic value owing to unanticipated changes to balance sheet volumes or rates as a result of embedded options in the banking book.

The objective of the Group is to secure stable and optimal net interest income over both a 12-month period and over the long term, as exemplified via the investment term of equity and non-interest-bearing deposits.

Interest rate risk is principally managed through the use of interest rate swaps, forward rate agreements, overnight index swaps and futures. All products are used within approved mandates, with strategies subject to monthly reporting to Group ALCO and Regional ALCOs.

Basis risk is more difficult to manage, given limited market liquidity in basis risk products. To mitigate this risk, Group Treasury and the Group Non-Traded Market Risk team closely monitor pricing strategies, product innovation and marketing, since these play an important role in reducing the mismatch attributable to repricing characteristics of assets and liabilities provided to customers.

The Group employs VaR as one of its principal measures for interest rate risk, along with an Earnings at Risk (EaR) measure that calculates the impact on future net interest income over the next 12 months. These limit measures are calibrated to calculate structural interest rate risk, incorporating different confidence intervals, holding periods and reporting timeframes than those for traded market risk, and are complemented by sensitivity and scenario analyses.

The table below presents a summary of the aggregated structural interest rate risk relating to non-trading assets and liabilities. The table contains forward-looking statements (*refer to forward-looking statements on page 4*). Based on the structural interest rate risk position at balance date, the table shows the potential impact on net interest income, for the year ending September 30, 2007 of an immediate 1% parallel movement in interest rates across the whole yield curve.

The non-Australian exposure (expressed in Australian dollars) is the net exposure of offshore controlled branches and controlled entities, excluding life insurance and fund management entities. Structural interest rate exposure in some countries may be biased towards rising interest rates, whilst in others may be biased towards declining interest rates, depending on different economic conditions or cycles.



	Forecast effect on net interest income 2006(1)		Forecast effect on net interest income 2005(2)	
	Rates up 1% \$m	Rates down 1% \$m	Rates up 1% \$m	Rates down 1% \$m
Australian Operations	(11)	11	42	(42)
Non-Australian Operations	46	(46)	10	(10)

(1) Represents the forecast effect on net interest income for the year ending September 30, 2007 as calculated by the EaR measure.

(2) Represents the forecast effect on net interest income (as at September 30, 2005) for the year ended September 30, 2006.

### Hedging strategies



Regional Treasuries execute hedging strategies to mitigate risk and manage exposures within limits and metrics set by Group and Regional ALCOs, in line with the risk appetite approved by the Board. The Regional Treasuries have a set of approved products to execute hedging strategies, primarily interest rate swaps, forward rate agreements and interest rate futures contracts. These strategies reduce risk via offsetting the exposures to achieve a lower level of VaR/EaR, consistent with the hedge strategy intent. The strategies are targeted to minimise the exposure to a loss of earnings and capital, and are subject to validation by Group Non-Traded Market Risk. In addition to the objective of reducing repricing risk across the balance sheet, the strategies are evaluated with regard to AIFRS reporting requirements. In the majority of cases, hedging relationships that are effective under AIFRS are established. Where the requirements of AIFRS are not met, such derivative financial instruments are classified as non-hedging for accounting purposes.

Hedge relationships are formally documented at inception. The documentation includes identification of the hedged item and the hedging instrument, details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued.

### **Structural foreign exchange risk**

Structural foreign exchange risk arises from investments in the Group's foreign branches and controlled entities. Both earnings and capital are exposed to movements in foreign exchange rates as a result of these investments.

Reported earnings and capital are exposed to movements in exchange rates as a result of the need to translate earnings and net assets of the foreign operations into the Australian dollar consolidated financial statements. This exposure is referred to as an accounting or translation exposure which, in the absence of any long-term realignment in exchange rates, has no lasting impact on underlying economic exposures. As a consequence, the Group does not hedge these exposures as a matter of course.

Transaction foreign exchange exposures arise from the risk that future cash flows will be converted to Australian dollars at less favourable rates than at present. Such cash flows could result from the repatriation of profits or capital back to the Company. The policy of the Group is to fully hedge these exposures at the time of commitment, if they are of a material nature. Hedging of transaction exposures relating to offshore acquisitions and divestments is assessed on a case-by-case basis.

### ***Liquidity and funding risk***



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Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due at acceptable cost, and includes:

intra-day ability of the Group to meet intra-day collateral requirements in relation to clearing and settlement obligations;

operational ability of the Group to meet refinancing requirement for a predefined period i.e. up to 30 days; and

structural liquidity risk profile of the Group balance sheet to accommodate the Group strategic plan and Board risk appetite.

Funding Risk is the appetite and capacity of the market to provide adequate diversified term and short term funds to meet the Group's strategic plan objectives, and includes:

concentration risk - ability of the Group to diversify its funding sources to prevent undue reliance on a single or related counterparties;

tenor risk - ability of the Group to raise adequate longer term funds (maturity at issue in excess of 12 months); and

market access risk - the risk that the Group cannot access the market either domestically or via other banking subsidiaries within the Group at the time funding is needed.

The Group manages liquidity and funding risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets, maintenance of a prudent funding strategy and diversification of its funding base. The Group undertakes a conservative approach by imposing internal prudential limits that are in addition to regulatory requirements.

Regulatory supervision of banking liquidity in Australia is undertaken by APRA through its Prudential Standard APS 210 Liquidity (APS 210). In accordance with the requirements of APS 210, risk is measured and managed in the Group's banking entities on a cash flow basis. Each regional bank is required to monitor under both going concern and name crisis scenarios, and cash flow mismatch limits have been established to limit the Group's exposure. An additional prudential requirement of the regional banks is to maintain liquid asset portfolios to meet unexpected cash flow requirements.

Regulatory authorities in some countries in which the Group operates impose their own requirements to ensure that liquidity is managed prudently. These requirements may involve the bank maintaining a reserve deposit account with the central bank, holding a portfolio of highly liquid securities and overseeing the internal prudential supervision of liquidity.

Short term funding (under one year) is managed by nabCapital and Regional Treasuries on a Regional basis, consistent with the Group's Liquidity objectives. Funding over one year is managed by Group Treasury.

A three-level contingency plan has been established for the management of an escalated liquidity requirement where the Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers on each level, details the action required, allocates the key tasks to individuals, provides a timeframe and defines a management committee to manage the action plan.

*Refer also to liquidity, funding and capital resources on page 24.*



*Life insurance and funds management market risk*



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The life insurance business is exposed to market risk arising from adverse movements in market prices affecting fee income on investment-linked policies and the returns obtained from investing shareholder funds held in each life company. Market risk is also affected by mismatches between assets and the guaranteed returns offered on some classes of policy, which may not have been effectively hedged through the matching of assets.

The Group attempts, wherever possible, to segregate policyholder funds from shareholder funds. Appropriate investment mandates are then developed for each. The Group attempts to match asset characteristics with the nature of policy obligations. The shareholder funds are invested so as to meet the likely obligations of those funds in the event adverse risks transpire. However, certain clauses included in policy and sales documents, regulatory constraints or the lack of suitable investments may affect this.

The majority of the policyholder assets are held for investment-linked policies where the policyholder bears the risk of movements in the market value and determines the allocation of the assets. Should markets fall, fee income of the Group will decrease as it is based on the amount of assets invested.

### *Operational risk*



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Various reports are produced at management, Board committee and Board level to assist with their oversight and monitoring obligations. This incorporates regional reporting of risk profiles, key operational risk events, as well as consideration of external events and their relevance to the Group. This process generates visibility and understanding of the Group's overall operational risk profile.

The Operational Risk Framework is based on a set of core principles and defines the Group's standards for operational risk management. Its design recognises the importance of embedding operational risk into 'business-as-usual' activities. It has particular focus on defining and implementing the right behaviours and incorporating risk considerations into the Group's systems and processes.

The Operational Risk Framework includes:

a structured risk management process to facilitate the identification, assessment, quantification, monitoring and management of operational risks within the Group's operational risk appetite;

systematic management and oversight of the Group's operational risk; and

reference to the Group Risk Charter which contains an established governance structure that is used to ensure consistent application, management and reporting of the operational risk management process.

### *Regulatory risk*



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Regulatory risk arises from the risk of regulatory change or from failure to meet the requirements of law or regulation. Material impacts can include reputation impact, incurring restrictive conditions on how the Group does business or loss or suspension of licence to engage in certain activities. To mitigate this risk, the Group actively participates in regulatory developments with the regulatory authorities of the Australian Government, foreign governments and international agencies. The Group also places significant emphasis on maintaining appropriate internal compliance arrangements to ensure we meet these requirements.

### **Regulation of the financial services system**





*Australia*



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APRA is the prudential regulator of the Australian financial services industry, including authorised deposit-taking institutions (ADIs), life and general insurance companies, reinsurance companies, friendly societies and most members of the superannuation industry. ADIs are bodies corporate such as banks, credit unions and building societies that are authorised by APRA to conduct banking business in Australia.

The Reserve Bank of Australia (RBA) has overall responsibility for monetary policy, financial system stability and, through a Payments System Board, payment system regulation including the operations of Australia's real-time gross settlement system.

ASIC enforces and regulates company and financial services laws to protect consumers, investors and creditors. ASIC is an independent government body that regulates financial markets, corporations, securities, futures and consumer protection in superannuation, insurance and deposit taking.

ASIC has granted the Group its Australian Financial Services Licences issued pursuant to the *Corporations Act 2001* (Cth). The Group's Australian operations are operating under 19 licences representing the wide variety of financial services that it offers.

The Australian Competition and Consumers Commission (ACCC) administers the *Trade Practices Act 1974* (Cth). The ACCC promotes competition and fair trade in the market place to benefit consumers, business and the general community.

Consumer affairs offices in each Australian State and Territory are responsible for specific credit and fair trading legislation.

The Australian Transaction Reports and Analysis Centre (AUSTRAC) oversees compliance with the requirements of the *Financial Transactions Reports Act 1988* (Cth), which obliges the Group to identify its customers and collect and report information about certain transactions. AUSTRAC has dual roles as Australia's anti-money laundering regulator and specialist financial intelligence unit.

The *Banking Act 1959* (Cth) allows APRA to issue prudential standards that, if breached by ADIs or groups containing ADIs, can trigger legally enforceable directions. Under the *Banking Act 1959* (Cth), APRA has strong and defined powers to direct the activities of an ADI in the interests of depositors or when an ADI or a group containing an ADI has contravened its prudential framework. These direction powers enable APRA to impose corrective action without taking the step of assuming control. The *Banking Act 1959* (Cth) also requires an ADI to inform APRA of breaches of prudential requirements and of any materially adverse events (whether in respect of an ADI in a group or the overall group containing that ADI).

APRA has maintained prudential standards covering capital adequacy, market risk, funds management and securitisation, liquidity, credit quality, large exposures, associations with related entities and group risk management, outsourcing, business continuity management, risk management of credit card activities and audit and related arrangements for prudential reporting.

With effect from July 1, 2006, revisions to the prudential standards covering capital adequacy, credit quality, large exposures and funds management and securitisation were issued by APRA to address its response to AIFRS. APRA has also issued two new prudential standards with effect from October 1, 2006, covering fitness and propriety of key responsible persons and corporate governance.

Further, APRA is in the process of fully updating its suite of capital adequacy standards to reflect the introduction of the Basel II Capital Accord framework (*refer to further discussion under "changing regulatory environment"*).

APRA requires ADIs to provide regular reports covering a broad range of information, including financial and statistical data relating to their financial position and prudential matters. APRA gives special attention to capital adequacy, sustainability of earnings, loan loss experience, liquidity, concentration of risks, potential exposures through equity investments, funds management and securitisation activities, and international banking operations.

In carrying out its supervisory role, APRA supplements its analysis of statistical data collected from ADIs with selective on-site visits by specialist teams to overview discrete areas of banks' operations.

APRA also formalises a consultative relationship with each ADI's external auditor with the agreement of the ADI. The external auditors provide additional assurance to APRA that prudential standards applying to ADIs are being observed, and that statutory and other banking requirements are being met. External auditors also undertake targeted reviews of specific risk management areas selected at the annual meeting between the ADI, its external auditor and APRA. In addition, each ADI's chief executive officer attests to the adequacy and operating effectiveness of the risk management systems established to monitor and manage the key risks facing the ADI group.

Under APRA's prudential framework, the Company is required to obtain APRA's prior approval for the establishment or acquisition of a regulated presence domestically or overseas. There are also prior consultation requirements whereby the Company must consult with APRA before establishing or acquiring a subsidiary (other than certain special purpose financing entities), committing to acquire more than a 10% equity interest in an entity that operates in the field of finance, or in certain circumstances taking up an equity interest in an entity in a workout situation. Further, under section 63 of the *Banking Act 1959* (Cth), without the consent of the Treasurer of the Commonwealth of Australia, no ADI may enter into any agreement or arrangement for the sale or disposal of its business (by amalgamation or otherwise), or for the carrying on of business in partnership with an ADI, or effect a reconstruction.

The Group's wealth management business is regulated by both ASIC and APRA. ASIC administers legislation relating to Wealth Management's key financial services, including managed investments, superannuation, retirement income streams and insurance. Its role is to ensure industry participants comply with legislation, while promoting fair, confident and informed participation in the Australian market by investors and consumers. APRA provides prudential regulation through the oversight of Wealth Management's life insurance companies and approved trustees of superannuation funds and responsible entities of managed investment schemes. As with ADIs, APRA undertakes both off-site and on-site assessment of this activity at both a Wealth Management group and individual entity/business line level. APRA's industry focus over the past year has been on the re-licensing of approved trustees.

#### ***Non-Australian jurisdictions***



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APRA, under the international Basel framework, assumes the role of home banking supervisor and maintains an active interest in overseeing the operations of the Group, including its offshore branches and subsidiaries.

The Group's branch and banking subsidiaries in the UK are subject to supervision by the Financial Services Authority (FSA). The Group's banking subsidiary in New Zealand is subject to supervision by the Reserve Bank of New Zealand (RBNZ). In other offshore areas of banking and wealth management activity, the Group is subject to the operating requirements of relevant local regulatory authorities.

The local UK regulatory frameworks are broadly similar to those in force in Australia, which incorporate risk-based capital adequacy guidelines in accordance with the framework developed by the Basel Committee on Banking Supervision. The FSA also regulates the Group's UK wealth management operations, and is responsible for maintaining market confidence, promoting public awareness, protecting customers and reducing financial crime. The FSA has also introduced since October 2004, comprehensive frameworks addressing the provision of mortgage and general insurance.

In New Zealand, the emphasis of the RBNZ's regulatory approach is primarily on enhanced disclosure and directors' attestations to key matters. Under conditions of registration, banks are required to comply with minimum prudential and capital adequacy requirements. The RBNZ monitors banks' financial condition and conditions of registration, principally on the basis of published disclosure statements.

The Group's largest branch in the Asian region is in Hong Kong. The primary regulator in Hong Kong is the Hong Kong Monetary Authority, which is responsible for maintaining monetary and banking stability by regulating banking business and deposits and the supervision of authorised institutions.

In the US, branch operations are subject to supervision by the Office of the Comptroller of the Currency. The other key regulators of financial services are the Securities and Exchange Commission (SEC), the Board of Governors of the Federal Reserve System and the Office of Foreign Assets Control.

**Changing regulatory environment**





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Both within the financial services industry and more generally, businesses are working within a changing regulatory environment. An outline of the more significant current or pending regulatory changes impacting the Group is set out in the following sections.

### *Anti-money laundering*



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Each of the major countries in which the bank operates are undertaking revisions to their Anti-Money Laundering and Counter Terrorist Financing law and regulation.

On December 12, 2006, the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) became effective. The Group has been actively working with peer banks and external stakeholders in the development of the act and the attendant rules. The implementation of the requirements within the act will update and revise the anti-money laundering activity undertaken by the bank's Australian business operations. The bank has initiated a change program and project to implement the requirements of the act and rules within the business operations.

Revised requirements are being developed in New Zealand and are anticipated to proceed through the legislative process from late 2007.

The FSA in the UK have revised their approach to anti-money laundering and have updated the anti-money laundering Sourcebook, replacing it with high level provisions in the Senior Management Systems and Controls sourcebook and placing more onus on the Joint Money Laundering Steering Group (JMLSG) guidance. Her Majesty's Treasury approved the revised JMLSG guidance in February 2006. The revised guidance changes the way that the processes designed to detect money laundering and terrorist financing regulation are managed, enabling the UK financial services industry to take a sharper risk-based approach to anti-money laundering activity. The UK is also revising the Money Laundering Regulations in order to implement the requirements contained in the 3rd European Union (EU) Directive.

### ***Basel II Capital Accord***



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In 1988, the Bank for International Settlements (BIS) developed the Basel Capital Accord that set out international benchmarks for assessing banks' capital adequacy requirements. In response to changes in banking practices, BIS reviewed the Basel Capital Accord and released a revised regulatory framework known as the Revised Framework or Basel II. Amongst various objectives the Revised Framework seeks to encourage the development and use of more risk-sensitive capital calculations and to do so through greater use of risk assessments provided by banks' own internal systems.

The new framework incorporates changes to the measurement of banks' minimum regulatory capital requirements and additional identification of risk types. The framework is structured on:

minimum capital requirements;

key principles of supervisory review processes and banks' internal capital assessment processes; and

market discipline (public disclosure).

APRA has commenced releasing draft prudential standards in conformity with the Revised Framework which is expected to commence in Australia at the start of calendar year 2008.

Consistent with APRA requirements, the Group has submitted its first parallel run report for Basel II accreditation. This forms part of an accreditation process that will continue throughout calendar year 2007.

The Group continues to work with its key regulators in Australia and overseas to ensure that the Group's Basel II program aligns with regulatory requirements.

### *Payment system reforms in Australia*



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The RBA's reforms which significantly reduce interchange fees for EFTPOS Debit purchases and Visa Debit came into force on November 1, 2006.

Members of the Australian Payments Clearing Association and the RBA have finalised their access regime to allow new entrants to more easily connect to the EFTPOS bilateral network. These reforms have taken effect in September 2006.

### **UK Consumer Credit Acts 1974 and 2006**

The provision of credit to personal consumers in the UK is currently regulated by the *Consumer Credit Act 1974 (CCA)*. The CCA regulates all aspects of lending to consumers from advertising and documentation through to settlement and default procedures. Major revisions were made to the advertising and documentation regulations in 2004 and 2005. A new *Consumer Credit Act 2006 (CCA)* was passed earlier this year which supplements the 1974 Act.

The provisions of the new Act include:

new requirements for account maintenance and dealing with default;

additional scope for borrowers to challenge unfair lending; and

the removal of the current GBP25,000 financial limit to bring most consumer lending within the scope of the Act.

Implementation is phased, with the majority of the changes taking place in 2008. A project is underway to assess the impact and implement the changes.

### **MiFID (Markets in Financial Institutions Directive)**

MiFID is an EU directive, which will result in a major rewrite of the conduct of business rules for investment services in the UK. It was developed as part of the European Commission's Financial Services Action Plan, and is expected to come into force by November 1, 2007, replacing the current Investment Services Directive.

According to the FSA's November 2005 publication, *Planning for MiFID*, its implementation will significantly alter financial services regulation in the UK, how firms operate their businesses and the way they interact with customers. Most firms conducting investment business will be affected by MiFID. For example, the FSA will be re-writing significant sections of its handbook, which will affect all firms conducting investment business, changing the nature of their regulatory obligations to clients and their supervisory relationship with the FSA.





### **Certain legal proceedings**

Entities within the Group are defendants from time to time in legal proceedings arising from the conduct of their business.

The Company received a document request from the SEC Division of Enforcement in February 2004 as part of an investigation into certain Australian registrants and public accounting firms. The SEC Division of Enforcement has requested documents and information and is investigating issues that have occurred since at least as early as October 1, 2000 (the commencement of the 2001 year) regarding independence of the Company's former auditor, KPMG, and regarding the Company's accounting and internal controls, including the unauthorized foreign currency options trading matter and Homeside US.

During the 2003 and prior fiscal years, KPMG employees performed non-audit services for the Group, including loan reviews in the Credit Restructuring unit in Australia and in the tax and internal audit functions, while on secondment to entities within the Group. KPMG was the external auditor of the Company until January 31, 2005. All KPMG internal audit secondments were terminated by the end of the 2002 year and all KPMG secondments ceased from the end of the 2003 year. KPMG has also informed the Company and the SEC that during the 2004 year, 12 KPMG professionals maintained savings and checking accounts and three had loans with the Company that are not permitted by the SEC's auditor independence rules. While KPMG has reported that some of these circumstances were potential violations of the SEC independence rules, KPMG has advised the Company that it does not consider its independence to have been compromised. The SEC is also reviewing services of KPMG relating to potential or actual borrowers from the Company, such as acting as receiver and manager, investigating accountant, monitoring consultant and an agent for a mortgagee in possession, and legal services provided to the Group by a UK law firm formerly affiliated with KPMG.

The SEC Division of Enforcement has also requested information about the Company's investment in HomeSide US, which resulted in the recognition of a \$1,323 million (after tax) impairment loss on mortgage servicing rights (MSRs), \$1,436 million provision for changes in valuation assumptions to reduce the carrying value of the MSRs to an estimated market sale value and a \$858 million goodwill write down in 2001. The Company has also provided to the SEC information about the Company's unauthorized foreign currency options trading announced in January 2004. In the investigation of these losses, it was found that, in the Institutional Markets & Services division, there was inadequate supervision and failures in control procedures and risk management systems. Following a review conducted by APRA, the Company's prudential regulator, the Company has taken steps to improve its control systems. The issues identified in the APRA review have either been fully remediated or alternative controls have been reviewed and relied upon for financial reporting. A key outcome was the reopening in May 2005 of the foreign currency options trading desk.

The Company continues to cooperate fully with the SEC regarding this matter. While the Company cannot predict action the SEC may take in response to its investigation, it has authority to impose or negotiate a broad range of possible sanctions for any breaches. These include requiring the Company to make a monetary payment, entry of a cease-and-desist order or injunction requiring the Company to cease future violations of the U.S. securities laws or face substantial monetary sanctions, and requiring the Company to improve the Company's internal controls or policies, change or curtail the Company's business, change the Company's management or take other steps, such as engaging an independent consultant to evaluate and report on the Company's controls, policies or other matters and the Company's progress towards improvement within mandated timeframes.

The Group does not consider that the outcome of any proceedings, either individually or in aggregate, is likely to have a material effect on its financial position. Where appropriate, provisions have been made.

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*For further information on contingent liabilities of the Group including disputes with the Australian Taxation Office and the New Zealand Inland Revenue Department, refer to note 46 in the financial report.*



**Liquidity, funding and capital resources**



*Liquidity and funding*



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The Group's banking entities comply with the regulatory liquidity requirements of the banking regulators in Australia, the United Kingdom, New Zealand, United States and other geographies in which the Group operates as required. The Group's Wealth Management businesses also comply with the regulatory liquidity requirements of its Australian Financial Services Licences and the requirements of its various non-Australian regulators. Liquidity within the Group is also managed in accordance with policies approved by the Board, with oversight from regional and Group Asset and Liability Management Committees (*for further information refer to Risk management on page 15 for a detailed discussion*).

The principal sources of liquidity for the Group are:

trading securities and investments - available for sale;

interest received from customer loans;

customer deposits;

life insurance premiums;

proceeds from commercial paper, certificates of deposit, bonds, notes and subordinated debt issues;

fee income; and

interest and dividends from investments.

The Group's primary source of funding is from deposits and other borrowings - on-demand and short-term deposits, term deposits, and bank issued certificates of deposit. Of total liabilities at September 30, 2006 of \$456,813 million (2005: \$391,051 million), funding from customer deposits and certificates of deposit (including amounts accounted for at fair value) amounted to \$207,745 million (2005: \$186,027 million) or 45.5% (2005: 47.6%). Although a substantial portion of customer accounts are contractually repayable within one year, on-demand, or at short-notice, such customer deposit balances have provided a stable source of core long-term funding for the Group.

Deposits taken from the inter-bank market of \$37,489 million as at September 30, 2006 (2005: \$36,322 million) supplement the Group's customer deposits. The Group also accesses the domestic and international debt capital markets under its various funding programs. As at September 30, 2006, the Group had on issue \$68,621 million (2005: \$41,490 million) of term debt securities (bonds, notes and subordinated debt including bonds, notes and subordinated debt accounted for at fair value) and the following funding programs available to fund the Group's general banking businesses:

Short-term funding programs:

US commercial paper program - National Australia Funding (Delaware) Inc. (unconditionally guaranteed by National Australia Bank Limited);

Global commercial paper and certificate of deposit program - National Australia Bank Limited;

Global commercial paper program - Bank of New Zealand;



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Global commercial paper program Bank of New Zealand International Funding Limited (guaranteed by Bank of New Zealand); and

Euro-commercial paper program Clydesdale Bank PLC.

Long-term funding programs:

Global medium-term note program National Australia Bank Limited, Clydesdale Bank PLC and Bank of New Zealand International Funding Limited (guaranteed by Bank of New Zealand);

Debt issuance program National Australia Bank Limited;

Term certificate of deposit program National Australia Bank Limited;

US extendible note program National Australia Bank Limited;

US medium-term note program National Australia Bank Limited;

Registered transferable deposits program Bank of New Zealand; and

Debt issuance program National Wealth Management Holdings Limited.

*Refer to note 32 in the financial report for further details of the Group's funding programs.*

At September 30, 2006, the Company's credit ratings were as follows:

	Short-term debt	Senior long-term debt
Standard & Poor's Corporation	A-1+	AA-
Moody's Investors Service, Inc.	P-1	Aa3
Fitch, Inc.	F1+	AA

Ratings are not a recommendation to purchase, hold or sell securities, and may be changed, superseded or withdrawn at any time.

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The ability to realise assets quickly is an important source of liquidity for the Group. The Group holds sizeable balances of marketable treasury and other eligible bills and debt securities which could be disposed of to provide additional funding should the need arise. As at September 30, 2006, the Group held \$13,740 million (2005: \$15,154 million) of trading securities and \$1,493 million (2005: \$3,860 million) of available for sale investments. In addition, the Group held \$300,551 million (2005: \$264,674 million) of net loans and advances to customers (including loans accounted for at fair value), of which \$91,362 million (2005: \$79,360 million) is due to mature within one year although a proportion of these maturing customer loans will be extended in the normal course of business.

Within the Group's Wealth Management business, the principal sources of liquidity are premiums received from policyholders, charges levied upon policyholders, investment income and proceeds from the sale and maturity of investments. The investment policies adhered to by the Group's life insurance companies consider the anticipated cash flow requirements by matching cash inflows with projected liabilities.

Based on the level of resources within the Group's businesses, and the ability of the Group to access wholesale money markets and issue debt securities should the need arise, overall liquidity is considered sufficient to meet current obligations to customers, policyholders and debtholders.

The following table sets out the amounts and maturities of the Group's long-term contractual cash obligations at September 30, 2006:

	Payments due by period				Total \$m
	Less than 1 year \$m	1 to 3 year(s) \$m	3 to 5 years \$m	After 5 years \$m	
Long-term debt dated	5,748	29,396	17,288	16,189	68,621
Other debt issues undated				2,274	2,274
Operating leases	364	521	359	1,217	2,461
Capital expenditure commitments	97	1			98
Total contractual cash obligations	6,209	29,918	17,647	19,680	73,454

The above table excludes deposits and other liabilities taken in the normal course of banking business and short-term and undated liabilities, including life insurance policy liabilities.

The following table sets out the amounts and maturities of the Group's contingent liabilities and other commercial commitments at September 30, 2006:

	Amount of commitment expiration per period				Total \$m
	Less than 1 year \$m	1 to 3 year(s) \$m	3 to 5 years \$m	After 5 years \$m	
<b>Contingent liabilities</b>					
Guarantees	1,747	326	666	343	3,082
Letters of credit	4,217	698	1,720	226	6,861
Performance-related contingencies	3,028	219	26	341	3,614
Other contingent liabilities	193				193
<b>Other commercial commitments</b>					
Other binding credit commitments (1)	102,175	14,567	7,574	3,942	128,258

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Investment commitments (2)	1,040				1,040
Total commercial commitments	112,400	15,810	9,986	4,852	143,048

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(1) *Credit-related commitments arise from contracts entered into in the normal course of business generally relating to financing needs of customers (refer to note 46 in the financial report).*

(2) *In the normal course of business of the Group's life insurance business statutory funds, various types of investment contracts are entered into that give rise to contingent or future obligations.*

*Refer to note 46 in the financial report for further discussion of contingent liabilities and credit commitments.*

**Description of off-balance sheet arrangements (special purpose entities)**

Special purpose entities (SPEs) are entities that are typically set up for a specific, limited purpose and generally would not enter into an operating activity or have any employees. These SPEs do not have, or are not reasonably likely to have, a current or future effect on the Company's financial condition, revenue or expenses, and results of operations.

The primary purposes of SPEs relating to the Group are to:

- assist customers to securitise their assets;
- provide diversified funding sources to customers; and
- tailor new products to satisfy customers' funding requirements.

The most common form of SPE involves the acquisition of financial assets that are funded by the issuance of securities to external investors. The repayment of these securities is determined by the performance of the assets acquired by the SPE. These entities form an integral part of many financial markets.

The Group generally does not hold any material interest in the SPEs that it sponsors or sets up, but may provide arm's length services to the SPEs. The Group may provide standby liquidity facilities to SPEs. Generally, an SPE may only make a drawing under a standby liquidity facility in certain limited circumstances such as market circumstances (where commercial paper is unable to be issued at an economic rate on a maturity date). Standby liquidity facilities are not available to be drawn where an obligor defaults in respect of assets held by an SPE. If such an event occurs, the commitment in respect of the liquidity facility is reduced to the extent of the amount in default.

An important feature of financial accounts prepared under AIFRS is that they are required to present a true and fair view, which includes reflecting the economic substance of transactions and arrangements and not just their legal form or structure.

Australian Accounting Standard AASB 127 Consolidated and Separate Financial Statements (AASB 127) requires a company to consolidate entities it controls and not just entities in which it has majority ownership. Therefore, an SPE would be required to be consolidated if the Group had the capacity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of the SPE, so as to enable the SPE to operate with it in pursuing the objectives of the Group.

Further, Urgent Issues Group Interpretation 112 Consolidation Special Purpose Entities provides additional guidance as to some of the factors that would indicate control relating to the activities, decision making powers, and exposure to the risks and benefits of an SPE that would generally require the SPE to be consolidated.

An SPE is consolidated in the Group if it either meets the requirements of AASB 127 or if the risks and rewards associated with the SPE lie with the Group such that the substance of the relationship is that of a controlled entity. Substance over form means examining all the agreements in relation to the transaction, including side letters or agreements relating to either the provision of guarantees or collateral on loans, or equity funding based on the value of the entity. The Group, in the ordinary course of business, has established or sponsored the establishment of SPEs for various types of transactions, which are described below.

#### **Asset securitisation**

The Group makes use of asset securitisation arrangements. SPEs for securitisation are created when the Group has a financial asset (eg. a residential mortgage loan portfolio), which it sells to an SPE. The SPE in turn sells interests in the asset as securities to investors. This type of securitisation program benefits the Group by providing an alternative source of funding and enables the Group to monetise long-term assets which reduces the Group's credit exposure and positively impacts the Group's regulatory capital requirements.

During the year ended September 30, 2006, the Group securitised Australian residential mortgage loans amounting to \$3,406 million. No loans were securitised during the 2005 year. During the year ended September 30, 2004, the Group securitised Australian residential mortgage loans amounting to \$2,483 million, and during the year ended September 30, 2001, the Group securitised Australian residential mortgage loans amounting to \$1,924 million. Outstanding securitised loans off these programs totalled \$4,245 million as at September 30, 2006 (2005: \$1,919 million). Neither the Company nor the Group stands behind the capital value or performance of securities or assets of the programs except to the limited extent provided in the transaction documents for the programs through the provision of arm's length services and facilities. The Company and the Group do not guarantee the payment of interest or repayment of principal due on the securities. The Company and the Group are not obliged to support any losses that may be suffered by the investors and do not intend to provide such support. The Company and the Group have no obligation to repurchase any of the securitised loans other than in limited circumstances. The Company has transacted with the SPEs on an arm's length basis to act as servicer in relation to the loans and to provide the SPEs with fixed and basis swaps, and limited redraw and liquidity facilities.

#### **Multi-seller securitisation conduits**

The Group manages two multi-seller securitisation conduits, Titan Securitisation Limited and Quasar Securitisation Limited. These conduits provide off-balance sheet funding for the Group's corporate customers. This type of securitisation program has no material impact on the Group's liquidity, capital resources or credit risk because the substance of the economic arrangement is to provide a securitisation service to the Group's customers. These securitisation conduits use SPEs to provide access to funding via the asset-backed commercial paper and medium-term note (MTN) investor markets.

These securitisation arrangements generally involve the sale of financial assets by customers to SPEs, which then issue commercial paper or MTNs to fund the purchases. The assets acquired by the conduits, which totalled \$5,589 million at September 30, 2006 (2005: \$3,479 million), included debt securities, mortgages, lease receivables, commodity receivables and loans. These financial assets do not represent assets of the Group and are not reported on the Group's balance sheet at September 30, 2006. Certain administrative activities and the provision of liquidity and credit facilities to the programs are performed by the Group under arm's length contracts that it or the conduits' independent board of directors can terminate. Fees received by the Group for performing these services are recorded as fees and commission income when earned.

#### **Repackaging securitisation**

The Group sponsors and manages a special purpose vehicle, Script Securitisation Pty Limited (Script). Script raises funds by issuing debt instruments to customers of the Group and uses those funds to acquire or invest in assets such as approved investments and derivative contracts. Approved investments can consist of appropriately rated debt instruments or other securities. The assets acquired by Script are ring fenced and are intended to generate sufficient income and principal to cover the liabilities of Script linked to those assets. This type of securitisation or repackaging arrangement has no material impact on the Group's liquidity, capital resources or credit risk because the substance of the economic arrangement is to provide a securitisation service to or provide investment product for the Group's customers.

#### **Structured finance transactions**

The use of an SPE to isolate cash flows and assets is common in the banking industry to enable a customer to minimise their funding cost or maximise their investment returns, and the bank to have access to specific collateral. The Group has relationships with numerous SPEs to provide financing to customers. Any financing relationships are entered into under normal lending criteria and are subject to the Group's credit approval process. The assets arising from these financing activities are generally included in loans and advances to customers, investment securities, or shares in entities and other securities depending on the economic substance of the transaction. The Group also has relationships with SPEs to enable the placement of customers' surplus funds with the Group. These surplus funds are in all cases included in the Group's balance sheet as deposits and other borrowings.

#### ***Capital resources***



The Group assesses its capitalisation against market, regulatory and ratings agency expectations, having regard to Australian and international peers, and the Group's own asset base, risk profile and capital structure. The Group believes it has sufficient capital to meet current and likely future commitments.

### Capital adequacy

The Group's primary prudential supervisor is APRA. APRA establishes capital adequacy requirements on banks, the prime objective of which is to ensure that an adequate level of capital is maintained, thereby providing a buffer to absorb unanticipated losses. Consistent with the international standards of the Basel Committee on Banking Supervision, APRA's current approach, in accordance with Basel I to assessing capital adequacy of banks, focuses on three main elements: the credit risk associated with a bank's exposures, the market risk associated with a bank's trading activities, and the form and quantity of a bank's capital.

In order to provide a broad indication of relevant credit risk, all assets are allocated into four categories of risk weighting (0%, 20%, 50% and 100%). The assets to which those weightings apply are described more fully below (*refer to risk-adjusted assets and off-balance sheet exposures*). Off-balance sheet transactions are converted to balance sheet equivalents, using a credit conversion factor, before being allocated to a risk-weight category.

Off-balance sheet activities giving rise to credit risk are categorised as follows: direct credit substitutes such as financial guarantees and standby letters of credit; trade and performance-related contingent items such as performance bonds, warranties, and documentary letters of credit; long-term commitments such as formal credit lines with a residual maturity exceeding one year; and market-related transactions such as foreign exchange contracts, currency and interest rate swaps and forward rate agreements.

Market risk is defined as the risk of losses in on- and off-balance sheet positions arising from movements in market prices pertaining to interest rate-related instruments and equities in the trading book, and foreign exchange risk and commodity risk throughout the Group. APRA's current capital requirements for market risk, which involves creating equivalent risk-weighted exposures (*refer to risk-adjusted assets and off-balance sheet exposures on page 31*) are broadly consistent with the recommendations of the Basel Committee on Banking Supervision.

For regulatory purposes, capital comprises two elements, eligible Tier 1 and Tier 2 capital, from which certain deductions are made to arrive at Tier 1 and Tier 2 capital. Tier 1 capital includes paid-up ordinary shares, hybrid instruments (such as National Income Securities), reserves (excluding asset revaluation reserves, cash flow hedging reserves and the general reserve for credit losses), retained profits less goodwill and other intangible assets, and certain other deductions. In addition, where recognised deferred tax assets are greater than deferred tax liabilities, the net deferred tax asset is deducted from Tier 1 capital. Tier 2 capital includes a portion of asset revaluation reserves, collective provisions for doubtful debts (net of associated deferred tax assets) and the general reserve for credit losses, certain hybrid debt/equity instruments and subordinated long-term debt.

The total amount of the resultant capital is subject to further deductions to form the capital base. Such deductions include net assets in controlled entities that are deconsolidated for regulatory capital purposes and provision of first loss guarantees to securitisation entities. Tier 2 capital is limited to 100% of net Tier 1 capital. Lower Tier 2 capital is restricted to 50% of Tier 1 capital, with Upper Tier 2 representing the balance.



Under guidelines issued by APRA, investments in life insurance and funds management entities are deconsolidated for the purposes of calculating capital adequacy and those activities are excluded from the calculation of risk-weighted assets. The tangible component of such investments, comprising net tangible assets on acquisition, is deducted from the total capital base. The goodwill (being the difference between acquisition costs and the tangible component at acquisition) is deducted from Tier 1 capital. Additionally, any profits from these entities included in the Group's results, to the extent that they have not been remitted to the Company in the form of dividends are excluded from the determination of Tier 1 capital.

As the measure of capital adequacy, Australian banks are required to maintain a minimum ratio of capital base to total risk-weighted assets of 8.0%, of which a minimum of 4.0% must be held in Tier 1 capital. The numerator of the ratio is the capital base. The denominator of the ratio is the total risk-weighted asset exposure (ie. sum of credit risk-weighted exposures and the equivalent market risk-weighted exposure). Ultimately, a breach of the required ratios under the prudential standards may trigger legally enforceable directions by APRA, which can include a direction to raise additional capital or cease business.

The Basel Committee on Banking Supervision has released wide-ranging and detailed proposals for the reform of capital adequacy guidelines for banks known as the Basel II Capital Accord. The Basel Committee on Banking Supervision's reform objective is to develop more risk-sensitive, internationally accepted, capital adequacy guidelines that are aligned more accurately with the individual risk profiles of banks.

### **Regulatory changes**

On May 31, 2006, APRA issued its revised Prudential Standards, APS 110, Capital Adequacy, and APS 111, Capital Adequacy: Measurement of Capital, with related Guidance Notes, to be applied from July 1, 2006. The revised Prudential Standards define how the Group calculates and manages its regulatory capital under AIFRS. Capital adequacy at September 30, 2006 is measured in line with these revised Prudential Standards.

The revised APS 111 redefines Tier 1 capital and introduces the concept of Non-Innovative Tier 1 capital. Up until January 1, 2008, the hybrid limit of 20% applies to total Tier 1 capital before deductions, and could consist entirely of Innovative Tier 1 capital. Innovative Tier 1 capital includes any instrument that includes features such as an incentive for the issuer to call, such as a step-up in distribution rate, or is issued indirectly through a special purpose vehicle. Under the revised APS 111, from January 1, 2008 Residual Tier 1 capital is limited to 25% of net Tier 1, with Fundamental capital representing the balance. Residual Tier 1 is defined as being made up of two categories being Innovative Tier 1, which will be limited to 15% of net Tier 1 capital, and a new category of Non-Innovative Tier 1 representing the balance of residual Tier 1 capital. Non-Innovative Tier 1 capital is defined as perpetual non-cumulative preference shares that satisfy the relevant criteria set out in the related Guidance Note. APRA has confirmed that the Group's National Income Securities will qualify for Non-Innovative Treatment. Fundamental Tier 1 is defined as consisting of paid up ordinary shares, other reserves (excluding general reserve for credit losses, cash flow hedge reserves and asset revaluation reserves), retained earnings, current year earnings and foreign currency translation reserve.

### **Capital ratios**

In addition to the Tier 1 and total capital regulatory capital ratios, the Group also uses the adjusted common equity (ACE) ratio to manage its capital position. The ACE ratio measures the core equity capital available to support banking operations and is generally calculated as Tier 1 capital less residual Tier 1 instruments, the tangible component of the investment in non-consolidated controlled entities and any other items deducted from total capital. The ACE ratio is a key measure used by analysts and rating agencies to assess a financial institution's capital strength.

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Capital ratios are monitored against internal capital targets, which are set by reference to factors such as market, regulatory and rating agencies expectations and the Group's risk profile. During the year to September 30, 2006, the Group announced changes to its Board approved target capital ranges. The changes better align the Group's capital ranges with peers and its target credit rating and have a wider spread to accommodate the increased volatility arising from the application of AIFRS. The ranges at September 30, 2006, and comparatives at September 30, 2005 are as follows:

	Target ranges at September 30, 2006	Target ranges at September 30, 2005
	%	%
ACE ratio	<b>4.25 - 5.00</b>	4.75 - 5.25
Tier 1 ratio	<b>6.25 - 7.00</b>	7.00 - 7.50
Total capital ratio	<b>10.00 - 10.50</b>	10.00 - 10.50

The total capital target range reflects the APRA imposed requirement in 2004 for the Group's internal target for total capital to rise to 10.0% of risk-weighted assets. Previously, the Group's internal target capital ratio was 9.0% to 9.5%.

	2006	2005
	%	%
Adjusted common equity	<b>5.4</b>	5.5
Tier 1	<b>7.3</b>	7.9
Tier 2	<b>3.9</b>	3.6
Deductions	<b>(0.4)</b>	(1.0)
Total capital	<b>10.8</b>	10.5

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APRA required regulatory capital to be calculated in accordance with AGAAP accounting principles until July 1, 2006. As a result, 2005 comparatives are calculated under the prudential standards and guidelines applicable at the time and have not been reclassified.

Capital ratios were calculated under AGAAP at September 30, 2005 and AIFRS at September 30, 2006. During the 2006 year, the Group's ACE and Tier 1 capital ratios fell, primarily as a result of the implementation of AIFRS. AIFRS reduced the Group's Tier 1 capital by \$3.6 billion mainly relating to defined benefit pension plans and Tier 1 deductions relating to capitalised software and the wealth management business. Following the revision to the Group's targets, the capital ratios are above the Group's stated target ranges at September 30, 2006.

The Tier 1 and Total Capital ratios also reflect the issue of two tranches of National Capital Instruments in September 2006. The Group raised approximately \$400 million (\$397 million net of issue costs) through the issue of 8,000 National Capital Instruments of \$50,000 each. In addition, the Group raised EUR400 million (\$679 million) through the issue of 8,000 National Capital Instruments of EUR50,000 each. These securities qualify as Tier 1 capital. An additional impact was the conversion of \$566 million in exchangeable capital units into ordinary shares. *Refer to note 33 and note 37 in the financial report for further detail.* Further impacts include the sale of Custom Fleet and the sale of the MLC Asia businesses.

The capital position also increased due to the reinvestment of dividends under the Company's dividend reinvestment plan (DRP), bonus share plan (BSP), and employee share and option plans. During the years ended September 30, 2006 and 2005, 9.1 million and 11.5 million fully paid ordinary shares respectively, were issued under the DRP and BSP to shareholders at varying prices. There was also significant subordinated debt issuance, contributing to Tier 2 capital.

The capital ratios also continue to be impacted by the change in methodology of the calculation of the market risk component of risk-weighted assets from an Internal Model Method to the Standard Method as directed by APRA in 2004. The Standard Method, as prescribed by APRA in Prudential Standard APS 113, limits recognition of portfolio effects on outstanding positions and is substantially more restrictive on the rules regarding the matching of positions. The effect of using the Standard Method was an increase in risk-weighted assets of \$9,923 million at September 30, 2006 (\$10,076 million at September 30, 2005).

### Regulatory capital

	2006 \$m	2005 \$m
<b>Tier 1</b>		
Contributed equity	12,279	11,486
Reserves	1,064	667
Retained profits	14,461	15,903
Minority interest in controlled entities	168	6,224
Total equity (1)	27,972	34,280
Adjusted for:		
Exchangeable Capital Units - embedded derivative and foreign exchange movements	572	
National Capital Instruments - debt (2)	679	
Treasury shares	966	
Eligible deferred fee income	186	
Adjusted total equity (1)	30,375	34,280
Estimated reinvestment under the dividend reinvestment plan and bonus share plan (3)	57	152
Deduct:		

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Banking goodwill	(553)	(522)
Estimated final dividend	(1,367)	(1,304)
Goodwill and intangible assets - Wealth Management	(3,921)	(2,448)
Asset revaluation reserve	(100)	(18)
Deconsolidation of Wealth Management profits (net of dividends)	(110)	(1,293)
Profit on sale arising from Wealth Management restructure (4)	494	494
Deferred tax assets (DTA) (excluding DTA on the collective provision for doubtful debts) (5)	(199)	(143)
Non-qualifying minority interest in controlled entities	(168)	(6,224)
Capitalised expenses (6)	(69)	(195)
Cash flow hedge reserve	(52)	
Capitalised software (excluding Wealth Management)	(687)	
General reserve for credit losses	(135)	
Defined benefit pension surplus	(161)	
<b>Total Tier 1 capital</b>	<b>23,404</b>	<b>22,779</b>

	2006 \$m	2005 \$m
<b>Tier 2</b>		
Eligible collective provision for doubtful debts	1,389	1,443
General reserve for credit losses (7)	135	
Total collective provision for doubtful debts	1,524	1,443
Asset revaluation reserve	45	18
Perpetual floating rate notes	334	328
Dated subordinated debts	9,786	7,422
Exchangeable Capital Units	665	1,231
Notional revaluation of investment securities to market		(18)
<b>Total Tier 2 capital</b>	<b>12,354</b>	<b>10,424</b>
<b>Other deductions (8)</b>	<b>(1,351)</b>	<b>(2,922)</b>
<b>Total regulatory capital</b>	<b>34,407</b>	<b>30,281</b>

- (1) For the 2005 year, total equity has been calculated on an AGAAP basis. APRA required regulatory capital to be calculated on an AGAAP basis until July 1, 2006.
- (2) National Capital Instruments (Euro tranche) issued on September 29, 2006 are classified as debt for accounting purposes but qualify as Tier 1 capital for regulatory capital purposes.
- (3) The amount is derived from reinvestment experience on the Company's dividend reinvestment and bonus share plans.
- (4) Relates to the profit, arising in the banking group, from the sale of the life and insurance businesses of Bank of New Zealand and National Australia Group Europe to NAFiM subsidiaries on January 1, 2002. The capital position of the National's banking and wealth management entities are separately regulated and assessed. In accordance with this approach, the profit on sale of \$494 million arising in the banking entities concerned is recorded as Tier 1 capital of the National. With effect from December 31, 2007, the National expects the regulatory capital treatment to change, and for the profit on sale to be excluded from Tier 1 capital.
- (5) APRA requires that any excess deferred tax asset (DTA) (excluding DTA on the collective provision for doubtful debts) over deferred tax liabilities be deducted from Tier 1 capital.
- (6) Comprises capitalised costs associated with debt raisings and securitisations. Loan origination fees are now netted against eligible deferred fee income.
- (7) In line with APRA's requirements, a general reserve for credit losses was established at July 1, 2006. This is an appropriation from retained earnings to non-distributable reserves and qualifies as Tier 2 capital. The reserve is calculated on a basis which aligns the Group's coverage ratios with the APRA benchmark of 0.5% (post-tax effect) of total risk-weighted credit risk assets.
- (8) Includes \$1,223 million (2005: \$2,922 million) investment in non-consolidated controlled entities, net of intangible component deducted from Tier 1 capital.

	2006 \$m	2005 \$m
<b>Adjusted common equity</b>		
Total Tier 1 capital	23,404	22,779
Deduct:		
National Income Securities	(1,945)	(1,945)
Trust Preferred Securities	(975)	(975)
Trust Preferred Securities II	(1,014)	(1,014)
National Capital Instruments - debt (1)	(679)	
National Capital Instruments - equity	(397)	
Deductions (2)	(1,351)	(2,922)
<b>Adjusted common equity</b>	<b>17,043</b>	<b>15,923</b>

- 
- (1) *National Capital Instruments (Euro tranche) issued on September 29, 2006 are classified as debt for accounting purposes but qualify as Tier 1 capital for regulatory capital purposes.*
- (2) *Includes \$1,223 million (2005: \$2,922 million) investment in non-consolidated controlled entities (net of intangible component deducted from Tier 1 capital).*

## Risk-adjusted assets and off-balance sheet exposures

	2006	Balance	2005	Risk	Risk-adjusted balance (1)	
	\$m		\$m	weights	2006	2005
				%	\$m	\$m
<b>Assets</b>						
Cash, claims on Reserve Bank of Australia, Australian Commonwealth and State Governments, OECD central governments and central banks (2)	44,925		24,852	0		
Claims on Australian banks, local governments and banks incorporated in OECD countries	13,094		16,962	20	2,619	3,392
Housing loans(3)	148,224		128,790	50	74,112	64,395
All other assets	197,542		174,387	100	197,542	174,387
Total assets(4)	403,785		344,991		274,273	242,174

	Contract or notional amount	Credit equivalent amount	Risk	Risk-adjusted balance (1)	
	2006	2006	weights	2006	2005
	\$m	\$m	%	\$m	\$m
<b>Off-balance sheet exposures</b>					
Financial guarantees, standby letters of credit and other letters of credit	13,145	12,164	0 100	6,689	9,226
Performance-related guarantees, warranties and indemnities	4,945	2,473	0 - 100	2,432	1,731
Commitments to provide finance facilities with residual term to maturity of over 12 months and other commitments	123,918	21,165	0 - 100	15,778	14,428
Foreign exchange, interest rate and other market-related transactions(5)	2,313,958	20,384	0 50	5,599	8,981
Total off-balance sheet exposures	2,455,966	56,186		30,498	34,366
Total risk-adjusted assets				274,273	242,174
Total risk-adjusted assets and off-balance sheet exposures credit risk				304,771	276,540
Add: Risk-adjusted assets market risk(6) (7)				13,552	13,293
Total assessed risk exposure				318,323	289,833

- (1) Claims secured by cash, government securities or guarantees from banks and governments reflect the risk weight attaching to the collateral security or a direct claim on the guarantor.
- (2) Short-term claims on the Australian Commonwealth Government are those with a residual term to maturity of less than 12 months; longer-term claims are those with a residual term to maturity of greater than 12 months. Both categories held in the banking book attract a 0% risk weighting.
- (3) Housing loans approved after September 5, 1994 having a loan to market valuation ratio in excess of 80% must be risk weighted at 100%. However, these loans may qualify for the 50% risk weighting if they are covered by an adequate level of mortgage insurance provided by an acceptable lenders mortgage insurer. These loans are reported under all other assets.
- (4) Total assets differ from those in the Group's balance sheet due to the adoption of APRA's classification of certain items for capital adequacy purposes, particularly goodwill and provision for doubtful debts. In addition, fair values of trading derivative financial instruments have been excluded as they have been incorporated into the calculation of the credit equivalent amount of off-balance sheet exposures.

- (5) *Refer to notes 11 and 58 for additional information on derivative financial instruments.*
- (6) *Under APRA Prudential Standard APS 113 Capital Adequacy: Market Risk , Australian banks are required to hold sufficient levels of capital to cover market risk.*
- (7) *The calculation to determine the market risk capital component of risk-weighted assets at September 30, 2006 and September 30, 2005 was carried out under the Standard Method as directed by APRA. Prior to March 2004, the market risk capital component of risk-weighted assets was calculated using the Internal Model Method. The Standard Method as prescribed by the APRA Prudential Standard (APS 113), limits recognition of portfolio effects on outstanding positions and is substantially more restrictive on the rules regarding the matching of positions.*



**Financial review**



**Financial performance summary**

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	2006 \$m	Group	2005 \$m
Net interest income	8,686		6,944
Net life insurance income	1,417		1,505
Other income	5,420		7,244
Operating expenses	(7,642)		(8,743)
Charge to provide for doubtful debts	(606)		(534)
<b>Profit before income tax expense</b>	<b>7,275</b>		<b>6,416</b>
Income tax expense	(2,134)		(1,814)
<b>Net profit</b>	<b>5,141</b>		<b>4,602</b>
Net profit attributable to minority interests	(749)		(610)
<b>Net profit attributable to members of the Company</b>	<b>4,392</b>		<b>3,992</b>

Net profit attributable to members of the Company of \$4,392 million in 2006, increased \$400 million or 10.0% compared with 2005.

Net interest income of \$8,686 million in 2006, was \$1,742 million or 25.1% higher than 2005. This result reflects continued solid growth in housing lending and improved business lending, as well as an increase in the net interest margin from 2.13% to 2.31%. The increase also reflects the reclassification of bill acceptance income from loan fees (classified within other operating income in 2005) to net interest income in 2006.

The increase in margins has occurred as a result of AIFRS changes during 2006, which has favourably impacted the net interest margin by 7 basis points. After adjusting for AIFRS impacts during the 2006 year, the net interest margin has increased 11 basis points, primarily due to the reduction in low yielding assets in the Group's businesses. These impacts have been partly offset by continued growth in lower margin mortgages and fixed rate lending within the retail banking businesses, as well as competitive pressures in all regions.

Net life insurance income decreased \$88 million from \$1,505 million in 2005 to \$1,417 million in 2006. This was driven by a decrease in investment earnings resulting from a downturn in global equity markets, partly offset by an increase in policy liabilities and favourable claims experience.

Other operating income of \$5,420 million in 2006, was \$1,824 million or 25.2% lower than 2005. This outcome reflects:

- significant revenue of \$319 million due to reforms made to the United Kingdom defined benefit pension funds resulting in the recognition of past service revenue;

- significant revenue being the net profit of \$1,354 million on the sale of Northern Bank Limited and National Irish Bank Limited (Irish Banks) in 2005;

- lower loan fees of \$690 million reflecting changes in accounting policy from October 1, 2005 resulting in the reclassification of bill acceptance fees to net interest income and the reclassification of certain loan related fees to net interest income under effective yield requirements, partly offset by growth in third party distribution channels;

- on July 31, 2006 the Group sold its Custom Fleet businesses resulting in a net profit from the sale of controlled entities of \$196 million before tax;

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gains less losses on financial instruments at fair value decreased by \$168 million or 26.3% mainly due to a reduction in trading income of \$255 million offset by non trading fair value adjustments of \$87 million. Trading income reduced largely due to the inclusion of derivative costs associated with short term funding under AIFRS. Under AIFRS, derivatives associated with funding activities are fair valued and recognised in trading income.

Previously under AGAAP, these costs were treated as hedges and accrual accounted, and incorporated as part of net interest income; and

revaluation losses on exchangeable capital units of \$122 million in 2006.

Operating expenses of \$7,642 million in 2006 were \$1,101 million or 12.6% lower than 2005. This outcome reflects:

on May 8, 2006 the Group sold its life insurance and related wealth management companies in Asia resulting in a net loss from the sale of controlled entities of \$63 million; and

significant restructuring expenses of \$793 million in 2005.

Excluding the expenses of disposed operations and significant restructuring expenses, operating expenses increased \$104 million or 1.4%, reflecting increased personnel expenses of \$229 million as a result of the Group's focus on performance based remuneration and Enterprise Bargaining Agreement related increases. This was partially offset by a decrease in other operating expenses of \$123 million. This includes a decrease in operational risk losses of \$69 million and a decrease in superannuation charge of \$50 million primarily due to reforms made to the UK pension schemes.

The charge to provide for doubtful debts of \$606 million in 2006, was \$72 million or 13.5% higher than 2005. The increase was primarily due to the deterioration identified in specific consumer segments in Australia in the second half of the year.

Income tax expense of \$2,134 million in 2006, was \$320 million or 17.6% higher than 2005. The increase in income tax expense in 2006 reflects higher operating profits before tax in all businesses, partly offset by a reduction in tax expense attributable to the statutory funds of the life insurance business. In addition, in 2005, income tax expense was impacted by a one-off tax benefit of \$372 million in relation to the non-assessable profit on the sale of the Irish Banks, partly offset by the significant income tax item in respect of the settlement of a tax dispute with the Australian Taxation Office of \$97 million in respect of the TrUEPrS<sup>SM</sup> tax matter.

*Financial performance adjusted to accord with US GAAP*



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Adjusted to accord with US GAAP, consolidated net income for the year to September 30, 2006 was \$4,232 million compared to \$3,891 million in 2005.

*Refer to note 57 in the financial report for additional information on the reconciliation with US GAAP and other US GAAP disclosures.*

**Balance sheet summary**

	2006 \$m	Group	2005 \$m
<b>Assets</b>			
Cash and liquid assets	12,768		8,441
Due from other banks	24,372		15,595
Trading derivatives	13,384		13,959
Trading securities	13,740		15,154
Investments available for sale	1,493		3,860
Investments held to maturity	1,388		7,466
Investments relating to life insurance business	54,784		49,783
Other financial assets at fair value	22,123		
Loans and advances	283,777		264,674
Due from customers on acceptances	41,726		27,627
All other assets	15,230		16,039
<b>Total assets</b>	<b>484,785</b>		<b>422,598</b>
<b>Liabilities</b>			
Due to other banks	37,489		36,322
Trading derivatives	12,008		12,613
Other financial liabilities at fair value	17,680		1,487
Deposits and other borrowings	222,277		212,557
Liability on acceptances	32,114		27,627
Life policy liabilities	46,475		42,123
Bonds, notes and subordinated debt	65,006		41,490
Other debt issues	2,274		1,559
All other liabilities	21,490		15,273
<b>Total liabilities</b>	<b>456,813</b>		<b>391,051</b>
<b>Total equity</b>	<b>27,972</b>		<b>31,547</b>
<b>Total liabilities and equity</b>	<b>484,785</b>		<b>422,598</b>

Total assets at September 30, 2006 increased by 14.7% to \$484,785 million from \$422,598 million at September 30, 2005.

Net loans and advances (including loans at fair value) increased \$35,877 million or 13.6% to \$300,551 million at September 30, 2006. This increase primarily reflects strong growth in housing lending across all regions and continued sound economic conditions, as well as solid business term lending growth.

Due from customers on acceptances increased \$14,099 million or 51.0% from \$27,627 million at September 30, 2005 to \$41,726 million at September 30, 2006. This increase is partly offset by a corresponding increase in liabilities from acceptances. However, as a result of AIFRS transition changes, acceptances repurchased by the Company as part of trading activities have been reclassified from trading securities to acceptances. Excluding the impact of this reclassification, volumes have grown 15.9% during the year as bill acceptances continue to be a product favoured by business customers due to favourable pricing and flexibility.

Investments relating to life insurance business increased by \$5,001 million or 10.0% during the 2006 year to \$54,784 million. This increase primarily reflects growth in funds under management. The increase was largely offset by an increase in life policy liabilities of \$4,352 million or 10.3% to \$46,475 million as the movement in investment assets primarily reflects returns made on policyholder contributions to the investment linked businesses.



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Amounts due from other banks increased by \$8,777 million or 56.3% to \$24,372 million at September 30, 2006. This increase was driven by the Group's decision to reduce risk-weighted assets such as marketable debt securities, and reinvest funds in reverse repurchase assets due to its zero risk weighting.

Marketable debt securities (trading securities, available for sale and held to maturity investments) decreased \$9,859 million or 37.2% to \$16,621 million at September 30, 2006. The decrease in these securities reflects the 2006 AIFRS transition adjustments, including the accounting for acceptances repurchased by the Company and the reclassification of certain securities to other financial assets at fair value.

Total liabilities at September 30, 2006 increased by 16.8% to \$456,813 million from \$391,051 million at September 30, 2005.

Deposits and other borrowings (including those at fair value) increased by \$20,342 million or 9.6% during the year to \$232,899 million. This increase reflects sound growth in on-demand and savings deposits, particularly in Australia and the UK and term deposits growth in the UK and New Zealand, partly offset by a decrease in certificates of deposits in Australia reflecting the Group's current strategy of reducing its reliance on short-term borrowings and lengthening its debt maturity profile.

Bonds, notes and subordinated debt (including those at fair value) increased by \$27,131 million or 65.4% to \$68,621 million at September 30, 2006. The Group has a number of funding programs available, and the increase reflects further issues of the Group's Euro and Domestic medium-term notes programs undertaken to fund asset growth and re-finance maturing short-term and long-term debt. Group subsidiaries also issued debt under the Group's US\$30 billion global medium term program.

Total equity in the Group decreased from \$31,547 million at September 30, 2005 to \$27,972 million at September 30, 2006. However, excluding the impact minority interests relating to the life insurance business of \$6,224 million which were reclassified to liabilities from October 1, 2005 under AIFRS, total equity increased by \$2,649 million during the year. Total parent entity interest in equity increased by \$2,481 million to \$27,804 million at September 30, 2006. This increase primarily reflects ordinary share issues, dividend reinvestment and conversion of exchangeable capital units to ordinary shares, as well as the \$400 million issue of National Capital Instruments in September 2006.

### *Balance sheet adjusted to accord with US GAAP*

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Adjusted to accord with US GAAP, consolidated total assets increased to \$485,728 million at September 30, 2006 from \$424,628 million at September 30, 2005. Consolidated net assets increased to \$25,911 million at September 30, 2006 from \$23,385 million at September 30, 2005.

*Refer to note 57 in the financial report for additional information on the reconciliation with US GAAP and other US GAAP disclosures.*

*Return on average equity*

	2006 \$m	2005 \$m
Weighted average equity (1)	22,019	21,074
Return on average equity (1) (2)	18.8%	18.0%

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(1) *Based on average ordinary shareholder funds (refer to page 7 for a reconciliation of average ordinary shareholder funds).*

(2) *Return represents net profit attributable to members of the Company, after deducting distributions on other equity instruments.*

Return on average equity increased to 18.8% in 2006 from 18.0% in 2005. The increase in the return on average equity in the 2006 year compared to the 2005 year has been impacted by the 10.0% increase in net profit, which has more than offset the 4.5% increase in weighted average equity during the year. The increase in weighted average equity reflects the full effect of the issue of Trust Preferred Securities II in the 2005 year and an increase in retained earnings. The increase also reflects an increase in average ordinary share capital as a result of conversions of exchangeable capital units to ordinary share capital and reinvestment of dividends.

*Refer to page 32 for a detailed discussion on the Group's improvement in operating performance for the 2006 year.*

#### *Earnings and dividends per share*

	2006 Cents	2005 Cents
Earnings per share		
Basic	262.6	246.3
Diluted (1)	261.8	242.3
Dividends per share		
Interim	83.0	83.0
Final	84.0	83.0

(1) Calculated based on the weighted average diluted number of ordinary shares, which includes the impact of performance options and performance rights, partly paid ordinary shares, staff share and allocation and ownership plans and potential conversion of exchangeable capital units, as set out in note 8 in the financial report.

Basic earnings per share increased 16.3 cents or 6.6% in 2006 to 262.6 cents. Diluted earnings per share increased 19.5 cents or 8.0% in 2006 to 261.8 cents. The increase in basic and diluted earnings per share reflects improved earnings in all business segments (after excluding significant items in both the 2006 and 2005 years). Refer to page 32 for a detailed discussion on the Group's improvement in operating performance for the 2006 year and refer to pages 35 to 39 for a detailed review of the financial performance of the Group's business segments.

An interim dividend of 83 cents per fully paid ordinary share was paid during the year ended September 30, 2006, compared to an interim dividend of 83 cents per share in 2005. The final dividend declared from the 2006 profit was 84 cents per share, which increased 1 cent from the 2005 final dividend. The 2006 final dividend was paid on December 12, 2006.

The Company expects to continue its policy of paying regular cash dividends; however, there is no assurance as to future dividends. Future dividends will be determined by the Board with regard to the Company's earnings, capital requirements, financial conditions and applicable government regulations and policies. The dividend payout ratio for 2006 was equivalent to 67.4% (2005: 79.6%) of after-tax cash earnings (before significant items), compared to the Board's target range of between 60% to 65%. In addition, the payment of dividends is subject to the restrictions described in note 7 in the financial report.

The interim dividend paid was 80% franked and the final dividend was 90% franked. The franked portion of these dividends carry imputation tax credits at a tax rate of 30%, reflecting the current Australian company tax rate of 30%. For non-resident shareholders for Australian tax purposes, the dividends will not be subject to Australian withholding tax. This is because Australian dividend withholding tax is not imposed on franked dividends, while the unfranked portion of the dividends are paid from the Company's conduit foreign income account which exempts the unfranked dividend from withholding tax.

**Net profit by segment****Contribution to Group net profit attributable to members of the Company by operating segment**

	2006 \$m	2005 \$m
Australia Region	2,515	1,981
United Kingdom Region	868	1,630
New Zealand Region	389	307
nabCapital	618	503
Other	2	(429)
Net profit attributable to members of the Company	4,392	3,992

*For a detailed discussion of the Group's business operating model, refer to pages 9 to 13.*

**Australia Region**

	2006 \$m	2005 \$m
Net interest income	4,839	3,837
Non-interest income	10,070	11,848
Net operating income	14,909	15,685
Operating expenses	(10,021)	(11,120)
Charge to provide for doubtful debts	(278)	(257)
Significant items		(406)
Profit from ordinary activities before income tax	4,610	3,902
Income tax expense	(1,346)	(1,311)
Net (profit)/loss attributable to outside equity interest	(749)	(610)
Net profit attributable to members of the Company	2,515	1,981
Significant items after tax		287
Net profit attributable to members of the Company excluding significant items	2,515	2,268

The region increased its contribution to net profit attributable to members of the Company by \$534 million or 27.0% to \$2,515 million in 2006, from \$1,981 million in 2005. The 2005 result included significant items of \$287 million (after tax) in relation to restructuring expenses. Excluding the 2005 significant items, the net profit attributable to members of the Company increased by \$247 million or 10.9% to \$2,515 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income increased \$1,002 million or 26.1% to \$4,839 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the reclassification of bill acceptance fees from non-interest income and inclusion of certain loan related fees which are now deferred and amortised in net interest income under effective yield requirements. In addition, net interest income increased due to continued strong growth in volumes in both housing and business lending, as a result of product innovation and the restoration of credit risk settings. Retail deposit volumes also grew due to the introduction of online transaction accounts. The volume increase was partially offset by a 10 basis point reduction in net interest margin to 2.38%, driven by product margin contraction as a result of competitive pressures and adverse changes in product mix caused by the increased proportion of lower margin housing lending in the loan portfolio and lower margin deposit products.

Non-interest income decreased \$1,778 million or 15.0% to \$10,070 million. This decrease primarily reflects changes in accounting policy from October 1, 2005 resulting in the reclassification of bill acceptance fees to net interest income and the reclassification of certain loan related fees to net interest income under effective yield requirements. There was also a decline in Wealth Management life insurance revenue of \$1,204 million, from \$8,573 million in 2005 to \$7,369 million in 2006. This was impacted by a decrease in investment revenue of \$1,183 million (2006: \$6,511 million, 2005: \$7,694 million) reflecting a downturn in the performance of global equity markets compared to 2005 and is consistent with the decrease in the change in policy liabilities. These decreases have been partly offset by higher fees in banking due to strong growth in transaction and fees driven by lending growth.

Operating expenses decreased \$1,099 million or 9.9% to \$10,021 million. This decrease was largely driven by a decrease in Wealth Management life insurance expenses of \$1,088 million, from \$6,915 million in 2005 to \$5,827 million in 2006. This reflects a decrease in the change in policy liabilities of \$1,114 million (2006: \$4,457 million, 2005: \$5,571 million) as a result of a downturn in the performance of global equity markets compared to 2005 and is consistent with the decrease in investment revenue. The reduction in operating expenses was also a result of non-depreciation of leased motor vehicles being designated as held for sale from April 1, 2006 up until the sale of the Custom Fleet business on July 31, 2006. This has been partly offset by increased personnel costs reflecting higher annual salaries and enterprise bargaining agreements, net of a reduction in average staff numbers, and higher performance-based remuneration along with increased contractor costs due to increased investment to support frontline operations.

The charge to provide for doubtful debts increased from \$257 million in 2005 to \$278 million in 2006. This was largely attributable to growth in lending outstandings, a higher specific provision in consumer segments (New South Wales mortgages, credit cards and personal loans) and the internal re-rating of a number of large loans to higher credit risk categories during the year as part of the Group's ongoing credit review process.

*For a discussion on the Group's significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group's income tax expense, refer to page 47.*

**United Kingdom Region**



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	2006 \$m	2005 \$m
Net interest income	1,840	1,794
Non-interest income	1,144	1,249
Net operating income	2,984	3,043
Operating expenses	(1,794)	(2,036)
Charge to provide for doubtful debts	(308)	(216)
Significant items	348	1,041
Profit from ordinary activities before income tax	1,230	1,832
Income tax expense	(362)	(202)
Net profit attributable to members of the Company	868	1,630
Significant items after tax	(250)	(1,096)
Net profit attributable to members of the Company excluding significant items	618	534

The region decreased its contribution to net profit attributable to members of the Company by \$762 million or 46.7% to \$868 million in 2006, from \$1,630 million in 2005. The 2006 result included significant items of \$250 million (after tax) in relation to reforms made to the United Kingdom defined benefit pension funds and the release of provisions raised in the 2005 year for disposal costs on the sale of the Irish banks that are no longer required. This compares to significant items of \$1,096 million profit (after tax) in relation to the profit on sale of the Irish Banks in 2005, partly offset by restructuring expenses and provisions in 2005. Excluding the 2006 and 2005 significant items the region increased its contribution to the net profit attributable to members of the Company by \$84 million or 15.7% from \$534 million in 2005 to \$618 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income increased \$46 million or 2.6% to \$1,840 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the inclusion of certain loan related fees that are now deferred and amortised in net interest income under effective yield requirements. The increase reflects the significant growth of the Financial Solutions Centres and third party distribution network with strong underlying volume growth, partly offset by the managed effects of margin contraction and changing portfolio mix along with net interest income earned by the Irish Banks up until their sale on February 28, 2005. Net interest margin declined 18 basis points to 3.51%. A small decrease in balances in higher margin personal loans and credit cards has been offset by strong growth in mortgage and business lending. The margin management across the lending and deposit portfolio through re-pricing has resulted in the anticipated shift to lower margin products by customers. This has been further impacted by the effect of historic high margin product run off as this is replaced with new lower margin offerings.

Non-interest income decreased \$105 million or 8.4% to \$1,144 million. This decrease primarily reflects changes in accounting policy from October 1, 2005 resulting in the reclassification of certain loan related fees to net interest income under effective yield requirements partly offset by the recognition of hedging ineffectiveness and fair value movements on trading financial instruments. There has also been a decrease as a result of the sale of the Group's Custom Fleet business on July 31, 2006 and the Irish Banks on February 28, 2005. This is partly offset by an increase in income from Danske Bank A/S in respect of the provision for transitional services (offset by an increase in expenses) and an increase in fees driven by the growth of the Integrated Financial Solutions centres and third party propositions.

Operating expenses decreased \$242 million or 11.9% to \$1,794 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the reclassification of certain fees that are now deferred and amortised under effective yield requirements. There has also been a decrease due to benefits flowing through the current year as a result of restructuring initiatives (including staff reductions and other productivity improvements), lower depreciation and fleet maintenance costs on leased vehicle assets as a result of the Group's sale of its Custom Fleet business on July 31, 2006, lower superannuation expense as a result of reforms to the United Kingdom's defined benefit pension plans, and the sale of the Irish Banks on February 28, 2005. This is partly offset by an increase in the costs associated with transitional services provided to Danske Bank A/S (offset by increase in revenue) and increased personnel costs reflecting higher annual salaries and performance based remuneration.

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The charge to provide for doubtful debts increased from \$216 million in 2005 to \$308 million in 2006. This was driven by market deterioration in credit cards and unsecured personal lending, together with additional collective provision charges as a result of increased lending growth.

*For a discussion on the Group's significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group's income tax expense, refer to page 47.*

**New Zealand Region**

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	2006 \$m	2005 \$m
Net interest income	775	739
Non-interest income	525	552
Net operating income	1,300	1,291
Operating expenses	(678)	(785)
Charge to provide for doubtful debts	(46)	(38)
Significant items		(14)
Profit from ordinary activities before income tax	576	454
Income tax expense	(187)	(147)
Net profit attributable to members of the Company	389	307
Significant items after tax		10
Net profit attributable to members of the Company excluding significant items	389	317

The region increased its contribution to net profit attributable to members of the Company by \$82 million or 26.7% to \$389 million in 2006, from \$307 million in 2005. The 2005 result included significant expenses of \$10 million (after tax) in relation to restructuring expenses. Excluding the 2005 significant items, the net profit attributable to members of the Company increased by \$72 million or 22.7% to \$389 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income increased \$36 million or 4.9% to \$775 million. This was driven by changes in accounting policy from October 1, 2005, resulting in the inclusion of certain loan related fees that are now deferred and amortised in net interest income under effective yield requirements. There was also an increase as a result of strong volume growth in housing and business lending, and retail deposits, partly offset by increased downward pressure on the net interest margin, which declined by 8 basis points to 2.50%. The decline in the net interest margin reflects competitive pressures in the New Zealand market, combined with a change in product mix, as customers continue to move to lower margin fixed rate products.

Non-interest income decreased \$27 million or 4.9% to \$525 million. This decrease reflects lower rental income from leased assets as a result of the Group's sale of its Custom Fleet business on July 31, 2006. There has also been a decrease as a result of customers moving towards lower cost channels, fee structures and products, reflecting continuing focus by the business on making the customer proposition more attractive offset by an increase in volume-related fees. The changes in accounting policy from October 1, 2005 resulted in a favourable impact from the recognition of hedge ineffectiveness and fair value movements on financial instruments, partly offset by the reclassification of certain loan related fees to net interest income under effective yield requirements.

Operating expenses in 2005 decreased by \$107 million or 13.6% to \$678 million. This decrease reflects lower depreciation and fleet maintenance costs on leased vehicle assets as a result of the Group's sale of its Custom Fleet business on July 31, 2006 and lower superannuation expense. This is partly offset by increased personnel costs due to annual salary increases and the introduction of new employee performance based remuneration and share option schemes.

The charge to provide for doubtful debts increased from \$38 million in 2005 to \$46 million in 2006. This higher charge reflects an overall re-rating of the business and agribusiness portfolios.

*For a discussion on the Group's significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group's income tax expense, refer to page 47.*



**nabCapital**

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	2006 \$m	2005 \$m
Net interest income	937	502
Non-interest income	579	927
Net operating income	1,516	1,429
Operating expenses	(758)	(742)
Charge to provide for doubtful debts	24	(24)
Significant items	(7)	(83)
Profit from ordinary activities before income tax	775	580
Income tax (expense)/benefit	(157)	(77)
Net profit attributable to members of the Company	618	503
Significant items after tax	5	74
Net profit attributable to members of the Company excluding significant items	623	577

nabCapital increased its contribution to net profit attributable to members of the Company by \$115 million in 2006 to \$618 million, from \$503 million in 2005. The 2006 result included significant expenses of \$5 million (after tax) relating to reforms made to the United Kingdom defined benefit pension funds, compared to \$74 million (after tax) in 2005 relating to restructuring expenses, partly offset by the reversal of the provision for foreign currency options trading losses. Excluding the 2006 and 2005 significant items, the net profit attributable to members of the Company increased by \$46 million or 8.0% to \$623 million in 2006. Details of this result (excluding significant items) are as follows.

Net interest income has increased \$435 million or 86.7% to \$937 million. This is driven by changes in accounting policy from October 1, 2005 resulting in the cost of derivative financial instruments being amortised in net interest income and the reclassification of certain loan related fees from non-interest income under effective yield requirements. Net interest income was also higher due to increased origination activity in Corporate Finance as a result of new business initiatives and improved performance in Financial Institutions as a result of higher volumes.

Non-interest income decreased \$348 million or 37.5% to \$579 million. This is driven by changes in accounting policy from October 1, 2005 resulting in the mark-to-market gains or losses on derivative financial instruments being recognised in non-interest income and the reclassification of certain loan related fees to net interest income under effective yield requirements. Non-interest income also decreased due to lower income in Institutional Banking from the strategy to exit low yielding assets, offset by increased sales of risk management products in the Markets business as a result of the increased focus on relationships with regions to better leverage regional distribution channels, and conducive market factors in the form of increased interest and foreign exchange rate volatility.

Operating expenses in 2006 increased by \$16 million or 2.2% to \$758 million. The increase in operating expenses was due to increased personnel costs as a result of enterprise bargaining agreement salary increases in 2006 and higher performance based remuneration, increased deal related fees and the commencement of the Strategic Investment Program, partly offset by the benefits achieved from rebasing of the Asian, United States and United Kingdom operations.

The charge to provide for doubtful debts decreased from \$24 million in 2005 to \$24 million provision release in 2006. This reflects recoveries on facilities that had been provided for in prior periods and net reductions in exposures in the September 2006 year as a result of the strategy to improve return on equity.

*For a discussion on the Group's significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group's income tax expense, refer to page 47.*





**Other**

	2006 \$m	2005 \$m
Net operating income (excluding significant items)	497	56
Operating expenses (excluding significant items)	(406)	(476)
Significant items	(7)	68
Profit/(loss) from ordinary activities before income tax	84	(352)
Income tax (expense)/benefit (including significant tax item)	(82)	(77)
Net profit/(loss) attributable to members of the Company	2	(429)
Significant items after tax	7	47
Net profit /(loss) attributable to members of the Company excluding significant items	9	(382)

The Other segment increased its contribution to net profit attributable to members of the Company by \$431 million to a \$2 million net profit in 2006, from a \$429 million net loss in 2005. The 2006 result included significant expenses of \$7 million (after tax) relating to reforms made to the United Kingdom defined benefit pension funds compared to \$47 million (after tax) in relation to restructuring expenses, and provision for settlement of a tax dispute with the Australian Taxation Office in 2005. Excluding significant items, the net profit attributable to members of the Company increased by \$391 million from a net loss of \$382 million in 2005 to a net profit of \$9 million in 2006.

The main factors impacting the \$391 million increase (excluding significant items) in the Other segment during the 2006 year, were:

A net profit on the sale of the Group's Custom Fleet business on July 31, 2006;

A net loss on the sale of the Group's life insurance and related wealth management companies in Asia;

higher interest income earned on surplus Group funds;

higher income due to an insurance recovery relating to AUSMAQ litigation costs and a favourable legal judgement on a tax matter in the USA;

lower personnel costs as functions are transferred into regions, consistent with the strategy of a regional accountability model; and

lower costs due to one-off costs associated with a Northern Bank Limited robbery in December 2004 and the outcome of a legal action in South Korea awarded against the Group not repeating in 2006.

*For a discussion on the Group's significant revenue and expense items during the 2006 and 2005 years, refer to pages 45 and 47. For a discussion on the Group's income tax expense, refer to page 47.*

**Net interest income**

2006	\$	8,686 million
2005	\$	6,944 million

Net interest income increased by \$1,742 million or 25.1% to \$8,686 million (2005: \$6,944 million). The result reflects the favourable impact of the full adoption of AIFRS during 2006. Excluding the impact of AIFRS, net interest income increased 8.9%. This increase partly reflects a rise in the average net interest margin from 2.13% to 2.31% and continued sound growth in housing and business lending volumes in all regions, particularly in Australia and in the United Kingdom.

**Volume and rate analysis**

The following table allocates movements in net interest income between changes in volume and changes in rate for the year ended September 30, 2006. Volume and rate variances have been calculated on the movement in average balances and the change in interest rates on average interest-earning assets and average interest-bearing liabilities. The variance caused by changes of both volume and rate has been allocated in proportion to the relationship of the absolute dollar amounts of each change to the total.

	Average balance \$m	2006 Increase/(decrease) due to change in Average rate \$m	Total \$m
<b>Interest-earning assets (1)</b>			
Due from other banks			
Australia	49	9	58
Overseas	(11)	100	89
Marketable debt securities			
Australia	(544)	10	(534)
Overseas	(63)	(12)	(75)
Loans and advances			
Australia	1,302	(49)	1,253
Overseas	211	567	778
Other interest-earning assets			
Australia	110	(166)	(56)
Overseas	34	153	187
Change in interest income	1,088	612	1,700

(1) From October 1, 2005, under AIFRS, acceptances are interest-earning assets but are excluded from the above table. Prior to October 1, 2005, acceptances were classified as non-interest earning assets. Interest on acceptances in 2006 was \$2,750 million.



	Average balance \$m	2006 Increase/(decrease) due to change in Average rate \$m	Total \$m
<b>Interest-bearing liabilities (1)</b>			
Term deposits and certificates of deposit			
Australia	(381)	72	(309)
Overseas	392	161	553
On-demand and savings (short-term) deposits			
Australia	446	311	757
Overseas	8	65	73
Government and official institution deposits			
Australia	(1)	4	3
Overseas	5	16	21
Due to other banks			
Australia	(136)	(31)	(167)
Overseas	(225)	247	22
Short-term borrowings			
Australia	181	182	363
Overseas	(93)	141	48
Long-term borrowings			
Australia	406	118	524
Overseas	170	1	171
Other debt issues			
Australia	14	(2)	12
Overseas	(18)	(26)	(44)
Other interest-bearing liabilities			
Australia	(380)	(801)	(1,181)
Overseas	(125)	229	104
Change in interest expense	263	687	950
Change in net interest income	825	(75)	750

(1) From October 1, 2005, under AIFRS, liability on acceptances are interest-bearing liabilities but are excluded from the above table. Prior to October 1, 2005, liability on acceptances were classified as non-interest bearing. Interest expense on liability on acceptances in 2006 was \$1,758 million.

Average interest-earning assets for 2006 increased by \$50.2 billion or 15.4% to \$375.7 billion (2005: \$325.5 billion), however excluding acceptances which were classified as non-interest earning in 2005, average interest-earning assets increased \$12.3 billion or 3.8%. The impact of the volume growth (excluding acceptances) on interest income was an increase of \$1,088 million in 2006. This reflects a continued environment of housing lending-driven volume growth in all regions. In addition, Australian business lending was particularly strong with recent front line investment and strong customer relationships, along with product innovation and restoration of credit risk settings, driving market share gains within a strong operating environment. The movement in rates (excluding acceptances) over the same period resulted in an increase in interest income of \$612 million in 2006. This increase in 2006 mainly reflects an environment of rising interest rates in all regions, and improvement in net interest margins.

For a further discussion of the main factors influencing the movement in average interest-earning assets, refer to gross loans and advances on page 48.

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Average interest-bearing liabilities increased by \$47.6 billion or 16.1% to \$342.9 billion (2005: \$295.3 billion), however, excluding liability on acceptances which were classified as non-interest bearing in 2005, average interest-bearing liabilities increased \$16.9 billion or 5.7%. The impact of the increasing volumes (excluding liability on acceptances) on interest expense was an increase of \$263 million in 2006. The movement in rates (excluding liability on acceptances) over the same period resulted in an increase in interest expense of \$687 million in 2006. The increase in interest expense mainly reflects growth in short-term borrowings, on-demand and savings deposits and long-term borrowings to fund asset growth. The increase in interest expense is mainly in long-term borrowings in Australia, reflecting the Group's continued strategy of lengthening the maturity profile of the Group's debt issues, a continued increase in on-demand and savings deposits due to a greater product offering with more competitive pricing in 2006, an increase in repurchase agreement volumes in Australia which has been driven by growth in demand, and rising interest rates in all regions during the year.

**Net interest spreads and margins**

	2006 \$m	2005 \$m
<b>Group</b>		
Net interest income	8,686	6,944
Average interest-earning assets	375,691	325,482
Net interest spread (%) (1)	1.88	1.69
Benefit of net free liabilities, provisions and equity (%)	0.43	0.44
Net interest margin (%) (2)	2.31	2.13
<b>Geographical region</b>		
Average interest-earning assets		
Australia	239,501	191,151
Overseas	136,190	134,331
Net interest spread (1)		
Australia	1.93	1.58
Overseas	1.79	1.81
Net interest margin (2)		
Australia	2.43	2.15
Overseas	2.11	2.11
<b>Business segment</b>		
<b>Australia Region (3)</b>		
Average interest-earning assets (4)	201,829	153,612
Net interest margin (%) (2)	2.38	2.48
<b>United Kingdom Region (3)</b>		
Average interest-earning assets (4)	52,423	48,608
Net interest margin (%) (2)	3.51	3.69
<b>New Zealand Region (3)</b>		
Average interest-earning assets (4)	31,003	28,665
Net interest margin (%) (2)	2.50	2.58
<b>nabCapital</b>		
Average interest-earning assets (4)	138,174	136,565
Net interest margin (%) (2)	0.68	0.37
<b>Other (5)</b>		
Average interest-earning assets (4)	(47,737)	(41,968)
Net interest margin (%) (2)	(0.69)	(0.24)

(1) Net interest spread represents the difference between the average interest rate earned and the average interest rate incurred on funds.

(2) Net interest margin is net interest income as a percentage of average interest-earning assets.

(3) *The Australia Region business segment here excludes the Australian Wealth Management business and the Asian banking business.*

(4) *Average interest-earning assets include intercompany balances.*

(5) *Other includes the Australian Region Wealth Management business, Asian banking business, Group Funding, Corporate Centre and inter-divisional eliminations.*

**Net interest margin (geographical basis)**

The net interest margin (net interest income as a percentage of average interest-earning assets), increased by 18 basis points to 2.31% in 2006, from 2.13% in 2005. Changes to accounting policies under AIFRS in the 2006 year have had a favourable 7 basis points impact. After adjusting for AIFRS impacts, the Group net interest margin increased 11 basis points from 2005 primarily due to the reduction in low margin assets and a favourable rate environment, partly offset by on-going competitive pressures together with unfavourable portfolio mix impacts from the continuing shift to lower margin lending and deposit products.

The increase in net interest margin in Australia of 28 basis points in 2006 to 2.43% from 2.15% in 2005, resulted primarily from favourable AIFRS impacts and the reduction in assets invested in low margin products, as well as a favourable rate environment. The increase during 2006 was also driven by the improved margin performance of the nabCapital division which resulted from the exit of low yielding assets and increased lending to higher yielding counterparties. This was partly offset by some margin contraction due to ongoing competitive pressures together with unfavourable portfolio mix impacts from the continuing shift to lower-margin home loans and deposit products.

The overseas net interest margin remained stable at 2.11% in 2006, and primarily reflects favourable AIFRS impacts, offset by the continued shift in product mix towards lower margin lending products, particularly in the UK reflecting margin management as part of the expansion strategy in the UK, an unfavourable change in deposit mix due to competition, and continued reliance on longer term wholesale funding, for both the UK and New Zealand.



**Net life insurance income**

2006	\$	1,417 million
2005	\$	1,505 million

Net life insurance income comprises the revenue and interest component of premiums, dividends, realised and unrealised capital gains and other returns on investments under the life insurers' control, net of claims expense, change in policy liabilities, policy acquisition and maintenance expense, and investment management fees (*refer to note 55 in the financial report for disclosure in relation to the Group's life insurance business*).

Net life insurance income decreased by \$88 million to \$1,417 million income in 2006, from \$1,505 million in 2005.

This result was primarily impacted by a decrease in investment revenue of \$1,156 million or 15.3% to \$6,375 million, reflecting weaker investment performance in 2006 than 2005, offset by the corresponding decrease in policy liabilities of \$1,114 million or 20.0% to \$4,456 million in 2006 from \$5,570 million in 2005.

**Other income**

Other income excluding significant revenue decreased by \$804 million or 13.7% to \$5,086 million in 2006. Refer below for a detailed analysis of the main categories of other income:

**Gains less losses on financial instruments at fair value**

2006	\$	471 million
2005	\$	639 million

Gains less losses on financial instruments at fair value includes all realised and unrealised profits and losses resulting directly from trading securities, derivative trading activities (foreign exchange, interest rate and other derivatives) and movements in assets, liabilities and derivatives designated at fair value and in hedge relationships.

Gains less losses on financial instruments at fair value decreased by \$168 million or 26.3% to \$471 million in 2006. The decrease for the year was mainly due to a reduction in trading income of \$249 million offset by non trading fair value adjustments of \$81 million. Trading income reduced largely due to the inclusion of derivative costs associated with short term funding due to a change of accounting policy from October 1, 2005.

**Banking fees**

2006	\$	833 million
2005	\$	1,523 million

Banking fees primarily consist of acceptance fees for accepting bills of exchange (applicable for the 2005 year only), fees to cover costs of establishing lending facilities, commitment fees to compensate for undrawn funds set aside for a customer's ultimate use, and service fees to cover costs of maintaining credit facilities.

Banking fees decreased by \$690 million or 45.3% to \$833 million in 2006. The decrease in 2006 is primarily due to the change of accounting policy from October 1, 2005 reflecting the impacts of effective yield and reclassification of bill acceptances. This has been partly offset by core lending growth and higher packaged annual fees and fixed rate loan service fees.

**Money transfer fees**

2006	\$	564 million
2005	\$	622 million

Money transfer fees are fees earned on the transfer of monies between accounts and/or countries and also includes fees for bank cheques and teletransfers, dishonours and special clearances, and periodical payments.

Money transfer fees decreased by \$58 million or 9.3% to \$564 million in 2006. This decrease primarily reflects the impact of the sale of the Irish Banks on February 28, 2005, as well as customers continuing to move to lower-cost transaction channels.

**Fees and commissions**

2006	\$	1,492 million
2005	\$	1,528 million

Fees and commissions consist of fees charged to cover the costs of establishing credit card facilities, commissions from selling insurance and investment products, and other fees.

Fees and commissions decreased by \$36 million or 2.4% to \$1,492 million in 2006. The decrease in 2006 primarily reflects the impact of the sale of the global Custom Fleet business in July 2006, the sale of BNZ Investment Management in January 2006, as well as the sale of the Irish Banks in February 2005.

**Investment management fees**

2006	\$	438 million
2005	\$	349 million

Investment management fee income relates to management fees received for services rendered acting as a responsible entity and/or an approved trustee for retail and wholesale unit trusts.

Investment management fees increased by \$89 million or 25.5% to \$438 million in 2006. The increase in 2006 reflects an increase in funds under management and administration, and growth in the investment market.

**Fleet management fees**

2006	\$	148 million
2005	\$	154 million

Fleet management fees consist of fleet and Custom Fleet management fees. Specifically, fleet management fees include fleet management, maintenance and fleet card fees, whilst Custom Fleet management fees include operating lease, sale and leaseback and management service fees.

Fleet management fees decreased by \$6 million or 3.9% to \$148 million in 2006. The decrease in 2006 primarily reflects the sale of the global Custom Fleet business in July 2006.

**Rentals received on leased vehicle assets**

2006	\$	654 million
2005	\$	740 million

Rentals received on leased vehicle assets represents income earned where the Group is the lessor. Depreciation on these assets is included within general expenses.

Rentals received on leased vehicle assets decreased by \$86 million or 11.6% to \$654 million in 2006. The decrease in 2006 primarily reflects the sale of the global Custom Fleet business in July 2006.

**Other income**

2006	\$	290 million
2005	\$	335 million

Other income includes dividend revenue, profit on sale of property, plant and equipment and other assets, net foreign exchange income, revaluation gains/(losses) on exchangeable capital units and other sundry income items.

Other income decreased by \$45 million or 13.4% to \$290 million in 2006. The decrease in 2006 primarily reflects the revaluation losses on the exchangeable capital units and the profit on UK property transactions received in 2005. This was offset by increased income attributable to transitional services provided to Danske Bank A/S in connection with the sale of the Irish Banks, insurance recovery received upon defence of a litigation case, and gains in relation to the Mastercard initial public offering.

**Net profit from the sale of controlled entities - Custom Fleet business**

On July 31, 2006, the Group sold its Custom Fleet business to GE Commercial Finance. The assets and liabilities of these entities no longer form part of the Group. The profit arising from the sale was as follows:

	Proceeds from sale \$m	Cost of assets sold \$m	Profit on sale (before tax) \$m	Income tax expense \$m	Profit on sale (after tax) \$m
Custom Fleet business	571	(375)	196	(25)	171

**Significant revenue****Pensions revenue**

During the 2006 year, an agreement was reached between the Company, staff members and trustees to reforms to the United Kingdom pension schemes. This has resulted in significant revenue amounting to \$319 million (\$223 million after tax). This amount consists of past service gain revenue of \$387 million, expected return on asset revenue of \$274 million, offset by interest costs of \$231 million and current service costs of \$111 million.

**Sale of National Europe Holdings (Ireland) Limited**

On February 28, 2005, the Group sold to Danske Bank A/S all of the share capital of National Europe Holdings (Ireland) Limited. National Europe Holdings (Ireland) Limited was the immediate parent entity of Northern Bank Limited and National Irish Bank Limited (Irish Banks). The assets and liabilities of National Europe Holdings (Ireland) Limited and the Irish Banks no longer form part of the Group. The profit arising from the sale was as follows:

	Proceeds from sale \$m	Cost of assets sold \$m	Profit on sale (before tax) \$m	Income tax benefit \$m	Profit on sale (after tax) \$m
National Europe Holdings (Ireland) Limited	2,493	(1,139)	1,354	(34)	1,320

During the 2006 year, \$15 million of provisions and other costs expected to be incurred in respect of the sale of the Irish Banks were written back to the income statement as these costs are no longer expected to be incurred.

**Operating expenses**

Other

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**Personnel expenses**

2006	\$	3,869 million
2005	\$	3,807 million

Personnel expenses increased by \$62 million or 1.6% to \$3,869 million in 2006. The increase in 2006 reflected higher contractor salaries as a result of the Group's investment in infrastructure and business initiative projects, higher average salaries as a result of increases under the enterprise bargaining agreement effective from March 1, 2006 and higher performance-based remuneration. This has been partly offset by the reduction in staff numbers resulting from the impact of the sale of controlled entities during the 2005 and 2006 years, the reduction in staff numbers resulting from further restructuring initiatives undertaken by the Group during the 2006 year and a reduction in superannuation expense as a result of reforms to the United Kingdom pension scheme.

**Occupancy-related expenses**

2006	\$	523 million
2005	\$	539 million

Occupancy-related expenses decreased by \$16 million or 3.0% to \$523 million in 2006. The decrease in 2006 reflects a reduction in occupancy costs resulting from the sale of controlled entities during the 2005 and 2006 years and lower occupancy costs as a result of restructuring initiatives undertaken by the Group during the 2006 year. This has been partly offset by higher occupancy costs as a result of annual market-base rent reviews.

**General expenses**

2006	\$	3,187 million
2005	\$	3,649 million

General expenses decreased by \$462 million or 12.7% to \$3,187 million in 2006. The decrease in 2006 reflects a reduction in depreciation expense following the Group's leased motor vehicles being designated as held for sale from April 1, 2006 and a reduction as a result of one-off items not repeated in 2006, including \$40 million operational risk event losses due to customer overcharging for BAD tax and fixed rate interest-only loans, \$49 million associated with the Northern Bank Limited robbery in December 2004 and costs of \$49 million associated with the outcome of a legal action in South Korea. In addition, there was a reduction as a result of lower operational risk event losses relating to customer overcharging for Choice package. This is partly offset by higher costs of transitional services provided to Danske Bank A/S from the sale of the Irish Banks and higher fees and commissions as a result of items no longer meeting deferral criteria following the Group's change of accounting policy on October 1, 2005.

**Net loss from the sale of controlled entities - MLC Asia businesses**

On May 8, 2006, the Group sold to AXA Asia Pacific Holdings its life insurance and related wealth management companies in Asia. The assets and liabilities of these entities no longer form part of the Group. The loss arising from the sale was as follows:

	Proceeds from sale \$m	Cost of assets sold \$m	Loss on sale (before tax) \$m	Income tax benefit \$m	Loss on sale (after tax) \$m
MLC Asia businesses	565	(628)	(63)		(63)

**Charge to provide for doubtful debts****Charge to provide for doubtful debts by geographical region**

	2006 \$m	2005 \$m
Australia	264	320
Europe	292	182
New Zealand	46	34
United States	7	7
Asia	(3)	(9)
Total charge to provide for doubtful debts	606	534

The total charge to provide for doubtful debts increased by \$72 million or 13.5% to \$606 million in 2006. This increase is primarily due to an increase in Europe, reflecting growth in lending volumes including non-secured lending, as well as recoveries received in 2005 which decreased the 2005 charge. This was partly offset by a decrease in the charge in Australia, mainly reflecting a reduction in specific provisions in nabCapital. *For further information on the movement in the charge to provide for doubtful debts per each business segment, refer to pages 35 to*

*39 and note 18 in the financial report.*



**Significant expenses****Restructuring costs**

During the 2005 year, the Group recognised restructuring expenses and provisions amounting to \$793 million (\$576 million after tax). These costs are expected to be recovered through ongoing efficiency and productivity enhancements, streamlined functions and ongoing cost reductions. The restructuring initiatives comprise a fundamental reorganisation of the management and organisational structure of the Group to a regional model, including the integration of the retail banking, corporate banking and wealth management businesses in Australia, the streamlining of operations and reconfiguration of distribution networks in the United Kingdom, the refocusing of the nabCapital business, as well as other streamlining and business efficiency programs, property rationalisation and

decommissioning systems in all business segments.

The details of this amount are set out as follows:

	Personnel \$m	Occupancy \$m	Other \$m	Total \$m
Total restructuring costs	439	137	217	793

In addition, during the 2002 year, the Group recognised significant restructuring costs of \$580 million resulting from the Positioning for Growth initiatives. In 2005, excess provisions totalling \$11 million (\$7 million after tax) were written back to the income statement.

**Foreign currency options trading losses and reversal of residual risk provision**

In January 2004, the Company announced that it had identified losses relating to unauthorised trading in foreign currency options and had established a structured process to review and resolve all issues arising from this matter.

The Company recognised a total loss of \$360 million before tax, or \$252 million after tax, arising from the unauthorised foreign currency options trading. This total loss consisted of losses arising from the removal of fictitious trades from the foreign currency options portfolio of \$185 million and a further loss of \$175 million arising from a risk evaluation and complete mark-to-market revaluation of the foreign currency options portfolio in January 2004. Included within the total loss of \$360 million was a valuation allowance for long-dated and illiquid trading derivatives in other portfolios of \$26 million as at September 30, 2004.

In the 2005 year, following a detailed review of the residual risk in the remaining portfolio, \$34 million (\$24 million after tax) was written back to the income statement.

**Provision for the settlement of Australian Taxation Office tax dispute in relation to TrUEPrS<sup>SM</sup>**

In November 2005, the Company reached an in-principle heads of agreement with the Australian Taxation Office (ATO) in respect of a settlement of amounts in dispute in relation to the TrUEPrS<sup>SM</sup> capital raising transaction.

An amount of \$97 million was recognised as a significant tax item for the 2005 year. In accordance with the ATO practice on disputed assessments, the Company had previously paid to the ATO 50% of the amounts owing under relevant amended assessments. The amount paid to the ATO of approximately \$97 million was recognised by the Company at the time as an asset on the balance sheet. This amount has been written off reflecting the settlement reached with the ATO.

**Income tax expense**

2006	\$	2,134 million
2005	\$	1,814 million

Income tax expense relating to ordinary activities of \$2,134 million in 2006, was \$320 million or 17.6% higher than 2005. The effective tax rate in 2006 of 29.3% compares to 28.3% in 2005, however excluding statutory funds attributable to the life insurance business, the effective tax rate for the 2006 year is 29.9% which is consistent with the Group's prima-facie tax rate of 30.0% and compares to 24.6% in 2005. The increase in income tax expense in 2006 reflects higher operating profits before tax in all businesses, partly offset by a reduction in tax expense attributable to the statutory funds of the life insurance business. The quantum of income tax expense in relation to the statutory funds attributable to the life insurance business is also impacted by wealth management products and activities, to which a wide range of tax rates are applied.

The effective tax rate excluding statutory funds attributable to the life insurance business for the 2005 year of 24.6%, was favourably impacted by the non-assessable profit in respect of the sale of the Irish Banks amounting to \$372 million, partly offset by the settlement of the ATO tax dispute of \$97 million. Excluding significant items and the statutory funds attributable to the life insurance business, the effective tax rate for the 2005 year was 30.5%.

**Gross loans and advances****Average balances**

	2006 \$m	2005 \$m
<b>Average gross loans and advances</b>		
Australia	<b>180,426</b>	162,055
Overseas	<b>100,294</b>	97,206
Total average gross loans and advances	<b>280,720</b>	259,261

The diversification and size of the Group are such that its lending is widely spread both in terms of geography and types of industries served. The loan portfolio continues to consist of short-term outstandings with 30.4% of the loans and advances (including loans and advances accounted for at fair value) at September 30, 2006 maturing within one year, 20.7% maturing between one year and five years and 48.9% maturing after five years. Real estate mortgage lending comprises the greatest portion of the loan portfolio maturing after five years. The average balance of loans and advances in 2006 equated to 60.6% of the total average assets of the Group. This compares with 60.2% in 2005.

The loan portfolio within Australia largely comprises real estate lending (\$129,423 million), which equates to 66.8% of the portfolio at September 30, 2006. The remainder of the portfolio primarily consists of other commercial and industrial lending (14.0% of the portfolio) and asset and lease financing (5.8% of the portfolio). The overseas loan portfolio primarily consists of real estate lending (\$42,339 million or 38.1% of the portfolio), other commercial and industrial lending (30.0% of the portfolio) and instalment loans and other personal lending (8.3% of the portfolio) as at September 30, 2006. The nature of the Group's lending reflects the operations of the Group's business divisions, and the regional lending markets in which these divisions operate.

Average gross loans and advances increased \$21,459 million or 8.3%, to \$280,720 million in 2006, from \$259,261 million in 2005. The increase in 2006 reflects continued strong growth of 9.4% in housing lending across all regions to \$157,984 million and improved business lending in Australia which experienced growth of 17.9% to \$60,369 million.

Australian average gross loans and advances accounted for 64.3% of the total average gross loans and advances in 2006, compared with 62.5% in 2005. Australian average gross loans and advances increased \$18,371 million or 11.3% to \$180,426 million. The increase mainly reflects continued strong growth in housing lending, term lending and lease financing.

Overseas average gross loans and advances increased \$3,088 million or 3.2%, to \$100,294 million in 2006. The increase has been driven predominately by continued strong growth in underlying housing and term lending in both the UK and New Zealand, partly offset by the sale of Irish Banks during the 2005 year.

**Loans by industry for the Group as at September 30, 2006 (1) (2)**

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	Australia \$m	Europe \$m	New Zealand \$m	United States \$m	Asia \$m	Total \$m
Government and public authorities	640	585	272	23		1,520
Agriculture, forestry, fishing and mining	6,278	2,654	5,100		31	14,063
Financial, investment and insurance	6,092	2,118	1,183	1,241	699	11,333
Real estate construction	1,188	1,792	153		222	3,355
Manufacturing	3,736	2,712	1,386	265	14	8,113
Real estate mortgage	129,423	23,976	17,818		545	171,762
Instalment loans to individuals and other personal lending (including credit cards)	8,236	7,696	1,533			17,465
Asset and lease financing	11,184	5,747	10		12	16,953
Other commercial and industrial	27,100	23,079	9,511	286	423	60,399
Total gross loans and advances	193,877	70,359	36,966	1,815	1,946	304,963
Deduct:						
Unearned income	(1,571)	(644)	(1)			(2,216)
Deferred fee income	(27)	(128)	(20)			(175)
Provisions for doubtful debts	(1,145)	(718)	(130)	(22)	(6)	(2,021)
Total net loans and advances	191,134	68,869	36,815	1,793	1,940	300,551

(1) Refer to note 17 in the financial report for comparative information.

(2) Included within loans by industry are loans accounted for at fair value of \$16,774 million which is included within other financial assets at fair value on the balance sheet (refer to note 16 in the financial report for further information).

In Australia, gross loans and advances grew by \$17,755 million or 10.0% to \$193,877 million at September 30, 2006. The increase mainly reflects continued strong growth in housing and business lending volumes. Housing lending increased by \$11,705 million or 9.9%, reflecting continued strong housing market growth and sound economic conditions. Business lending (including term and lease financing) has also increased reflecting sound business and economic conditions.

In Europe, gross loans and advances (including loans accounted for at fair value) grew by \$15,822 million or 29.0% to \$70,359 million at September 30, 2006. The strong underlying growth in 2006, reflects growth across the third party distribution channel, branch network and Integrated Financial Solutions Centres. The UK business is continuing to successfully implement strategies designed to increase housing lending and target volume growth expansion strategies, with significant growth in variable rate home lending. In addition, lending volumes have also increased reflecting sound economic conditions.

In New Zealand, gross loans and advances (including loans accounted for at fair value) increased by \$2,350 million or 6.8% to \$36,966 million at September 30, 2006. Lending volumes grew during the year driven by the continued success of the Unbeatable housing campaign and growth in business lending, where the New Zealand business improved its market share despite an intensively competitive New Zealand banking environment.

In the US, gross loans and advances decreased by \$426 million or 19.0% to \$1,815 million at September 30, 2006. The decrease in volumes primarily reflects the maturity of structured finance lending transactions and funded loans during the 2006 year.

In Asia, gross loans and advances increased by \$263 million or 15.7% to \$1,946 million at September 30, 2006. Following the nab Capital consolidation of the Asian business in 2005, increase in volumes reflects an increase in loans to corporate clients in Hong Kong during the 2006 year.

#### Asset quality disclosures, charge to provide and provisions for doubtful debts

##### Impaired assets

	Gross \$m	2006 Specific provision \$m (1)	Net \$m	Gross \$m	2005 Specific provision \$m (1)	Net \$m
Australia	836	137	699	761	201	560
Europe	169	28	141	137	68	69
New Zealand	51	18	33	103	33	70
United States				25	13	12
Asia	1	1		1	1	
Total	1,057	184	873	1,027	316	711
Percentage of risk-weighted assets	0.33%	0.06%	0.27%	0.35%	0.11%	0.25%

2006  
\$m

2005  
\$m

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Net impaired assets	<b>873</b>	711
Equity (parent entity interest)	<b>27,804</b>	25,323
Percentage of net impaired assets to equity	<b>3.1%</b>	2.8%

(1) *Includes specific provisions for impaired off-balance sheet credit exposures.*

Total impaired assets less specific provision for doubtful debts at September 30, 2006 were \$873 million, an increase of \$162 million or 22.8% from the 2005 balance of \$711 million. This increase is reflective of the softer economic conditions being experienced in the current credit environment and a change in accounting policy from October 1, 2005.

Gross impaired assets (being impaired assets before specific provision for doubtful debts) at September 30, 2006 were \$1,057 million, an increase of \$30 million or 2.9% from the balance at September 30, 2005.

The Group's gross impaired assets to risk-weighted assets was 0.33% at September 30, 2006, which decreased from 0.35% at September 30, 2005, largely as the result of reductions in impaired assets in New Zealand and the United States, offset by increases in Australia and Europe. The Australian component of the gross impaired assets at September 30, 2006 was \$836 million, reflecting an increase of \$75 million or 9.9% from 2005. In Europe, gross impaired assets increased by \$32 million or 23.4% to \$169 million. In New Zealand, gross impaired assets decreased by \$52 million or 50.5% to \$51 million which reflected the settlement of a single large exposure during 2006. Gross impaired assets in the United States decreased by \$25 million or 100%, as a result of a single large exposure being written off during the 2006 year.

The Group has specialised business service units operating in each region, which continue to result in the early identification and rectification of problem loans.

**Provisions for doubtful debts (closing balance by geography)**

	2006 \$m	2005 \$m
Australia		
Collective	1,008	1,258
Specific (1)	136	217
	<b>1,144</b>	1,475
Europe		
Collective	690	613
Specific (1)	28	88
	<b>718</b>	701
New Zealand		
Collective	112	160
Specific (1)	18	35
	<b>130</b>	195
United States		
Collective	22	29
Specific (1)		13
	<b>22</b>	42
Asia		
Collective	6	4
Specific (1)	1	1
	<b>7</b>	5
Group		
Collective	1,838	2,064
Specific (1)	183	354
Total provisions for doubtful debts	<b>2,021</b>	2,418
Percentage of risk-weighted assets	<b>0.63%</b>	0.83%

(1) Excludes specific provisions for impaired off-balance sheet credit exposures.

Total provisions for doubtful debts, excluding off-balance sheet credit exposures, held at September 30, 2006 were \$2,021 million or 0.63% of risk-weighted assets, compared with \$2,418 million or 0.83% of risk-weighted assets at September 30, 2005. Of the total provisions for doubtful debts at September 2006, the collective provision represented \$1,838 million or 0.58% of risk-weighted assets, compared with 0.71% in 2005.

From 1 July 2006, a general reserve for credit losses has been established to align with APRA's proposed benchmark of 0.5% of credit risk-weighted assets on a post-tax basis. As at September 30, 2006, an additional reserve to the collective provision of \$135 million was held for capital purposes to meet APRA's requirements. The general reserve for credit losses has been appropriated from retained profits (refer to notes 38 and 39 for further details).

**Credit quality data**

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ( a loss event ), and that loss event or events has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics in a collective assessment for impairment.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

**In prior financial periods, the Group adopted a statistically based provisioning method for its general provision for doubtful debts. Under this method, the Group estimated the level of losses inherent, but not specifically identified, in its existing credit portfolios at balance date. The approach applied for 2005 differed in certain respects to the approach applied for 2006 following transition to AASB 139. Key changes included applying more detailed loss estimation methods, more accurate estimates of loan loss emergence and other refinements to the approach.**

Further information in respect of the Group's loan loss provisioning methodology under AASB 139 and associated assumptions is provided in the Critical Accounting Policies section (refer page 54).



	2006 \$m	2005 \$m
Provisions for doubtful debts		
Specific (excluding off-balance sheet credit exposures)	183	354
Collective	1,838	2,064
Gross impaired assets	1,057	1,027
Charge to income statement    ordinary	606	534
Charge to income statement    significant		

Ratios (1)	2006 %	2005 %
Provisions for doubtful debts at year end as a percentage of year-end loans (before provisions)		
Specific	0.06	0.13
Collective	0.64	0.77
	0.70	0.90
Provisions for doubtful debts at year end as a percentage of year-end loans and acceptances (before provisions)		
Specific	0.06	0.12
Collective	0.56	0.70
	0.62	0.82
Provisions for doubtful debts at year end as a percentage of year-end risk-weighted assets		
Specific	0.06	0.12
Collective	0.58	0.71
	0.64	0.83
Gross impaired assets as a percentage of year-end loans (before provisions)	0.37	0.38
Charge to income statement (ordinary and significant) as a percentage of		
Year-end loans	0.21	0.20
Year-end loans and acceptances	0.18	0.18
Average loans and acceptances	0.19	0.19
Year-end risk-weighted assets	0.19	0.18

(1) *Ratios exclude specific provisions for impaired off-balance sheet credit exposures and loans at fair value.*

#### Provisioning coverage ratio

The provisioning coverage ratio (ie. the level of provisioning to impaired assets) is determined having regard to all identifiable losses anticipated to result from impaired assets. The identifiable losses anticipated is management's determination of losses that have been incurred for individual loans that are considered impaired. This considers all available information, including future cash flows, the effective rate of interest, the secondary market value of the loan, and the fair value of collateral. The estimate is not determined over the life of the loan, only at the point at which the loan is considered impaired. Accordingly, the balance of the specific provision is maintained equal to the total of all estimated incurred losses on impaired loans.

To ensure that adequate provisions for write-offs are maintained, rigorous credit monitoring procedures are in place to facilitate the early identification of doubtful debts and correspondingly, the estimated losses likely to arise. Central to this process, all entities in the Group are required to formally review their loan portfolio at least quarterly to identify doubtful debts and loss estimations. Provisions must be adjusted upwards or downwards to equate to the current estimates of loss on doubtful loan accounts.

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The actual levels of specific provisioning set aside to cover estimated incurred losses on loans which are considered to be sufficiently impaired to warrant raising a provision are set out below:

	2006 %	2005 %
Specific provision coverage (1)	17.4	34.9
Total provision coverage (1)	204.0	235.8

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(1) Ratios include specific provisions for impaired off-balance sheet credit exposures.

The collective provision (against both loans recorded at amortised cost and at fair value) provides further coverage against these loans of 186.6% at September 30, 2006, bringing total effective coverage to 204.0%.

**Deposits and other borrowings**

Total deposits and other borrowings increased by \$9,720 million or 4.6% to \$222,277 million at September 30, 2006, compared with \$212,557 million at September 30, 2005; however, including deposits and other borrowings accounted for at fair value, total deposits and other borrowings increased by \$20,342 million or 9.6%. The increase reflects sound growth in on-demand and savings deposits particularly in Australia and Europe, reflecting more competitive pricing and new product offerings and initiatives, as well as term deposit growth in Europe and New Zealand. This is partly offset by a decrease in certificates of deposits in Australia.

In Australia, deposits and other borrowings increased by \$8,406 million or 6.9% to \$130,710 million, reflecting strong growth in on-demand and short-term deposits and term deposits, partly offset by a decrease in certificates of deposit reflecting the Group's strategy of reducing its reliance on short-term borrowings and lengthening its debt maturity profile.

In Europe, deposits and other borrowings (including deposits and other borrowings accounted for at fair value) increased by \$13,172 million or 28.2% to \$59,820 million, reflecting strong growth in on-demand and short-term deposits and continued growth in term deposit volumes. These movements reflect the continuing success of the third party distribution channel, the branch network and the Integrated Financial Solutions Centres.

In New Zealand, deposits and other borrowings (including deposits and other borrowings accounted for at fair value) increased by \$3,032 million or 11.6% to \$29,204 million. Underlying growth in this region primarily reflects an increase in volumes in term deposits.

In the US, deposits and other borrowings decreased by \$5,877 million or 43.9% to \$7,513 million. This decrease is driven by a reduction in the US commercial paper program reflecting the Group's strategy of reducing its reliance on short-term borrowings and lengthening its debt maturity profile.

In Asia, deposits and other borrowings increased by \$1,609 million or 39.8%, to \$5,652 million as at September 30, 2006. This increase represents growth in corporate and retail market deposits largely driven by the deposits campaign in Hong Kong.

**Deposits and other borrowings for the Group as at September 30, 2006 (1) (2)**

	Australia \$m	Europe \$m	New Zealand \$m	United States \$m	Asia \$m	Total \$m
Deposits not bearing interest	7,555	3,701	476	402	2	12,136
On-demand and short-term deposits	63,278	29,936	7,375	1,165	340	102,094
Certificates of deposit	8,180	12,982	2,866	484		24,512

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Term deposits	34,967	12,186	13,954	2,586	5,310	69,003
Securities sold under agreements to repurchase	3,629	968		729		5,326
Borrowings	13,101		4,544	2,147		19,792
Fair value adjustment		47	(11)			36
Total deposits and other borrowings	130,710	59,820	29,204	7,513	5,652	232,899

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(1) *Refer to note 28 in the financial report for comparative information.*

(2) *Included within deposits and other borrowings are deposits and other borrowings accounted for at fair value of \$10,662 million which is included within other financial liabilities at fair value on the balance sheet (refer to note 27 in the financial report for further information).*

**Assets under management and administration**

The assets of the Group as reported on the balance sheet include certain assets managed on behalf of others eg. where statutory funds and registered schemes are required to be consolidated by the Group under AIFRS. Assets on trust relate to funds held in trust by the Group's trust services businesses. The Group and its associated entities also manage and perform administration for entities such as superannuation funds and unit trusts, the assets of which do not form part of the total assets recorded on the Group's balance sheet. *(Refer to note 54 in the financial report for further details.)*

A summary of the Group's assets under management and administration, is set out as follows:

	2006 \$m	2005 \$m
<b>By type</b>		
Assets under management	76,335	71,012
Assets under administration	16,649	15,007
Assets on trust	4,227	4,856
Total assets under management and administration	97,211	90,875
<b>By geography</b>		
Australia	94,053	84,155
Europe	3,158	3,752
New Zealand		2,304
Asia		664
Total assets under management and administration	97,211	90,875
<b>By investor</b>		
Retail	55,197	54,614
Corporate	42,014	36,261
Total assets under management and administration	97,211	90,875

Total assets under management and administration increased by 7.0% to \$97,211 million at September 30, 2006, compared with \$90,875 million at September 30, 2005. The growth in total assets under management and administration amidst relatively flat investment markets was driven by strong sales across core retail platforms as investors began to take advantage of superannuation changes announced in the Federal Budget in May 2006. In 2005, the growth in total assets under management and administration was primarily due to increased investment earnings as a result of continued strong investment market conditions in the year to September 30, 2005.

**Cross border outstandings**

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The following table analyses the aggregate cross border outstandings due from countries other than Australia where such outstandings individually exceed 0.75% of the Group's assets. For the purposes of the annual financial report, cross border outstandings are based on the country of domicile of the counterparty or guarantor of the ultimate risk, and comprise loans and advances, balances due from other financial institutions, acceptances and other monetary assets including trading derivative assets and reverse repurchase agreements. Local currency activities with local residents by foreign branches and subsidiaries are excluded.

The reporting threshold used below is for disclosure guidance only and is not intended as an indicator of a prudent level of lending by the Group to any one country.

	<b>Government and official institutions \$m</b>	<b>Banks and other financial institutions \$m</b>	<b>Commercial and industrial \$m</b>	<b>Other \$m</b>	<b>Total \$m</b>	<b>% of total assets</b>
<b>As at September 30, 2006</b>						
Germany	2,182	3,569	151	14	5,916	1.2
UK		4,425	429	376	5,230	1.1
US	153	5,477	2,036	252	7,918	1.6
<b>As at September 30, 2005</b>						
Germany	5,819	4,511	364	13	10,707	2.5
US	458	5,123	3,188	208	8,977	2.1

In addition, as at September 30, 2006, the US had off-balance sheet commitments of \$8,277 million (2005: \$4,342 million).

### *Critical accounting policies*

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The Group's annual financial report has been prepared in accordance with Australian Equivalents to International Financial Reporting Standards (AIFRS). The Group's principal accounting policies are disclosed in note 1 to the financial report and in note 57 with respect to policies that differ from US GAAP.

Certain of these policies are considered to be critical to the representation of the Group's financial performance and position, since they require difficult, subjective or complex judgements. The following disclosure is intended to provide an enhanced level of understanding of these judgements and their impact on the Group's financial statements. These judgements necessarily involve assumptions or estimates in respect of future events, which can vary from what is forecast. However, the Company believes that its financial statements and its ongoing review of the estimates and assumptions utilised in preparing those financial statements, are appropriate to provide a true and fair view of the Group's financial performance and position over the relevant period.

Management has discussed the development and selection of its critical accounting policies with the Audit Committee and the Committee has reviewed the Group's disclosure relating to them as set out below.

*Provision for doubtful debts*



Under AIFRS, loans and advances are generally carried at amortised cost, representing the gross value of the outstanding balance adjusted for provisions for doubtful debts. To best meet this requirement, the Group has adopted a statistically-based provisioning method for its provision for doubtful debts, which is consistent with other large financial institutions in Australia and the US. Under this method, the Group estimates the level of losses incurred, but not specifically identified, in its existing credit portfolio at balance date. The amount of the estimated loss is recognised using an allowance account and is included in the income statement.

In applying this policy the Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ( a loss event ), and that loss event or events has had an impact on the estimated future cash flows of the financial asset or the portfolio that can be reliably estimated.

The amount of impairment loss for a loan or portfolio of loans is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets within the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions. In addition, the Group uses its experienced judgement to estimate the amount of an impairment loss.

The Group's loan portfolio is split between retail and non-retail loans with a loan loss provision being calculated separately for each of these components.

For retail loans (personal loans, credit cards and home loans) the Group typically applies a roll rate methodology as follows. Under the roll rate methodology, loans are categorized into classes depending on their product type and their performance status, including performing, 0-30, 30-60, 60-90 days past due and beyond. Default and loss probabilities are then applied to each class in order to estimate the level of incurred losses. These probabilities are determined individually for each class and are based on observed historical experience across the portfolio.

For non-retail loans a statistical based provisioning methodology is applied. This calculates the level of incurred losses in the portfolio based upon the probability of default multiplied by the loss given default. The Group uses its internal credit risk assessment scale to group loans with common risk characteristics together. The Group's internal scale assigns a rating from 1 through to 16 (increasing as the assessment of the credit quality deteriorates) to each loan. This rating is based on the loan officer's assessment of the credit worthiness of the loan and the expected future cash flows from the loan. Individual probabilities of default and loss given default estimates are then determined for each rating category and are based on observed historical experience across the portfolio. Probabilities of default are directly correlated with the loss emergence period determined for that portfolio of financial assets.

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The Group's loan loss provisioning methodology incorporates a number of assumptions, including estimates of probabilities of default and loss given default. The methodology and assumptions used for estimating the level of loan loss provisions are reviewed regularly to reduce any differences between loss estimates and actual loss experience. The assumptions applied by management are also subject to regular review and oversight by the Group Risk Management Committee and Board Risk and Audit Committees.

### *Life insurance and investment policy liabilities*

Policy liabilities for insurance contracts in the Group's balance sheet and the change in policy liabilities disclosed as an expense in the income statement have been calculated using the Margin on Services methodology in accordance with guidance provided by the Life Insurance Actuarial Standard Board's Actuarial Standard AS 1.04 Valuation of Policy Liabilities. Under this approach policy liabilities for life insurance contracts are measured generally using the projection method, which is based on the net present value of estimated future policy cash flows.

Future cash flows incorporate investment income, premiums, expenses, redemptions and benefit payments (including bonuses). A risk free discount rate is applied. Deferred acquisition costs where permissible are offset against this liability.

Policy liabilities for life investment contract business are calculated using the accumulation method. The liability is stated gross. It is measured as the present value of future cashflows using a discount rate that reflects the returns on the assets backing those liabilities and generally reflects the accumulation of amounts invested by policyholders plus investment earnings less fees specified in policy contracts.

The measurement of policy liabilities is subject to actuarial assumptions, which involve complex judgements. Assumptions made in the calculation of policy liabilities at each balance date are based on best estimates at that date. The assumptions include the benefits payable under the policies on death, disablement or surrender, future premiums, investment earnings and expenses. Best estimate means that assumptions are neither optimistic nor pessimistic but reflect the most likely outcome. The assumptions used in the calculation of the policy liabilities are reviewed at each balance date.

#### **Defined benefit superannuation and pension arrangements**

The Group maintains several defined benefit superannuation and pension arrangements, details of which are given in note 34 in the financial report. The measurement of any pension assets and liabilities, and the annual pension expense involves actuarial and economic assumptions. The key variables used in pension accounting relate to the size of the employee and pensioner population, actuarial assumptions, the expected long-term rate of return on plan assets and the discount rate. The annual pension expense and balance sheet position for the Group are currently most sensitive to discount rate and return on asset assumptions.

The Group's defined benefit plans provide defined lump sum benefits based on years of service and a salary component determined in accordance with the specific plan. A liability or asset in respect of defined benefit superannuation plans is recognised in the balance sheet and is measured as the present value of the defined benefit obligation at the reporting date less the fair value of the fund's assets at that date and any unrecognised past service cost.

Under AIFRS requirements the present value of the defined benefit obligations for each plan is discounted by either the government bond rate, or the average AAA credit rated bond rate for bonds that have maturity dates approximating to the terms of the Group's obligations. The present value of the defined benefit obligations is calculated every three years using the projected unit credit method and updated every year for material movements in the plan position.

Past service costs are recognised immediately in income, unless the changes to the superannuation fund are conditional on the employees remaining in service for a specified period of time (vesting period). In this case, the past service cost is amortised on a straight line basis over the vesting period.

Pension expense attributable to the Group's defined benefit plans comprises current service cost, interest cost, expected return on plan assets and amortisation of any past service cost which has yet to vest. The Group's policy where actuarial gains and losses arise as a result of actual experience is to fully recognise such amounts directly into retained earnings.

*Accounting developments*

The Australian Accounting Standards Board (AASB) has issued new standards and amendments that were available for adoption, but not mandatory for September 30, 2006 reporting periods. In some cases these amendments relate to items which are not applicable to the Group. Those amendments which are applicable and which are likely to have an impact on the Group's disclosures but have not yet been applied by the Group in preparing this financial report are as follows:

AASB 7 Financial Instruments: Disclosure (August 2005) (AASB 7) withdraws AASB 130 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and supersedes paragraphs 51-95 of AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after January 1, 2007.

AASB 2005-10 Amendments to Australian Accounting Standards (AASB 2005-10): following the issue of AASB 7 the following AASB standards have been amended - AASB 132; AASB 101 Presentation of Financial Statements ; AASB 114 Segment Reporting ; AASB 117 Leases ; AASB 133 Earnings per Share ; AASB 139; and AASB 4 Insurance Contracts ; AASB 1023 General Insurance Contracts ; and AASB 1038 Life Insurance Contracts .

The Group plans to adopt AASB 7 and AASB 2005-10 from October 1, 2007. The initial application of AASB 7 and AASB 2005-10 is not expected to have an impact on the financial results of the Company or the Group as the standards are concerned only with disclosures.

#### **United States Generally Accepted Accounting Principles**

*Refer to note 57 in the financial report for additional information on the impact of changes in US GAAP on the Group.*

*Non-GAAP financial measures*

The following is a summary of the key non-GAAP financial measures used throughout the annual financial report:

### **Cash earnings**

Cash earnings is a key performance measure and financial target used by the Group. Dividends paid by the Company are based on after-tax cash earnings (adjusted for significant items). Cash earnings is a key performance measure used in the investment broking community, as well as by those Australian peers of the Group with a similar business portfolio. Management considers that the exclusion of the items detailed below from net profit is a prudent and useful indicator of the Group's underlying operating performance. Cash earnings does not refer to, or in any way purport to represent, the cash flows, funding or liquidity position of the Group. It does not refer to any amount represented on a statement of cash flows.

Adjustments are made between net profit and cash earnings as follows:

Minority interests reflects the allocation of profit to minority interests in the Group, and is adjusted from net profit to reflect the amount of net profit that is attributable to ordinary shareholders.

Minority interests of life businesses reflects the allocation of profit to controlled unit trusts of life companies.

Distributions this reflects payments to holders of National Income Securities, Trust Preferred Securities and Trust Preferred Securities II, and is adjusted from net profit to reflect the amount of net profit that is attributable to ordinary shareholders.

Revaluation gains/losses on exchangeable capital units the Group's exposure to foreign exchange risk is eliminated through the existence of certain conversion features that convert the exchangeable capital units to equity at pre-determined exchange rates.

Treasury shares relates to the movement in treasury share assets (direct investments in National Australia Bank Limited) caused by the movement in the share price.

Net profit/loss on sale of controlled entities relates to profits or losses on the sale of controlled entities.

Revaluation gains/losses on economic hedge of the proceeds on sale of controlled entities represents the fair value movement on derivatives taken out to protect against foreign exchange rate movements and relates directly to the profit/loss on sale of controlled entities.



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Investments earnings on shareholders retained profits (IoRE) discount rate variation relates to the movement attributable to the variation between applying the short term and long term discount rates when calculating the IoRE.

Impairment of goodwill relates to the impairment expense recognised on the application of an annual impairment test. Financial statement users generally do not regard impairment of goodwill as being useful information in analysing investments. As it relates to an intangible asset, management believes it is prudent to isolate this amount from the underlying operating result.

*Refer to page 7 for the reconciliation of net profit to cash earnings before significant items.*

### **Significant items**

Significant items including significant revenue, significant expenses and the associated income tax expense are defined as follows.

When an item of revenue or expense is of such a size, nature or incidence that its disclosure is relevant in explaining the financial performance of the entity for the reporting period, its nature and amount is disclosed separately either on the face of the or in the notes to the financial report.

Management believes that the inclusion of these items distorts the underlying operating results of the Group and causes difficulty in identifying underlying performance trends and issues. Through the clear separation and identification of these items, the Group ensures that they are identified and discussed in full, as well as ensuring that the underlying performance is highlighted and discussed in full.

*Refer to page 7 for the reconciliation of net profit to net profit attributable to members of the Company to net profit attributable to members of the Company before significant items.*

## **Disclosure controls and procedures and internal control over financial reporting**

### **Evaluation of disclosure controls and procedures**

The Group has designed its disclosure controls and procedures to ensure the information required to be disclosed in the Group's external reports is reliably recorded, processed, summarised, and reported within the required time periods. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in the annual financial report and Form 20-F is accumulated and communicated to senior management, including the Group Chief Executive Officer and Group Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Although the effectiveness of these procedures has been evaluated it should be recognised that there are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention of overriding controls. Accordingly, the Group's disclosure controls and procedures provide reasonable assurance, not absolute assurance, of achieving their objectives.

Management, with the participation of the Group Chief Executive Officer and Group Chief Financial Officer, has evaluated the effectiveness of the Group's disclosure controls and procedures (as defined in the rules of the United States Securities and Exchange Commission) as of the end of the period covered by this report and has concluded that such disclosure controls and procedures are effective.

### **Management report on internal control over financial reporting**

Management of the Group is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13(a)–15(f) under the *Securities Exchange Act of 1934*, as amended. Although the framework is tested it should be recognised that there are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention of overriding controls. Accordingly, even effective internal control can only provide reasonable assurance with respect to financial statement preparation.

Management assessed the effectiveness of the Group's internal control over financial reporting as of September 30, 2006 based on the framework set forth by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based on that assessment, management concluded that, as of September 30, 2006, the Group's internal control over financial reporting is effective.

Management's assessment of the effectiveness of the Group's internal control over financial reporting as of September 30, 2006, has been audited by Ernst & Young, an independent registered public accounting firm. As stated in their report appearing on page 265, Ernst & Young have expressed an unqualified opinion on management's assessment of the effectiveness of the Group's internal control over financial reporting as of September 30, 2006.

### **Changes in the Group's internal control over financial reporting that occurred during the 2006 year**

The Group made certain disclosures in the annual financial report 2005 around disclosure controls and procedures that also impact internal control over financial reporting. Enhancements were made to the Group's internal control over financial reporting during the year. Specifically, the following changes were made over the previously identified deficiencies to address these issues in all material respects:

**Reconciliation with US GAAP**

Following weaknesses identified in the process for completing the US GAAP reconciliation in the annual financial report 2005, the Group has undertaken a review of its US GAAP reporting process. In order to ensure the controls and procedures were improved to support the financial statements at year-end, the Group made the following changes in the Group's internal control over financial reporting with regards to reconciling with US GAAP:

reviewed and redesigned the end to end process for reporting US GAAP;

increased the focus and number of resources skilled in US GAAP; and

increased the amount of US GAAP reconciliation analysis and documentation.

**Extent of manual processes necessary in order to compensate for the identified system deficiencies**

In the annual financial report 2005, it was highlighted that while the core financial systems of the Group were sound and controlled effectively, there were a significant number of manual processes involved in the production of the financial statements. Where manual controls have been identified in the key processes supporting the preparation of the financial report, these have been reviewed, tested and where appropriate redesigned to ensure that the controls were designed and operating effectively to support the production of the annual financial report 2006.

**Discovery of unauthorised trading in foreign currency options**

In the Annual Financial Report 2005, an update was provided on the progress made towards resolution of the control issues identified through the investigation into losses incurred following unauthorised trading in foreign currency options, announced by the Group in January 2004. In the annual financial report 2005, the Group identified that there were four key issues still requiring further remediation.

These were:

design and implementation of improved governance structures;

validation of complex models;

regular reconciliation of key data flows; and

improvements to the corporate culture.

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Issues relating to the reconciliation of key data flows and the validation of models, as they pertain to the annual financial report, have been resolved. The controls over those data flows and models that drive valuations impacting the production of the annual financial statements have been satisfactorily tested as part of the overall program of management review of the internal control framework over financial reporting.

*Refer to page 15 for information regarding the resolution of culture and governance related issues.*

## **Corporate governance**

The Board of directors of the Company is responsible for the governance of the Company and its controlled entities. Corporate governance is vitally important in the Group and is undertaken with due regard to all of the Group's stakeholders including the communities in which it operates. Good corporate governance is a fundamental part of the culture and the business practices of the Group. The main corporate governance practices for the 2006 year are outlined in this section.

## **The roles of the Board and management**

The Board has adopted a formal charter that details the functions and responsibilities of the Board which may be found on the Group's website at [www.nabgroup.com](http://www.nabgroup.com)

The Board's most significant responsibilities are:

*Stakeholder interests*

**serving in the interests of long term sustainable returns for shareholders with regard to the interests of other stakeholders including customers, regulators, staff and the communities in the regions in which the Group operates;**

**building trust in the Group through consistent business performance, behaviour, transparency and accountability; and**



reviewing and monitoring corporate governance and corporate social responsibility throughout the Group;

**Strategy**

**reviewing, approving and monitoring corporate strategy and plans;**

**making decisions concerning the Group s capital structure and dividend policy;  
and**

**reviewing, approving and monitoring major investment and strategic commitments and the Group risk appetite;**

**Performance**

**reviewing business results; and**

**monitoring budgetary controls;**

**Integrity of external reporting**

**reviewing and monitoring the processes, controls and procedures which are in place to maintain the integrity of the Group's accounting and financial records and statements; and**

**reviewing and monitoring reporting to shareholders and regulators, including the provision of objective, comprehensive, factual and timely information to the various markets in which the Company's securities are listed;**

**Risk management and compliance**

**monitoring and reviewing the risk management processes, the Group's risk profile and processes for compliance with prudential regulations and standards and other regulatory requirements; and**



**reviewing and monitoring processes for the maintenance of adequate credit quality;**

Executive review, succession planning and culture

**approving key executive appointments and remuneration, and monitoring and reviewing executive succession planning;**

**reviewing and monitoring the performance of the Group Chief Executive Officer and senior management; and**

**monitoring and influencing the Group s culture, reputation and ethical standards; and**

**Board performance**

**monitoring Board composition, director selection, Board processes and performance with the Nomination Committee s guidance.**

The Board has delegated authority and responsibility to the Group Chief Executive Officer to manage the day-to-day affairs of the Group. These authorities are broad ranging and are subject to strict limits. They may be sub-delegated. The delegated authorities and responsibilities include:

**strategic development and implementing Board approved strategies;**

**the achievement of operational plans within both a comprehensive risk management framework and the corporate principles;**

**developing appropriate corporate culture; and**



**sound relationship management with the Group s stakeholders.**



**Composition of the Board**

The Board requires that each of its directors possess unquestionable integrity and character. The Nomination Committee assists the Board in identifying other appropriate skills and characteristics required for the Board and individual directors in order for the Company to fulfill its goals and responsibilities to shareholders and other key stakeholders.

The composition of the Board is based on the following factors:

**the Board will be of a size to assist in efficient decision making;**

**the Chairman of the Board should be an independent non-executive director;**

**the Chairman must not be a former executive officer of the Group;**

**the Board should comprise a majority of independent non-executive directors;  
and**

**the Board should comprise directors with a broad range of expertise, skills and experience from a diverse range of backgrounds including sufficient skills and experience appropriate to the Group s business.**



The Board is composed of a majority of independent non-executive directors. There are three executive directors and ten independent non-executive directors. The role of Chairman and that of Group Chief Executive Officer are held by two separate individuals. The Chairman is an independent non-executive director and the Group Chief Executive Officer is an executive director. The other executive directors are the Executive Director and Chief Executive Officer, Australia and the Group Chief Financial Officer.

In 2006, APRA introduced Prudential Standard 520. This requires directors, senior management and auditors of an authorised deposit-taking institution to be assessed to determine whether or not they have the appropriate skills, experience and knowledge to perform their role. They also need to be able to establish that they have acted with honesty and integrity.

A Fit and Proper policy that meets the requirements of the Prudential Standard has been approved by the Board and implemented by the Company. The assessment process includes police checks and confirming the authenticity of academic records and employment history. All responsible persons, as defined by the standard, have been assessed as meeting the criteria to ensure that they are fit and proper.

*The skills, experience, expertise and commencement dates of the directors are set out in the report on the directors and officers.*

**Independence of directors**

Directors are expected to bring independent views and judgment to Board deliberations. In assessing whether a director is independent the Board has regard to the standards it has adopted that reflect independence requirements of applicable laws, rules and regulations, including the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations, the corporate governance standards of New York Stock Exchange, Inc. and the US *Sarbanes-Oxley Act of 2002*.

An independent director must be independent of management and free to exercise unfettered and independent judgment. They must provide all relevant information to allow a regular assessment of their independence.

The Board considers that all of the non-executive directors are independent. The non-executive directors regularly meet informally, without the Group Chief Executive Officer, other executive directors and other members of management present.

The independent directors are identified (with their period in office) in the report on the directors and officers.

*Disclosure of related party transactions is set out in note 51 in the financial report.*

#### **Appointment and re-election of Board members**

The process for appointing a director is that, when a vacancy exists, the Board's Nomination Committee, identifies candidates with the appropriate expertise and experience, using external consultants as appropriate. The most suitable candidate is appointed by the Board but must stand for election by the shareholders at the next annual general meeting of the Company.

The Company has formal letters of appointment for each of its directors, setting out the key terms and conditions of the appointment.

The process for re-election of a director is in accordance with the Company's Constitution, which requires that, other than the Group Chief Executive Officer and those directors appointed during the year, one-third (or the nearest number to one-third) are required to retire by rotation at each annual general meeting and are eligible to stand for re-election. Directors appointed during the year to fill any vacancy must retire and stand for election.

Before each annual general meeting, the Board assesses the performance of each director due to stand for re-election, the Board decides whether to recommend to the shareholders that they vote in favor of the re-election of each director.

The Board has set a limit of 10 years for which an individual may serve as a director, subject to an annual review after this period. The Board regards this as an appropriate period of service. *(The commencement dates of the directors are set out in the report on the directors and officers on pages 67 to 70).* The retirement age for directors is fixed by the Company's Constitution at 70 years of age.

**Induction and continuing education**

Management, working with the Board, provides an orientation program for new directors. The program includes discussions with executives and management, reading material, tutorials and workshops. These cover the Group's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its Code of Conduct, its management structure, its internal and external audit programs, and directors' rights, duties and responsibilities.

Management periodically conducts additional presentations and tutorial sessions for directors about the Group, and the factors impacting, or likely to impact, on its businesses. These assist the non-executive directors to gain a broader understanding of the Group. Directors are also encouraged to keep up to date on topical issues.

**Board meetings**

The number of Board meetings and each director's attendance at those meetings are set out in the report on the directors and officers. Directors are expected to prepare adequately for, attend and participate at Board meetings and meetings of committees. Directors are also expected to attend on-site inspections. The Board meets once a year in the United Kingdom and in New Zealand, where the Company has significant business interests. This allows them to meet customers, employees and other stakeholders.

### **Board performance**

The Board conducts an annual assessment of its performance and an annual review of individual directors before they stand for re-election at the annual general meeting.

External experts are engaged as required to review many aspects of the Board's activities and to assist in a continuous improvement process to enhance the effectiveness of the Board.

In 2006, an external expert surveyed each member of the Board and members of senior management before preparing a report which was discussed by the Board as a whole. The Chairman reviewed the performance of individual members of the Board.

### **Remuneration of directors**

Shareholders determine the maximum total amount to be paid to non-executive directors. From this amount, the individual directors are remunerated based on a philosophy of compensating the directors at around the upper quartile of the market, having regard to the size and complexity of the Group.

The Remuneration Committee receives advice from independent experts on appropriate levels of director remuneration and guides the Board in respect of these matters.

The total directors' remuneration is disclosed as part of the shareholder approved aggregate amount and includes all statutory superannuation and all fees payable for work performed in relation to subsidiary company boards.

*The remuneration policy for the Board and the remuneration of each director is set out in the remuneration report which forms part of the report on the directors and officers, and in note 52 in the financial report.*

### **Remuneration of senior executives**

*The remuneration policy for senior executives is set out in the remuneration report and in note 52 in the financial report.*

## Conflicts of interest

Directors are expected to avoid any action, position or interest that conflicts or appears to conflict with an interest of the Group. A director who has a material personal interest in a matter relating to the Group's affairs must notify the other directors of that interest.

The *Corporations Act 2001* (Cth) together with the Company's Constitution require that a director who has a material personal interest in a matter that is being considered at a directors' meeting cannot be present while the matter is being considered at the meeting or vote on the matter, except in the following circumstances:

the directors without a material personal interest in the matter have passed a resolution that identifies the director, the nature and extent of the director's interest in the matter and its relation to the affairs of the Company, which states that the remaining directors are satisfied that the interest should not disqualify the director from voting or being present;

ASIC has made a declaration or order under the *Corporations Act 2001* (Cth), which permits the director to be present and vote even though the director has a material personal interest;

there are not enough directors to form a quorum for a directors' meeting because of the disqualification of the interested directors, in which event one or more of the directors (including a director with a material personal interest) may call a general meeting to address the matter; and

the matter is of a type which the *Corporations Act 2001* (Cth) specifically permits the director to vote upon and to be present at a directors' meeting during consideration of the matter notwithstanding the director's material personal interest.

Even though the *Corporations Act 2001* (Cth) and the Company's Constitution allow these exceptions, the Group's corporate governance standards provide that when a potential conflict of interest arises, the director concerned does not receive copies of the relevant Board papers and withdraws from the Board meeting while such matters are considered. Accordingly, in such circumstances the director concerned takes no part in discussions and exercises no influence over other members of the Board. If a significant conflict of interest with a director exists and cannot be resolved, the director is expected to tender his or her resignation after consultation with the Chairman.

Financial services are provided to directors under terms and conditions that would normally apply to the public. The provision of financial services to directors is subject to any applicable legal or regulatory restrictions, including the *Corporations Act 2001* (Cth) and the US *Sarbanes-Oxley Act of 2002*. Refer to note 51 in the financial report for further information.

## Transactions with related and other non-independent parties



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In the year to September 30, 2006 the Group had a number of related party transactions (*refer to note 51 in the financial report*). These transactions were made in the ordinary course of business and were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons or charged on the basis of equitable rates agreed between the parties. These transactions did not involve more than the normal risk of collectability or present other unfavorable features.

Other non-independent parties are parties that are able to negotiate terms of transactions that are not on an arm's length basis, but do not meet the definition of a related party. The Group is not aware of any relationships or transactions with such parties that would materially affect its financial position or results of operations.

### **Access to management**

Board members have complete and open access to management.

The Company Secretary provides advice and support to the Board and is responsible for the Group's day-to-day governance framework.

### **Access to independent professional advice**

Written guidelines entitle each director to seek independent professional advice at the Company's expense, with the prior approval of the Chairman.

The Board can conduct or direct any investigation to fulfill its responsibilities and can retain, at the Company's expense, any legal, accounting or other services, it considers necessary to perform its duties.

### **Confidential information**

The directors regard the confidentiality of customer information as highly important. The Group has a written policy about preserving confidentiality and fosters a culture to prevent the disclosure of confidential customer information outside the Group or the use of that information for the financial gain of any other entity (including any entity with which a director has an association).

**Restrictions on share dealings by directors**

Directors, officers and employees are subject to the *Corporations Act 2001* (Cth) restrictions on applying for, acquiring and disposing of securities in, or other relevant financial products of, the Company (or procuring another person to do so), if they are in possession of inside information. Inside information is that information which is not generally available, and which if it were generally available, a reasonable person would expect it to have a material effect on the price or value of the securities in, or other relevant financial products of, the Group.

Further, directors, officers and employees are prohibited from trading in the Company's securities during prescribed blackout periods prior to the release of the Group's annual and half-yearly results announcements. Directors, officers and certain employees are further required to notify their intention to trade in the Company's securities prior to trading.

There are also legal restrictions on insider trading imposed by the laws of other jurisdictions that apply to the Group and its directors, officers and employees.

The Group expressly prohibits directors or employees taking derivatives over unvested performance based remuneration or short term trading in any Company securities.

Directors, officers and employees must not trade in the shares of any other entity if inside information on such entity comes to their attention by virtue of their position as a director, officer or employee of the Group.

**Shareholding requirements**

Within two months of appointment, a director must hold at least 2,000 fully paid ordinary shares in the Company. Non-executive directors must receive or acquire at market prices the equivalent of at least 10% and up to 40% of their annual remuneration in the form of shares in the Company. Under the National Australia Bank Staff Share Ownership Plan, Australian resident directors are provided these shares as approved by shareholders. Executive directors may receive shares, performance options and performance rights as approved by shareholders.

*Details of all shareholdings by directors in the Company are set out in the report on the directors and officers and note 52 in the financial report.*

**Board and committee agendas**

Board and committee agendas are structured to assist the Board to meet its significant responsibilities. This includes the Board's consideration of strategy and the approval and monitoring of financial and other goals. The Board receives a detailed overview of the performance and significant issues faced by each business and the major risk elements for review.

Directors receive and discuss detailed financial, operational and strategy reports from management.

Clear guidelines have been established to enable matters raised by regulators to be promptly and effectively addressed and referred to the Board if necessary.

### **Board committees**

To help it carry out its responsibilities the Board has established the following committees and has adopted charters setting out the matters relevant to the composition, responsibilities and administration of these committees:

Risk Committee;

Audit Committee;

Nomination Committee; and

Remuneration Committee.

Other matters of special importance in relation to which Board committees are established include consideration of borrowing programs, projects, capital strategies, major investments and commitments, capital expenditure, delegation of authorities to act, and the allocation of resources.

The qualifications of each committee's members and the number of meetings they attended each year are set out in the report of directors.

### **Risk Committee**

#### **Membership**

The members of the Risk Committee are:

Mr Paul Rizzo (Chairman);

Ms Jillian Segal; and

Mrs Patrica Cross.

The members of the Risk Committee have a range of different backgrounds, skills and experiences, to enable them to have oversight of the operational, financial and strategic risk profile of the Group.

**Responsibilities and Risk Committee charter**

The roles, responsibilities, composition and membership requirements are documented in the Risk Committee charter approved by the Board, which may be found on the Group's website at [www.nabgroup.com](http://www.nabgroup.com)

The Risk Committee's responsibilities include:

review and oversight of the risk profile of the Group within the context of the Board determined risk appetite;

making recommendations to the Board concerning the Group's risk appetite and particular risks or risk management practices of concern to the Committee;

reviewing management's plans for mitigation of the material risks faced by the various business units of the Group; and

promotion of awareness of a risk based culture and the achievement of a balance between risk minimisation and reward for risks accepted.

#### **Activities during the year**

At each scheduled meeting, the Risk Committee received a report from the Group Chief Risk Officer and updates in relation to key matters from the general managers of the Group's key risk functions, being Portfolio Management, Traded Market Risk, Non-Traded Market Risk and Operational Risk. The Group's capital management position was also reviewed on regular basis with the Group Treasurer.

Key activities undertaken by the Risk Committee during the year include:

review of the budget and headcount of the Group's risk management function;

review of the Group's risk rating and escalation methodology with a continued focus on improving the quality of risk reporting to the Board;

review and recommendation to the Board of the Group's 2006 risk appetite statement;

review of the Group's risk and assurance management framework;

review of regional risk profiles and risk management processes;

review of the certifications from management in relation to the Group's compliance with applicable prudential standard obligations;



review of the certifications and assurances from internal audit and management in relation to the effectiveness of the Group's internal controls and risk management;

meetings without the presence of management with APRA; and

joint meetings with the Wealth Management risk committee and the Group's New Zealand and United Kingdom board risk committees to consider key local risk issues.

The charters and modes of operation developed for the Group Risk Management Committee, the Group Credit Risk Committee, the Group Market Risk Committee, Group Asset and Liability Committee and the Group Operational Risk and Compliance Committee were further refined in 2006 and each of the management in the committees were subject to rigorous performance reviews.

The Risk Committee met 13 times during the year.

*More comprehensive details on risk management appear on pages 15 to 23.*

**Audit Committee**

## Membership

The members of the Audit Committee are:

Mr John Thorn (Chairman);

Mr Daniel Gilbert;

Mr Kerry McDonald; and

Mr Paul Rizzo.

In December 2006, Mr Geoffrey Tomlinson and Mr Daniel Gilbert exchanged their positions on the Remuneration and Audit Committees respectively.

All members of the Audit Committee must be independent non-executive directors. Independence for these purposes is determined in accordance with the standard adopted by the Board, which reflects the independence requirements of applicable laws, rules and regulations, including those of the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations, the corporate governance standards of New York Stock Exchange, Inc. and the US *Sarbanes-Oxley Act of 2002*.

It is considered appropriate that members of the Audit Committee be financially literate and have a range of different backgrounds, skills and experiences, having regard to the operations, and financial and strategic risk profile of the Group. The Board recognises the importance of the Audit Committee having at least one member with appropriate accounting or financial expertise, as required by applicable laws, best practice guidelines and listing standards. All members of the Audit Committee are financially literate.

Members are appointed for an initial term of three years. The Audit Committee must consist of at least three members. Membership is reviewed every three years. Periodic rotation is encouraged so that no more than one committee member each year resigns as a result of periodic rotation.

The Chairman of the Board cannot be a member of the Audit Committee.

## Audit Committee financial expert

The Board has determined that Mr Thorn is an audit committee financial expert and is independent as defined in the listing standards of New York Stock Exchange, Inc. Although the Board has determined that Mr Thorn has the requisite attributes defined under the applicable rules of the US SEC, his responsibilities are the same as those of the other Audit Committee members.

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He is not an auditor or accountant for the Company, does not perform field work and is not an employee of the Company. The SEC has determined that an audit committee member who is designated as an audit committee financial expert will not be deemed as an expert for any purpose as a result of being identified as an audit committee financial expert. The Audit Committee is responsible for the oversight of management in the preparation of the Group's financial statements and financial disclosures. The Audit Committee relies on the information provided by management and the external auditor. The Audit Committee does not have the duty to plan or conduct audits or to determine that the Group's financial statements and disclosures are complete and accurate. These are the responsibility of management and the external auditor.

### **Responsibilities and Audit Committee charter**

The Audit Committee's role, responsibilities, composition and membership requirements are documented in the Audit Committee charter, which the Board has approved and may be found on the Group's website at [www.nabgroup.com](http://www.nabgroup.com)

The Audit Committee is responsible for review and oversight of:

the integrity of the accounting and financial reporting processes of the Group;

the Group's external audit;

the Group's internal audit; and

compliance with applicable accounting standards to give a true and fair view of the financial position and performance of the Group.

The Audit Committee met 12 times during the year.

The Audit Committee has the authority to conduct or direct any investigation required to fulfill its responsibilities and has the ability to retain, at the Company's expense, such legal, accounting or other advisers, consultants or experts as it considers necessary from time to time in the performance of its duties.

### **Activities during the year**

Key activities undertaken by the Audit Committee during the year include:

review of the scope of the annual audit plans for 2006 of the external auditor and internal auditor and overseeing the work performed by the auditors throughout the year;

review with management of significant accounting, financial reporting and other issues raised by the internal and external auditors;

review of the performance and independence of the external auditor and internal auditor together with their assurance that all applicable independence requirements were met;

meetings without the presence of management with the Group General Manager, Internal Audit and key partners from Ernst & Young;

consideration and recommendation to the Board on significant accounting policies and areas of accounting judgment;

review of the Group's certification process framework supporting the certifications from the Group Chief Executive Officer and Group Chief Financial Officer;

review of the certifications from the Group Chief Executive Officer and Group Chief Financial Officer; and

review and recommendation to the Board for the adoption of the Group's half-year and annual financial statements.

Senior representatives from Ernst & Young and Internal Audit attended every scheduled meeting of the Audit Committee throughout the period. A meeting of the Group's regional audit committee Chairmen was held in October 2006 at which key finance related issues from a regional and Group perspective were considered.

#### **Access to the Committee**

To draw appropriate matters to the attention of the Committee, the following individuals have direct access to the Committee: Group Chief Executive Officer; Group Chief Financial Officer; Deputy Group Chief Financial Officer; Group Financial Controller; Group Chief Risk Officer; Group General Counsel; General Manager, Internal Audit and the external auditor. Direct access means that the person has the right to approach the Committee without having to proceed via normal reporting line protocols.

Other employees of the Group may have access to the Audit Committee through the Whistleblower Protection Program. Refer to page 66 for further information on the Whistleblower Protection Program.

#### **Confidential financial submissions**

The Audit Committee has established procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters. It is a responsibility of the Audit Committee to ensure that employees can make confidential, anonymous submissions regarding such matters (refer to the Whistleblower Protection Program section on page 66 for further information).

#### **External auditor**

The Audit Committee is responsible for the selection, evaluation, compensation and, where appropriate, replacement of the external auditor, subject to shareholder approval where required.

The Audit Committee ensures that the external lead audit partner and concurring review partner rotate off the Group's audit at least every five years and that they are not reassigned to the Group's audit for another five years.

The Audit Committee meets with the external auditor throughout the year to review the adequacy of the existing external audit arrangements with particular emphasis on the scope, quality and independence of the audit.

The Audit Committee receives assurances from the external auditor that they meet all applicable independence requirements.

## Internal audit

The Audit Committee is responsible for assessing whether the Internal Audit function is independent of management and is adequately staffed and funded. The Committee also assesses the performance of the General Manager, Internal Audit and may recommend to the Board, the appointment and dismissal of this general manager.

## Audit Committee pre-approval policies and procedures

The Audit Committee is responsible for the oversight of the work of the external auditor. To assist it in discharging its oversight responsibility, the Audit Committee has adopted an External Auditor Independence Policy which requires it, among other things, to pre-approve all audit and non-audit services to be provided by the external auditor. The External Auditor Independence Policy incorporates auditor independence requirements of applicable laws, rules and regulations and applies these throughout the Group.

In accordance with the External Auditor Independence Policy, the external auditor may only provide a service to the Group if:

- (i) the external auditor is not prohibited from providing that service by applicable auditor independence laws, rules and regulations;
- (ii) in the opinion of the Audit Committee, the service does not otherwise impair the independence of the external auditor;
- (iii) in the opinion of the Audit Committee, there is a compelling reason for the external auditor to provide the service; and
- (iv) the service is specifically pre-approved by the Audit Committee.

The Audit Committee may set an annual fee limit for each type of audit or non-audit service to be provided by the external auditor. Unless the Audit Committee approves otherwise, the fees paid or due and payable to the external auditor for the provision of non-audit services in any financial year must not exceed the fees paid or due and payable to the external auditor for audit services in that year.

The Audit Committee may delegate to the Audit Committee Chairman or any other member of the Audit Committee the authority to pre-approve audit and non-audit services to be provided by the external auditor. The decision of any delegate to specifically pre-approve any audit or non-audit service is presented to the Audit Committee at its next scheduled meeting. The Audit Committee has delegated the authority to pre-approve audit and non-audit services to the Audit Committee Chairman.

*Details of the services provided by Ernst & Young to the Group and the fees paid or due and payable for those services are set out in the report on the directors and officers and note 53 in the financial report.*

**Remuneration Committee**



## Membership

The Remuneration Committee's members are:

Mr Peter Duncan (Chairman);

Mr Geoffrey Tomlinson; and  
Ms Jillian Segal.

In December 2006, Mr Geoffrey Tomlinson and Mr Daniel Gilbert exchanged their positions on the Remuneration and Audit Committees respectively.

## Responsibilities and Remuneration Committee charter

The Remuneration Committee's role, responsibilities, composition and membership requirements are documented in a Remuneration Committee charter approved by the Board, which is available on the Group's website at [www.nabgroup.com](http://www.nabgroup.com)

The responsibilities of the Remuneration Committee are to:

oversee the Group's general remuneration strategy;

monitor, review and make recommendations to the Board concerning:

remuneration policy and Total Reward for the Group Chief Executive Officer, and for senior executives who report directly to him;

remuneration arrangements for non-executive Board directors (as listed on page 92);

arrangements for recruiting, retaining and terminating senior executives;

key appointments and proposals for the executive succession planning process;

support the Board with monitoring the Group's culture, and the process for managing behaviours against quality gates and standards.

*The remuneration policy for senior executives is set out in the remuneration report.*

#### **Activities during the year**

Key activities undertaken by the Remuneration Committee during the year include:

reviewing and recommending to the Board the remuneration package for the Group Chief Executive Officer and other senior executives;

reviewing and recommending to the Board the incentives payable to senior executives based on performance criteria structured on increasing shareholder value;

reviewing employee equity plans and allocations;

reviewing remuneration of non-executive directors of subsidiary companies;

reviewing and monitoring the Group's people and culture dashboard at regular intervals; and

monitoring the Group's efforts to improve diversity in the workforce.

#### **Nomination Committee**

## **Membership**

The Nomination Committee's members are:

Mr Michael Chaney (Chairman);  
Mrs Patricia Cross;

Mr Peter Duncan;  
Mr Daniel Gilbert;

Mr Kerry McDonald;

Mr Paul Rizzo;

Ms Jillian Segal;

Mr John Thorn;  
Mr Geoffrey Tomlinson; and  
Mr Malcolm Williamson.

All members of the Nomination Committee are independent directors.

## **Responsibilities and Nomination Committee charter**

The Nomination Committee's role, responsibilities, composition and membership requirements are documented in a Nomination Committee charter, approved by the Board, which is available on the Group's website at [www.nabgroup.com](http://www.nabgroup.com)

The Nomination Committee is responsible for review and oversight of:

Board performance and the methodology for Board performance reviews;

Board and Committee membership and composition; and

succession planning for the Board and senior management.

## **Activities during the year**

Key activities undertaken by the Nomination Committee during the year include:

- determining the methodology for the annual Board performance review;
- assessing the appropriate size and composition of the Board; and
- reviewing Committee membership.

#### **Controlled entities**

The activities of every company in the Group are overseen by its own board of directors.

Directors of each of these controlled entities are given corporate governance guidelines, approved by the Board. The guidelines describe the specific roles, duties, responsibilities and rights of the directors of controlled entities and the key expectations that the Board has of the boards of controlled entities. The guidelines have been specifically tailored for the different types of entities depending on the nature of their business and their activities.

Mr Geoffrey Tomlinson is the Chairman of National Wealth Management Holdings Limited, and certain wealth management controlled entities. Mr Malcolm Williamson is the Chairman of National Australia Group Europe Limited and of Clydesdale Bank PLC. Mr Kerry McDonald is Chairman of Bank of New Zealand. The Board's confidence in the activities of a controlled entity board is based on having a high quality controlled entity board committed to the Group's objectives.

There is a standing invitation to all of the Company's directors to attend any board meeting of a controlled entity through consultation with the Chairman. Such visits are undertaken to develop a broader understanding of the Group's total operations.

#### **Communicating with shareholders**

#### **Strategy**

The Group aims to be open and transparent with all stakeholders, including the owners of the business – the shareholders. Information is communicated to shareholders regularly through a range of forums and publications and online. These include:

- the Company's annual general meeting;
- notices and explanatory memoranda of annual general meetings;

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the concise annual report (unless a shareholder has requested not to receive this);

the annual financial report (for those shareholders who have requested a copy);

disclosures to the stock exchanges in Australia, London, Luxembourg, New York, New Zealand and Switzerland, and to ASIC and the SEC;

letters from the Chairman to specifically inform shareholders of key matters of interest; and

the Group's website at [www.nabgroup.com](http://www.nabgroup.com) where there is a Shareholder Centre which includes access to Company announcements, media releases and investor presentations.

In 2006, the Company conducted surveys and focus groups to better understand the communications needs of its retail shareholders. In response to the feedback received, the Company will be seeking to further improve the style and content of its shareholder communications in the next 12 months.

### **Meetings**

The notice of annual general meeting details the business to be considered by shareholders and details about each candidate standing for election or re-election as a director of the Company. For those shareholders who are unable to attend the meeting, the Company provides a webcast. The Company's external auditor attends the meeting to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.

### **Continuous disclosure**

The Company's policy is that shareholders are informed of all major developments that impact on the Group. There is a detailed disclosure policy in place, which is intended to maintain the market integrity and market efficiency of the Company's securities. The policy may be found on the Group's website [www.nabgroup.com](http://www.nabgroup.com)

The Company has established written guidelines and procedures to supplement the disclosure policy which are designed to manage the Company's compliance with the continuous disclosure obligations to the various stock exchanges on which the Company's securities are listed (including ASX) and to attribute accountability at a management level for that compliance.

### **ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations**

Under recommendation 7.2 of the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice recommendations, the Group Chief Executive Officer and the Group Chief Financial Officer are required to state to the Board in writing that the certifications they give to the Board under Recommendation 4.1 (as to the integrity of the Company's financial statements) are founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board, and that the Company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.

The statement given to the Board by the Group Chief Executive Officer and the Group Chief Financial Officer with respect to the Company's financial statements for the 6 months ended March 31, 2006 was qualified by reference to matters that had been previously reported (namely, the discovery in 2004 of unauthorised trading in foreign currency options and the extent of manual processes necessary in order to compensate for certain identified systems deficiencies). Those matters, and the steps taken to address them, are described in more detail on page 57.

Throughout 2006 the Company complied with the Recommendations contained in the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations in all other respects.

**Comparison of the Company's practices with New York Stock Exchange, Inc. Corporate Governance Standards**

Under section 303A of the New York Stock Exchange Listing Manual (New York Stock Exchange Corporate Governance Standards), non-US companies are permitted to follow the corporate governance requirements of their home country in lieu of the requirements of the New York Stock Exchange Corporate Governance Standards, except for certain requirements pertaining to audit committees, and certain disclosure obligations. One of those disclosure obligations is to compare the corporate governance practices of the Company with those required of domestic US companies under the New York Stock Exchange Corporate Governance Standards, and to disclose a brief and general summary of the significant differences. The significant differences identified are as follows:

**Audit Committee** since the Company is not required to prepare annual proxy statements under US law, the Company does not prepare an audit committee report for inclusion in such annual proxy statements. Further, the Risk Committee, rather than the Audit Committee, has responsibility for the discussion of policies with respect to risk assessment and risk management; and

**Equity compensation plans** the Company is not required under Australian law to provide shareholders with the opportunity to vote on new equity compensation plans. It is also not required by Australian law to provide shareholders with the opportunity to vote on material revisions to existing equity compensation plans (as listed in note 41 in the financial report) other than in respect of certain changes to the terms of options that require shareholder approval under ASX Listing Rule 6.23. However, the issue of shares, performance options or performance rights to directors (whether pursuant to an equity compensation plan or otherwise) is subject to approval of shareholders.

**Ethical standards**

The Board has worked with management to develop a set of Corporate Principles, as the basis for the Group's core beliefs and values. The five principles are:

we will be open and honest;

we take ownership and hold ourselves accountable (for all of our actions);

we expect teamwork and collaboration across our organisation for the benefit of all stakeholders;

we treat everyone with fairness and respect; and

we value speed, simplicity and efficient execution of our promises.

The Group reward strategy and performance management process are aligned to the Group's Principles.

The Corporate Principles are reinforced by the Company's Code of Conduct, which requires the observance of strict ethical guidelines. The Code of Conduct applies to all employees of the Group, as well as to directors, and temporary workers. In addition the Board charter also governs the conduct of the Board and each director.

The Code of Conduct covers:

Nomination Committee

personal conduct;

honesty;

relations with customers;



prevention of fraud;

financial advice to customers;

conflict of interest; and

disclosure.

All Australian employees must complete mandatory compliance training in a range of topics, including the Code of Conduct, the Code of Banking Practice, privacy, disability and trade practices.

The Group regularly reviews its relationships with the external suppliers of goods and services. Organisations with high ethical standards are favourably considered. Where there is transition of management between the Group and major suppliers or customers, appropriate confidentiality and independence issues are addressed in both principle and process.

The Board supports the code of conduct issued by the Australian Institute of Company Directors.

The Group has also adopted a code of conduct for financial professionals which applies to the Group Chief Executive Officer, Group Chief Financial Officer and all employees serving in finance, accounting, tax or investor relations roles. This code of conduct is available on the Group's website at [www.nabgroup.com](http://www.nabgroup.com)

The Company supports the Code of Banking Practice 2003 of the Australian Bankers' Association, which includes:

major commitments and obligations to customers;

principles of conduct; and

the roles and responsibilities of an independent external body, the Code of Compliance Monitoring Committee, which investigates complaints about non-compliance.

#### **Whistleblower Protection Program**

The Group has a Whistleblower Protection Program for confidential reporting of unacceptable or undesirable conduct. The system enables disclosures to be made to a protected disclosure officer by the Group's employees, or, where applicable, if the matter is highly sensitive and the employee believes it more appropriate, direct to the Audit Committee.

The Group does not tolerate incidents of fraud, corrupt conduct, adverse behaviour, legal or regulatory non-compliance, or questionable accounting and auditing matters by its employees.

The Company will take all reasonable steps to protect a person who comes forward to disclose unacceptable or undesirable conduct, including disciplinary action, or potentially dismissed, of any person taking reprisals against them.

Staff are also urged to escalate any issues they believe could have a material impact on the Group's profitability, reputation, governance or compliance.

**Report on the directors and officers**

**Principal activities and significant changes in nature of activities**

The principal activities of the Group during the year were banking services, credit and access card facilities, leasing, housing and general finance, international banking, investment banking, wealth management, funds management, life insurance, and custodian, trustee and nominee services.

**Review of operations and Group results**

*A review of the operations of the Group, and the results of those operations, is contained in the financial review on pages 32 to 33 of the annual financial report. These sections are incorporated by reference into and form part of this report on the directors and officers.*

**Directors**

Details of directors of the Company in office as of November 30, 2006, and each director's qualifications, experience and special responsibilities (or holding office during the year) are below:

**Mr Michael A Chaney** AO, BSc, MBA, Hon. LLD Western Australia, FAIM, FAICD



*Term of office:* Chairman since September 2005 and director since December 2004.

*Independent:* Yes

*Skills & Experience:* 22 years with Wesfarmers Limited, including Managing Director and Chief Executive Officer from 1992 until July 2005. Three years with investment bank Australian Industry Development Corporation, 1980 to 1983.



**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Director of Woodside Petroleum Ltd (since December 2005)

Chairman of Gresham Partners Holdings Limited (since July 2005 - director since 1985)

Director of Centre for Independent Studies (since October 2000)

Chairman of Australian Research Alliance for Children and Youth Limited (since July 2002)

President of Business Council of Australia (since October 2005)

Chancellor of University of Western Australia (since January 2006)

Council member of Australian National Gallery (since December 2000)

Member of JP Morgan International Advisory Council (since October 2003)

Governor of the Committee for the Economic Development of Australia (CEDA) (since July 2005)

Former Director of BHP Billiton Limited (from May 1995 to November 2005) & BHP Billiton Plc (from June 2001 to November 2005)

***Board Committee membership***

Chairman of the Nomination Committee

**Mr John M Stewart** BA, ACII, FCIB





*Term of office:* Director since August 2003. Managing Director and Group Chief Executive Officer from February 2004.

*Independent:* No

*Skills & Experience:* 26 years in banking and finance in the United Kingdom including four years as Group Chief Executive of Woolwich PLC until its acquisition by Barclays PLC in 2000 when he was appointed Deputy Group Chief Executive of Barclays PLC.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Member of the Business Council of Australia (since August 2005)

**Mrs Patricia A Cross** BSc (Hons), FAICD, FAIM

*Term of office:* Director since December 2005.

*Independent:* Yes

*Skills & Experience:* 25 years in international banking and finance, including management and senior executive roles in Europe, the United States and Australia with Chase Manhattan Bank, Banque Nationale de Paris and National Australia Bank. Mrs Cross is a Fellow of the Finance and Treasury Association and was a founding member of the Financial Sector Advisory Council to the Federal Treasurer serving for five years until 2003. In 2003, she received a Centenary Medal for service to Australian society through the finance industry.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Director of Wesfarmers Limited (since February 2003)

Qantas Airways Limited (since January 2004)

Director of Murdoch Childrens Research Institute (since August 2005)

***Board Committee membership***

Member of the Risk Committee

Member of the Nomination Committee

**Mr Peter JB Duncan** BE (Chem) (1<sup>st</sup> Class Hons), DBS (with Distinction)



*Term of office:* Director since November 2001.

*Independent:* Yes

*Skills & Experience:* 36 years with Royal Dutch/Shell Group of companies, including senior finance and general management positions in Australia, New Zealand, South America, Europe and South East Asia. He was Chairman of the Shell Group of Companies in Australia and New Zealand. Former Chairman of the Australian Institute of Petroleum.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Chairman of Cranlana Programme (since August 2006)

Chairman of Scania Australia Pty Limited (since August 2003)

Director of Orica Limited (since June 2001)

Former Director of GasNet Australia Limited (from October 2001 to September 2005)

Former Director of CSIRO (from June 2002 to September 2005)

Governor of the Committee for the Economic Development of Australia (CEDA) (since March 2003)

President of the Australian German Association (from September 2001 to 2005)

***Board Committee membership***

Chairman of the Remuneration Committee

Member of the Nomination Committee

**Mr Ahmed Fahour** BEc (Hons), MBA, FAIM





*Term of office:* Director since October 2004. Chief Executive Officer, Australia since September 2004.

*Independent:* No

*Skills & Experience:* 20 years in economics and finance, most recently as Chief Executive Officer, Australia and New Zealand, Citigroup in 2004, and he held senior management positions in Citigroup from 2000 to 2003 including Chief Executive Officer and Vice Chairman of Citigroup Investment Ltd. Previously Managing Director, iFormation Private Equity Group and a director of Boston Consulting Group from 1995 to 1999. He is an honorary Business Ambassador for Melbourne's North.



**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Rip Curl Group Pty Ltd. (since July 2004)

**Mr Daniel T Gilbert** AM, LLB



*Term of office:* Director since September 2004.

*Independent:* Yes

*Skills & Experience:* 30 years in commercial law, specialising in technology and corporate law.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Managing Partner of Gilbert + Tobin (which he co-founded in 1988)

Former Chairman of Australian Film, Television & Radio School (from 2000 to July 2006)

***Board Committee membership***

Member of the Audit Committee

Member of the Nomination Committee

**Mr Thomas (Kerry) McDonald** BCom, MCom (Hons), AFID, FNZIM





*Term of office:* Director since December 2005.

*Independent:* Yes

*Skills & Experience:* 40 years in economic consulting, energy, resources, logistics and banking in Australia and New Zealand with a particular interest in organisation performance and improvement.

He was a senior executive of Comalco from 1981 and Managing Director and member of the Comalco Group Executive Committee from 1988 to 2000.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Chairman of Bank of New Zealand (director since August 1991)

Chairman of Advanced Dynamics NZ Ltd (since April 2003)

Deputy Chairman of NZ Institute of Economic Research (since October 2002) (Trustee and Director since 1989)

Vice Chairman of Oceana Gold Limited (director since December 2003)

Director of Ports of Auckland (from August 2002)

Director of Gough Gough & Hamer Limited (since August 2000)

Former Director of Carter Holt Harvey Limited (from April 1998 until December 2005)

Former Director of Dux Industries Limited (from March 2001 to November 2005)

Former NZ Chairman of Australia-New Zealand Leadership Forum (from 2004 to 2006)

Trustee and Member of the Board of Management of the NZ Business & Parliament Trust

Life Member of Australia New Zealand Business council

Member of the Governing Board of Antarctica New Zealand (since July 2003)

Member of National Council and Wellington Chairman, Institute of Directors, New Zealand

***Board Committee membership***

Member of the Audit Committee

Member of the Nomination Committee

**Mr Paul J Rizzo** BCom, MBA



*Term of office:* Director since September 2004.

*Independent:* Yes

*Skills & Experience:* 36 years in banking and finance. Formerly Dean and director of Melbourne Business School from 2000 to 2004, Group Managing Director, Finance and Administration, Telstra Corporation Limited from 1993 to 2000, senior roles at Commonwealth Bank of Australia from 1991 to 1993, Chief Executive Officer of State Bank of Victoria in 1990 and 24 years with Australia and New Zealand Banking Ltd from 1966 to 1990.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Director of BlueScope Steel Limited (since May 2002)

Consultant director to Mallesons Stephen Jaques (since August 2002)

Director of Villa Maria Society (since July 2006)

Chairman of the Foundation for Very Special Kids (since July 2004)

***Board Committee membership***

Chairman of the Risk Committee

Member of the Audit Committee

Member of the Nomination Committee

**Ms Jillian S Segal** AM, BA, LLB, LLM (Harvard), FAICD





*Term of office:* Director since September 2004.

*Independent:* Yes

*Skills & Experience:* 20 years as a lawyer and regulator, most recently at the Australian Securities and Investments Commission from 1997 to 2002 as Commissioner and then Deputy Chairman and as Chairman of the Board of the Banking & Financial Services Ombudsman from 2002 to 2004. She was an environmental and corporate partner and consultant at Allen Allen & Hemsley and worked for Davis Polk & Wardwell in New York.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Director of Australian Stock Exchange Limited (since July 2003)

Member of Australia Council's Major Performing Arts Board (since February 2003)

Member of University of New South Wales Council (since February 2006)

President of the Administrative Review Council (since September 2005)

***Board Committee membership***

Member of the Risk Committee

Member of the Remuneration Committee

Member of the Nomination Committee

**Mr John G Thorn FCA**

***Term of office:*** Director since October 2003.

***Independent:*** Yes

***Skills & Experience:*** 37 years in professional services with PricewaterhouseCoopers, over 20 years as a partner responsible for significant international and Australian clients. Australian National Managing Partner and a member of the Global Audit Management Group until 2003.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Director of Amcor Limited (since December 2004)

Director of Caltex Australia Limited (since June 2004)

Director of Salmat Limited (since September 2003)

***Board Committee membership***

Chairman of the Audit Committee

Member of the Nomination Committee

**Mr Geoffrey A Tomlinson BEc**

***Term of office:*** Director since March 2000.

***Independent:*** Yes

***Skills & Experience:*** 29 years with the National Mutual Group, six years as Group Managing Director and Chief Executive Officer until 1998.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Chairman of National Wealth Management Holdings (since August 2000) subsidiary of the National

Chairman of Dyno Nobel Limited (since February 2006)

Chairman of Programmed Maintenance Services Ltd. (since October 1999)

Director of Amcor Limited (since March 1999)

Former Deputy Chairman of Hansen Technologies (director since March 2000)

Former Director of Funtastic Limited (from May 2000 to May 2006)

Former Director of Mirrabooka Investments Limited (from February 1999 to March 2006)

Former Director of Reckon Limited (from June 1999 to August 2004)

***Board Committee membership***

Member of the Remuneration Committee

Member of the Nomination Committee

**Mr Michael J Ullmer** BSc (Maths) (Hons), FCA, SF Fin



*Term of office:* Director since October 2004. Group Chief Financial Officer from September 2004.

*Independent:* No

*Skills & Experience:* 32 years in banking and finance, including seven years with Commonwealth Bank of Australia as Group Executive, Institutional and Business Services from 2002 to 2004 and Group Executive, Financial and Risk Management from 1997 to 2002. Formerly partner of Coopers & Lybrand from 1992 to 1997 and 20 years with KPMG including partner from 1982 to 1992.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Former Director of Sydney Symphony Pty Ltd (from February 1996 to March 2005)

**Mr G Malcolm Williamson**





*Term of office:* Director since May 2004.

*Independent:* Yes

*Skills & Experience:* 49 years in banking and finance in the United Kingdom and the United States. He served with Barclays PLC from 1957 to 1985, reaching the position of Regional General Manager, London. This was followed by a period as a member of the Post Office board and Managing Director of Girobank PLC. In 1989, he joined Standard Chartered PLC and became Group Chief Executive. In 1998, he moved to the United States and took up the role of President and Chief Executive Officer of Visa International, which he held until 2004.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

Chairman of National Australia Group Europe Limited and select subsidiaries (since June 2004)

Chairman of Signet Group PLC (director since November 2005 and Chairman since June 2006)

Deputy Chairman and Senior Independent Director Resolution PLC (since September 2005)

Director of JP Morgan Cazenove Holdings (since April 2005)

Chairman of CDC Group PLC (director since January 2004 and Chairman since July 2004)

Director of the Prince of Wales International Business Leaders Forum (since February 2006)

Director of Group 4 Securicor PLC (since May 2004)

Former Chairman of Britannic Group PLC (from October 2004 to September 2005)

Former Director of Securicor PLC (from April 2004 to May 2004)

***Board Committee membership***

Member of the Nomination Committee



**Company Secretaries**



**Details of company secretaries of the Company in office as at November 30, 2006, and each company secretary's qualifications and experience are below:**





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**Ms Michaela J Healey** LLB, FCIS was appointed Company Secretary in April 2006. She has experience in a range of corporate legal roles in listed companies and was formerly Company Secretary of Orica Limited and North Limited. The Company Secretary advises and supports the Board to enable the Board to fulfill its role.

**Mr Brendan T Case** BEc, GDip App Fin, Dip Fin Plan, CPA, ACIS joined the Group in 1997 and has held the position of Associate Company Secretary since 2003. He is Head of the Risk Committee and the Audit Committee Secretariat. He has senior management experience in corporate finance, corporate governance and financial planning.

**Mr Garry F Nolan** was Company Secretary from June 1992 until September 29, 2006.



**Board changes**



**Mr Robert G Elstone** BA (Hons), MA (Econ), MCom

*Term of office:* Director from September 2004 to July 5, 2006. Mr Robert Elstone retired as non-executive director and Chairman of the Risk Committee on July 5, 2006 following his appointment as Managing Director and Chief Executive Officer of the Australian Stock Exchange. (Mr Paul Rizzo was appointed Chairman of the Risk Committee upon Mr Elstone's retirement.)

*Skills & Experience:* 25 years in financial and senior management roles and has been Managing Director and Chief Executive Officer of SFE Corporation Limited since 2000. Formerly Finance Director of Pioneer International Limited from 1995 to 2000 and Chief Financial Officer of Air New Zealand Limited from 1991 to 1994. Mr Elstone is an Honorary Fellow of the Finance and Treasury Association and has completed the senior management programs at the Harvard and Stanford business schools.

**Directorships of listed entities within the last three years, other directorships and offices (*current & recent*)**

SFE Corporation Limited related entities, including the Sydney Futures Exchange, SFE Clearing Corporation and Austraclear Limited

**Directors and officers indemnity**

*The Company's constitution*





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Article 21 of the Company's constitution provides:

Every person who is or has been an officer is entitled to be indemnified out of the property of the Company to the relevant extent against:

every liability incurred by the person in the capacity as an officer (except a liability for legal costs); and

all legal costs incurred in defending or resisting (or otherwise in connection with) proceedings, whether civil, criminal or of an administrative or investigatory nature, in which the officer becomes involved in that capacity, unless:

the Company is forbidden by statute to indemnify the person against the liability or legal costs; or

an indemnity by the Company of the person against the liability or legal costs would, if given, be made void by statute.

The reference to the relevant extent means to the extent and for the amount that the officer is not otherwise entitled to be indemnified and is not actually indemnified.

The Company may also pay, or agree to pay, whether directly or through an interposed entity, a premium for a contract insuring a person who is or has been an officer against liability incurred by the person in their capacity as an officer, including a liability for legal costs, unless:

the Company is forbidden by statute to pay or agree to pay the premium; or

the contract would, if the Company paid the premium, be made void by statute.

The Company may enter into a contract with an officer or former officer to give:

effect to the rights of the officer or former officer conferred by Article 21; and

an officer or former officer access to papers, including those documents provided from or on behalf of the Company or a related body corporate of the Company to the officer during their appointment and those documents which are referred to in such documents or were made available to the officer for the purpose of carrying out their duties as an officer.

Article 21 does not limit any right the officer otherwise has. In the context of Article 21, officer means a director, secretary or executive officer of the Company or of a related body corporate of the Company.

The Company has executed deeds of indemnity in terms of Article 21 in favour of each director of the Company and certain non-executive directors of related bodies corporate of the Company. Some Companies within the Group have extended equivalent deeds of indemnity in favour of directors of those companies.

**Directors and officers insurance**

During the year, the Company, pursuant to Article 21, paid a premium for a contract insuring all directors, secretaries, executive officers and officers of the Company and of each related body corporate of the Company. The insurance does not provide cover for the independent auditors of the Company or of a related body corporate of the Company.

In accordance with usual commercial practice, the insurance contract prohibits disclosure of details of the nature of the liabilities covered by the insurance, the limit of indemnity and the amount of the premium paid under the contract.

### **Dividends**

The directors declared a final dividend of 84 cents per fully paid ordinary share, 90% franked, which was paid on December 12, 2006. The payment amount was estimated to be \$1,352 million as at November 30, 2006.

Dividends paid since the end of the previous financial year:

the final dividend for the year ended September 30, 2005 of 83 cents per fully paid ordinary share, 80% franked, paid on December 19, 2005. The payment amount was \$1,327 million.

the interim dividend for the year ended September 30, 2006 of 83 cents per fully paid ordinary share, 80% franked, paid on July 13, 2006. The payment amount was \$1,334 million.

*Information on the dividends paid and declared to date is contained in note 7 in the financial report.*

The franked portion of these dividends carries imputation tax credits at a tax rate of 30%, reflecting the current Australian company tax rate of 30%. For non-resident shareholders of the Company for Australian taxation purposes, the unfranked portion of the dividend will be declared to be conduit foreign income. Accordingly, for non-resident shareholders the unfranked portion of the dividend will not be subject to Australian withholding tax.

The extent to which future dividends will be franked, for Australian taxation purposes, will depend on a number of factors including the proportion of the Group's profits that will be subject to Australian income tax and any future changes to Australia's business tax system.

### **Significant changes in the state of affairs**

#### *Claim for compensation for foreign currency options trading losses*

In September 2005, the Company issued letters of demand claiming compensation exceeding \$539 million against ICAP PLC and another broker in relation to the foreign currency options trading losses announced in January 2004.

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The Company is seeking compensation for losses including foreign currency trading losses, additional expenses and loss of profit as a result of the disruption to foreign currency options trading services. The Company has also indicated its intention to seek exemplary damages against ICAP PLC and another broker in any proceedings brought against those firms. The Company has conducted a detailed forensic investigation over the course of more than a year in preparing its claims, and has also had regard to evidence gained during inquiries by APRA and PricewaterhouseCoopers.

The Company is confident it has a strong case to seek compensation from the parties involved in the foreign currency options trading losses. While the Company would prefer to resolve its claims against those parties by negotiation, it may be necessary for it to bring legal proceedings against them to enforce its rights.

### *New ongoing employment arrangement for the Company's Group Chief Executive Officer John Stewart*

The Company announced in December 2005 that the Company's Group Chief Executive Officer John Stewart agreed to terms of a new ongoing employment arrangement.

### *UK staff support changes to UK pension schemes*

The Group announced in March 2006 that its UK staff have supported a series of reforms to their final salary and defined contribution pension schemes.

Key aspects of the reforms to the defined benefit schemes are as follows:

All defined benefits accrued to March 31, 2006 are unaffected and the defined benefit schemes remain non-contributory; and

From April 1, 2006, the defined benefit schemes moved to a structure known as career average, under which members earn blocks of pension every year. Rather than receiving a pension based solely on a final salary at retirement, the proposed structure builds pension benefits year-on-year based on a member's annual salary.

The Group has made a one-off contribution of GBP100 million across its three UK defined benefit schemes during the 2006 financial year. This contribution reduces the deficit with no resulting material income statement impact.

### **Events subsequent to balance date**

The Group announced in November 2006 that based upon its strong capital position at year end and commitment to active capital management, that it intends to commence an on-market share buyback program of \$500 million (or approximately 13 million shares) in the first half of the 2007 financial year.

No further matter, item, transaction or event of a material and unusual nature has arisen in the interval between the end of the financial year and the date of this report that, in the opinion of the directors, has significantly affected or may significantly affect the operations of the Group, the results of those operations, or the state of affairs of the Group in future financial years.

**Future developments**

In the opinion of the directors, disclosure of any further future developments would be likely to result in unreasonable prejudice to the interests of the Group.

**Proceedings on behalf of the Company**

There are no proceedings brought or intervened in, or applications to bring or intervene in proceedings, on behalf of the Company by a member or other person entitled to do so under section 237 of the *Corporations Act 2001* (Cth).

**Environmental regulation**

The Group can perform a key role, as a global provider of financial products and services, to contribute to environmental sustainability of communities in which it operates. The Group's approach to environmental sustainability is outlined in its environmental policy at [www.nabgroup.com](http://www.nabgroup.com), and the Group's management of direct and indirect environmental impacts is outlined in the 2006 Corporate Social Responsibility Report.

The operations of the Group are not subject to any particular or significant environmental regulation under law of the Australian Commonwealth Government or of a state or territory, but the Group can incur environmental liabilities as a lender. The Group has developed credit policies to ensure this is managed appropriately.

**Rounding of amounts**

Pursuant to Class Order 98/100 made by the Australian Securities and Investments Commission (ASIC) on July 10, 1998, the Company has rounded off amounts in this report and the accompanying financial report to the nearest million dollars, except where indicated.

**Executive performance options and performance rights**

Performance options and performance rights are granted by the Group under the National Australia Bank Executive Share Option Plan No. 2 (executive share option plan) and the National Australia Bank Performance Rights Plan (performance rights plan). The executive share option plan was approved by shareholders at the annual general meeting in January 1997, and the performance rights plan at the 2002 annual general meeting. *Refer to the remuneration report for a description of the key terms and conditions of the executive share option plan and the performance rights plan.*

All performance options and performance rights that have not expired are detailed in note 41 in the financial report. Each performance option or performance right is for one fully paid ordinary share in the Company. The number and terms of performance options and performance rights granted by the Company during 2006 (and since October 1, 2006 up to November 30, 2006) over ordinary shares by the Group under the executive share option plan and the performance rights plan, and the Company's valuation of those performance options and performance rights at grant date are shown in the table below:

Grant date	Exercise period (1)	Exercise price (2)	Held at September 30, 2006 (No.)	Lapsed during the period (3) (No.)	Granted since October 1, 2005 (No.)	Fair value as at grant date (4)
<b>Performance options</b>						
Dec 19, 2005	Feb 7, 2008 - Feb 6, 2010	\$ 31.78	60,384		60,384	\$ 165,452
Feb 6, 2006	Feb 7, 2008 - Feb 6, 2010	\$ 34.53	111,500		111,500	\$ 360,145

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Feb 6, 2006	Feb 6, 2009 - Aug 6, 2011	\$	34.53	7,063,326	361,222	7,424,548	\$	27,183,313
Feb 20, 2006	Feb 6, 2009 - Aug 6, 2011	\$	34.53	477,487	43,800	521,287	\$	1,887,542
Feb 22, 2006	Feb 6, 2009 - Aug 6, 2011	\$	34.53	443,000		443,000	\$	1,320,140
Mar 10, 2006	Feb 6, 2009 - Aug 6, 2012	\$	34.53	500,000		500,000	\$	1,550,000
May 3, 2006	Feb 6, 2009 - Aug 6, 2011	\$	34.53	51,300		51,300	\$	238,545
May 3, 2006	Feb 6, 2009 - Aug 6, 2011	\$	37.55	29,773		29,773	\$	111,649
Jul 31, 2006	Feb 6, 2009 - Aug 6, 2011	\$	34.53	16,875		16,875	\$	81,675
Jul 31, 2006	Feb 6, 2009 - Aug 6, 2011	\$	35.50	108,125		108,125	\$	430,337

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Grant date	Exercise period (1)	Exercise price (2)	Held at September 30 2006 (No.)	Lapsed during the period (3) (No.)	Granted since October 1, 2005 (No.)	Fair value as at grant date (4)
<b>Performance rights</b>						
Dec 19, 2005	Feb 7, 2008 - Feb 6, 2010	\$ 1.00	15,098		15,098	\$ 258,327
Feb 6, 2006	Feb 6, 2009 - Aug 6, 2011	\$ 1.00	1,725,784	90,119	1,815,903	\$ 46,973,561
Feb 20, 2006	Feb 6, 2009 - Aug 6, 2011	\$ 1.00	119,446	10,949	130,395	\$ 3,227,137
Feb 22, 2006	Feb 6, 2009 - Aug 6, 2011	\$ 1.00	110,750		110,750	\$ 1,950,308
Mar 10, 2006	Feb 6, 2009 - Aug 6, 2012	\$ 1.00	140,000		140,000	\$ 2,452,800
May 3, 2006	Feb 6, 2009 - Aug 6, 2011	\$ 1.00	20,269		20,269	\$ 395,448
Jul 31, 2006	Feb 6, 2009 - Aug 6, 2011	\$ 1.00	4,221		4,221	\$ 127,179
Jul 31, 2006	Feb 6, 2009 - Aug 6, 2011	\$ 1.00	27,033		27,033	\$ 543,904

(1) Performance options and performance rights generally expire on the last day of their exercise period.

(2) A notional sum of \$1.00 is payable by the holder on exercise of all performance rights exercised on any particular day.

(3) Performance options and performance rights generally lapse 30 days after the end of an individual holder's employment unless otherwise determined by the Board in accordance with their terms attaching to each grant of performance options and performance rights.

(4) Fair values of performance options and performance rights are based on a numerical pricing model. For the purposes of this table, the fair value at grant date represents the full fair value in the year of grant and has not been allocated over the expected life of the performance option or performance right. Refer above and to note 41 in the financial report for further information.

**Performance options and performance rights on issue and number exercised**

At November 30, 2006, there were 46,955,239 performance options and 6,674,647 performance rights which were exercisable, or may become exercisable in the future, under the respective plans.

There were 1,639,130 fully paid ordinary shares of the Company issued during the year as a result of performance options granted being exercised, for a total consideration of \$40,769,090. There were 748,060 fully paid ordinary shares of the Company issued since September 30, 2006 up to November 30, 2006 as a result of performance options granted being exercised, for a total consideration of \$19,201,098. No performance rights were exercised during the relevant time. The amount paid on issue of each of these shares is set out in note 41 in the financial report.



No person holding an option has or had, by virtue of the performance option, a right to participate in a share issue of any body corporate other than the Company.

The holders of exchangeable capital units have the right to exchange those units for ordinary shares in the Company or, at the Company's option, cash. *Refer to note 33 in the financial report for the full details of the number and terms of exchangeable capital units issued by the Group.*

**Directors meetings**

The table below shows the number of directors meetings held (including meetings of Board committees) and number of meetings attended by each of the directors of the Company during the year:

Directors	Directors meetings of the Company		Audit Committee meetings of the Company attended by members of the Committee		Risk Committee meetings of the Company attended by members of the Committee		Remuneration Committee meetings of the Company	
	Scheduled meetings attended	Scheduled meetings held	Meetings attended	Meetings held	Meetings attended	Meetings held	Meetings attended	Meetings held
MA Chaney	10	10						
PA Cross (4)	8	8			9	9		
PJB Duncan (6)	10	10			4	4	6	6
RG Elstone (3)	8	8			11	11		
A Fahour	10	10						
DT Gilbert	10	10	12	12				
TK McDonald (4)	8	8	8	8				
PJ Rizzo	10	10	12	12	13	13		
JS Segal (5)	10	10	4	4	9	9	6	6
JM Stewart (8)	10	10			2	4		
JG Thorn (7)	10	10	12	12			1	1
GA Tomlinson	10	10					6	6
MJ Ullmer	10	10						
GM Williamson	10	10						

Directors	Nomination Committee meetings		Directors meetings of controlled entities (1)		Additional meetings (2) Meetings attended
	Meetings attended	Meetings held	Meetings attended	Meetings held	
MA Chaney	1	1	4	4	4
PA Cross (4)	1	1	4	4	
PJB Duncan (6)	1	1	4	4	1
RG Elstone (3)	1	1	4	4	1
A Fahour			7	10	
DT Gilbert	1	1	4	4	1
TK McDonald (4)	1	1	30	30	
PJ Rizzo	1	1	4	4	6
JS Segal (5)	1	1	4	4	
JM Stewart (8)			5	5	1
JG Thorn (7)	1	1	4	4	6
GA Tomlinson	1	1	41	41	1
MJ Ullmer			4	4	7
GM Williamson	1	1	26	26	

(1) Reflects the number of meetings held during the time the director held office during the year. Where a controlled entity holds Board meetings in a country other than the country of residence of the director, or where there may be a potential conflict of interest, the number of meetings held is the number of meetings the director was expected to attend, which may not be every board meeting held by the controlled entity during the year.

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(2) *Reflects the number of additional formal meetings attended during the year by each Director, including committee meetings (other than Audit Committee, Risk Committee, Remuneration Committee or Nomination Committee) where any two Directors are required to form a quorum.*

(3) *Mr Elstone resigned as a Director of National Australia Bank Limited on July 5, 2006.*

(4) *Mrs Cross and Mr McDonald were appointed as Directors of National Australia Bank Limited on December 1, 2005.*

(5) *Ms Segal ceased to be an Audit Committee member after the Audit Committee meeting held on December 3, 2005 and was appointed a member of the Risk Committee effective December 3, 2005.*

(6) *Mr Duncan ceased to be a Risk Committee member after the Risk Committee meeting held on December 1, 2005.*

(7) *Mr Thorn ceased to be a member of the Remuneration Committee in December 2005.*

(8) *Mr Stewart ceased to be a member of the Risk Committee after the Risk Committee meeting held on December 1, 2005.*

**Directors and executives interests**

The tables below show the interests of each director and executive in the issued ordinary shares and National Income Securities of the Group, and in registered schemes made available by the Group as at November 30, 2006. No director or senior executive held an interest in Trust Preferred Securities, Trust Preferred Securities II, National Capital Instruments or exchangeable capital units of the Company.

<b>Directors</b>	<b>Fully paid ordinary shares of the Company</b>	<b>Performance options over fully paid ordinary shares of the Company (1)</b>	<b>Performance rights over fully paid ordinary shares of the Company (1)</b>	<b>National Income Securities</b>	<b>Registered schemes</b>
MA Chaney (2)	22,322				
PA Cross (2)	10,194				
PJB Duncan (2)	12,127				
RG Elstone (2)					
A Fahour	389,534	444,000	111,000		
DT Gilbert (2)	8,897			1,253	
TK McDonald	2,000				
PJ Rizzo (2)	3,397				
JS Segal (2)	9,527			180	
JM Stewart	69,579	1,675,000	418,750		
JG Thorn (2)	6,138				
GA Tomlinson (2)	32,625			350	
MJ Ullmer	22,138	259,000	64,750		
GM Williamson	6,396				

<b>Senior executives (3)</b>	<b>Fully paid ordinary shares of the Company</b>	<b>Performance options over fully paid ordinary shares of the Company (1)</b>	<b>Performance rights over fully paid ordinary shares of the Company (1)</b>	<b>National Income Securities</b>	<b>Registered schemes</b>
CA Clyne	7,059	173,750	43,438		
MJ Hamar	13,419	71,250	17,813		
JE Hooper	26,432	257,344	50,586		
LM Peacock	37,655	445,732	111,433		
PL Thodey	1,896	654,620	88,655		

(1) Exercise price, exercise period, expiry date and fair value of performance options and performance rights for those issued during the year are disclosed in note 52 in the financial report.

(2) Includes shares acquired under the Non-Executive Director Share Plan operated through the National Australia Bank Staff Share Ownership Plan.

(3) Senior executives in current employment with the Group as at September 30, 2006 where information on shareholdings is disclosed in note 52 in the financial report.

There are no contracts, other than those disclosed above, to which directors are a party, or under which the directors are entitled to a benefit and that confer the right to call for or deliver interests in a registered scheme made available by the Company or a related body corporate. All of the directors have disclosed interests in organisations not related to the Group and are to be regarded as interested in any contract or proposed contract that may be made between the Company and any such organisations.

**Past employment with external auditor**

Ernst & Young has been the Company's external auditor since January 31, 2005. There is no person who has acted as an officer of the Group during the year who has previously been a partner at Ernst & Young when that firm conducted the Company's audit.

**Non-audit services**

Fees paid or due and payable to the external auditor, Ernst & Young, for non-audit services provided by the external auditor to the Group during the year to September 30, 2006 are set out in the table below:

	<b>Group 2006 \$ 000</b>
<b>Audit-related fees (regulatory)</b>	
APRA reporting (attestation in connection with the Company's Basel II accreditation program)	705
National Custodian Services Auditing Guidance Statement (AGS) 1026 reports	665
APRA reporting (attestation relating to Prudential Standard APS 310 and tripartite review)	649
Regulatory audits/attestations for Wealth Management entities (in all regions)	425
Other regulatory audits/attestations (in all regions)	190
UK regulatory audits/attestations	84
New Zealand regulatory audits/attestations	58
Audit of the Company's Australian Financial Services Licence	77
Asia regulatory audits/attestations	26
<b>Total audit-related fees (regulatory)</b>	<b>2,879</b>
<b>Audit-related fees (non-regulatory)</b>	
Agreed-upon procedures on results announcements	395
Provision of audit commentary on the Group's proposed accounting treatment for transactions	388
Procedures with regard to the reconciliation of half-year financials under Australian GAAP to US GAAP	464
Audit of employee benefit plans	84
Other (including procedures in relation to the Group's corporate social responsibility report)	89
<b>Total audit-related fees (non-regulatory)</b>	<b>1,420</b>
<b>Tax fees</b>	
Tax services to expatriate employees	1,134
Provision of standard tax compliance software to Wealth Management Australia	2
<b>Total tax fees</b>	<b>1,136</b>
<b>All other fees</b>	
Sub-lease of office space to BNZ on commercial terms	664
Regulatory or compliance audits/attestations for Wealth Management entities (in all regions) unrelated to the audit or review of the Group's financial statements	391
Other regulatory audits/attestations (in all regions) unrelated to the audit or review of the Group's financial statements	76
<b>Total all other fees</b>	<b>1,131</b>
<b>Total non-audit services fees</b>	<b>6,566</b>

*Fees exclude goods and services tax, value added tax or equivalent taxes.*

Ernst & Young issued several comfort letters to underwriters in connection with the Company's funding programs. The fees paid or due and payable to Ernst & Young for these services during the year to September 30, 2006 total \$331,611. These services are classified by the Audit Committee as audit services.

Ernst & Young also provides audit and non-audit services to non-consolidated securitisation vehicles sponsored by the Group, non-consolidated trusts of which a Group entity is trustee, manager or responsible entity and non-consolidated Group superannuation or pension funds. The fees paid or due and payable to Ernst & Young for these services during the year to September 30, 2006 total \$2,476,314.

In accordance with advice received from the Audit Committee, the directors are satisfied that the provision of non-audit services during the year to September 30, 2006 by Ernst & Young is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001* (Cth). The directors are so satisfied because the Audit Committee has assessed each service, having regard to auditor independence requirements of applicable laws, rules and regulations, and concluded in respect of each non-audit service or type of non-audit service that the provision of that service or type of service would not impair the independence of Ernst & Young.

*A description of the Audit Committee's pre-approval policies and procedures is set out on page 63. Details of the services provided by Ernst & Young to the Group during 2006 and the fees paid or due and payable for those services are set out in note 53 in the financial report. A copy of Ernst & Young's independence declaration is set out on the following page.*

**Remuneration report**

**Remuneration Committee**

**Role**

The Remuneration Committee charter (which is approved by the Board) sets out the membership, responsibilities, authority and activities of the Remuneration Committee. The charter is available at [www.nabgroup.com](http://www.nabgroup.com)

The Remuneration Committee:

oversees the Group's general remuneration strategy;

monitors, reviews and makes recommendations to the Board concerning:

remuneration policy and Total Reward for the Group Chief Executive Officer, and for senior executives who report directly to him;

remuneration arrangements for non-executive Board directors (*as listed on page 91*);

arrangements for recruiting, retaining and terminating senior executives;

key appointments and proposals for the executive succession planning process; and

supports the Board with monitoring the Group's culture, and the process for managing behaviours against quality gates and standards.

The Board has delegated authority to the Remuneration Committee to approve:

changes to the factors regarding the measurement of Total Business Return (TBR) which impacts the Group's employee short-term and long-term incentive programs;

incentive pool amounts for general employee incentive programs;

offers under existing employee share, performance option and performance rights plans, including setting terms of issue (within the total number of securities approved by the Board); and



fees payable to non-executive directors of controlled entity boards.

### **Membership and meetings**

The Remuneration Committee met seven times during the year (*attendance is set out on page 74*). Committee members at September 30, 2006 were:

Mr Peter JB Duncan (Chairman);

Ms Jillian S Segal; and

Mr Geoffrey A Tomlinson.

The Remuneration Committee invites the Chairman of the Board and members of management to assist its deliberations (except concerning their own remuneration). It also took specialist remuneration advice during the year from external advisers.

### **Reward philosophy**

The Company's philosophy is to manage a Total Reward framework designed to:

link employee rewards to creating sustainable value for shareholders;

attract, recognise and foster top talent;

recognise capabilities and promote opportunities for career and professional development;

motivate people with energy and passion;

reward those who deliver superior performance;

provide fair and consistent rewards, benefits and conditions within an integrated global strategy;

provide rewards that are competitive within the global markets in which the Group operates; and

build a partnership between employees and other shareholders through employee ownership of Company shares and securities.

**The structure of Total Reward**    **setting the nature of reward**

Total Reward comprises fixed remuneration, and at risk remuneration, which is made up of short-term incentive (STI) and long-term incentive (LTI). Each of these components is discussed in further detail in the following sections.

An appropriate target reward mix is determined for each management level with at risk rewards increasing with the level of responsibility and the criticality of the person's role.

The target Total Reward mix for the Group Chief Executive Officer is:

25% to 35% fixed remuneration;

30% to 35% STI; and

30% to 50% LTI.

The target Total Reward mix for the senior executive team (executive general managers (EGMs)) is:

25% to 50% fixed remuneration;

25% to 50% STI; and

15% to 35% LTI.

The following graph shows the actual average percentage Total Reward mix for each level as at September 30, 2006. The mix for each individual may vary according to market relativity and with appropriate management approval.

*This data is as at the point in time on September 30, 2006 and does not match the remuneration data shown from page 86 for the whole year to September 30, 2006.*

**Market relativity setting Total Reward benchmarks**

The Group targets fixed remuneration at the market median (50th percentile) being paid in the finance industry in the global markets in which the Group operates and in any other relevant specialist markets. STI and LTI targets are set between the median and the upper quartile of the relevant market.

An individual's actual remuneration is set:

within parameters approved by the Board and the Remuneration Committee (such as the size of STI pool as described on page 80);

by the degree of achievement of performance measures under the performance management framework; and

by assessment of the individual's talent and potential under the executive talent framework.

The performance management and executive talent frameworks are set out in detail at [www.nabgroup.com](http://www.nabgroup.com)

#### **Individual performance and talent – the impact of the individual on Total Reward**

The Group's performance management framework includes:

setting quality gates, which are threshold measures for compliance and behaviour for each individual;

setting corporate Key Performance Indicators (KPIs) for the Group, which roll down into individual KPIs for each employee via an individual scorecard. KPIs include both financial and non-financial measures; and

a peer review process where peer managers compare and calibrate the performance of their collective group reports.

For management employees, the performance management process is followed with assessment under the executive talent framework. This considers an individual's potential capability, and identifies employees who can contribute to the organisation's performance through strong leadership behaviour as well as performance.

The performance management and executive talent frameworks are designed to drive superior rewards for employees who have the best relative performance and potential with:

fixed remuneration levels set at a higher market percentile and in the higher part of the range;

a greater STI multiple; and

a larger LTI reward;

as described in the following sections.

#### **Fixed remuneration linked to market measures**

Up to 25% of employees may be ranked with the highest scores under the performance management framework. Their individual fixed remuneration is then linked to higher fixed remuneration market measures (55<sup>th</sup> to 60<sup>th</sup> percentiles) rather than to median market measures. For all employees, individual remuneration is set between 80% and 120% around the applicable market percentile, but the 100% to 120% part of the range is limited to exceptional circumstances and these higher scoring performers.

#### **Short term incentive (STI) rewards**

The Group measures each employee's performance firstly against their individual scorecard (KPIs) and then against the scorecard outcomes for their peers. Each scorecard is a balance of measures including financial, customer, community, employees, process improvements and quality. The measures are selected for their alignment to the Group's direction. Through the scorecard approach and subsequent peer review, the STI program is structured to reward the highest achievers against key individual, business and Group performance outcomes.

To receive an STI reward a person must generally achieve a threshold level of performance and achieve their specified quality gates (as described above). Their performance relative to that of their peers may earn rewards between zero and two times their STI Target amount (referred to as their STI multiple). Only the most outstanding performers (10% or less employees) may receive an STI multiple of more than 1.6. The total for all employees is limited to the size of the funded STI pool (described below).

Executive directors (*listed on page 84*) must receive at least half of any STI reward as Company shares (subject to any required shareholder approval). This aligns their outcomes with shareholder interests. Specific terms (including restrictions and forfeiture conditions) apply to the shares, which are approved by shareholders.

The majority of other employees receive any STI reward above their STI Target as Company shares (subject to legal or tax constraints and to nominal threshold values). These above target shares:

are held in trust with restrictions on employees trading for at least 1 year; and

are subject to forfeiture conditions including on termination for serious misconduct, resignation or not achieving individual quality gates in the first year after allocation.

Australian employees are able to nominate a longer holding period of up to 10 years, with forfeiture only on termination for serious misconduct during this extended period.

The employee receives any dividends paid on these shares. The Remuneration Committee believes these restrictions instil an appropriate focus on Group performance beyond the current year, help to ensure that targets are consistently achieved and encourage an appropriate level of shareholding by employees.

**Employees in Australia may also express a preference to receive a portion of their STI reward (up to their target) in superannuation contributions or in Company shares (or both). This does not apply to employees overseas. The shares are held in trust with restrictions on trading for between 1 and 10 years (unless the employee leaves the Group earlier) with the shares forfeited on termination for serious misconduct involving dishonesty. Employees receive any dividends on the shares.**

#### **Long term incentive (LTI) rewards**

*In shares:*

Most employees participate in the general share-based LTI program (subject to minimum service criteria). The Remuneration Committee determines the program's value based on Group performance, which was measured by movement in Economic Value Added (EVA®) for the 2001 to 2004 offers and by a balanced scorecard of outcomes for the 2005 and 2006 offers including cash earnings. The shares are held in trust with restrictions on employees trading for three years, though they receive any dividends. *EVA® is a registered trademark of Stern Stewart & Co.*

*In performance options and performance rights:*

LTI in the form of performance options and performance rights is a key mechanism for recognising executive potential and talent in the Group. It is primarily offered to two groups of employees: management (less than 5,000 individuals); and the top 5% of the Group's salesforce. Details of the terms and conditions for LTI granted up to September 30, 2006 are shown on page 82.

The executive talent framework provides an objective basis for determining appropriate long-term rewards. Through this process,

individual LTI allocations transparently recognise current contribution, future capability and potential contribution to the Group's performance over coming years. An executive's talent score will determine the individual's eligibility for an LTI reward and also the amount of LTI granted to them.

### **Joining and retention awards**

Commencement awards are only entered into with Executive General Manager (EGM) approval, to enable buy-out of equity from previous employment for significant new hires. The amount and timing of any benefits must be based on evidentiary information. The awards are primarily provided in the form of Company shares, performance options and performance rights, subject to restrictions and certain forfeiture conditions, including forfeiture on resignation. Cash is only used in limited circumstances.

Similarly, the Company provides limited retention awards (with EGM approval) for key individuals in roles where retention is critical over a medium-term timeframe (two to three years). These are normally provided in the form of shares with a minimum two-year restriction period, subject to performance standards and certain forfeiture conditions, including staggered forfeiture on resignation before key milestones are achieved.

### **Group and business performance – the impact of collective performance on Total Reward**

#### **Size of the STI reward pool**

For 2006 the performance of the Group and the size of the pool for STI payments is determined by Total Business Return (TBR). TBR links growth in cash earnings (before significant items) and return on equity (ROE). TBR correlates closely with Total Shareholder Return (TSR) as defined on page 82 but can also be measured on a regional basis. A more extensive description of TBR is located at [www.nabgroup.com](http://www.nabgroup.com)

The Group's annual operating plan and the TBR target are approved by the Board. At the end of the performance period, the Remuneration Committee then determines the size of the STI reward pool, taking into account the quality of the TBR result and the agreed performance sensitivities. If Group performance falls below the target TBR level, the size of the STI reward pool decreases at a greater rate.

The following graph shows the average of individual payments (as a % of individual STI Target) for Key Management Personnel (executive directors and other senior executives) as defined on page 84. The graph shows how the average STI% relates to the Group's earnings (cash earnings before significant items) from 2002 to 2006:

### **LTI reward in Company shares**

In December 2006, the Company will allocate approximately \$1,000 in Company shares to most employees under a general employee share offer, in respect of Group performance against a scorecard of objectives for the 2006 financial year. The following graph shows the approximate value of the share award from 2002 to 2006 compared with Group earnings (cash earnings before significant items).

*The target annual offer (ie. for on target Group performance) is A\$1,000, with the actual offer value varying according to the actual level of Group performance.*

### **LTI reward in performance options and performance rights**

**Full details of terms and conditions of LTI allocations are shown on page 82 and the link between company performance and LTI reward received by executives is demonstrated on page 81.**

The performance hurdles for the performance options and performance rights directly links rewards for the most senior 80 (approximately) positions to NAB's TSR performance compared with the TSR performance of companies in two peer groups - Top 50 companies and Top financial services companies. TSR and the determination of the peer groups are described on page 82 and peer group lists are available at [www.nabgroup.com](http://www.nabgroup.com)



In grants made during 2006, the performance hurdle on performance options granted to other employees is based on regional ROE performance and regional cash earnings (RCE) growth against targets set in each regional business plan. The hurdle on their performance rights is based on relative earnings per share (EPS) growth measured against the financial services peer group (the same group as for the TSR hurdle above). A description of the changes to the performance hurdle anticipated for grants made during 2007 is set out on page 81.

All of these performance hurdles are measured over a three to five year period, aligning any rewards for employees to the outcomes for other shareholders over the same timeframe. The value of any LTI reward (if and when any securities vest) also depends on the market value of the Company's ordinary shares at the time of exercise.

The combination of performance options and performance rights is designed to reduce the number of securities issued. Fewer performance rights are issued as they have a higher financial value than traditional performance options. Performance rights (with their exercise price of \$1 per batch exercised) also continue to motivate employees even when the share price is below the strike price of the performance options - as long as they vest by the Company outperforming its peers. Details of the terms and conditions for LTI granted up to September 30, 2006 are shown on

page 82, and the fair valuation model used is detailed on page 89. No terms and conditions have been altered after the applicable grant date. The terms of the Group's Insider Trading Policy specifically prohibit directors and employees from protecting the value of unvested LTI with derivative instruments. Employees are able to protect the value of vested LTI in limited circumstances. Further details on the Insider Trading Policy are set out in the Corporate governance section on page 60.

#### **Review of the LTI program for 2007 to ensure ongoing cultural change**

The Remuneration Committee reviews the structure of the LTI program annually. It seeks advice from external remuneration advisers, considers best practice in the Australian and international markets, considers market commentary and consults with stakeholders.

This year's review was designed to reinforce ongoing cultural change, to transparently link to the new regional business model, and to improve alignment and line of sight between individual participants and their impact on the business.

For participants in the LTI program, other than those in the most senior 80 (approximately) positions, the performance hurdle measure on both the performance options and the performance rights will be 3-year cumulative growth in Group/Regional TBR against business operation plan. *TBR is described in the Size of the STI reward pool section above.*

The changes take effect from October 1, 2006. They will not affect the most senior 80 (approximately) positions in the Group - being the EGMs and each of their leadership teams. For them, the TSR performance hurdle will continue to operate.

#### **Company performance and the value of LTI granted**



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The graphs below show absolute annual TSR performance, share price growth and dividends received by shareholders within each of the last 5 financial years.

The table below shows the value of LTI reward from the main grants made to employees from 2000 to 2003. The table includes the three-year absolute TSR from grant to initial test date for each allocation. It illustrates the link between long-term performance of the Group and individual reward (the value of each option at the initial test date). Vesting has only occurred where the Group has returned superior TSR performance against the selected peer group. The table also tracks the relative TSR performance (as at September 30, 2006) of grants made from 2004 to 2006, which are still within the restriction period and not yet in the testing period.

Allocations not yet in testing period

Year of allocation	Start of test period	Vesting Theoretical relative TSR percentile at Sep 30, 2006	Value on vesting		Shareholder wealth		
			Exercise price	Dividends from grant to Sep 30, 2006	Share price movement from grant to Sep 30, 2006	Absolute TSR result from grant to Sep 30, 2006 (2)	
2006	February 6, 2009	62nd	\$ 34.53	\$ 0.83	\$ 2.17	12%	
2005	February 7, 2008	55th	\$ 29.93	\$ 2.49	\$ 6.77	34%	
2004	January 16, 2007	22nd	\$ 30.25	\$ 4.15	\$ 6.45	39%	

Allocations in testing period

Year of allocation	Start of test period	Vesting Relative TSR percentile ranking at initial test date	Percentage of options that vested at initial test date (1)	Value on vesting			Shareholder wealth		Three-year absolute TSR from grant to initial test date (2)
				Closing share price at test date	Exercise price of options	Value of each option at initial test date	Dividends from grant to initial test date	Share price movement from grant to initial test date	
2003	March 21, 2006	14th	0%	\$ 36.00	\$ 30.46	\$ 4.95	\$ 5.54	39%	
2002		12th	0%	\$ 30.97	\$ 36.14	\$ 4.87	\$ (5.17)		

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	June 14, 2005												
2001	March 23, 2004	50th	50% \$	31.45	\$	27.85	\$	3.60	\$	4.45	\$	3.60	29%
2000	March 23, 2003	88th	100% \$	30.90	\$	21.29	\$	9.61	\$	4.05	\$	9.61	65%

(1) For each of the vested allocations (2000 and 2001) shown in the table, vesting has only occurred on the initial test date as shown. Although the hurdles are tested on an ongoing basis, no further vesting has occurred, and no vesting has occurred in respect of the 2002 and 2003 grants as shown.

(2) Absolute TSR movement is calculated on the basis that all dividends and distributions are reinvested in Company shares.

Summary of all long-term equity instruments on issue

Terms and conditions	March 2000	June 2002	Grant dates		February 2006
	September 2001		March 2003	September 2004	July 2006
Securities granted	Performance options		June 2004	December 2005	Performance options and performance rights
Frequency of offers	One major annual allocation of LTI awards, with later, smaller grants (as required) generally for executives who join the Group after the annual allocation.				
Basis for determining individual LTI allocation	Based on seniority and assessed future value of the individual.		Based on individual assessments of performance and potential under the Group's annual Executive Talent Review.		
Restriction period	There is an initial restriction period of three years, when no performance testing is performed.		The restriction period may be less than three years (but always greater than two) for grants that refer to a previous performance hurdle date, eg. grants on April 2005 and July 2005 have an effective date of February 2005, and refer back to the February 2005 performance hurdle for determination of vesting. So for those grants, the restriction periods are less than three years.		
Performance testing period	The restriction period is followed by a performance period during which the performance hurdle is tested up until three months before the expiry date.			The performance hurdle is tested on 3 occasions over a 24 month performance period which ends 6 months before the expiry date.	
Expiry date of securities	The securities lapse on the eighth anniversary of the grant date. Vested securities may be exercised until the expiry date. Any securities that do not vest in the performance period lapse.		When an effective date is used, and the restriction period is shorter than three years (as above), then the expiry date will also be correspondingly earlier than eight years.	The securities will lapse on the fifth anniversary of the date of grant (unless an effective date and shorter restriction period applies as above).	The securities will lapse five years and six months after the date of grant (unless an effective date and shorter restriction period applies as above).
Performance hurdle measures	Total Shareholder Return (TSR) - that is, the return a shareholder receives through dividends (and any other distributions) plus capital gains over the relevant period. It is calculated on the basis that all dividends and distributions are reinvested in Company shares.			The previous TSR performance hurdle remains for the 80 most senior positions in the Group. The performance hurdle measure for all other employees is: for performance options - regional ROE performance and regional RCE growth against 3 to 5 year business plan, and for performance rights - Group EPS growth against a financial services peer group.	

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<p>Reasons for the performance hurdles</p>	<p>The TSR hurdle was considered most relevant for shareholders over the medium to long term and particularly relevant for the most senior executives in the Company.</p>	<p>The new performance hurdle is intended to significantly increase the line of sight between business performance and the performance outcomes for regional executives. This strongly supports the new regional business model.</p>	
<p>Performance hurdle peer groups (peer group listing is available at <a href="http://www.nabgroup.com">www.nabgroup.com</a>)</p>	<p>The vesting (and exercise) of the securities is determined by growth in the Company's TSR from the grant date, compared with that of the top 50 companies in the S&amp;P ASX100 by market capitalisation (excluding the Company and property trusts), determined as at the effective date of the grant.</p>	<p>Half the performance options and half the performance rights are tested against top 50 companies as shown to the left.</p> <p>The vesting (and exercise) of the remaining half of the securities is determined by the Company's TSR growth relative to the top 12 financial services companies in the S&amp;P ASX200 by market capitalisation, excluding the Company determined as at the effective date of the grant.</p>	<p>For the 80 most senior positions in the Group, the TSR peer groups remain the same (as described to the immediate left). The new EPS growth hurdle for the performance rights for other executives uses the same financial services peer group as used in the TSR hurdle.</p>
<p>Rationale for peer group selection</p>	<p>Peer group selection attempts to approximate the types of companies that investors might choose as an alternative to investing in the Company.</p> <p>The size of the peer groups is an important consideration. A larger peer group helps to reduce volatility, and means that any change in the members of the group composition (due to liquidations, etc), should have less of an impact.</p>	<p>Using two peer groups in tandem prevents the possibility of all of the securities vesting if the Company performs poorly relative to other organisations in the financial services business sector.</p>	<p>Using the same financial services peer group for both the TSR and the EPS hurdles (as described above) maintains a link between the outcomes for senior and other executives, and ensures that the EPS hurdle is equally challenging.</p>

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Terms and conditions	Grant dates		September 2004 December 2005	February 2006 July 2006
	March 2000 September 2001	June 2002		
Measuring the performance hurdles and reasons for choosing these testing methods	<p>Each TSR comparison to the relevant peer group data is averaged over five trading days to prevent vesting being based on any short-term spike in TSR results.</p> <p>Performance is tested daily during the performance period - although for practical reasons, performance tests are generally conducted quarterly.</p>		<p>The TSR comparison is averaged over 30 trading days to better ensure that any short-term spike in TSR results does not impact on vesting.</p>	<p>In addition to the 30-day averaging, the relevant TSR percentile must be maintained for 30 consecutive trading days (ie. vesting only occurs if there is sustained TSR performance).</p> <p>Daily testing has been replaced with three separate hurdle tests at the 3rd, 4th, and 5th anniversary of the grant (or effective ) date. Each test uses 30-day averaged TSR, and the available RCE, ROE, and EPS data for the Company and for each peer organisation. Each participant s allocation is divided into three equal tranches, with tranche 1 tested on the 3rd and 4th anniversaries, tranche 2 tested on the 4th and 5th anniversaries, and tranche 3 tested only once, on the 5th anniversary date.</p> <p>This change minimises retesting of the performance hurdle, yet maintains employee focus on the 3 to 5 year time horizon.</p>
Vesting of securities	Vesting occurs to the extent that the performance hurdle is satisfied as shown below. Vesting does not occur during the restriction period (unless the maximum life of the securities has been shortened due to the end of the individual s employment as described below).			
TSR performance hurdle vesting schedule	<p>No vesting occurs below the 25th percentile performance of the peer group. A quarter of the securities vest at the 25th percentile. A further 1% vesting per percentile continues up to the point where half of the securities would vest at the 50th percentile, and then 2% further vesting per percentile up to 100% vesting at (and above) the 75th percentile.</p>	<p>No vesting occurs below the 50th percentile performance of the peer group. Half of the securities vest at the 50th percentile with 2% further vesting per percentile up to 100% being vested at (and above) the 75th percentile.</p>	<p>No vesting occurs below the 51st percentile performance of each peer group. Half of the securities vest at the 51st percentile with 2% further vesting per percentile up to 100% being vested at (and above) the 76th percentile.</p>	<p>For the TSR and EPS hurdle tests, no vesting occurs below the 51st percentile performance of each peer group. 35% of the securities vest at the 51st percentile with 2.6% further vesting per percentile up to 100% being vested at (and above) the 76th percentile. For the ROE/RCE hurdle test, no vesting occurs if ROE is more than 1 percentage point below plan. Once this threshold is</p>



		met, 35% of the performance options vest at 90% of RCE planned growth, with 2.2% further vesting per % achievement up to 100% of the options being vested when RCE growth is at (or above) 120% of plan.
Lapsing of securities	<p>Securities will lapse if unexercised on or before their expiry date as above. Securities will also generally lapse 30 days (or such shorter time as determined at the time of grant) after an executive ceases to be employed by the Group - unless the Board determines otherwise (generally only in cases of retirement, redundancy, contract completion, death, or total and permanent disablement).</p> <p>For some grants if an executive ceases employment with the Group as the result of death or total and permanent disablement, the securities may be automatically retained. For some grants, securities retained in such cases may be exercised before the end of the restriction period and regardless of the level of achievement of the performance hurdle.</p>	In addition to the terms shown on the left, where the Board determines that securities may be retained at the end of an individual's employment during the restriction period, then only a pro-rated amount of securities may be retained, and for a maximum of two years from the date of cessation. This does not apply to securities provided on commencement. (Generally, the Board will allow securities to be retained in this way only in cases of retirement, redundancy, contract completion, death, or total and permanent disablement.)
Board discretion	The Board may allow security holders to exercise the securities regardless of the normal criteria if certain events occur, including a takeover offer or announcement to the holders of fully paid ordinary shares in the Company.	

The following table illustrates the structure of the performance hurdle in relation to performance options and performance rights, which has applied to grants since January 1, 2006. This example is based on the February 6, 2006 allocation.

**Remuneration for Key Management Personnel and named executives**

**Key Management Personnel (KMP)**

**The remainder of the Remuneration report shows remuneration information for the KMP of the Group and the Company as defined in AASB 124 Related Party Disclosures . These individuals have been divided into three separate groups for ease of reference:**

KMP (non executive directors), being those individuals listed on page 91;

KMP (executive directors), being those individuals listed in the table below. These individuals are all KMP both of the Company and of the Group. All of these individuals were also KMP during 2005 and continue to hold the same position in 2006; and

KMP (other senior executives), being those individuals who, in addition to the executive directors, have been members of the Group Executive Committee during 2006. These individuals are listed on page 85. These individuals are all KMP both of the Company and of the Group. All of these individuals were also KMP during 2005 and continue to hold the same position in 2006. They are the five named Group executives who received the highest remuneration for the year.

**Five named executives of the Company**



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In addition, some of the following tables include information for Mr George Frazis and Mr Stephen J Tucker (as other named executives ). Together with Mr John E Hooper, Ms Lynne M Peacock and Mr Peter L Thodey, they are the five named Company executives who received the highest remuneration for the year.

### Summary of remuneration for KMP (executive directors)

The following table summarises the remuneration arrangements for KMP (executive directors).

	<b>Mr JM Stewart</b>	<b>Mr A Fahour</b>	<b>Mr MJ Ullmer</b>
Position	Director (executive) appointed August 11, 2003  Group Chief Executive Officer commenced February 2, 2004	Director (executive) commenced October 7, 2004  Executive Director and Chief Executive Officer, Australia commenced September 1, 2004	Director (executive) commenced October 7, 2004  Finance Director and Group Chief Financial Officer commenced September 1, 2004
Term of employment agreement	No fixed term. A new employment agreement was entered into in January 2006.	4 years from September 1, 2004	4 years from September 1, 2004
Notice period	Employee six months  Company six months notice plus 12-month termination payment	Employee 13 weeks  Company 52 weeks	Employee 13 weeks  Company 52 weeks
Total employment cost (TEC) (1)	TEC at September 30, 2006: \$2,750,000	TEC at September 30, 2006: \$1,515,863	TEC at September 30, 2006: \$1,060,967
Review of TEC	TEC will not be reviewed until October 2008.	TEC is reviewed annually, with the most recent review in October 2006, with no increase in the TEC shown above. The figures above include superannuation adjustments in July 2006. The next review is scheduled around October 2007.	

A portion of TEC may be taken in the form of packaged benefits (such as a motor vehicle and parking), and includes fringe benefits tax and employer superannuation contributions.(2)

Short-term incentive	\$1,472,500 in cash	\$1,683,000 in cash	\$777,000 in cash
	\$1,472,500 in shares	\$1,683,000 in shares	\$777,000 in shares
	(represents 114% of Mr Stewart's 2006 pro-rated target of \$2,583,333 - based on TEC under his former and current contracts (new contract effective February 1, 2006))	(represents 171% of 2006 target)  Target STI 130% of September 30, 2006 TEC	(represents 146% of 2006 target)  Target STI 100% of September 30, 2006 TEC
	Target STI 100% of TEC		

STI remuneration is determined annually according to the Group's STI plan - *see page 79 for details*. The rewards above are for performance for the period October 1, 2005 to September 30, 2006. The cash portion was paid in November 2006. The issue of the shares is subject to any required shareholder approval at the Company's annual general meeting (AGM) on January 31, 2007 on the terms and conditions set out in the Notice of Meeting. If approved, it is intended that the shares will be allocated in February 2007.

The Board determines STI Targets (as a percentage of TEC) annually for the coming year. Each year, the Board also determines reasonable performance measures and targets for assessing each executive director. After the end of each financial year, the Board reviews each executive director's performance against these measures and targets. The Board may elect to award an STI reward for exceptional individual performance of up to 150% of Target STI for Mr Stewart and up to 200% of Target STI for Mr Fahour and Mr Ullmer.

At least half of the STI remuneration must be provided in the form of Company shares (subject to any required shareholder approval). Shares are held in trust for each executive director under the terms of the National Australia Bank Staff Share Ownership Plan. During this time, the executive directors are entitled, through the trustee, to receive dividend payments and to exercise voting rights attaching to those shares. The shares may be forfeited in some circumstances.

Long-term incentive	None to be allocated in February 2007 (3)	Performance options and performance rights (estimated financial value \$2,274,000 at the time of grant)	Performance options and performance rights (estimated financial value \$1,220,112 at the time of grant)
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The performance options and performance rights shown above are for assessments as at September 30, 2006. The granting of this LTI is subject to shareholder approval at the Company's AGM on January 31, 2007. If approved, the LTI will be allocated in February 2007. Continued LTI allocations are not guaranteed as they are subject to annual assessments.

When each executive director's employment with the Company ends, the retention of any performance options and performance rights granted to them during their employment will be determined according to the terms of grant under the respective plans.

The method used to value the performance options and performance rights, as prescribed by AASB 124 'Related Party Disclosures', is set out on page 89. The performance hurdle is detailed on page 82.

Subject to shareholder approval at the Company's AGM on January 31, 2007, an allocation of shares is intended to be made to Mr Ullmer to strengthen the retention position for him as Finance Director and Group Chief Financial Officer and to ensure the successful completion of a series of long-term projects underway, which are critical to the Group. Mr Ullmer would be restricted from trading these shares until January 2011 and the successful completion of the identified projects. Full terms and conditions of the issue of these shares are set out in the Notice of AGM.

Other benefits	Executive directors are eligible to participate in other benefits that are normally provided to executives employed by the Company, subject to any overriding legislation prevailing at the time including the <i>Corporations Act 2001 (Cth)</i> and the United States <i>Sarbanes-Oxley Act of 2002</i> .
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(1) *Total Employment Cost (TEC)* is the Group's primary measure of fixed remuneration which includes superannuation and non-monetary benefits but excludes leave accrued not taken. It does not include STI or LTI payments.

(2) The Company is not required by Australian law to provide superannuation contributions in connection with Mr Stewart's employment due to the type of Australian visa issued to him. However, under the employment agreement, the Company agrees to pay annual superannuation contributions to the National Australia Bank Group Superannuation Fund. Those contributions form part of Mr Stewart's annual fixed remuneration. Mr John M Stewart may, in lieu of receiving those Australian superannuation benefits, elect to participate in a pension or other scheme in the United Kingdom. Again, any such payments form part of Mr Stewart's fixed pay.

(3) Mr John M Stewart was offered an LTI allocation at the commencement of his previous three-year employment agreement in 2004, which was designed to cover his contract period and to tie the value of any reward to the change in shareholder wealth over that agreement period. 900,000 performance options and 210,000 performance rights (combined estimated annualised value \$0.917 million based on a grant date of January 31, 2005) were subsequently awarded in February 2005 following shareholder approval at the January 31, 2005 AGM. If Mr Stewart resigns before February 2, 2007 (which was the end of his original employment agreement), then he will retain the performance options and performance rights on a pro-rata basis calculated from his appointment date of February 2, 2004 to the date of termination. Such performance options and performance rights will have two years from the date of his resignation to satisfy the performance conditions after which they will lapse if not exercised. Mr Stewart was offered a further 500,000 performance options and 140,000 performance rights upon signing his new employment agreement in January 2006. This grant was approved by shareholders at the January 30, 2006 AGM, and subsequently awarded in March 2006. If Mr Stewart resigns before February 6, 2009, then he will retain the performance options and



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performance rights on a pro-rata basis calculated from February 6, 2006 (the performance hurdle effective date) to the date of termination. Such performance options and performance rights will have two years from the date of his resignation to satisfy the performance conditions after which they will lapse if not exercised.

**Employment agreements for KMP (other senior executives) and other named executives**

Remuneration and other terms of employment for KMP (other senior executives) and other named executives of the Company and the Group are formalised in individual employment agreements. Each of these agreements provides for performance-related cash bonuses, fringe benefits plus other benefits, including participation, if eligible, in performance option and performance rights plans and termination benefits. Termination payments are generally calculated as the Company notice period multiplied by TEC. Details of the arrangements as at September 30, 2006 are set out below.

Name	Position	Term of agreement/contract and date commenced, if during the year	TEC \$(1)	Target STI(2)	Notice period Employee	Notice period Company (3)
Cameron A Clyne	Executive General Manager, Group Development	No fixed term.	600,548	75%	13 weeks	52 weeks
George Frazis	Executive General Manager, Business and Private Banking Australia	4 years.	725,661	75%	13 weeks	26 weeks
Michael J Hamar	Group Chief Risk Officer	4 years.	725,661	80%	13 weeks	26 weeks
John E Hooper	Chief Executive Officer, nabCapital	No fixed term.	775,707	130%	13 weeks	52 weeks
Lynne M Peacock	Chief Executive Officer, United Kingdom	No fixed term.	GBP 535,000	100%	Three months	12 months
Peter L Thodey	Managing Director and Chief Executive Officer, Bank of New Zealand	No fixed term. Current contract commenced October 3, 2005.	NZD 650,000	100%	Six months	12 months
Stephen J Tucker	Executive General Manager, Wealth Management Australia	No fixed term.	650,000	75%	13 weeks	26 weeks

(1) *Total Employment Cost (TEC) is the Group's primary measure of fixed remuneration which includes superannuation and non-monetary benefits but excludes leave accrued not taken. It does not include STI or LTI payments. In this table, TEC is expressed in the currency agreed in the employment agreement.*

(2) *Target STI as a percentage of TEC is subject to achievement of individual and Group performance goals and to passing the compliance and behaviour quality gates. The Target STI percentage (of TEC shown above) is earned for an on-target individual and Group performance. The size of the STI reward pool as determined by the Remuneration Committee acts as a multiplier to these individual STI targets. Individual performance is overlaid, with individual outcomes being in the range from nil to 200% based on individual performance under the performance framework, resulting in a further increase or reduction in individual outcomes.*

(3) *Termination payments calculated as the Company notice period multiplied by TEC are payable if the Company terminates the executive's employment agreement on notice and without cause, and makes payment in lieu of notice. Termination payments are not generally payable on resignation, summary termination or unsatisfactory performance, although the Board may determine exceptions to this. Performance options and performance rights generally lapse 30 days (or such shorter time as determined at the time of grant) after employment ends - unless otherwise determined by the Board. In certain circumstances and depending on the terms of grant, in cases such as contract completion, death, retirement, retrenchment, or total and permanent disablement, the Board may consider each case on its individual merits and may allow the executive to retain some or all of their performance options and performance rights for a period of time no later than up to the relevant expiry date of the securities. Vesting and exercise of the securities remain subject to the applicable performance hurdle. Certain shares held in trust are forfeited in certain circumstances that depend on the relevant program. These circumstances can include termination for serious misconduct involving dishonesty, resignation, failure to meet compliance gates in the 12 months after allocation, summary termination or breach of the Company's Code of Conduct.*

**Remuneration for KMP (executive directors), KMP (other senior executives) and other named executives**

*(each of these employee groups is defined on page 84)*

The following table shows details of the nature and amount of each element of the remuneration paid or payable for services provided to the Company and to the Group for the year to September 30, 2006 (including STI and LTI amounts in respect of performance during the year to September 30, 2006). All individuals listed are paid in Australian dollars - with the exception of Ms Lynne M Peacock, who is paid in GBP (converted here at a rate of A\$1.00 = GBP 0.4150 for 2006) and Mr Peter L Thodey who is paid in NZD (converted here at a rate of A\$1.00 = NZD 1.1432 for 2006).

Performance options and performance rights in relation to the performance year to September 30, 2006 are anticipated to be granted in February 2007. No performance options or performance rights have been granted to the listed individuals since the end of 2006 up to November 30, 2006. No retirement benefits were paid or payable to the listed individuals in 2006.

Cash salary fixed(1)	Short-term benefits		Post-employment benefits		Equity-based benefits		Termination benefits(8)	Total
	Cash STI at risk(2)	Non-monetary fixed(3)	Super-annuation fixed(4)	Other long-term benefits(5)	Shares at risk(6)	Options and rights at		

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		\$	\$	\$	\$	\$	\$	risk(7)	\$	\$
<b>Executive directors</b>										
JM Stewart	2006	2,505,339	1,472,500	113,948	80,000	1,578,235	2,655,020			8,405,042
	2005	2,123,713	1,402,500	82,742	78,768	891,789	1,653,324			6,232,836
A Fahour	2006	1,538,022	1,683,000	3,983	41,743	2,454,312	775,498			6,496,558
	2005	1,617,654		4,781	12,624	2,955,309	418,750			5,009,118
MJ Ullmer	2006	955,160	777,000	7,435	103,251	730,210	461,446			3,034,502
	2005	986,159	640,500	7,595	12,624	402,329	261,719			2,310,926
<b>Other senior executives</b>										
LM										
Peacock	2006	1,041,583	1,572,771	372,799	246,968	636,838	903,731			4,774,690
	2005	1,033,431	1,207,644	229,518	245,167	265,069	567,845			3,548,674
JE Hooper	2006	857,650	1,230,271	5,566	13,222	12,920	309,361			2,830,453
	2005	758,679	975,000	5,245	87,968		198,099			2,263,114
PL Thodey	2006	589,528	693,667	20,569		42,101	135,086			2,309,960
	2005	566,806	569,182	24,098			73,628			1,895,706
MJ Hamar	2006	602,964	708,245	47,184	104,103		121,297			1,716,260
	2005	509,835	493,323	28,391	62,818		269,420			1,434,679
CA Clyne	2006	594,065	549,501		41,512		106,830			1,641,379
	2005	576,723	358,215		12,624		29,604			1,199,541
<b>Total KMP</b>	<b>2006</b>	<b>8,684,311</b>	<b>8,686,955</b>	<b>571,484</b>	<b>630,799</b>	<b>55,021</b>	<b>6,072,169</b>			<b>31,208,844</b>
Total										
KMP(9)	2005	10,772,600	7,811,498	566,008	660,785	103,616	5,260,943	6,056,609	2,109,639	33,341,698
<b>Other named executives</b>										
G Frazis	2006	672,805	702,563		13,222		732,189			2,425,181
	2005	546,399	410,230		11,367		413,989			1,526,121
SJ Tucker	2006	599,288	641,845		85,899	10,833	518,228			2,278,756
	2005	584,738	410,234	3,897	80,982		130,721			1,469,353
<b>Total</b>	<b>2006</b>	<b>9,956,404</b>	<b>10,031,363</b>	<b>571,484</b>	<b>729,920</b>	<b>65,854</b>	<b>7,322,586</b>			<b>35,912,781</b>
<b>Total(9)</b>	<b>2005</b>	<b>11,903,737</b>	<b>8,631,962</b>	<b>569,905</b>	<b>753,134</b>	<b>103,616</b>	<b>5,805,653</b>	<b>6,459,526</b>	<b>2,109,639</b>	<b>36,337,172</b>

(1) Includes cash salary and short-term compensated absences such as annual leave entitlements accrued but not taken during the year.

(2) *Includes all short-term performance-based remuneration awarded for the performance year to September 30, 2006 in the form of cash. Amounts paid in the form of superannuation contributions (upon employee nomination in respect to amounts up to STI Target for Australian employees only) and in Company shares (upon employee nomination for amounts up to their STI Target and as required by the Company in respect of amounts awarded above STI Target) are shown in the Superannuation and Shares columns respectively. The revision to accounting standards requires such allocation, where under the previous accounting standard the full amount of STI awarded for the performance year to September 30, 2005 was included in STI bonus at risk in the 2005 financial report, irrespective of the form in which it was provided. 2005 comparative figures have been restated in line with the approach detailed above. STI amounts provided in the form of shares for the year ended September 30, 2005 were therefore disclosed in full as STI bonus at risk in the 2005 financial report, but a relevant portion is included again in the 2006 report within the calculations for the Shares column.*

*Refer to page 79 for further information regarding STI arrangements for employees (including KMP (other senior executives) and other named executives). All STI payments to such individuals are made in November, following the end of the performance year on September 30 (whether paid as cash, shares, or superannuation). Refer to page 84 for further information regarding STI arrangements for executive directors (for whom at least 50% of the value of STI rewards paid (and payable) are paid in the form of Company shares following approval by shareholders at the relevant AGM). Mr George Frazis and Mr Stephen J Tucker also participate in an Australian Leadership Team stretch incentive program, which entails rewards in the form of cash and shares upon achievement of business efficiency targets within the Australian region. The cash portion of this reward for the performance year to September 30, 2006 is included in the Cash STI at risk column, while the 2006-portion (\$270,128 each) of the total value of the shares is included in the Shares at risk column (with a further 2007-portion (\$270,871 each) to be included next year unless all of the shares are forfeited upon resignation, or upon the targets not being met for the September 30, 2007 performance year).*

*Separate disclosure of the nature and value of the STI rewards is included in the following section Short-term and long-term incentive remuneration .*

(3) *Includes motor vehicle benefits and parking. Also includes \$324,610 in regard to UK National Insurance contributions for Ms Lynne M Peacock, and health fund benefits for Mr John M Stewart and Mr John E Hooper. Fringe benefits tax on non-monetary benefits is included within the value of the benefit. The portion of Ms Peacock's non-monetary benefit in 2005 which related to UK National Insurance contributions has been restated from \$2,065 to \$183,874 to include the period of time Ms Peacock resided in the UK during the year. The 2005 misstatement was discovered while compiling this report.*

(4) *Includes Company contributions to superannuation and allocations by employees made by way of salary sacrifice. Individuals based in Australia may also nominate to be provided all or part of amounts up to STI Target in the form of additional Company superannuation contributions. No such elections were made by KMP and other named executives for 2006. For Mr Stephen J Tucker, who is a member of a defined benefit plan, the amount included for remuneration purposes is the annual benefit received by Mr Tucker during the year, and may or may not reflect the contributions made. Mr Tucker's 2005 figure has been restated accordingly.*

(5) *Includes long service entitlements accrued but not taken during the year.*

(6) *Represents the 2005 and 2006 portions of share-based payments paid or payable to KMP and other named executives. The value of each share allocation is spread over the length of time that forfeiture or performance conditions apply (vesting period). For example, shares that are intended to be granted to KMP (other senior executives) and to other named executives in November 2006 in respect of rewards above STI Target for the performance year to September 30, 2006 are expensed over the period from October 1, 2005 (the start of the relevant performance period) through to November 2007 (end of vesting period when the primary forfeiture conditions no longer apply).*

*The amounts disclosed in the Shares at risk column for 2005 and 2006 therefore do not reflect the payments made in respect of only each financial year. They include relevant portions of 2005 and 2006 year STI rewards as described above and in footnote (2), and relevant portions of 2005 awards (and 2006 awards for Ms Lynne M Peacock and Mr Peter L Thodey) provided under the general employee share offer (excludes executive directors) as described on page 80. They also include relevant portions of Commencement shares (as described on page 80) provided to Mr Ahmed Fahour in 2004 (some with ongoing performance condition), and to Mr Michael J Hamar and Mr George Frazis in 2005 with performance conditions which have been met during the 2005 and 2006 years. For Mr Stephen J Tucker, the 2005 amount includes shares allocated under the Wealth Management Ownership program (5% of notional benefit salary provided in the form of shares) and for Mr John E Hooper, the 2005 amount includes Retention shares allocated in 2004 in respect of his acting role as head of nabCapital, with retention conditions which were met during the 2005 year.*

*(7) Performance options and performance rights are issued as part of the Group's LTI program. Allocations are generally made in the week following the AGM each year in respect of assessments for the preceding year to September 30. Continued allocations are not guaranteed as they are subject to annual assessments. The exercise price of the performance options is determined by the volume weighted average price of the Company's ordinary shares traded on the ASX over the week following the AGM. No terms of vested performance options or rights were altered during the reporting period. The amount included in remuneration each year is the grant date fair value which has been amortised on a straight line basis over the expected vesting period. Refer to page 89 for an explanation of fair value basis used to determine remuneration.*

*(8) No listed executives had post-employment benefits that required approval by members of the Company in accordance with the Corporations Act 2001 (Cth).*

*(9) Group aggregate totals in respect of the financial year ended September 30, 2005 do not equal the sum of 2005 amounts disclosed for 2006 KMP and named executives, as there are differences in the individuals identified as KMP in 2005. The aggregate totals for KMP 2005 includes 14 individuals for the period they held the position of KMP, i.e. for full or part year, during 2005, and the grand total for 2005 includes those individuals plus remuneration for named executives in 2005.*

In addition to remuneration benefits above, the Company paid an insurance premium for a contract insuring all KMP of the Company or Group (or both) as officers. It is not possible to allocate the benefit of this premium between individuals. In accordance with usual commercial practice, the insurance contract prohibits disclosure of details of the premium paid.

**Short-term and long-term incentive remuneration**

The design of the share, performance option, and performance rights plans (and the expected outcome for executives) seek to conform with the guidelines set out in Executive Share and Option Scheme Guidelines, Guidance Note 12, Investment and Financial Services Association, which specifies the key principles that should be considered in designing incentive schemes, and the process for shareholder approval of the schemes. The principal difference to the guidelines is that performance rights issued by the Company have a nominal exercise price and that any performance options whose exercise price is set at a date other than at the date of grant could potentially have an exercise price lower (or higher) than the market price prevailing at or around the date of grant. The Group's various employee equity plans are discussed in detail in note 41 of the financial report.

The following table calculates the amounts shown in the previous table to show the proportions that are linked to Company performance.

	Remuneration not linked to Company performance(1) %	Performance related remuneration			Total %
		Cash-based Cash STI at risk %	Shares at risk %	Equity-based Options and rights at risk %	
<b>Executive directors</b>					
JM Stewart	31%	18%	19%	32%	100%
A Fahour	24%	26%	38%	12%	100%
MJ Ullmer	35%	26%	24%	15%	100%
<b>Other senior executives</b>					
LM Peacock	35%	33%	13%	19%	100%
JE Hooper	31%	44%	11%	14%	100%
PL Thodey	28%	30%	6%	36%	100%
MJ Hamar	44%	41%	7%	8%	100%
CA Clyne	39%	33%	7%	21%	100%
<b>Other named executives</b>					
G Frazis	28%	29%	30%	13%	100%
SJ Tucker	30%	28%	23%	19%	100%

(1) Includes cash salary fixed, non-monetary fixed, superannuation fixed, other long-term benefits, and termination benefits as shown in the table on page 86.

**Percentage of STI Target awarded in respect of the performance year to September 30, 2006**

The following table shows the percentage of each individual's STI Target awarded in respect of the performance year to September 30, 2006.

	STI Target as % of fixed remuneration(1)	STI awarded as % of fixed remuneration	STI Cash awarded 2006 % of STI bonus \$	STI Shares awarded 2006 % of STI bonus \$	Total cash and shares 2006 \$	Total cash and shares 2005 \$
<b>Executive directors</b>						

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JM Stewart(2)	96%	109%	1,472,500	50%	1,472,500	50%	2,945,000	2,805,000
A Fahour(2)	124%	213%	1,683,000	50%	1,683,000	50%	3,366,000	2,880,000
MJ Ullmer(2)	99%	146%	777,000	50%	777,000	50%	1,554,000	1,281,000
<b>Other senior executives</b>								
LM Peacock	78%	142%	1,572,771	67%	788,675	33%	2,361,446	1,775,312
JE Hooper	113%	194%	1,230,271	71%	492,729	29%	1,723,000	1,141,000
PL Thodey	87%	117%	693,667	91%	69,979	9%	763,646	726,958
MJ Hamar	77%	103%	708,245	91%	71,755	9%	780,000	493,323
CA Clyne	71%	112%	549,501	77%	165,499	23%	715,000	420,000
<b>Other named executives</b>								
G Frazis	123%	197%	702,563	52%	646,204	48%	1,348,767	1,039,001
SJ Tucker	113%	156%	641,845	59%	441,143	41%	1,082,988	977,464

(1) *Fixed remuneration includes cash salary fixed, non-monetary fixed, superannuation fixed, other long-term benefits and termination benefits (as shown in the table on page 86). STI Target as a percentage of fixed remuneration differs from STI Target as a percentage of TEC, as described on page 86.*

(2) *The issue of the share component for executive directors is subject to required shareholder approval.*

**Range of potential short-term and long-term incentive payments in respect of the performance year to September 30, 2006**

The following table shows the composition and aggregate minimum and maximum values of STI and LTI payments earned by each individual in respect of the performance year to September 30, 2006.

	Paid %	Forfeited(1) %	Short-term incentives (STI)		Maximum deferred value \$	Long-term incentives (LTI)		
			Deferred(2) %	Minimum deferred value(3) \$		Minimum value (all deferred)(3) \$	Maximum value (all deferred)(4) \$	
<b>Executive directors</b>								
JM Stewart	50%		50%		1,472,500			
A Fahour	50%		50%		1,683,000		2,274,000	
MJ Ullmer	50%		50%		777,000		1,220,112	
<b>Other senior executives</b>								
LM Peacock	67%		33%		788,675		810,000	
JE Hooper	71%		29%		492,729		960,000	
PL Thodey	91%		9%		69,979		722,250	
MJ Hamar	91%		9%		71,755		580,529	
CA Clyne	77%		23%		165,499		780,000	
<b>Other named executives</b>								
G Frazis	52%		48%		646,204		675,000	
SJ Tucker	59%		41%		441,143		590,625	

(1) All of the listed individuals have earned in excess of their Target STI for the 2006 performance year, with no portion of Target STI forfeited.

(2) Deferred STI is the shares component from the table above. The shares are held in trust with restrictions on trading for a minimum of one year (or longer if nominated by the employee). Various forfeiture conditions apply as set out on page 79.

(3) Shares allocated as deferred STI rewards are subject to forfeiture conditions, and performance options and performance rights granted as LTI rewards lapse on cessation of employment or if performance hurdles are not achieved. The minimum deferred value for both is therefore shown as zero.

(4) The maximum deferred value of LTI rewards is the anticipated fair value (based on the fair value of recent allocations) of the performance options and performance rights at grant date, which is anticipated to be in February 2007.

**Fair value basis used to determine equity remuneration**



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The disclosure of the allocation of fair value of performance options and performance rights in the earlier tables is based upon the requirements of AASB 124 Related Party Disclosures. Under these guidelines, each year a portion of the fair value of all unvested performance options and rights is included in the individuals' remuneration for disclosure purposes. This portion of the fair value is based on a straight-line allocation of fair value over the vesting period of each unvested performance option or performance right. Under AIFRS, only performance options and performance rights granted after November 7, 2002 that were unvested at January 1, 2005 are included in the remuneration calculation.

Performance options and rights granted as part of executive remuneration have been valued using a numerical pricing model. The model takes account of factors including: the exercise price(s); the current level and volatility of the underlying share price; the risk-free interest rate; expected dividends on the underlying share; current market price of the underlying share; and the expected life of the securities. The probability of the performance hurdle being reached has been taken into consideration in valuing the securities. *For further details, refer to note 41 in the financial report.* The fair value and exercise price per performance option and performance right (at grant) are set out below for grants provided to KMP (executive directors), KMP (other senior executives) and other named executives.

Grant Date	Performance options		Performance rights		Exercise Period(2)	
	Fair value \$	Exercise Price \$	Fair value \$	Exercise Price(1) \$	From	To
February 6 & February 20, 2006	\$ 3.39	\$ 34.53	\$ 18.23		February 6, 2009	August 6, 2011
February 22, 2006(3)	\$ 2.98	\$ 34.53	\$ 17.61		February 6, 2009	August 6, 2011
March 10, 2006(3)	\$ 3.10	\$ 34.53	\$ 17.52		February 6, 2009	August 6, 2012

(1) *The total exercise price payable on the exercise of performance rights is \$1 for the total number exercised on any one calendar day.*

(2) *These performance options and performance rights are granted in 3 tranches (in 4 tranches for those allocated to Mr John M Stewart on March 10, 2006). Each tranche has a different testing schedule, vesting period, and exercise period. The exercise period shown here is the total exercise period covering all tranches. All vested and unexercised securities lapse at the end of this exercise period.*

(3) *Approval of the granting of these performance options and performance rights to the executive directors was provided by shareholders at the AGM held on January 30, 2006. The grant date for the purposes of calculating the fair value and for share-based payments purposes is therefore January 30, 2006.*

**Value of performance options and performance rights granted**

The following tables show the value of performance options and performance rights issued to each individual as part of their remuneration that were granted, exercised, lapsed or vested during the year to September 30, 2006. The performance options and performance rights are rights to acquire ordinary shares, subject to certain conditions being met, under the Company's National Australia Bank Executive Share Option Plan No. 2 (executive share option plan) and the National Australia Bank Performance Rights Plan (performance rights plan). No performance options or performance rights are granted to KMP (non-executive directors). *The terms and conditions of each performance option and right, including a summary of the performance hurdle required to be met in order to vest, are set out on page 82.*

No amounts are paid by individuals for the issue of performance options and performance rights. All shares issued upon the exercise of performance options and performance rights are paid for in full by the individual based on the relevant exercise price. Under the executive share option plan a loan may be available to executives if and when they wish to exercise their performance options - subject to applicable laws and regulations (including the United States *Sarbanes-Oxley Act of 2002*). The rules of the executive share options plan provide that the rate of interest on such a loan shall be the Company's base lending rate plus any margin determined by the Board. Dividends payable in respect of a share loan are applied firstly towards payment of any interest which is due, and secondly towards repayment of the principal amount outstanding under the loan. *For further information on the executive share option plan refer to note 41 in the financial report.*

	Granted No.	Grant date	Number of performance options			Value of performance options			Total \$
			Exercised No.	Lapsed No.	Vested No.	Granted(1) \$	Exercised \$	Lapsed \$	
<b>Executive directors</b>									
JM Stewart	500,000	Mar 10, 2006				1,550,000			1,550,000
A Fahour	284,000	Feb 22, 2006				846,320			846,320
MJ Ullmer	159,000	Feb 22, 2006				473,820			473,820
<b>Other senior executives</b>									
LM Peacock	195,732	Feb 6, 2006				663,531			663,531
JE Hooper	82,344	Feb 6, 2006				279,146			279,146
PL Thodey	67,120	Feb 20, 2006				227,537			227,537
MJ Hamar	31,250	Feb 6, 2006				105,938			105,938
CA Clyne	63,750	Feb 6, 2006				216,113			216,113
<b>Other named executives</b>									
G Frazis	90,250	Feb 6, 2006				305,948			305,948
SJ Tucker	79,750	Feb 6, 2006				271,268			271,268

	Granted No.	Grant date	Number of performance rights			Value of performance rights			Total \$
			Exercised No.	Lapsed No.	Vested No.	Granted(1) \$	Exercised \$	Lapsed \$	
<b>Executive directors</b>									
JM Stewart	140,000	Mar 10, 2006				2,452,800			2,452,800
A Fahour	71,000	Feb 22, 2006				1,250,310			1,250,310
MJ Ullmer	39,750	Feb 22, 2006				699,998			699,998
<b>Other senior executives</b>									
LM Peacock	48,933	Feb 6, 2006				892,049			892,049
JE Hooper	20,586	Feb 6, 2006				375,283			375,283
PL Thodey	16,780	Feb 20, 2006				305,899			305,899
MJ Hamar	7,813	Feb 6, 2006				142,431			142,431
CA Clyne	15,938	Feb 6, 2006				290,550			290,550
<b>Other named executives</b>									

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G Frazis	22,563	Feb 6, 2006	411,323	411,323
SJ Tucker	19,938	Feb 6, 2006	363,470	363,470

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(1) Value of performance options and performance rights granted is determined as the fair value at grant date multiplied by the total number of performance options or performance rights granted. The value of performance options and performance rights disclosed above represents the full value over the vesting period - which is greater than one year.

**KMP (non-executive director) remuneration**

The following persons were KMP (non-executive directors) of the Group and Company at September 30, 2006:

<b>Name</b>	<b>Position</b>	<b>Date commenced, if during year</b>
MA Chaney	Chairman	
PA Cross	Director	December 1, 2005
PJB Duncan	Director	
DT Gilbert	Director	
TK McDonald	Director	December 1, 2005
PJ Rizzo	Director	
JS Segal	Director	
JG Thorn	Director	
GA Tomlinson	Director	
GM Williamson	Director	

The following person resigned from his position as a KMP (non-executive director) of the Group and Company during the year ended September 30, 2006:

<b>Name</b>	<b>Position</b>	<b>Date resigned</b>
RG Elstone	Director	July 5, 2006

**Remuneration policy**

The fees paid to KMP (non-executive directors) on the Board are based on advice and data from the Group's remuneration specialists and from external remuneration advisers. This advice takes into consideration the level of fees paid to board members of other major Australian corporations, the size and complexity of the Group's operations, the activities of the Group and the responsibilities and workload requirements of Board members.

Fees are established annually for the Chairman and non-executive directors on the Board. Additional fees are paid, where applicable, for participation in Board committees and for serving on the boards of controlled entities. The fees include compulsory Company contributions to superannuation. As part of its annual review of fees paid to the Chairman and non-executive directors, the Board decided, at its meeting in November 2006, that no increases to fees would be made in respect of the Company's 2007 financial year.

The total fees paid by the Group to members of the Board, including fees paid for their involvement on Board committees, are kept within the total approved by shareholders from time to time. Shareholders approved a maximum fee pool of \$3.5 million per annum at the Company's annual general meeting held on December 19, 2003.

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At the Company's annual general meeting held in December 2003, shareholders approved the continuation of the KMP (non-executive directors) share arrangement under the Non-Executive Director's Share Plan (which is operated through the National Australia Bank Staff Share Ownership Plan). Under this arrangement, shares are provided to Australian-resident KMP (non-executive directors) as part of their remuneration. For all KMP (non-executive directors), a minimum of 10% of fees and a maximum of 40% is provided by way of shares issued to or acquired by the KMP. The trustee of the National Australia Bank Staff Share Ownership Plan determines the issue date of shares under the Plan in its sole discretion.

During 2002, the Board decided not to enter into any new contractual obligations to pay retirement allowance benefits to KMP (non-executive directors) appointed after December 31, 2002. At the Company's annual general meeting held on December 19, 2003, a proposal was approved permitting directors of the Company and its controlled entities who had accrued retirement benefits to apply those benefits, frozen as at December 31, 2003, to either cash (to be paid on retirement), to additional superannuation contributions or to the acquisition of shares in the Company (to be held in trust until retirement). Where directors elected to apply those benefits toward shares held in trust, the dividends earned on those shares are applied to the acquisition of further Company shares in the week up to and including the date of allocation, less \$0.01, rounded down to the nearest whole number, on the Company's dividend payment date (*refer footnote 1 to the following table*).

All directors can elect to set aside part of their remuneration as additional Company superannuation contributions.

The appointment letters for the KMP (non-executive directors) set out the terms and conditions of their appointments. These terms and conditions are in conjunction with, and subject to, the Company's constitution and the charters and policies approved by the Board from time to time (*refer to the corporate governance section on page 59*).

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The following table shows details of the nature and amount of each element of the emoluments of each of the KMP (non-executive directors) of the Company relating to services provided in the 2006 year. No performance options or performance rights have been granted to KMP (non-executive directors) during or since the end of 2006 up to November 30, 2006.

		Short-term benefits		Post-employment benefits(1)		Equity-based benefits			Total
		Cash salary and fees (2) fixed	Bonus at risk	Non-monetary fixed	Super-annuation (3) fixed	Other long-term benefits	Shares fixed(4)	Options and rights at risk	
		\$	\$	\$	\$	\$	\$	\$	\$
<b>Current</b>									
M A									
Chaney(5)	2006	497,913			100,587		66,500		665,000
	2005	116,665			11,491		11,250		139,406
PA Cross(6)	2006	104,414			10,253		64,500		179,167
PJB Duncan	2006	183,578			12,276		34,563		230,417
	2005	176,083			18,512		30,072		224,667
DT Gilbert	2006	48,692			80,308		86,000		215,000
	2005	147,218			15,903		29,750		192,871
TK									
McDonald(6)	2006	269,042							269,042
PJ Rizzo	2006	208,945			12,501		24,605		246,051
	2005	200,135					19,000		219,135
JS Segal	2006	138,849			12,276		81,375		232,500
	2005	123,982			15,976		54,356		194,314
JG Thorn	2006	165,688			46,253		30,976		242,917
	2005	164,217			18,367		40,500		223,084
GA Tomlinson	2006	270,779			12,276		119,214		402,269
	2005	326,605			30,220		10,767		367,592
GM									
Williamson	2006	561,446							561,446
	2005	507,122							507,122
<b>Former</b>									
RG Elstone	2006	164,023					18,044		182,067
	2005	176,255					17,804		194,059
<b>Total</b>	<b>2006</b>	<b>2,613,369</b>			<b>286,730</b>		<b>525,777</b>		<b>3,425,876</b>
	2005(7)	2,362,701			153,468		283,998		2,800,167

(1) No retirement benefits have been accrued by directors since January 1, 2004. In accordance with shareholder approval given at the Company's annual general meeting on December 19, 2003 to freeze contractual entitlements, the value of accumulated retirement benefits of Mr Peter JB Duncan and Mr Geoffrey A Tomlinson were provided to them during 2004 in the form of shares to be held on trust until retirement. The value of the accrued benefits provided at that time was: Mr Duncan \$104,855; and Mr Tomlinson \$272,608. The dividends earned on those shares were applied to the acquisition of further Company shares in the week up to and including the date of allocation, less \$0.01, rounded down to the nearest whole number, on the Company's dividend payment date. During 2006, 197 shares were acquired in this way in respect of Mr Duncan and 512 shares were acquired in respect of Mr Tomlinson. From December 31, 2003, neither new nor existing non-executive directors are entitled to additional retirement benefits.

(2) Non-executive directors' remuneration represents fees in connection with their roles, duties and responsibilities as a non-executive director, and includes attendance at meetings of the Board, Board committees and boards of controlled entities and includes payments of \$110,709 (2005: \$nil) to Mr T Kerry McDonald, \$191,852 (2005: \$160,890) to Mr Geoffrey A Tomlinson and \$371,446 (2005: \$362,230) to Mr G Malcolm Williamson in respect of services performed as non-executive directors of controlled entity boards and committees.

(3) Reflects compulsory Company contributions to superannuation and, where applicable, includes additional contributions made by the Company, in lieu of payment of fees, at the election of the non-executive director. Mr Robert Elstone and Mr Paul Rizzo had elected to have

*their employer superannuation contribution paid as cash remuneration. In July 2006, Mr Rizzo elected to make salary sacrifice contributions to superannuation.*

*(4) Represents the value of newly-issued ordinary shares in the Company that were allocated to Australian non-executive directors. The price used to determine the number of shares was the volume weighted average price of the Company's ordinary shares traded on the ASX during the one week up to and including the date of allocation.*

*(5) Mr Michael Chaney was appointed Chairman with effect from September 29, 2005.*

*(6) Mrs Patricia Cross and Mr T Kerry McDonald were appointed as non-executive directors in December 2005 and accordingly the remuneration shown is for the period December 1, 2005 to September 30, 2006.*

*(7) This is the total for non-executive directors that was disclosed in last year's annual financial report and differs from the 2005 total in respect of the current non-executive directors due to changes in non-executive directors during the 2005 year.*

**KMP (non-executive director) fees**

The total fees paid by the Group to non-executive members of the Board, including fees paid for their involvement on Board committees, are kept within the total pool approved by shareholders from time to time. The following table shows details of the components of KMP (non-executive director) remuneration paid in the form of Board and committee fees:

**Board and committee remuneration**

	Board \$	Audit Committee \$	Risk Committee \$	Remuneration Committee \$	Nomination Committee \$	Meetings of controlled entities \$	Total \$
<b>Current</b>							
MA Chaney	665,000						665,000
PA Cross(1)	158,334		20,833				179,167
PJB Duncan	190,000		8,333	32,084			230,417
DT Gilbert	190,000	25,000					215,000
TK McDonald(1)(2)	158,333					110,709	269,042
PJ Rizzo	190,000	25,000	31,051				246,051
JS Segal	190,000	4,167	20,833	17,500			232,500
JG Thorn	190,000	50,000		2,917			242,917
GA Tomlinson	190,000			20,417		191,852	402,269
GM Williamson(2)	190,000					371,446	561,446
<b>Former</b>							
RG Elstone	144,132		33,333			4,602	182,067
<b>Total</b>	<b>2,455,799</b>	<b>104,167</b>	<b>114,383</b>	<b>72,918</b>		<b>678,609</b>	<b>3,425,876</b>

(1) Mrs Patricia Cross and Mr T Kerry McDonald were appointed as non-executive directors in December 2005 and accordingly the fees shown are for the period December 1, 2005 to September 30, 2006.

(2) The fees that were paid to Mr McDonald and Mr Williamson in respect of their services performed as non-executive directors of controlled entity boards and committees were paid in New Zealand dollars and sterling respectively. The exchange rates used to convert those fees to Australian dollars were A\$1.00 = GBP0.4150 and NZ\$1.1432 respectively.

Included in the table above is remuneration paid as Company shares. The price used to determine the number of Company shares was the volume weighted average price of the Company's ordinary shares traded on the ASX during the one week up to and including the date of allocation.

Certain disclosures required by AASB 124 Related Party Disclosures are contained within this remuneration report. Pages 78 to 93 of this report have been audited as required.





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**Financial report**

## Income statement

For the year ended September 30	Note	Group		Company	
		2006 \$m	2005 \$m	2006 \$m	2005 \$m
Interest income	3	25,553	21,103	19,462	15,521
Interest expense	3	(16,867)	(14,159)	(13,786)	(11,337)
Net interest income		8,686	6,944	5,676	4,184
Premium and related revenue		887	906		
Investment revenue		6,375	7,531		
Claims expense		(565)	(590)		
Change in policy liabilities		(4,456)	(5,570)		
Policy acquisition and maintenance expense		(791)	(739)		
Investment management expense		(33)	(33)		
Net life insurance income		1,417	1,505		
Gains less losses on financial instruments at fair value	4	471	639	342	506
Other operating income	4	4,419	5,251	2,646	5,309
Net profit from the sale of controlled entities	4	196			
Significant revenue					
Pensions revenue	4	319		43	
Net profit/(loss) from the sale of National Europe Holdings (Ireland) Limited	4	15	1,354		(41)
Total other income		5,420	7,244	3,031	5,774
Personnel expenses	5	(3,869)	(3,807)	(2,507)	(2,269)
Occupancy-related expenses	5	(523)	(539)	(302)	(277)
General expenses	5	(3,187)	(3,649)	(1,546)	(1,533)
Charge to provide for doubtful debts	5	(606)	(534)	(262)	(294)
Net loss from the sale of controlled entities	5	(63)			
Significant expenses					
Restructuring costs	5		(793)		(499)
Foreign currency options trading losses reversal	5		34		34
Reversal of prior years restructuring provision	5		11		6
Total operating expenses		(8,248)	(9,277)	(4,617)	(4,832)
<b>Profit before income tax expense</b>		<b>7,275</b>	<b>6,416</b>	<b>4,090</b>	<b>5,126</b>
Income tax expense	6	(2,134)	(1,814)	(1,003)	(873)
<b>Net profit</b>		<b>5,141</b>	<b>4,602</b>	<b>3,087</b>	<b>4,253</b>
Net profit attributable to minority interest		(749)	(610)		
<b>Net profit attributable to members of the Company</b>		<b>4,392</b>	<b>3,992</b>	<b>3,087</b>	<b>4,253</b>
Basic earnings per share (cents)	8	262.6	246.3		
Diluted earnings per share (cents)	8	261.8	242.3		
Dividends per ordinary share (cents)					
Interim	7	83	83		
Final	7	84	83		

## Balance sheet

As at September 30	Note	Group		Company	
		2006 \$m	2005 \$m	2006 \$m	2005 \$m
<b>Assets</b>					
Cash and liquid assets	9	12,768	8,441	5,913	3,334
Due from other banks	10	24,372	15,595	19,565	16,225
Trading derivatives	11	13,384	13,959	12,311	13,416
Trading securities	12	13,740	15,154	12,873	14,101
Investments - available for sale	13	1,493	3,860	965	3,234
Investments - held to maturity	14	1,388	7,466	883	2,425
Investments relating to life insurance business	15	54,784	49,783		
Other financial assets at fair value	16	22,123		780	
Hedging derivatives	11	480		383	
Loans and advances	17	283,777	264,674	199,515	175,629
Due from customers on acceptances	20	41,726	27,627	41,714	27,612
Property, plant and equipment	21	1,877	3,829	834	766
Due from controlled entities				28,067	29,641
Investments in controlled entities and joint venture entities	22		16	15,300	11,021
Goodwill and other intangible assets	23	5,203	5,458	336	341
Deferred tax assets	24	1,631	1,734	1,055	950
Other assets	25	6,039	5,002	3,262	2,685
<b>Total assets</b>		<b>484,785</b>	<b>422,598</b>	<b>343,756</b>	<b>301,380</b>
<b>Liabilities</b>					
Due to other banks	26	37,489	36,322	33,015	32,605
Trading derivatives	11	12,008	12,613	11,002	11,642
Other financial liabilities at fair value	27	17,680	1,487	3,509	637
Hedging derivatives	11	333		179	
Deposits and other borrowings	28	222,277	212,557	157,664	144,842
Liability on acceptances	20	32,114	27,627	32,102	27,612
Life policy liabilities	29	46,475	42,123		
Current tax liabilities	30	532	145	526	19
Provisions	31	1,618	1,847	1,045	1,137
Due to controlled entities				17,913	13,729
Bonds, notes and subordinated debt	32	65,006	41,490	55,513	38,108
Other debt issues	33	2,274	1,559	334	328
Defined benefit pension scheme liabilities	34	313	985	32	101
Managed fund units on issue	35	7,249			
Deferred tax liabilities	30	1,490	1,226	342	1,016
Other liabilities	36	9,955	11,070	4,712	5,486
<b>Total liabilities</b>		<b>456,813</b>	<b>391,051</b>	<b>317,888</b>	<b>277,262</b>
<b>Net assets</b>		<b>27,972</b>	<b>31,547</b>	<b>25,868</b>	<b>24,118</b>
<b>Equity</b>					
Contributed equity	37	12,279	10,828	11,796	10,532
Reserves	38	1,064	814	653	141
Retained profits	39	14,461	13,681	13,419	13,445
Total equity (parent entity interest)		<b>27,804</b>	<b>25,323</b>	<b>25,868</b>	<b>24,118</b>
Minority interest in controlled entities	40	168	6,224		
<b>Total equity</b>		<b>27,972</b>	<b>31,547</b>	<b>25,868</b>	<b>24,118</b>

## Recognised income and expense statement

For the year ended September 30	Note	Group		Company	
		2006 \$m	2005 \$m	2006 \$m	2005 \$m
Actuarial gains/(losses) from defined benefit pension plans	39	207	(107)	151	1
Cash flow hedges					
Gains/(losses) taken to equity	38	77		119	
Transferred to income statement	38	2			
Revaluation of land and buildings	38	11	(6)		(3)
Exchange differences on translation of foreign operations	38	357	(538)	(24)	(2)
Income tax on items taken directly to or transferred directly from equity		(72)	42	(75)	
<b>Net income recognised directly in equity</b>		<b>582</b>	<b>(609)</b>	<b>171</b>	<b>(4)</b>
Net profit		5,141	4,602	3,087	4,253
<b>Total net income recognised</b>		<b>5,723</b>	<b>3,993</b>	<b>3,258</b>	<b>4,249</b>
Attributable to					
Members of the parent		4,974	3,383	3,258	4,249
Minority interest		749	610		
<b>Total net income recognised</b>		<b>5,723</b>	<b>3,993</b>	<b>3,258</b>	<b>4,249</b>
<b>Effect of changes in accounting policy (1)</b>					
Net decrease in retained profits	39	(893)		(164)	
Net decrease in reserves	38	(420)		(25)	
<b>Effect of change in accounting policy</b>		<b>(1,313)</b>		<b>(189)</b>	

(1) This represents the impact of the initial application of AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1038 *Life Insurance Contracts* and AASB 4 *Insurance Contracts*. Refer to note 1B for further information.

## Cash flow statement

For the year ended September 30	Note	Group		Company	
		2006 \$m	2005 \$m	2006 \$m	2005 \$m
<b>Cash flows from operating activities</b>					
Interest received		24,501	20,967	18,894	15,198
Interest paid		(15,232)	(13,942)	(12,531)	(10,989)
Dividends received		16	2	859	2,930
Life insurance					
Premiums received		7,869	7,594		
Investment and other revenue received		1,848	1,853		
Policy payments		(7,308)	(6,837)		
Fees and commissions paid		(396)	(350)		
Net trading revenue received/(paid)		1,745	609	1,501	399
Other operating income received		5,540	5,203	2,204	2,238
Cash payments to employees and suppliers					
Personnel expenses paid		(3,816)	(3,881)	(2,365)	(2,170)
Other operating expenses paid		(4,135)	(4,249)	(1,873)	(2,252)
Goods and services tax (paid/received)		(101)	(33)	12	6
Cash payments for income taxes		(1,940)	(1,416)	(882)	(1,008)
Cash flows from operating activities before changes in operating assets and liabilities		8,591	5,520	5,819	4,352
<b>Changes in operating assets and liabilities arising from cash flow movements</b>					
Net placement of deposits with and withdrawal of deposits from supervisory central banks that are not part of cash equivalents		(1)	6	13	20
Net payments for and receipts from transactions in acceptances		(3,271)		(3,271)	
Net funds advanced to and receipts from customers for loans and advances		(30,137)	(34,649)	(21,449)	(22,888)
Net acceptance from and repayment of deposits and other borrowings		14,629	10,430	12,174	1,382
Movement in life insurance business investments					
Purchases		(7,036)	(12,575)		
Proceeds from disposal		5,545	8,922		
Net movement in other life insurance assets and liabilities					
		(406)	1,449		
Net payments for and receipts from transactions in treasury bills and other eligible bills held for trading and not part of cash equivalents					
		(223)		(129)	
Net payments for and receipts from transactions in trading securities					
		(3,803)	9,160	(5,000)	9,483
Net payments for and receipts from trading derivatives					
		(1,507)	456	(909)	406
Net funds advanced to and receipts from other financial assets at fair value					
		(2,638)	(572)	(486)	
Net funds advanced to and receipts from other financial liabilities at fair value					
		6,929	1,069	2,174	(194)
Net decrease/(increase) in other assets		447	(542)	666	514
Net (decrease)/increase in other liabilities		2,640	101	898	1,408
Net cash used in operating activities	44(a)	(10,241)	(11,225)	(9,500)	(5,517)





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For the year ended September 30	Note	Group		Company	
		2006 \$m	2005 \$m	2006 \$m	2005 \$m
<b>Cash flows from investing activities</b>					
Movement in investments - available for sale					
Purchases	13	(18,704)	(4,465)	(18,199)	(3,815)
Proceeds from disposal	13	1,354	1,384	1,306	784
Proceeds on maturity	13	19,877	3,560	19,264	3,555
Movement in investments - held to maturity					
Purchases	14	(16,856)	(27,155)	(16,426)	(24,199)
Proceeds from disposal and on maturity	14	17,718	30,184	17,497	26,568
Net movement in amounts due from/to controlled entities				5,423	(3,151)
Movement in shares in controlled entities and joint venture entities					
Purchases			(18)	(4,703)	(74)
Proceeds from disposal			106		526
Proceeds from sale of controlled entities, net of cash disposed and costs to sell	44(e)	1,020	2,335		(41)
Purchase of property, plant, equipment and software		(1,300)	(1,483)	(331)	(295)
Proceeds from sale of property, plant, equipment and software, net of costs		755	774	71	162
Net cash provided by investing activities		3,864	5,222	3,902	20
<b>Cash flows from financing activities</b>					
Repayments of bonds, notes and subordinated debt		(8,337)	(6,679)	(7,921)	(5,623)
Proceeds from issue of bonds, notes and subordinated debt, net of costs		28,528	13,837	21,239	13,683
Proceeds from issue of ordinary shares, net of costs		42	45	42	45
Net proceeds from issue of Trust Preferred Securities II, net of costs			1,014		1,014
Net proceeds from issue of National Capital Instruments, net of costs		1,076		397	
Dividends and distributions paid		(2,555)	(2,416)	(2,495)	(2,385)
Net cash provided by financing activities		18,754	5,801	11,262	6,734
Net increase/(decrease) in cash and cash equivalents		12,377	(202)	5,664	1,237
Cash and cash equivalents at beginning of year		(12,459)	(12,531)	(13,113)	(14,944)
Effects of exchange rate changes on balance of cash held in foreign currencies		(224)	274	(144)	594
<b>Cash and cash equivalents at end of year</b>	44(b)	<b>(306)</b>	<b>(12,459)</b>	<b>(7,593)</b>	<b>(13,113)</b>

**Notes to the financial statements**

**1 Principal accounting policies and explanation of transition to AIFRS**

**1A. Principal accounting policies**

The Group is an international financial services group that provides a comprehensive and integrated range of financial products and services. It is organised around three regional businesses in Australia, the United Kingdom and New Zealand together with a global business, nabCapital, which focuses on debt, risk management and investment products for corporate and institutional customers. The regional businesses include the retail bank brands, National Australia Bank Limited, Bank of New Zealand Limited and Yorkshire Bank and Clydesdale Bank PLC. The Group also provides wealth management and transactional and custodial operations.

The financial report of the National Australia Bank Limited (the Company) and the Company and its subsidiaries (the Group) for the year ended September 30, 2006 was authorised for issue in accordance with a resolution of the directors on November 29, 2006.

**(a) Basis of preparation**

The financial report, comprising the financial statements and notes thereto, is a general-purpose financial report, which has been prepared in accordance with the requirements of the *Banking Act 1959* (Cth), *Corporations Act 2001* (Cth), Australian Accounting Standards, Urgent Issues Group Consensus Views and other authoritative pronouncements of the Australian Accounting Standards Board (AASB). The financial statements have been prepared under the historical cost convention, as modified by the application of fair value measurements required by the relevant accounting standards.

The preparation of financial statements in conformity with Australian equivalents to International Financial Reporting Standards (AIFRS) requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosed amount of contingent liabilities. Assumptions made at each balance sheet date, for example, the calculation of loan loss provisions, defined benefit pensions and fair value adjustments, are based on best estimates at that date. Although the Group has internal control systems in place to ensure that estimates are reliably measured, actual amounts may differ from those estimates. It is not anticipated that such differences would be material.

The financial report also includes disclosures required by the United States SEC in respect of foreign registrants. Other prescribed SEC disclosures, which are not required to be included in the financial report, are presented elsewhere in this annual report. Certain key terms used in this financial report are defined in the glossary on page 285.

This is the first financial report prepared based on AIFRS and comparatives for the year ended September 30, 2005 have been restated accordingly. Reconciliations and descriptions of the impact of transition to AIFRS on the Group and the Company's income statement, balance sheet and statement of cash flows for the year ended September 30, 2005 are detailed in note 1B.

Comparative amounts relating to the financial year ending September 30, 2005 are not prepared in accordance with AASB 139 Financial Instruments: Recognition and Measurement (AASB 139), AASB 132 Financial Instruments: Disclosure and Presentation (AASB 132), AASB1038 Life Insurance Contracts (AASB 1038) or AASB 4 Insurance Contracts (AASB 4) as these standards are only applicable from October 1, 2005. The Group has adopted the exemption under AASB 1 First-time Adoption of Australian Equivalents to International Financial Reporting Standards (AASB 1) from having to apply AASB 132, AASB 139, AASB 1038 and AASB 4 to the comparative period. As a consequence, a brief explanation of the primary differences in accounting policies for comparative periods has been provided where the impact is material.

**(b) Statement of compliance**

The financial report complies with Australian Accounting Standards, which includes AIFRS. Compliance with AIFRS ensures that the Group financial report complies with International Financial Reporting Standards (IFRS). The financial statements of the Company are considered separate financial statements.

**(c) Early adoptions**

The Group has elected to early adopt the following accounting standards and amendments:

Amendments made to AASB 119 Employee Benefits (AASB 119) by AASB 2005-3 Amendments to Australian Accounting Standards for the year ended September 30, 2006. Comparatives have also been adjusted in accordance with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors.

Amendments made to AASB 139 by AASB 2005-4 Amendments to Australian Accounting Standards (amending AASB 139, AASB 132, AASB 1, AASB 1023 & AASB 1038 (Fair Value Option issued in June 2005)), for the year ended September 30, 2006. In accordance with the approach to application of AASB 139 outlined in (a) above, comparatives have not been adjusted.

**(d) Recently issued accounting standards to be applied in future reporting periods**

The AASB has issued new standards and amendments that were available for adoption, but not mandatory for September 30, 2006 reporting periods. In some cases these amendments relate to items which are not applicable to the Group. Those amendments which are applicable and which are likely to have an impact on the Group's disclosures but have not yet been applied by the Group in preparing this financial report are:

AASB 7 Financial Instruments: Disclosure (August 2005) (AASB 7) withdraws AASB 130 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and supersedes paragraphs 51-95 of AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after January 1, 2007.

AASB 2005-10 Amendments to Australian Accounting Standards (AASB 2005-10): following the issue of AASB 7 the following AASB standards have been amended - AASB 132; AASB 101 Presentation of Financial Statements ; AASB 114 Segment Reporting ; AASB 117 Leases ; AASB 133 Earnings per Share ; AASB 139; AASB 4; AASB 1023 General Insurance Contracts ; and AASB 1038.

The Group plans to adopt AASB 7 and AASB 2005-10 from October 1, 2007. The initial application of AASB 7 and AASB 2005-10 is not

expected to have an impact on the financial results of the Company or the Group as the standards are concerned only with disclosures.

**(e) Currency of presentation**

All amounts are expressed in Australian dollars unless otherwise stated.

**(f) Rounding of amounts**

In accordance with Australian Securities and Investments Commission Class Order 98/100 dated July 10, 1998, all amounts have been rounded to the nearest million dollars, except where indicated.

**(g) Principles of consolidation**

***(i) Controlled entities***

The consolidated financial report comprises the financial report of the Company and its controlled entities. Controlled entities are all those entities (including special purpose entities) over which the Company has the power to govern the financial and operating policies so as to obtain benefits from their activities. Special purpose entities require consolidation in circumstances such as those where the Group has access to the majority of the residual income or is exposed to the majority of the residual risk associated with the special purpose entity.

Entities are consolidated from the date on which control, or exposure to risks and benefits, is transferred to the Company. They are de-consolidated from the date that control, or exposure to risk and benefits, ceases. The effects of transactions between entities within the economic entity are eliminated in full upon consolidation.

External interest in the equity and results of the entities that are controlled by the Company are shown as a separate item, *minority interest*, in the consolidated financial report.

Statutory funds of the Group's life insurance business have been consolidated into the financial report. The financial report consolidates all of the assets, liabilities, revenues and expenses of the statutory funds and non-statutory fund life insurance business irrespective of whether they are designated as relating to policyholders or shareholders. In addition, where the Group's life insurance statutory funds have the capacity to control managed investment schemes, the Group has consolidated all of the assets, liabilities, revenues and expenses of these managed investment schemes.

*(ii) Associates*

Associates are entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Where material, associates are accounted for using the equity method. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

*(iii) Investments in joint venture entities*

The Group's interests in joint venture entities are accounted for, where material, using the equity method. In the Company's financial statements investments in joint venture entities are carried at cost.

**(h) Foreign currency translation**

*(i) Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial report is presented in Australian dollars, which is the Company's functional and presentation currency.

*(ii) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are normally recognised in the income statement. Such gains and losses will be deferred in equity as qualifying cash flow hedges and qualifying net investment hedges where applicable. Non-monetary items are translated using the exchange rate at the date of the initial recognition of the asset or liability.

*(iii) Controlled and other entities*

The results and financial position of all Group entities that have a functional currency different from the Group's presentation currency are translated into the presentation currency as follows:

assets and liabilities are translated at the closing rate at the date of the balance sheet;

income and expenses are normally translated at average exchange rates for the period; and

all resulting exchange differences are recognised as a separate component of equity in the foreign currency translation reserve.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other foreign currency instruments designated as hedges of such investments, are taken to the foreign currency translation reserve. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

**(i) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. For the purposes of segment reporting disclosures, the Group's activities are reported in the following segments: Australia Region, United Kingdom Region, New Zealand Region, nabCapital, and Other.

**(j) Fair value measurement**

Fair value is defined as the amount for which an asset could be exchanged or a liability settled, between willing parties in an arm's length transaction.

Where the classification of a financial asset or liability requires it to be stated at fair value, wherever possible, the fair value is determined by reference to the quoted bid or offer price in the most advantageous

active market to which the Group entity has immediate access. An adjustment for credit risk is also incorporated into the fair value.

Fair value for a net open position that is a financial liability quoted in an active market is the current offer price, and for a financial asset the bid price, multiplied by the number of units of the instrument held or issued.

Where no such active market exists for the particular asset or liability, the Group uses a valuation technique to arrive at the fair value, including the use of transaction prices obtained in recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques based on market conditions and risks existing at balance date. In doing so fair value is estimated using a valuation technique that makes maximum use of observable market inputs and places minimal reliance upon entity-specific inputs.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises the profit on initial recognition (ie. on day one).

*Primary difference in comparative financial periods*

Under previous AGAAP, when determining fair value, financial instruments were typically valued at mid-market prices. Additionally, within the comparative financial period fewer financial assets and liabilities were required to be carried at fair value.

**Assets**

**(k) Cash and cash equivalents**

For the purposes of the cash flow statement, cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. They are held for the purposes of meeting short term cash commitments (rather than for investment or other purposes) and include: cash and liquid assets, amounts due from other banks including securities held under reverse repurchase agreements and short-term government securities.

**(l) Acceptances**

The Group's liability arising from the acceptance of bills of exchange and the asset under acceptance representing the claims against its customer are measured initially at fair value and subsequently at amortised cost. When the Group discounts its own acceptance, the acceptance liability is derecognised. When the Group re-discounts its own acceptance, an acceptance liability is re-recognised and the asset remains recognised as an acceptance. The difference between the purchase and sale of the Group's own acceptance gives rise to realised profits and losses that are



recognised in the income statement. Bill acceptance fees are deferred and amortised on an effective yield basis over the life of the instrument.

*Primary difference in comparative financial periods*

Under previous AGAAP, the Group's liability arising from the acceptance of bills of exchange and the asset under acceptance representing the claims against its customer were measured at face value. When the Group discounted its own acceptances the asset was reclassified to trading securities. Fee income was recognised on a cash basis.

**(m) Derivative financial instruments and hedge accounting**

All derivatives are recognised in the balance sheet at fair value on trade date. All derivatives are classified as trading except where they are designated as a part of an effective hedge relationship and classified as hedging derivatives. The carrying value of a derivative is remeasured at fair value throughout the life of the contract. The fair value of derivatives is determined by calculating the expected cash flows under the terms of each specific contract, discounted back to present value. The expected cash flows for each contract are determined either directly by reference to actual cash flows implicit in observable market prices or through modelling cash flows using appropriate financial-markets pricing models. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The method of recognising the resulting fair value gain or loss on a derivative depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge);

hedges of highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction (cash flow hedge); or

hedges of net investments in foreign operations

Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, the risk being hedged and the Group's risk management objective and strategy for undertaking these hedge transactions. The Group documents how effectiveness will be measured throughout the life of the hedge relationship. In addition, the Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

**(i) Fair value hedge**

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Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the

carrying amount of a hedged item is amortised to the income statement on an effective yield basis. Where the hedged item is derecognised from the balance sheet the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement.

***(ii) Cash flow hedge***

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. The carrying value of the hedged item is not adjusted. Amounts accumulated in equity are transferred to the income statement in the period(s) in which the hedged item will affect profit or loss (for example, when the forecast hedged variable cash flows are recognised within the income statement).

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately transferred to the income statement.

***(iii) Net investment hedge***

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

***(iv) Derivatives that do not qualify for hedge accounting***

Certain derivative instruments do not qualify for hedge accounting. This could occur for two reasons:

The derivative is held for the purpose of short term profit taking; or

The derivative is held to economically hedge an exposure but does not meet the accounting criteria for hedge accounting.

In both of these cases the derivative is classified as a trading derivative.

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are separately measured at fair value with changes in fair value recognised in the income statement.

*Primary difference in comparative financial periods*

In the comparative period, derivatives (other than foreign currency) that were held or issued for purposes other than trading were not recorded on balance sheet at fair value. The net revenue or expense on derivatives used to manage interest rate exposures was recorded in the income statement on an accruals basis. If a derivative that was used to manage an interest rate exposure was terminated early, any resulting gain or loss was deferred within other assets or other liabilities and amortised to the income statement over the remaining period originally covered by the terminated contract.

**(n) Items classified as fair value through profit and loss**

Purchases and sales of financial assets classified within fair value through profit and loss are recognised on trade date, being the date that the Group is committed to purchase or sell a financial asset.

**(i) Financial assets held for trading**

A financial asset is classified as held-for-trading if it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

Assets held for trading purposes are classified as Trading derivatives or Trading securities within the balance sheet.

**(ii) Financial instruments designated at fair value through profit and loss**

Upon initial recognition financial assets may be designated as held at fair value through profit and loss. Financial assets classified as fair value through profit and loss (eg securities) are initially recognised at fair value with transaction costs being recognised in the income statement immediately. Subsequently they are measured at fair value with gains and losses recognised in the income statement as they arise.

Restrictions are placed on the use of the designated fair value option and the classification can only be used in the following circumstances:

if a host contract contains one or more embedded derivatives the Group may designate the entire contract as being held at fair value;  
or

designating the instruments will eliminate or significantly reduce measurement or recognition inconsistencies (eliminate an accounting mismatch) that would otherwise arise from measuring assets or liabilities on a different basis; or

assets and liabilities are both arranged and their performance is evaluated on a fair value basis in accordance with documented risk management and investment strategies.

*(iii) Assets relating to life insurance businesses*

*Refer to Note 1A(w) Assets relating to life insurance businesses for further details.*

**(o) Available for sale investments**

Available for sale investments are non-derivative financial assets that are designated as available for sale or are not categorised into any of the categories of (i) fair value through profit and loss, (ii) loans and receivables or (iii) held to maturity. Available for sale investments primarily comprise debt securities.

Available for sale investments are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes

in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement.

Interest income is determined using the effective interest method. Impairment losses and translation differences on monetary items are recognised in the income statement in the period in which they arise. Available for sale investments are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership. The carrying value on derecognition is calculated under a specific identification basis.

Consistent with other financial assets the Group applies trade date accounting to purchases and sales of available for sale investments.

*Primary difference in comparative financial periods*

Whilst the Group classified financial assets as available for sale, they were recorded at the lower of aggregate cost and fair value. Cost was adjusted for the amortisation of premiums and accretion of discounts to maturity. Unrealised losses in respect of market value adjustments and realised profits and losses on available for sale securities were recognised within the income statement.

**(p) Held to maturity financial assets**

Held to maturity investments are non-derivative financial assets with fixed or determinable payments that the Group has the intention and ability to hold to maturity. Held to maturity assets are initially recognised at fair value and subsequently recorded at amortised cost using the effective interest method.

**(q) Repurchase and reverse repurchase agreements**

Securities sold subject to repurchase agreements ( repos ) are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate based upon the counterparty to the transaction.

Securities purchased under agreements to resell ( reverse repos ) are accounted for as collateralised loans. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Such amounts are normally classified as deposits with other banks or cash and cash equivalents. Securities lent to counterparties are also retained in the financial statements.

It is the Group's policy to seek cash or other collateral security lodged from the counterparty typically representing 105% of the market value of the securities lent at the outset. The collateral security is marked to market or more frequently where market volatility is evident. This is required to ensure that there is sufficient margin between the value of collateral security and the value of security lent at all times. The borrower is required to lodge additional collateral security in specified circumstances to preserve the minimum margin arrangements in accordance with

contractual terms and conditions.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return them is recorded at fair value as a trading liability.

**(r) Loans and advances**

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale. They arise when the Group provides money or services directly to a customer with no intention of trading the loan.

Loans and advances are initially recognised at fair value including direct and incremental transaction costs. They are subsequently recorded at amortised cost, using the effective interest method, net of any provision for doubtful debts. They are derecognised when the rights to receive cash flows have expired or the Group has transferred substantially all the risks and rewards of ownership.

As noted above, in certain limited circumstances the Group applies the fair value measurement option to financial assets. This option is applied to loans and advances where there is an embedded derivative within the loan contract and the Group has entered into a derivative to offset the risk introduced by the embedded derivative. The loan is designated as being carried at fair value through profit and loss to offset the movements in the fair value of the derivative within the income statement. When this option is applied the asset is included within other financial assets at fair value and not loans and advances.

*Primary difference in comparative financial periods*

Loans and advances were carried at recoverable amount represented by the gross value of the outstanding balance adjusted for a provision for doubtful debts and unearned income. Interest was recognised as revenue when interest was earned.

**(s) Impairment**

*(i) Financial assets*

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the balance sheet date ( a loss event ). Further, it is considered that the loss event or events have had an impact on the estimated future cash flows of the financial asset (or the portfolio) that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.



For loans and receivables and held to maturity investments, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognised using an allowance account.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group.

Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. Specific risk factors considered as part of the year end process to assess whether the historical experience used in the loan loss provisioning model calculations should be adjusted to reflect current conditions include:

- levels of, and trends in, delinquencies and impaired loans;
- levels of, and trends in, charge-offs and recoveries;
- any changes in risk selection and underwriting standards;
- any changes in experience, ability and depth of lending management;
- any changes in collections or work-out activities and personnel;
- national and local economic trends and conditions; and
- industry concentrations and conditions.

The Group's loan portfolio is split between retail and non-retail loans with a loan loss provision being calculated separately for each of these components.

For retail loans (personal loans, credit cards and home loans) the Group typically applies a roll rate methodology as follows. Under the roll rate methodology, loans are categorized into classes depending on their product type and their performance status, including performing, 0-30,

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30-60, 60-90 days past due and beyond. Default and loss probabilities are then applied to each class in order to estimate the level of incurred losses. These probabilities are determined individually for each class and are based on observed historical experience across the portfolio.

For non-retail loans a statistical based provisioning methodology is applied. This calculates the level of incurred losses in the portfolio based upon the probability of default multiplied by the loss given default. The Group uses its internal credit risk assessment scale to group loans with common risk characteristics together. The Group's internal scale assigns a rating from 1 through to 16 (increasing as the assessment of the credit quality deteriorates) to each loan. This rating is based on the loan officer's assessment of the credit worthiness of the loan. Probabilities of default and loss given default estimates are then determined individually for each rating category and are based on observed historical experience across the portfolio. Probabilities of default are directly correlated with the loss emergence period determined for that portfolio of financial assets.

The Group's loan loss provisioning methodology incorporates a number of assumptions, including estimates of probabilities of default and loss given default. The methodology and assumptions used for estimating the level of loan loss provisions are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Where a range of possible outcomes is possible, the Group determines the approach that is considered the most likely outcome. The Group will then apply this approach on a consistent basis period on period to ensure comparability of loan loss provision levels.

As part of the loan loss provisioning process the Group is required to use its experienced judgement to estimate the amount of an impairment loss. The assumptions and judgements applied by management are subject to regular review and oversight by the Group Risk Management Committee and Board Risk and Audit Committees.

Following impairment, interest income is recognised on the unwinding of the discount from the initial recognition of impairment using the original effective rate of interest which was used to discount the future cash flows for the purpose of measuring the impairment loss. Interest on impaired facilities is recognised as interest income when received and where the amount is identified not as a repayment of principal.

When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the expense in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

In the case of equity instruments classified as available for sale, the Group seeks evidence of a significant or prolonged decline in the fair value of the security below its cost to determine whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement. In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as all other financial assets. Reversals of impairment of debt securities classified as available for sale are recognised in the income statement. Reversals of impairment of equity instruments classified as available for sale are not recognised in the income statement. Increases in the fair value of equity shares classified as available for sale after impairment are recognised directly in equity.

*Primary difference in comparative financial periods*

The Group adopted a statistically based provisioning method for its general provision for doubtful debts. Under this method, the Group estimated the level of losses inherent, but not specifically identified, in its existing credit portfolios at balance date. This approach considered latent risks inherent in the portfolio over the full life of the loan.

*(ii) Non-financial assets*

Tangible and intangible assets (excluding deferred tax assets, defined benefit pension scheme assets and life insurance assets) are written down to recoverable amount where their carrying value exceeds recoverable amount.

Assets with an indefinite useful life, including goodwill, are not subject to amortisation and are tested on an annual basis for impairment, and additionally whenever an indication of impairment exists. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The recoverable amount of an asset is the higher of its fair value less costs to sell or its value in use. Value in use represents the present value of the future amount expected to be recovered through the cash inflows and outflows arising from the asset's continued use and subsequent disposal. Any decrement in the carrying value is recognised as an expense in the income statement in the reporting period in which the impairment loss occurs.

In determining value in use, management judgement is applied in establishing forecasts of future operating performance, as well as the selection of growth rates, terminal rates and discount rates. These judgements are applied based on historical information and expectations of future performance.

The expected net cash flows included in determining recoverable amounts of assets are discounted to present values using a market determined, risk adjusted, discount rate. When determining an appropriate discount rate, the weighted average cost of capital is the initial point of reference, adjusted for specific risks associated with each different category of assets assessed.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to establish cash generating units (which are determined according to the lowest level of aggregation for which an active market exists as this evidences the assets involved create largely independent cash inflows.) Each of these cash-generating units is represented by an individual primary reporting segment, or a subdivision of a primary segment.

**(t) Goodwill and other intangible assets**

**(i) Goodwill**

Goodwill arises on the acquisition of an entity, and represents the excess of the fair value of the purchase consideration and direct costs of making the acquisition, over the fair value of the Group's share of the net assets at the date of the acquisition. Goodwill has been allocated to cash generating units that benefit from the synergies of the acquisition.

**(ii) Software costs**

The identifiable and directly associated external and internal costs of acquiring and developing software are capitalised and recognised as an intangible asset where the software is controlled by the Group, and where it is probable that future economic benefits that exceed its cost will flow from its use over more than one year. Costs associated with maintaining software are recognised as an expense as incurred.

Capitalised software costs are amortised on a straight-line basis over their expected useful lives: usually this is between three and five years. Other intangibles are amortised on a straight-line basis over their useful lives: usually this is between 3 and 5 years.

Computer software and other intangibles are stated at cost, less amortisation and impairment losses, if any.

**(u) Property, plant and equipment**

Property assets (land and buildings) are revalued annually, effective 1 July, by directors to reflect fair values. Directors' valuations are based on advice received from independent valuers. Such valuations are performed on an open market basis, being the amounts for which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the valuation date. Newly acquired property assets are held at cost (i.e. equivalent to fair value due to their recent acquisition) until the time of the next annual review, a period not exceeding twelve months.

Revaluation increments are credited directly to the asset revaluation reserve. However, the increment will be recognised in the income statement to the extent it reverses a revaluation decrement previously recognised as an expense. Revaluation decrements are charged against the asset revaluation reserve to the extent that they reverse previous revaluation increments for a specific asset. Any excess is recognised as an expense in the income statement. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

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All other items of property, plant and equipment are carried at cost, less accumulated depreciation and any impairment losses. The cost of property, plant and equipment includes an obligation for removal of the asset or restoration of the site where such an obligation exists and if that cost can be reliably estimated.

With the exception of freehold land, all items of property, plant and equipment are depreciated or amortised using the straight-line method at the rates appropriate to its estimated useful life to the Group. For major classes of property, plant and equipment, the annual rates of depreciation or amortisation are: buildings 3.3%; leasehold improvements up to 10%; furniture, fixtures and fittings and other equipment from 10% to 20%; motor vehicles - 20%; personal computers 33.3%; and other data processing equipment from 20% to 33.3%. Assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains or losses on the disposal of property, plant and equipment, which are determined as the difference between the net sale proceeds, if any, and the carrying amount at the time of sale are included in the income statement.

Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

### (v) Leases

#### *(i) As lessee*

The leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the term of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

#### *(ii) As lessor*

Leases entered into by the Group as lessor, where the Group transfers substantially all the risks and rewards of ownership to the lessee are classified as finance leases. The net investment in the lease, which is comprised of the present value of the lease payments including any guaranteed residual value and initial direct costs, is recognised within Loans and Advances. The difference between the gross receivable and the present value of the receivable is unearned income. Income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Assets leased under operating leases are included within property, plant and equipment at cost and depreciated over the life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised within Other operating income in the income statement on a straight line basis over the life of the lease. Depreciation is recognised within the income statement consistent with the nature of the asset. *Refer to note 1A(u) Property, plant and equipment.*

**(w) Assets relating to life insurance business**

Assets held by the Group's life insurance businesses are recorded as follows:

***(i) Assets backing policy liabilities***

All assets held in statutory funds are considered to back policy liabilities and are therefore classified as fair value through profit and loss. *Refer to note 1A(j) for further detail on policies used to determine fair value.*

***(ii) Assets not backing life insurance liabilities***

Financial assets not specifically backing insurance liabilities are classified as fair value through profit and loss, with the exception of

investments in controlled entities that are treated under normal entity consolidation accounting rules.

Investments in controlled entities are stated at original cost less any necessary provision for impairment.

**(iii) Restrictions on assets**

The assets and liabilities held in the statutory funds of the Australian life insurance business are subject to the restrictions of the *Life Insurance Act 1995* (Cth) and the constitutions of the life insurance entities. The main restrictions are that the assets in a statutory fund can only be used to meet the liabilities and expenses of that fund, to acquire investments to further the business of the fund, or to make profit distributions when solvency and capital adequacy requirements of the *Life Insurance Act 1995* (Cth) are met. Therefore, assets held in statutory funds are not available for use by other parts of the Group's business other than any profits generated in the statutory funds.

**Liabilities**

**(x) Due to other banks**

Due to other banks includes deposits, vostro balances, repurchase agreements and settlement account balances due to other banks. These items are brought to account at the gross value of the outstanding balance.

**(y) Deposits and other borrowings**

Deposits and other borrowings include non-interest-bearing deposits redeemable at call, certificates of deposit, interest-bearing deposits, debentures and other funds raised publicly by borrowing corporations. These items are brought to account at the gross value of the outstanding balance.

**(z) Financial liabilities**

Financial liabilities comprise items such as due to other banks, due to customers, liabilities on acceptances, trading liabilities and deposits and other borrowings. Financial liabilities may be held at fair value through profit and loss or at amortised cost.

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A financial liability is recognised in the balance sheet when the Group becomes a party to the contractual provisions of the instrument. A financial liability is derecognised from the balance sheet when the Group has discharged its obligation, the contract is cancelled or expires.

When a financial liability is recognised, initially it is measured at its fair value plus transaction costs, unless the financial instrument is designated as fair value through profit and loss.

Items held at fair value through profit and loss comprise both items held for trading and items specifically designated as fair value through profit and loss at initial recognition. Financial liabilities held at fair value through profit and loss are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

Financial liabilities may be designated as fair value through profit and loss providing they meet the same criteria set down in note 1A(n). A financial liability is classified as held-for-trading if it is incurred principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship).

### *Primary difference in comparative financial periods*

There was no equivalent classification for liabilities designated at fair value through profit and loss for the comparative reporting period. Financial liabilities were brought to account at the gross value of the outstanding balance. Interest expense on financial liabilities was recognised as an expense as it was incurred.

### **(aa) Life insurance and investment policy liabilities**

Policy liabilities in the Group's balance sheet and the change in policy liabilities disclosed as an expense have been calculated in accordance with guidance provided by the Life Insurance Actuarial Standard Board's Actuarial Standard AS 1.04 Valuation of Policy Liabilities .

#### *(i) Investment contracts*

Policy liabilities for investment contracts are measured at fair value with this value determined as equal or greater than the surrender value of the policy. The discount rate reflects the return on assets backing the liabilities.

#### *(ii) Insurance contracts*



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Policy liabilities from insurance contracts are measured predominantly using the projection method which is the net present value of estimated future policy cash flows. Future cash flows incorporate investment income, premiums, expenses, redemptions and benefit payments (including bonuses). The accumulation method may be used only where the result would not be materially different to the projection method.

Unvested policyholder benefits represent amounts that have been allocated to certain non-investment-linked policyholders that have not yet vested with specific policyholders.

The measurement of policy liabilities is subject to actuarial assumptions. Assumptions made in the calculation of policy liabilities at each balance date are based on best estimates at that date. The assumptions include the benefits payable under the policies on death, disablement or surrender, future premiums, investment earnings and expenses. Best estimate means that assumptions are neither optimistic nor pessimistic but reflect the most likely outcome. The assumptions used in the calculation of the policy liabilities are reviewed at each balance sheet date. Deferred acquisition costs are presented as an off-set in policy liabilities.

To the extent that the benefits under life insurance contracts are not contractually linked to the performance of the assets held, the life insurance liabilities are discounted for the time value of money using risk-free discount rates based on current observable, objective rates that relate to the nature, structure and term of the future obligations. Where the benefits under life insurance contracts are contractually linked to the performance of the assets held, the life insurance liabilities shall be

discounted using discount rates based on the market returns on assets backing life insurance liabilities.

For reinsurance contracts, the group retains the primary obligation of the underlying life insurance contract.

**(bb) Provisions**

Provisions are recognised when a legal or constructive obligation exists as a result of a past event, it is probable that an outflow of economic benefits will be necessary to settle the obligation and it can be reliably estimated. Provisions are not discounted to the present value of their expected net future cash flows except where the time value of money is considered material.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured. Contingent liabilities are not recognised in the balance sheet but are disclosed unless they are remote.

**(cc) Operational risk events**

Provision for operational risk event losses is raised for losses incurred by the Group, which do not relate directly to amounts of principal outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation as at the reporting date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

**(dd) Restructuring costs**

Provision for restructuring costs include provisions for expenses incurred but not yet paid and future expenses that will arise as a direct consequence of decisions already made. A provision for restructuring costs is only made where the Group has made a commitment and entered into an obligation such that it has no realistic alternative but to carry out the restructure and make future payments to settle the obligation. Provision for restructuring costs is only recognised when a detailed plan has been approved and the restructuring has either commenced or has been publicly announced. This includes the cost of staff termination benefits and surplus leased space. Costs related to on-going activities are not provided for.

**(ee) Surplus leased space**

Surplus leased space is an onerous contract and a provision is recognised when the expected benefits to be derived from the contract are less than the costs that are unavoidable under the contract. This arises where premises are currently leased under non-cancellable operating leases and either the premises are not occupied, or are being sub-leased for lower rentals than the Group pays, or there are no substantive benefits beyond a known future date. The provision is determined on the basis of the present value of net future cash flows.

**(ff) Provision for dividends**

A provision for dividend is not recognised until such time the dividend is declared, determined or publicly recommended.

**(gg) Financial guarantees**

The Group provides guarantees in its normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Group to guarantee the performance of a customer to a third party. Guarantees are primarily issued to support direct financial obligations such as commercial bills or other debt instruments issued by a counterparty. It is the credit rating of the Group as a guarantee provider that enhances the marketability of the paper issued by the counterparty in these circumstances.

The financial guarantee contract is initially recorded at fair value which is equal to the premium received or paid, unless there is evidence to the contrary. Subsequently, the Group records and measures the financial guarantee contract at the higher of:

where it is likely the Group will incur a loss as a result of issuing the contract a liability is recognised, or asset where it is likely to receive payment as a result of purchasing the contract, for the estimated amount of the loss payable or receivable; and

the amount initially recognised less, when appropriate, amortisation of the fee which is recognised over the life of the guarantee, whether this is received or paid depending on whether the Group has issued or purchased the contract.

**(hh) Employee benefits**

Employee entitlements to long service leave are accrued using an actuarial calculation, based on legal and contractual entitlements and assessments having regard to staff departures, leave utilisation and future salary increases. This method does not differ materially from calculating the amount using present value techniques.

Wages and salaries, annual leave and other employee entitlements expected to be paid or settled within 12 months of providing the service are measured at their nominal amounts using remuneration rates that the Group expects to pay when the liabilities are settled.

All other employee entitlements that are not expected to be paid or settled within 12 months of the reporting date are measured at the present value of net future cash flows.

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Employees of the Group are entitled to benefits on retirement, disability or death from the Group's superannuation plans. The Group operates pension plans which have both defined benefit and defined contribution components.

The defined contribution plans receive fixed contributions from Group companies and the Group's obligation for contributions to these plans are recognised as an expense in the income statement as incurred. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payment is available.

The defined benefit plans provide defined lump sum benefits based on years of service and a salary component determined in accordance with the specific plan. A liability or asset in respect of defined benefit superannuation plans is recognised in the balance sheet and is measured as the present value of the defined benefit obligation at the reporting date less the fair value of the superannuation fund's assets at that date and any unrecognised past service cost.

The present value of the defined benefit obligations for each plan is discounted by either the government bond rate, or the average AAA credit rated bond rate for bonds that have maturity dates approximating to the terms of the Group's obligations. The present value of the defined benefit obligations is calculated every three years using the projected unit credit method and updated every year for material movements in the plan position.

Past service costs are recognised immediately in income, unless the changes to the superannuation fund are conditional on the employees remaining in service for a specified period of time (vesting period). In this case, the past service cost is amortised on a straight line basis over the vesting period.

The Group does not offset pension assets and liabilities arising from different defined benefit plans. The Group's policy where actuarial gains and losses arise as a result of actual experience is to fully recognise such amounts directly in retained earnings.

Future taxes that are funded by the entity and are part of the provision of existing benefit obligations (eg taxes on investment income and employer contributions) are taken into account in measuring the net liability or asset.

**(ii) Trustee and funds management activities**

The Group acts as trustee, custodian or manager of a number of funds and trusts, including superannuation and approved deposit funds, and wholesale and retail investment trusts. Where the Group does not have direct or indirect control of these funds and trusts as defined by Australian Accounting Standard AASB 127 Consolidated and Separate Financial Statements, the assets and liabilities are not included in the consolidated financial statements of the Group. When controlled entities, as responsible entities or trustees, incur liabilities in respect of their activities, a right of indemnity exists against the assets of the applicable trusts and funds. Where these assets are determined to be sufficient to cover liabilities, and it is not probable that the controlled entities will be required to settle them, the Group does not include the liabilities in the consolidated financial statements.

Commissions and fees earned in respect of the Group's trust and funds management activities are included in the income statement.

**(jj) Securitisation**

Through its loan securitisation program, the Group packages and sells loans (principally housing mortgage loans) as securities to investors through a series of securitisation vehicles.

All such financial assets continue to be held on the Group balance sheet, and a liability recognised for the proceeds of the funding transaction, unless:

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a full or proportional share of all or specifically identified cash flows are transferred to the lender, in which case, the full amount or that proportion of the asset is derecognised;

substantially all the risks and returns associated with the financial instruments have been transferred, in which case, the assets are derecognised in full; or

if a significant portion, but not all, of the risks and rewards have been transferred, the asset is derecognised entirely if the transferee has the practical ability to sell the financial asset or recognised only to the extent of the Group's continuing involvement in the asset.

### **(kk) Income tax**

Income tax expense or revenue is the tax payable (or receivable) on the current period's taxable income based on the applicable tax rate in each jurisdiction adjusted by changes in deferred tax assets and liabilities. Income tax is recognised in the income statement except to the extent that it related to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities are recognised for temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are only recognised for temporary differences, unused tax losses and unused tax credits if it is probable that future taxable amounts will arise to utilise those temporary differences and losses.

The effects of income taxes arising from asset revaluation adjustments are recognised directly in the asset revaluation reserve where relevant. Deferred tax assets and liabilities related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, are also credited or charged directly to equity. The tax associated with these transactions will be recognised in the income statement at the same time as the underlying transaction.

For life insurance business, taxation is not based on the concept of profit. Special legislative provisions apply to tax policyholders and shareholders on different bases. According to the class of business to which their policies belong, policyholders have their investment earnings taxed at the following rates in Australia:

superannuation policies 15%;

annuity policies 0%; or

non-superannuation investment policies 30%.

The life insurance business shareholders' funds are taxed at the company rate of 30% on fee income and profit arising from insurance risk policies less deductible expenses.

*(i) Tax consolidation*

The Group and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from October 1, 2002 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is National Australia Bank Limited.

Current tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax consolidated group are recognised in the separate financial statements of the members of the tax consolidated group using the group allocation approach by reference to the carrying amounts of assets and liabilities in the separate financial statements of each entity and the tax values applying under tax consolidation.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses of the subsidiaries are assumed by the head entity in the tax-consolidated group and are recognised as amounts payable (receivable) to (from) other entities in the tax-consolidated group in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Company as an equity contribution or distribution.

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses as a result of revised assessments of the probability of recoverability is recognised by the head entity only.

***(ii) Nature of tax funding arrangements and tax sharing arrangements***

The head entity, in conjunction with other members of the tax-consolidated group, has entered into a tax funding arrangement that sets out the funding obligations of members of the tax-consolidated group in respect of tax amounts. The tax funding arrangements require payments to/from the head entity equal to the current tax liability (asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity, resulting in the head entity recognising an inter-entity receivable (payable) equal in amount to the tax liability (asset) assumed. The inter-entity receivable (payable) is at call.

Contributions to fund the current tax liabilities are payable as per the tax funding arrangement and reflect the timing of the head entity's obligation to make payments for tax liabilities to the relevant tax authorities.

The head entity, in conjunction with other members of the tax-consolidated group, has also entered into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement, as payment of any amounts under the tax sharing agreement is considered remote.

***(iii) Franking credits***

The tax consolidation regime requires the tax-consolidated group to keep a single franking account. Accordingly, the amount of franking credits available to members of the Company at the end of the reporting period represent those available from the tax-consolidated group. This includes the benefit of imputation credits on dividends received by the Australian wholly-owned entities. Previously, members of the Company only had



access to franking credits available from the Company.

**(ll) Bonds, notes and subordinated debt and other debt issues**

Bonds, notes and subordinated debt and Other debt issues are short and long term debt issues of the Group including commercial paper, notes, term loans, medium term notes, mortgage backed securities and other discrete debt issues. Debt issues are typically recorded at amortised cost using the effective interest method. Premiums, discounts and associated issue expenses are recognised using the effective interest method through the income statement from the date of issue to accrete the carrying value of securities to redemption values by maturity date. Interest is charged to the income statement using the effective interest method. Embedded derivatives within debt instruments must also be separately accounted for where not closely related to the terms of the host debt instrument. These embedded derivative instruments are recorded at fair value with gains and losses on the embedded derivative recorded in the income statement.

Where debt issues are classified as held at fair value through profit and loss they are initially recognised at fair value with transaction costs being recognised immediately in the income statement. Subsequently they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

*Primary difference in comparative financial periods*

Under AGAAP the embedded derivative liability was not separately accounted for nor was there an option available to classify the debt issue as being carried at fair value through profit and loss.

**Equity**

**(mm) Contributed equity**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are directly included within equity. For the acquisition of a business incremental costs are included in the cost of the acquisition as a part of the purchase consideration.

**(nn) Treasury shares**

If a controlled entity acquires shares in the Company, the cost of the acquired shares is recognised as a deduction from share capital. Dividends on such shares held in the Company (treasury shares) are not credited to income, but eliminated on consolidation. Gains and losses on sale of treasury shares are accounted for as adjustments to issued capital and not part of income.

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Certain statutory funds of the Group's life insurance business hold investments in the Company. As these statutory funds are consolidated into the financial report, such investments held in the company are accounted for as treasury shares. Additionally, shares purchased on-market to meet the requirements of employee incentive schemes, and held in trust by a controlled entity of the Company, are likewise accounted for as treasury shares.

## **Revenue and expense recognition**

### **(oo) Interest income**

Interest income is reflected in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost using the effective interest rate of a financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, the cash flows are estimated considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options, and all fees and points paid or received between parties to the contract) excluding future credit losses.

Where it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Loan origination fees are recognised as revenue over the life of the loan as an adjustment of yield. Commitment fees are deferred until the commitment is exercised and are recognised over the life of the loan as an adjustment of yield or, if unexercised, recognised as revenue upon expiration of the commitment. Where commitment fees are retrospectively determined and nominal in relation to market interest rates on related loans, commitment fees are recognised as revenue when charged. Where the likelihood of exercise of the commitment is remote, commitment fees are recognised as revenue over the commitment period. Loan-related administration and service fees are recognised as revenue over the period of service. Credit card fees are recognised as revenue over the card usage period. Syndication fees are recognised as revenue after certain retention, timing and yield criteria are satisfied.

Direct loan origination costs are netted against loan origination fees and the net amount recognised as revenue over the life of the loan as an adjustment of yield. All other loan-related costs are expensed as incurred.

### *Primary difference in comparative financial periods*

Under AGAAP, loan origination and other fee revenue was either recognised immediately in the income statement or deferred in the balance sheet and amortised as an adjustment to yield over the expected life of the loan where material.

### **(pp) Dividend income**

Dividend income is recorded in the income statement on an accruals basis when the Group's right to receive the dividend is established.

**(qq) Fees and commissions**

Unless included in the effective interest calculation, fees and commissions are recognised on an accruals basis when the service has been provided. Fees and commissions not integral to the effective interest rate arising from negotiating, or participating in the negotiation of a transaction with a third party (such as the acquisition of loans, shares or other securities or the purchase or sale of businesses), are recognised on completion of the underlying transaction.

Asset management fees related to investment funds are recognised over the period the service is provided. The same principle is applied to the recognition of income from wealth management, financial planning and custody services that are continuously provided over an extended period of time. Account keeping charges, credit card fees, money transfer fees and loan servicing fees are recognised in the period the service is provided.

**(rr) Gains less losses on financial instruments at fair value**

Gains less losses on financial instruments at fair value comprises fair value gains and losses from four distinct activities:

trading derivatives;

trading securities;

financial instruments designated in hedge relationships; and

other financial instruments designated at fair value through profit and loss.

In general, gains less losses on trading derivatives recognises the full change in fair value of the derivatives inclusive of interest income and expense. However, in cases where the trading derivative is economically offsetting movements in the fair value of an asset or liability designated as being carried at fair value through profit and loss, the interest income and expense attributable to the derivatives is recorded within net interest income and not part of the fair value movement of the trading derivative.

Interest income and expense on trading securities is reported within interest income.

Gains less losses on hedging assets, liabilities and derivatives designated in hedge relationships recognises fair value movements on both the hedged item and hedging derivative in a fair value hedge relationship, and hedge ineffectiveness for both fair value and cash flow hedge relationships. Interest income and interest expense on both hedging instruments and instruments designated as fair value through profit and loss

at initial recognition are recognised in net interest income.

Gains less losses on financial assets and liabilities designated at fair value through profit and loss recognises fair value movements (excluding interest) on those items designated as fair value through profit and loss at inception.

*Primary difference in comparative financial periods*

There was no direct equivalent classification for financial assets and liabilities designated at fair value through profit and loss for the comparative reporting period.

Net revenue or expense on derivatives used to manage interest rate risk is recognised in net interest income on an accruals basis.

**(ss) Life insurance business**

The Group conducts its life insurance business through a number of controlled entities including National Australia Financial Management

Limited, MLC Lifetime Company Limited, MLC Limited and BNZ Life Insurance Limited.

***(i) Types of business***

The Australian life insurance operations of the Group consist of investment-linked business and non-investment-linked business, which are conducted in separate statutory funds as required under the *Life Insurance Act 1995* (Cth). The overseas life insurance operations of the Group consist primarily of non-investment-linked business.

Life investment contracts include investment-linked contracts where policyholders' investments are held within the statutory funds and policyholders' returns are directly linked to the investment performance of the assets in that fund. The policyholder bears all the risks and rewards of the investment performance. The policyholder has no direct access to the specific assets; however, the policy value is calculated by reference to the market value of the statutory fund's assets. Investment-linked business includes superannuation and allocated pension business. Fee income is derived from the administration of investment-linked policies and funds.

Life insurance contracts involve the acceptance of significant insurance risk. Insurance risk is defined as significant if an insured event could cause an insurer to pay significant additional benefits in any scenario that has commercial substance. Any products sold by a life insurer that do not meet the definition of a life insurance contract are classified as life investment contracts. Insurance contracts include those where an insured benefit is payable on the occurrence of a specified event such as death, injury or disability caused by accident or illness or, in the case of an annuity, the continuance of the annuitant's life or the expiry of the annuity term. The benefit payable is not directly referable to the market value of the fund's assets.

Non-investment-linked business includes traditional whole of life and endowment policies (where the risks and rewards generally are shared between policyholders and shareholders) and risk policies such as death, disability and income insurance (where the shareholder bears all the financial risks).

***(ii) Allocation of profit***

*Life insurance contracts*

Profits are brought to account in the statutory funds on a MoS basis. Under MoS, profit is recognised as fees are received and services are provided to policyholders over the life of the contract that reflects the pattern of risk accepted from the policyholder. When fees are received but the service has not been provided, the profit is not recorded at the point of sale. Losses are expensed when identified.

Consistent with the principle of deferring unearned profit is the requirement to defer expenditure associated with the deferred profit. MoS permits costs associated with the acquisition of life insurance policies to be charged to the income statement over the period that the policy will generate profits. However, costs may only be deferred to the extent that a policy is expected to be profitable.

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Profits arising from policies comprising non-investment-linked business is based on actuarial assumptions, and calculated as the excess of premiums and investment earnings less claims, operating expenses and the amortisation of acquisition costs that will be incurred over the estimate life of the policies. The profit is systematically recognised over the estimated time period the policy will remain in force.

Certain policies are entitled to share in the profits that arise from the non-investment-linked business. This profit sharing is governed by the *Life Insurance Act 1995 (Cth)* and the life insurance companies' constitutions. This profit sharing amount is treated as an expense in the profit and loss account.

### *Life investment contracts*

Profit from investment-linked business is derived as the excess of the fees earned by the shareholder for managing the funds invested over operating expenses.

### **(iii) Premium revenue**

#### *Life insurance contracts*

Premiums are separated into their revenue and liability components. Premium amounts earned by providing services and bearing risks including protection business are treated as revenue. Other premium amounts received, net of initial fee income, which are akin to deposits, are recognised as an increase in policy liabilities.

Premiums with a regular due date are recognised as revenue on a due basis. Premiums with no due date are recognised as revenue or an increase in policy liabilities on a cash received basis. Premiums due before the end of the year but not received at balance date are included as outstanding premiums receivable. Premiums due after but received before the end of the year are accounted for as premiums in advance.

#### *Life investment contracts*

The initial fee, which is the difference between the premium received and the initial surrender value is recognised as premium revenue. For the group's investment contracts, all premiums are recognised as an increase in policy liabilities.

### **(iv) Investment revenue**

Dividend and interest income is brought to account on an accruals basis when the life insurance controlled entity obtains control of the right to receive the dividend or interest income.

Net realised and unrealised profits and losses represent changes in the measurement of fair values in respect of all investments recognised at fair value and are recognised in the income statement in the period in which they occur.

*(v) Claims*

Claims are recognised when the liability to a policyholder under a policy contract has been established or upon notification of the insured event, depending on the type of claim. Claims are separated into their expense and liability components.



*Life insurance contracts*

Claims incurred that relate to the provision of services and bearing of risks are treated as expenses and are recognised on an accruals basis.

*Life investment contracts*

Claims incurred in respect of investment contracts, which are in the nature of investment withdrawals, are recognised as a reduction in policy liabilities. For investment contracts, all claims are recognised as a decrease in policy liabilities.

**(vi) Basis of expense apportionment**

All expenses charged to the income statement are equitably apportioned to the different classes of business in accordance with Division 2 of Part 6 of the *Life Insurance Act 1995* (Cth) as follows:

expenses and other outgoings that relate specifically to a particular statutory fund have been directly charged to that fund;

expenses and other outgoings (excluding commissions, medical fees and stamp duty relating to the policies which are all directly allocated) have been apportioned between each statutory fund and shareholders' fund.

Expenses are apportioned between classes of business by first allocating the expenses to major functions and activities, including those of sales support and marketing, new business processing and policyholder servicing, and then to classes of products using relevant activity cost drivers, including commissions, policy counts, funds under management and benchmark profit; and investment income, profits and losses on sale of property, plant and equipment, profits and losses on sale of investments, and appreciation and depreciation of investments have been directly credited or charged to the appropriate statutory fund or shareholders' fund.

**(vii) Deferred acquisition costs**

The extent to which policy acquisition costs are deferred varies according to the classification of the contract acquired (either life insurance or life investment).

*Life insurance contracts*

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The costs incurred in selling or generating new business include advisor fees, commission payments, application processing costs, relevant advertising costs and costs for promotion of products and related activities. These costs are deferred to the extent they are deemed recoverable in the premiums or policy charges (as appropriate for each policy class). Acquisition costs deferred are amortised over the period that they will be recovered from premiums or policy charges.

### *Life investment contracts*

The incremental costs incurred in selling or generating new business are expensed as incurred.

### *Primary difference in comparative financial periods*

The accounting policy relating to life insurance described above has had a significant impact upon the measurement, recognition and disclosure of the Group's life insurance business. A major feature of AGAAP was the recognition of the excess of market value over net assets (EMVONA). On transition to AIFRS, EMVONA was derecognised and revaluation movements are no longer be recognised in the Group's income statement. Broadly, EMVONA represented:

acquired goodwill in respect of life insurance controlled entities remaining at balance date;

increases in the value of goodwill of the controlled entities since acquisition; and

the difference between the values assigned to assets and liabilities of the controlled entity within the Group's financial report and those in the report of the controlled entity arising due to valuation methodology differences.

Under AGAAP deferred acquisition costs were recognised as a reduction to policy liabilities for both life investment and life insurance contracts.

### **(tt) Equity-based compensation**

The Group provides equity-based remuneration to its employees in respect of services received. The value of the services received is measured by reference to the fair value of the shares, performance options or performance rights provided to employees at grant date. The fair value expense of each tranche of shares, performance options or performance right granted is recognised in the income statement on a straight-line basis over the period that the services are received by the Group, which is the vesting period.

The fair value of share plans granted is generally determined by reference to the weighted-average Company share price in the week up to, and including, the date on which the shares were issued. Existing employee share plans are linked to internal performance or service conditions and vest when these conditions are satisfied.

The fair value and expected vesting period of the performance options and performance rights granted is determined using a simulated version of the Black Scholes option pricing model. The valuation technique takes into account factors such as the exercise price of the performance option, the current share price, the risk free interest rate, the expected volatility of the Company share price and the probability of achieving market-based performance hurdles. Non-market-based performance hurdles are not taken into account when determining the fair value and expected vesting period of performance options and performance rights. Instead, non-market-based performance conditions are taken into account by adjusting the number of performance options and performance rights included in the measurement of the expense so that ultimately, the amount recognised in the income statement reflects the number of performance options or performance rights that actually vest.

**(uu) Advertising and legal expenses**

Advertising costs, and legal costs, are expensed as they are incurred.

**(vv) Goods and services tax**

Revenues, expenses and assets are recognised net of the amount of goods and services tax or other value-added tax, except where the tax incurred is not recoverable from the relevant taxation authority. In these

circumstances, the tax is recognised as part of the expense or the cost of acquisition of the asset.

Receivables and payables are stated at an amount with tax included. The net amount of tax recoverable from, or payable to, the relevant taxation authority is included within other assets or other liabilities.

Cash flows are included in the statement of cash flows on a gross basis. The tax component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the relevant taxation authority is classified as operating cash flows.

### **1B. Explanation of transition to AIFRS**

These are the Group's first annual consolidated financial statements prepared in accordance with AIFRS. The Group adopted these standards for the financial year commencing October 1, 2005 and the accounting policies set out in Note 1A have been applied in the preparation of these financial statements.

In preparing its opening AIFRS balance sheet and the comparative information contained in these financial statements, the Group has made adjustments to the financial information previously reported in accordance with the prior basis of accounting (AGAAP).

The following notes and reconciliations, along with the accounting policies detailed in note 1A provide an explanation of how the transition from AGAAP to AIFRS has affected the Group's, and the Company's, financial statements.

The AIFRS impacts contained in the following reconciliations have been shown both for the Group and the Company as:

those arising from required recognition and measurement adjustments to the financial statements on transition from AGAAP to AIFRS either at October 1, 2004 or October 1, 2005 (transitional adjustments);

those arising during the year ended September 30, 2005 to adjust for measurement differences between AGAAP and AIFRS in the income statement or reserves (measurement adjustments); and

those concerning presentation and disclosure of items in the financial statements (reclassification adjustments) at the relevant dates.

Recognition and measurement adjustments that arise as a result of the opening transition process affect balance sheet values and are recognised in either retained earnings or an appropriate equity reserve at the date of transition. These may arise at either October 1, 2004 or October 1, 2005.

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Presentation and disclosure adjustments do not impact total equity or retained earnings, but (other than a reclassification of outside equity interests at October 1, 2005 from equity to liabilities) reclassify items from one line to another.

The areas of most significant impact and the adjustments arising from application of AIFRS are summarised below. In certain cases the transitional and measurement adjustments detailed in the following reconciliations differ from information disclosed in previous financial statements. These differences primarily arise through changes and refinements in interpretation of relevant accounting standards.

Transitional adjustments at October 1, 2004 have been held constant in the Transition column of the balance sheet reconciliations at September 30, 2005. Foreign currency revaluations of these adjustments have been reported as measurement adjustments.

The information presented below is in accordance with AASB 1. Unless stated otherwise, all adjustments have been presented on a pre-tax basis. Amounts in brackets represent the transitional impact on the Company.

### **Application of exemptions from retrospective application of AIFRS**

AASB 1 requires that the opening AIFRS balance sheet should comply with each AIFRS, including full retrospective application and the effect of such application should be reflected in retained earnings (or another category of equity if appropriate) as at the date of transition to AIFRS. However, AASB 1 allows certain elective exemptions from such full retrospective application and in addition, prohibits retrospective application of some aspects of AIFRS.

### **Elective exemptions**

Where appropriate, the impact of an elective exemption has been described in section A or B below. Those exemptions which relate to an item for which no transitional adjustment has been recognised are as follows:

The Group has elected to prospectively apply the requirements of AASB 3 Business Combinations (AASB 3) from the date of transition to AIFRS, rather than to retrospectively apply the standard and restate previous business combinations. If this election had not been made and AASB 3 had been applied retrospectively to a specific business combination, then that combination and all others following it would have been restated to comply with AASB 3. This would have had certain impacts on the balance sheet and income statement including:

the possible recognition of additional identifiable intangible assets, in place of goodwill;

acquired goodwill would not have been amortised, but would instead have been subject to an impairment test, while any additional intangibles acquired may have been amortised or subject to an impairment test depending upon their nature;

amortisation expense recognised would have been lower and impairment expenses may have been recognised; and

provisions recognised in respect of restructuring the activities of an acquired entity would have been recognised based on different criteria and may have had a resulting different balance to that which was recognised under AGAAP.

The following elective exemptions were not applicable to the Group and therefore have not been applied:

employee benefits exemption relating to the corridor approach;

compound financial instruments exemption, relating to the treatment of the equity component and the interest accreted on the liability component of a compound financial instrument where the liability component was no longer outstanding as at the date of transition;

assets and liabilities of subsidiaries, associates and joint ventures exemption, only relevant when a subsidiary, associate or joint venture adopts AIFRS at a later date than its parent; and

decommissioning liabilities included in the cost of property, plant and equipment exemption, only relevant when such liabilities have been identified.

**Application of mandatory exceptions from other AIFRS**

AASB 1 prohibits retrospective application of some aspects of other AIFRS relating to:

Derecognition of financial assets and liabilities, being specifically guidance as to the date from which the specific requirements within AASB 139 apply and allowing the choice of applying such requirements from a retrospective date of the Group's choosing;

Hedge accounting, being specifically allowing the designation of an individual item within a net position under previous GAAP as a hedged item under AIFRS and specific guidance on the treatment of an item designated as a hedge under previous GAAP, which fails to meet the hedge accounting requirements of AIFRS;

Estimates, being specific guidance relating to the consistency of estimates made upon transition to AIFRS being consistent with those made at the same date under previous GAAP; and

Assets classified as held for sale and discontinued operations, being specific guidance as to the application date of AASB 5 Non-current Assets Held for Sale and Discontinued Operations (AASB 5).

The Group has complied with the requirements of the above mandatory exceptions where applicable.

**A. Transitional and measurement adjustments arising as at October 1, 2004**

**(a) Defined benefit pension plans**

AIFRS requires defined benefit pension plan surpluses and deficits to be recognised on the balance sheet. Consequently, a transitional adjustment is required to recognise defined benefit pension surpluses and deficits on the balance sheet with a corresponding entry made to retained earnings.

An opening transitional adjustment recognises a defined benefit pension plan deficit of \$1,286 million (\$98 million), a defined benefit pension plan surplus of \$130 million (\$55 million) and de-recognises a pre-paid pension cost asset previously carried under AGAAP of \$575 million (\$nil).

For the year ended September 30, 2005, the defined benefit pension expense recorded within personnel expenses was \$27 million (\$1 million) less than had been previously recorded under AGAAP. In addition, under AGAAP, \$45 million (\$nil) in relation to redundancy related payments were recognised as a restructuring expense. On transition to AIFRS this expense was reversed as it had already been recognised in the October 1, 2004 opening AIFRS balance sheet.

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For the year ended September 30, 2005 the net profit on the sale of the Irish Banks (recognised as a Significant Item) was \$277 million (\$nil) greater than that previously reported under AGAAP. The increase is largely due to the impact of derecognising the defined benefit pension liabilities in respect of the Irish Banks.

### (b) **Wealth Management revaluation excess of market value over net assets (EMVONA)**

On transition to AIFRS, EMVONA is derecognised and revaluation movements are no longer recognised in the Group's income statement. Under AGAAP, EMVONA represented:

acquired goodwill in respect of life insurance controlled entities remaining at balance date;

increases in the value of goodwill of the controlled entities since acquisition; and

the difference between the values assigned to assets and liabilities of the controlled entity within the Group's financial statements and those in the report of the controlled entity arising due to valuation methodology differences.

The whole of the AGAAP EMVONA balance of \$4,905 million (\$nil) is written off to retained earnings upon transition to AIFRS and is replaced by acquired goodwill of \$4,094 million (\$nil) and other intangible assets relating to past acquisitions, of \$82 million (\$nil).

For the year ended September 30, 2005 revaluation uplift in EMVONA of \$335 million (\$nil) recognised under AGAAP has been reversed.

### (c) **Consolidation of special purpose entities**

Special purpose entities (SPE's) require consolidation where the Group has access to the majority of the residual income or is exposed to the majority of the residual risk associated with the SPE. The opening adjustment as at October 1, 2004 to consolidate the Group's SPE's where required under AIFRS is a gross up of assets and liabilities of \$5,732 million (\$nil) and \$5,734 million (\$nil) respectively, with a corresponding minimal impact on total equity.

These amounts are predominantly reflected in adjustments to loans and advances (assets) and deposits and other borrowings and bonds, notes and subordinated debt (liabilities).

For the year ended September 30, 2005, the impact on net profit before tax arising from the consolidation of these entities is minimal. The principal impact on the income statement is a gross up in interest income and interest expense by \$421 million (\$nil) and \$369 million (\$nil) respectively.

### (d) **Taxation**



AIFRS requires the Group to adopt a balance sheet approach to determining deferred tax items, based upon a comparison of accounting carrying amounts of assets and liabilities with their tax base. This method identifies a broader range of differences than those that arise under AGAAP.

An opening transitional adjustment results in an increase in retained earnings of \$609 million (\$12 million). This adjustment primarily arises from the tax impacts of the various transitional adjustments applicable from October 1, 2004.

For the year ended September 30, 2005, the income tax expense was \$17 million (\$8 million) greater than that recognised under AGAAP.

**(e) Equity based payments**

AIFRS introduces the requirement for the Group to recognise an expense in respect of all equity-based remuneration (performance options, performance rights and shares issued to employees) determined with reference to the fair value of the equity instruments issued. The fair value of each tranche of performance options and performance rights at

grant date will be expensed over their expected vesting period on a straight-line basis. Similarly, the fair value of shares granted under the staff share schemes will be recognised as an expense over their vesting period on a straight-line basis.

Under the elective exemption provided in AASB 1, the Group has not applied AASB 2 Share-based Payment to equity instruments issued prior to November 7, 2002. The transitional adjustment at October 1, 2004 is therefore calculated in respect of performance options, performance rights and shares granted after November 7, 2002 that remain unvested at January 1, 2005. Had this elective exemption not been applied, the requirements of AASB 2 would have been applied to equity instruments issued prior to November 7, 2002 and the impact on retained earnings and the executive share option reserve would have been different to that detailed below. Additionally, personnel expense relating to equity based payments in the years ended September 30, 2005 and September 30, 2006, would have been different to that detailed below.

An opening transitional adjustment results in the recognition of an equity based payments reserve of \$34 million (\$34 million) with a decrease in retained earnings of \$34 million (\$22 million) and an increase in due from controlled entities of nil (\$12 million).

For the year ended September 30, 2005, the expense for equity based payments is \$98 million (\$62 million).

**(f) Goodwill**

Upon transition to AIFRS, goodwill will no longer be amortised. Instead, goodwill will be tested for impairment annually and assessed for any indication of impairment at each reporting date to ensure that its carrying amount does not exceed its recoverable amount. If an impairment loss is identified, it will be recognised immediately in the income statement. No impairment of goodwill was identified at October 1, 2004.

For the year ended September 30, 2005, goodwill amortisation of \$98 million (\$nil) recognised under AGAAP has been reversed. No impairment of goodwill was identified for the year ended September 30, 2005.

**(g) Foreign currency translation**

Under the elective exemption provided in AASB 1, the Group has reset the foreign currency translation reserve (FCTR) to nil as at October 1, 2004, resulting in an increase in retained earnings of \$166 million (\$23 million).

Translation differences in relation to foreign controlled entities subsequent to transition to AIFRS will continue to be recorded in the FCTR. The gain or loss recognised in the income statement on a future disposal of a foreign controlled entity will include any translation differences that arise after October 1, 2004. Had the Group not applied the elective exemption, the balance of the FCTR would not have been reset to nil and the gain or loss on the future disposal of any foreign operation would have included translation differences that arose prior to the date of transition.

**(h) Wealth Management investment business revenue and expense recognition**

Under AGAAP, acquisition costs, net of initial commission revenue, relating to acquiring new investment contracts, were deferred and subsequently recognised in the income statement over the average life of the contracts. Under AIFRS, initial commission revenue will be recognised at the inception of the contract. Similarly, costs will be recognised and expensed as they are incurred.

An opening transitional adjustment of \$100 million (\$nil) represents a write-off of the cumulative deferred acquisition costs asset previously recognised under AGAAP in respect of contracts issued by entities other than life insurance entities. During the year ended September 30, 2005 the increase in the deferred acquisition costs asset recognised under AGAAP of \$12 million (\$nil) has been reversed from the balance sheet and recognised directly in the income statement.

**(i) Treasury shares**

Under AGAAP, direct investments in National Australia Bank Limited shares by the Group's life insurance statutory funds were recognised within investments relating to life insurance business in the balance sheet at market value. On transition to AIFRS, these investments will be classified as treasury shares and deducted from share capital. The opening transitional adjustment for treasury shares is:

a decrease of \$551 million (\$nil) in investments relating to life insurance business, being the market value of the investments in National shares;

a decrease of \$645 million (\$nil) in contributed equity, being the cost of the investments; and

an increase of \$94 million (\$nil) in retained earnings, being the reversal of the cumulative opening market value decrement.

For the year ended September 30, 2005, total net realised and unrealised gains and losses and dividend income of \$167 million (\$nil) relating to treasury shares was recognised in the income statement under AGAAP. This is reversed under AIFRS.

**(j) Asset revaluation reserve**

Under AGAAP, the Group carried all land and buildings at fair value. Valuation increments and decrements were offset against one another within the global group of land and buildings with the net movement being reflected in the asset revaluation reserve. The Group elected not to apply the exemptions available in AASB 1 to measure properties at their fair value and use that value as deemed cost as at the transition date, or use a previous AGAAP revaluation of properties as deemed cost at transition date. Had either of these exemptions been applied, the impact on the Group's balance sheet would have included the reversal of the asset revaluation reserve against retained earnings upon transition.

In contrast, the Group retrospectively applied AASB 116 and recognised historical valuation increments and decrements on an asset-by-asset basis. Under AIFRS the Group will continue to carry all land and buildings at fair value. The balance of the asset revaluation reserve has been restated to reflect the cumulative movements on property revaluations on an asset-by-asset basis. At October 1, 2004, the required adjustments

are an increase in the asset revaluation reserve of \$150 million (\$8 million) with a corresponding decrease in retained earnings.

**B. Transitional and measurement adjustments arising as at October 1, 2005**

The following adjustments relate to application of AASB 132, AASB 139, AASB 1038 and AASB 4 as at October 1, 2005. The information presented below is in accordance with AASB 1 that provides an exemption from presenting comparative financial information in relation to these standards.

**(k) Recognition of derivative financial instruments and hedging**

Under AIFRS, the Group has recognised all derivative financial instruments at fair value on the balance sheet, irrespective of whether the instrument is used in a hedging relationship or otherwise.

Where fair value hedge accounting criteria are met, fair value changes on both the hedged item (attributable to the hedged risk) and the hedging instrument are recognised directly in the income statement. Where cash flow hedge accounting criteria are met, the carrying value of the hedged item is not adjusted and the fair value changes on the related hedging instrument (to the extent the hedge is effective) are deferred in the cash flow hedge reserve. This amount will then be transferred to the income statement at the time the hedged item affects the income statement. Hedge ineffectiveness is recognised in the income statement immediately.

At October 1, 2005, the Group has recognised the following transitional adjustments attributable to derivative financial instruments and hedging. Many of these derivatives form an important part of the Group's risk management strategy and are designed to negate risk by the creation of off-setting fair value movements or a decrease in the variability of future cash flows. It should be noted that the overall net impact of the following adjustments upon opening retained earnings is an increase of \$28 million (\$183 million decrease).

**(i) Trading derivatives**

Initial recognition of trading derivatives at fair value resulting in an increase in total assets of \$196 million (\$61 million) and an increase in total liabilities of \$307 million (\$158 million). The increases are primarily recognised within Trading derivatives (assets) which have increased by \$330 million (\$61 million) and Trading derivatives (liabilities) which have increased by \$474 million (\$158 million) and Other assets and Other liabilities that have decreased by \$133 million (\$nil) and \$166 million (\$nil), respectively. The corresponding decrease in retained earnings is \$111 million (\$97 million). This is as a consequence of derivatives previously classified as off balance sheet hedging derivatives under AGAAP being recognised as trading derivatives on transition to AIFRS.

**(ii) Fair value hedge derivatives**

Initial recognition of derivatives designated within a fair value hedge relationship has resulted in an increase in hedging derivative assets of \$332 million (\$202 million), a decrease in other assets of \$17 million (\$nil) and an increase in hedging derivative liabilities of \$3 million (\$nil) at October 1, 2005. The corresponding increase in retained earnings is \$312 million (\$202 million).

*(iii) Assets and liabilities designated within a fair value hedge*

Where the Group has designated a financial asset or liability within a fair value hedging relationship, an adjustment is required to remeasure those assets or liabilities at fair value for changes in value attributable to the hedged risk. A decrease in loans and advances of \$118 million (\$8 million) and an increase in bonds, notes and subordinated debt of \$235 million (\$235 million) arise at October 1, 2005 as a result. The corresponding decrease in retained earnings is \$353 million (\$243 million).

*(iv) Cash flow hedging derivatives*

Initial recognition of derivatives designated within a cash flow hedge relationship has decreased hedging derivative assets by \$40 million (\$78 million) and decreased hedging derivative liabilities by \$28 million (\$42 million). The corresponding impacts on equity are an adjustment to the cash flow hedge reserve of \$6 million (\$36 million) and a decrease in retained earnings of \$6 million (\$nil).

*(v) Assets and liabilities at fair value through profit and loss*

Under the elective exemption provided in AASB 1, the Group has designated certain financial assets and liabilities as at fair value through profit and loss upon transition. Adjustments are required to: 1) reclassify the designated assets and liabilities into this category which have been detailed in section C(xii); and 2) remeasure those assets and liabilities at fair value. The measurement adjustments that arise as a result of this designation are an increase in Other financial assets at fair value of \$477 million (\$36 million) and an increase in Other financial liabilities at fair value of \$297 million (\$83 million). The increase in retained earnings as a consequence of designating certain financial assets and liabilities as fair value through profit and loss is \$180 million (\$47 million decrease). Had the AASB 1 elective exemption not been applied, the financial assets and liabilities would not have been reclassified as described in section C(xii) but would instead have remained in their respective AGAAP classification and adjusted for any other AIFRS changes impacting the class. The measurement impacts detailed above would not have been booked upon transition.

**(l) Loan loss provisioning**

Under AIFRS, the Group recognises loan impairment when objective evidence is available that a loss event has occurred and as a consequence the Group will not likely receive all amounts owed to it. Loan impairment is calculated as the difference between the carrying amount of the loan and the present value of future expected cash flows associated with the loan discounted at the loan's original effective interest rate.

The transitional adjustment at October 1, 2005 is a decrease in the total provision for doubtful debts of \$372 million (\$319 million), with a corresponding adjustment to retained earnings. As a number of loans have been designated as at fair value through profit and loss, the credit provision associated with these loans of \$85 million (\$nil) has been transferred across to that category, in addition to \$35 million (\$35 million) that has been transferred to and included in the carrying value of both trading and hedging derivatives. As a result the provision for doubtful debts (recorded against the balance of loans carried at amortised cost) has reduced by the same amount.



**(m) Revenue recognition effective yield**

Loan origination and other fee revenue historically under AGAAP has been either recognised immediately in the income statement or deferred in the balance sheet and amortised as an adjustment to yield over the expected life of the loan. Under AIFRS, a greater volume of fees are deferred and amortised over the expected life of the respective loans. Revenue that is deferred must be amortised on an effective interest rate basis. As part of the effective yield calculation AIFRS also requires deferral of related costs where these are both direct and incremental to origination of the loan.

At October 1, 2005, loans and advances have decreased by \$310 million (\$214 million) and amounts due from customers on acceptances decreased by \$91 million (\$91 million) in order to re-recognise fee revenue and costs previously recorded in the income statement. Retained earnings have decreased by a total corresponding amount of \$401 million (\$305 million).

**(n) Valuation of financial instruments using bid and offer prices**

AIFRS requires that in valuing financial instruments at fair value, the appropriate quoted market price to be used is usually the bid or offer price. Under AGAAP all financial instruments of the Group measured at fair value and transacted in an active market have been valued at the mid price. Under AIFRS it is acceptable to continue to use the mid price where there is an offsetting market risk position. Consequently, where there is no offsetting market risk position, an adjustment is required to remeasure those assets and liabilities at either the bid or offer price instead of the mid price.

At October 1, 2005, adjustments to the carrying value of financial assets and liabilities to value them on a bid or offer basis, where required, results in an increase on Other financial liabilities at fair value of \$14 million (\$11 million) within other liabilities at fair value and a decrease in the value of investments relating to life insurance business of \$2 million (\$nil).

Retained earnings have decreased by a corresponding amount.

**(o) Classification of convertible financial instruments**

Recent IASB discussions relating to an International Financial Reporting Interpretations Committee (IFRIC) interpretation have changed the accounting treatment of the exchangeable capital units classified within Other debt issues. This leads to the recognition of certain embedded derivatives not previously accounted for. Under this interpretation certain option features of this instrument embedded within the debt instrument permitting the holder to convert an exchangeable capital unit into a specified number of National ordinary shares are considered an embedded derivative that must be recorded at fair value. The combined impact of the recognition of the embedded derivative and foreign exchange movements to record the foreign denominated liability at the closing foreign exchange rate recognised under AIFRS increase other debt issues by \$879 million (Due to controlled entities: \$50 million) with a corresponding decrease in retained earnings.



**(p) Derecognition of financial assets and liabilities**

AIFRS contains more specific and stringent requirements prior to the Group being able to derecognise financial assets and liabilities from the balance sheet. Furthermore, the Group is required to review and consider the extent to which it retains the risks and rewards of ownership of a financial asset or whether the obligation specified within the contract is discharged, cancelled or expired prior to the derecognition of a financial liability.

At October 1, 2005, \$76 million (\$11 million) of customer-related financial liabilities that were previously derecognised from the Group's balance sheet have been re-recognised. Deposits and other borrowings have increased by \$54 million (\$nil), Other liabilities have increased by \$22 million (\$11 million) and retained earnings have decreased by \$76 million (\$11 million) as a result of this adjustment.

Additionally, mortgages previously derecognised through sale to a controlled SPE have been re-recognised in the Company increasing loans and advances by nil (\$1,676 million) and due to controlled entities by nil (\$1,676 million).

**(q) Insurance contracts & provision for selling costs Wealth Management**

Under AIFRS, contracts that do not have significant insurance risk are no longer treated as insurance contracts but as financial instruments. For non-insurance contracts which are accounted for as financial instruments, under AGAAP acquisition costs were previously deferred and subsequently recognised in the income statement. In contrast, under AIFRS these costs will be recognised and expensed as they are incurred.

At October 1, 2005 cumulative deferred acquisition costs included in net policy liabilities of life insurance entities of \$384 million (\$nil) have been de-recognised.

Those contracts that continue to meet the definition of an insurance contract will be accounted for under an amended Margin on Services approach. On transition to AIFRS, the actuarial calculation of policyholder liabilities is based on discount rates different to that used under AGAAP. At October 1, 2005, this has decreased policyholder liabilities by \$17 million (\$nil) with a corresponding increase in retained earnings.

The removal of the provision for selling costs previously included within the valuation of investments relating to life insurance business have increased the carrying value of these assets by \$11 million (\$nil) and increased the carrying value of life insurance liabilities by an equivalent amount. There has been no impact on retained earnings.

These adjustments have increased Investments relating to life insurance business by \$11 million (\$nil), increased Life insurance policy liabilities by \$378 million (\$nil) and decreased retained earnings by \$367 million (\$nil).

**(r) Reclassification of outside equity interests**

On transition to AIFRS, the outside equity interests in controlled unit trusts of the life companies no longer meet the definition of equity. As a result, the Group has reclassified outside equity interests in controlled unit trusts to liabilities. As at October 1, 2005, the result is an increase in managed fund units on issue and a corresponding decrease in equity of \$6,224 million (\$nil).

**(s) Taxation**

The tax impacts of the transitional adjustments arising as at October 1, 2005 include an increase in deferred tax assets of \$175 million (\$192 million), an increase in deferred tax liabilities of \$150 million (\$109 million) and a decrease in current tax liabilities of \$1 million (\$nil). The corresponding impacts on equity are an adjustment to the cash flow hedge reserve of \$3 million (\$11 million) and an increase in retained earnings of \$22 million (\$72 million).

**(t) Due from customers on acceptances and liability on acceptances**

Amounts due from customers on acceptances and Liabilities on acceptances must both initially be recognised at fair value and subsequently measured at amortised cost. Previously both acceptance assets and liabilities were recorded at face value. This change in accounting treatment has decreased the carrying value of the Due from customers on acceptances asset and Liability on acceptances each by \$202 million (\$202 million). There has been no impact upon retained earnings.

**(u) General reserve**

The statutory funds, within the life insurance business, retained profits are transferred from retained earnings into the general reserve. As a consequence of the AIFRS transitional adjustments the retained profits of the statutory funds have been reduced by \$417 million (\$nil). This is reflected through a decrease in the general reserve of \$417 million (\$nil) and a corresponding increase in retained earnings.

**(v) Other**

The items detailed above are the areas of most significant impact arising from the application of AIFRS on both the balance sheet and the income statement. In addition to these items certain other minor adjustments relating to leasing arrangements, provisions, reclassification into and remeasurement of trading securities and revaluation of investments relating to life insurance business have been made.

**C. Reclassifications made within the financial statements**

In addition to the transitional and measurement adjustments detailed above, the adoption of AIFRS introduces changes to the format of the income statement, balance sheet and other financial statement disclosures. Certain reclassifications of assets and liabilities and within equity reserves have occurred as a result of these changes.

**Reclassifications at October 1, 2004:**

The major items reclassified upon transition to AIFRS as at October 1, 2004 include:

**Balance sheet reclassifications**

(i) Capitalised computer software costs of \$655 million (\$378 million) have been reclassified from property, plant and equipment to intangible assets.

(ii) Motor vehicles leased to customers under operating lease agreements have been reclassified. Amounts of \$1,004 million (\$124 million) from Loans and advances and \$1,464 million (\$105 million) from Other assets have been reclassified to Property, plant and equipment.

(iii) Deferred tax assets and liabilities and current taxes have been separately disclosed.

(iv) Short positions in securities of \$845 million (\$840 million) have been reclassified from Other liabilities to Other financial liabilities at fair value.

(v) Regulatory deposits of \$177 million (\$93 million) have been combined with Due from other banks on the face of the balance sheet.

(vi) Shares in other securities of \$107 million (\$9 million) have been reclassified from Investments in associates and joint ventures and other securities to Trading securities.

**Income statement reclassifications for the year ended September 30, 2005**

(vii) Rentals received on motor vehicles leased to customers of \$729 million (\$70 million) have been included within Other operating income. Depreciation on these assets of \$539 million (\$52 million) has been included in General expenses. Under AGAAP the net of these amounts, \$190 million (\$18 million) was reported within Net Interest Income.

(viii) Trading income of \$644 million (\$506 million) has been included within Gains less losses on financial instruments at fair value. Previously this was reported within Other operating income.

The combination of these two adjustments above gives rise to a net increase of \$85 million (\$436 million decrease) in Other operating income.

In addition to the above reclassifications, the transition to AIFRS has required the recognition of a new equity reserve for equity based payments.

**Cash flow statement reclassifications for the year ended September 30, 2005**

On transition to AIFRS, reclassifications of income statement and balance sheet items have resulted in reclassifications in the cash flow statement. Additionally, there have been certain line item reclassifications within the cash flow statement to reflect the nature of the cash flows using an AIFRS approach. Other than such reclassifications, there have been no material adjustments to cash and cash equivalents of the Group.

**Reclassifications at October 1, 2005:**

The major items reclassified as at October 1, 2005 include:

**Balance sheet reclassifications**

(ix) A total of \$18,463 million (\$399 million) of financial instruments have been reclassified to other financial assets at fair value. Of this, the principal amounts relate to loans and advances amounting to \$14,468 million (\$399 million) inclusive of a doubtful debt provision of \$85 million (\$nil), \$560 million (\$nil) from cash assets, \$12 million (\$nil)

due from other banks and \$3,423 million (\$nil) from Investments held to maturity (previously Investment securities under AGAAP).

(x) Trading securities have decreased by \$6,432 million (\$6,432 million) through reclassifications to Due to customers on acceptances. This is due to a change in accounting for acceptances issued and repurchased as part of trading activities.

(xi) Trading securities have also increased by \$920 million (\$nil) through reclassifications of \$966 million (\$nil) from Investments held to maturity (previously Investment securities under AGAAP) and \$45 million (\$nil) to Investments available for sale. These reclassifications have been made to reflect appropriate asset classifications and their specific requirements within AIFRS.

(xii) A total of \$9,295 million (\$717 million) of financial instruments have been reclassified to other financial liabilities at fair value. Of this, the principal amounts relate to deposits and other borrowings of \$8,347 million (\$717 million), \$418 million (\$nil) of amounts due to other banks and \$530 million (\$nil) of bonds, notes and subordinated debt.

(xiii) Outside equity interests in Wealth Management controlled entities of \$6,224 million (\$nil) previously classified within equity have been reclassified to the liability category Managed fund units on issue.

(xiv) Amounts relating to foreign exchange revaluations attributable to hedging derivatives previously recognised within other assets of \$353 million (\$nil) and other liabilities of \$2,938 million (\$2,909 million) have been reclassified within hedging derivative assets and hedging derivative liabilities respectively.

(xv) Life insurance policy liabilities have increased by \$431 million (\$nil) as a result of reclassifying certain amounts relating to reinsurance to other assets.

In addition to the above reclassifications, the transition to AIFRS has required the recognition of a cash flow hedge reserve.

Finally, as a part of the AIFRS transition, a review of the mapping of all revenue and expense categories was undertaken. Whilst total revenue and expense lines have only changed due to AIFRS requirements certain line items within the categories have been amended to reflect a more appropriate mapping of revenue and expenses.

## Total equity reconciliations

	Ref	Group \$m	Company \$m
<b>Total equity as reported under Australian GAAP as at September 30, 2004</b>		29,766	21,088
<b>AIFRS October 1, 2004 adjustments to total equity</b>			
<b>Impacts on retained earnings</b>			
Recognition of defined benefit pension liability	a	(1,286)	(98)
Recognition of defined benefit pension asset	a	130	55
Derecognition of net prepaid pension asset	a	(575)	
Derecognition of EMVONA	b	(729)	
Leasing adjustments		(90)	
Transfer to executive share option reserve	e	(34)	(22)
Transfer from foreign currency translation reserve	g	166	23
Revenue and expense recognition investment contracts	h	(100)	
Reversal of market value decrement on treasury shares	i	94	
Transfer to asset revaluation reserve	j	(150)	(8)
Other		(55)	(2)
Tax effect of transitional adjustments and application of tax-effect accounting	d	609	12
<b>Impacts on contributed equity</b>			
Derecognition of treasury shares	i	(645)	
<b>Impacts on reserves</b>			
Transfer from retained earnings to executive share option reserve	e	34	34
Transfer from foreign currency translation reserve to retained earnings	g	(166)	(23)
Increase to asset revaluation reserve	j	114	8
<b>Total adjustments to equity as at October 1, 2004</b>		(2,683)	(21)
<b>Total equity measured under AIFRS as at October 1, 2004</b>		27,083	21,067
<b>Total equity as reported under Australian GAAP as at September 30, 2005</b>		<b>34,280</b>	24,100
<b>Total adjustments to equity as at October 1, 2004</b>		<b>(2,683)</b>	(21)
<b>AIFRS adjustments to net profit for the year ended September 30, 2005</b>		<b>(140)</b>	(60)
<b>AIFRS September 30, 2005 adjustments to total equity</b>			
<b>Impacts on retained earnings</b>			
Actuarial movements on defined benefit pension plans	a	(68)	(3)
Derecognition of dividend income and realised gains/losses on treasury shares	i	37	
Other			4
Transfer from asset revaluation reserve		31	4
Transfer to foreign currency translation reserve		(62)	(4)
<b>Impacts on contributed equity</b>			
Recognition of share-based payments		21	21
Recognition of realised gains/losses on treasury shares	i	(27)	
Derecognition of treasury shares	i	(7)	
<b>Impacts on reserves</b>			
Adjustment to executive share option reserve	e	76	76
Adjustment to foreign currency translation reserve		124	5
Adjustment to asset revaluation reserve		(35)	(4)

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<b>Total adjustments to equity for the year ended September 30, 2005</b>	<b>(50)</b>	<b>39</b>
<b>Total equity measured under AIFRS as at September 30, 2005</b>	<b>31,547</b>	<b>24,118</b>



	Ref	Group \$m	Company \$m
<b>Total equity as reported under AIFRS as at September 30, 2005</b>		31,547	24,118
<b>AIFRS October 1, 2005 adjustments to total equity</b>			
<b>Impacts on retained earnings</b>			
Recognition of non-hedging derivatives	k(i)	(111)	(97)
Recognition of fair value hedging derivatives	k(ii)	312	202
Fair value hedge adjustment to underlying hedged items	k(iii)	(353)	(243)
Adjustment to assets and liabilities recorded at fair value through profit and loss	k(v)	180	(47)
Loan loss provisioning	l	372	319
Revenue recognition effective yield	m	(401)	(305)
Valuation of financial instruments at bid and offer price	n	(16)	(11)
Revaluation of Exchangeable capital units	o	(879)	(50)
Rerecognition of customer-related financial liabilities	p	(76)	(11)
Derecognition of deferred acquisition costs life insurance contracts	q	(384)	
Other	v	7	7
Adjustment to policyholder liabilities due to changes in discount rates	q	17	
Remeasurement of statutory fund profit	u	417	
Tax effect of above transitional adjustments	s	22	72
<b>Impacts on reserves</b>			
Recognition of cash flow hedging derivatives within cash flow hedge reserve	k(iv), (s)	(3)	(25)
Remeasurement of statutory fund profit	u	(417)	
<b>Impacts on minority interest</b>			
Reclassification of outside equity interest to liabilities	r, xiii	(6,224)	
<b>Total adjustments to equity as at October 1, 2005</b>		<b>(7,537)</b>	<b>(189)</b>
<b>Total equity measured under AIFRS as at October 1, 2005</b>		<b>24,010</b>	<b>23,929</b>

## Group balance sheet reconciliation

	AGAAP (1) Sep 30, 04 \$m	Ref	Transition \$m	Ref	Reclassification \$m	AIFRS Oct 1, 04 \$m
<b>Assets</b>						
Cash and liquid assets	8,144	c	11			8,155
Due from other banks	22,939			v	177	23,116
Trading derivatives	17,939					17,939
Trading securities	24,248	c	4	vi	107	24,359
Investments - available for sale	4,610					4,610
Investments - held to maturity	11,513					11,513
Investments relating to life insurance business	41,013	i, v	(553)			40,460
Other financial assets at fair value						
Hedging derivatives						
Loans and advances	247,836	c, v	5,572	ii	(1,004)	252,404
Due from customers on acceptances	16,344					16,344
Property, plant and equipment	2,257	v	(24)	i, ii	1,813	4,046
Due from controlled entities						
Investments in controlled entities and joint venture entities						
	158	v	16	vi	(107)	67
Goodwill and other intangible assets	632	b	4,176	i	655	5,463
Regulatory deposits	177			v	(177)	
Deferred tax assets	1,301	c, d	458			1,759
Other assets	11,564	a, b, c, h	(5,418)	ii	(1,464)	4,682
<b>Total assets</b>	<b>410,675</b>		<b>4,242</b>			<b>414,917</b>
<b>Liabilities</b>						
Due to other banks						
	43,625					43,625
Trading derivatives						
	16,150					16,150
Other financial liabilities at fair value						
				iv	845	845
Hedging derivatives						
Deposits and other borrowings						
	219,028	c	2,179			221,207
Liability on acceptances						
	16,344					16,344
Life policy liabilities						
	36,134					36,134
Current tax liabilities						
	203		8			211
Provisions						
	1,129	v	48			1,177
Due to controlled entities						
Bonds, notes and subordinated debt						
	32,573	c	3,533			36,106
Other debt issues						
	1,612					1,612
Defined benefit pension scheme liabilities						
		a	1,286			1,286
Managed fund units on issue						
Deferred tax liabilities						
	975	d	46			1,021
Other liabilities						
	13,136	c, v	(175)	iv	(845)	12,116
<b>Total liabilities</b>	<b>380,909</b>		<b>6,925</b>			<b>387,834</b>
<b>Net assets</b>	<b>29,766</b>		<b>(2,683)</b>			<b>27,083</b>
<b>Equity</b>						
Contributed equity						
	10,191	i	(645)			9,546
Reserves						
	1,194	e, g, j	(18)			1,176
Retained profits						
	14,515		(2,020)			12,495
Total equity (parent entity interest)						
	25,900		(2,683)			23,217
Minority interest in controlled entities						
	3,866					3,866
<b>Total equity</b>	<b>29,766</b>		<b>(2,683)</b>			<b>27,083</b>

(1) *Certain previously disclosed AGAAP balances have been amended where it has been identified that trade date accounting has been incorrectly applied to repurchase and reverse repurchase agreements. The adjustments to the September 30, 2004 AGAAP balance sheet to correct the asset position are a \$64 million increase to Cash and liquid assets , a \$555 million decrease to Due from other banks , and a \$143 million decrease to Other assets . The adjustments to the liability position are a \$143 million decrease to Due to other banks and a \$491 million decrease to Other liabilities .*

## Group income statement reconciliation

For the year ended September 30, 2005	AGAAP \$m	Ref	Measurement	Reclassification	AIFRS \$m
			\$m	Ref	
Interest income	20,872	c	421	vii	21,103
Interest expense	(13,790)	c	(369)		(14,159)
Net interest income	7,082		52		6,944
Premium and related revenue	906				906
Investment revenue	7,698	i	(167)		7,531
Claims expense	(590)				(590)
Change in policy liabilities	(5,570)				(5,570)
Policy acquisition and maintenance expense	(739)				(739)
Investment management expense	(33)				(33)
Net life insurance income	1,672		(167)		1,505
Gains less losses on financial instruments at fair value			(5)	viii	639
Movement in the excess of net market value over net assets of life insurance controlled entities	335	b	(335)		
Other operating income	5,102	v	64	vii, viii	5,251
Significant revenue					
Net profit/(loss) from the sale of National Europe Holdings (Ireland) Limited	1,077	a	277		1,354
Total other income	6,514		1		7,244
Personnel expenses	(3,736)	a, e	(71)		(3,807)
Occupancy-related expenses	(622)		1		(539)
General expenses	(2,946)	c, h	(82)	vii	(3,649)
Amortisation of goodwill	(98)	f	98		
Charge to provide for doubtful debts	(534)				(534)
Significant expenses					
Restructuring costs	(838)	a	45		(793)
Reversal of prior years restructuring provision	11				11
Foreign currency options trading (losses)/reversal	34				34
Total operating expenses	(8,729)		(9)		(9,277)
<b>Profit before income tax expense</b>	6,539		(123)		6,416
Income tax expense	(1,797)	d	(17)		(1,814)
<b>Net profit</b>	4,742		(140)		4,602
Net profit attributable to minority interest Life insurance business	(610)				(610)
<b>Net profit attributable to members of the Company</b>	4,132		(140)		3,992

## Group balance sheet reconciliation

As at September 30, 2005	AGAAP (1) \$m	Transition \$m	Ref	Measurement \$m	Reclassification \$m	AIFRS \$m
<b>Assets</b>						
Cash and liquid assets	8,430	11				8,441
Due from other banks	15,477				118	15,595
Trading derivatives	13,959					13,959
Trading securities	15,075	4	c	3	72	15,154
Investments - available for sale	3,857				3	3,860
Investments - held to maturity	7,466					7,466
Investments relating to life insurance business	50,500	(553)	i	(164)		49,783
Other financial assets at fair value						
Hedging derivatives						
Loans and advances	260,053	5,572	c, v	262	(1,213)	264,674
Due from customers on acceptances	27,627					27,627
Property, plant and equipment	1,974	(24)	v	(3)	1,882	3,829
Due from controlled entities						
Investments in controlled entities and joint venture entities	75	16			(75)	16
Goodwill and other intangible assets	522	4,176	b, f	146	614	5,458
Regulatory deposits	118				(118)	
Deferred tax assets	1,430	458	c, d	(154)		1,734
Other assets	11,942	(5,418)	a, b, c, h, v	(239)	(1,283)	5,002
<b>Total assets</b>	<b>418,505</b>	<b>4,242</b>		<b>(149)</b>		<b>422,598</b>
<b>Liabilities</b>						
Due to other banks	36,322					36,322
Trading derivatives	12,407		c	206		12,613
Other financial liabilities at fair value	(201)				1,688	1,487
Hedging derivatives						
Deposits and other borrowings	209,079	2,179	c	1,299		212,557
Liability on acceptances	27,627					27,627
Life policy liabilities	42,123					42,123
Current tax liabilities	131	8	d	6		145
Provisions	1,823	48	a, v	(24)		1,847
Due to controlled entities						
Bonds, notes and subordinated debt	39,238	3,533	c	(1,281)		41,490
Other debt issues	1,559					1,559
Defined benefit pension scheme liabilities		1,286	a	(301)		985
Managed fund units on issue						
Deferred tax liabilities	1,250	46	b, c, d	(70)		1,226
Other liabilities	12,867	(175)	c, d, v	66	(1,688)	11,070
<b>Total liabilities</b>	<b>384,225</b>	<b>6,925</b>		<b>(99)</b>		<b>391,051</b>
<b>Net assets</b>	<b>34,280</b>	<b>(2,683)</b>		<b>(50)</b>		<b>31,547</b>
<b>Equity</b>						
Contributed equity	11,486	(645)	i	(13)		10,828
Reserves	667	(18)	a, e, g, j	165		814
Retained profits	15,903	(2,020)		(202)		13,681
Total equity (parent entity interest)	28,056	(2,683)		(50)		25,323
Minority interest in controlled entities	6,224					6,224
<b>Total equity</b>	<b>34,280</b>	<b>(2,683)</b>		<b>(50)</b>		<b>31,547</b>

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(1) *Certain previously disclosed AGAAP balances have been amended where it has been identified that trade date accounting has been incorrectly applied to repurchase and reverse repurchase agreements. The adjustments to the September 30, 2005 AGAAP balance sheet to correct the asset position are a \$882 million decrease to Trading securities , and a \$201 million decrease to Other assets . The adjustments to the liability position are a \$201 million decrease to Other financial liabilities at fair value and a \$882 million decrease to Other liabilities .*

## Group balance sheet reconciliation

	AIFRS Sep 30, 05 \$m	Ref	Transition \$m	Ref	Reclassification \$m	AIFRS Oct 1, 05 \$m
<b>Assets</b>						
Cash and liquid assets	8,441			ix	(560)	7,881
Due from other banks	15,595			ix	(12)	15,583
Trading derivatives	13,959	k(i)	330	l	(35)	14,254
Trading securities	15,154	v	5	x, xi	(5,512)	9,647
Investments - available for sale	3,860			x	45	3,905
Investments - held to maturity	7,466			ix, x	(4,389)	3,077
Investments relating to life insurance business	49,783	n,q	9			49,792
Other financial assets at fair value		k(v)	477	ix, l	18,463	18,940
Hedging derivatives		k(ii)(iv)	292	xiv	353	645
Loans and advances	264,674	k(iii), l, m	(56)	ix	(14,434)	250,184
Due from customers on acceptances	27,627	m, t	(293)	x	6,433	33,767
Property, plant and equipment	3,829					3,829
Due from controlled entities						
Investments in controlled entities and joint venture entities	16					16
Goodwill and other intangible assets	5,458					5,458
<b>Regulatory deposits</b>						
Deferred tax assets	1,734	s	175			1,909
Other assets	5,002	k(i)(ii)	(150)	xiv	79	4,931
<b>Total assets</b>	<b>422,598</b>		<b>789</b>		<b>431</b>	<b>423,818</b>
<b>Liabilities</b>						
Due to other banks	36,322			xi	(418)	35,904
Trading derivatives	12,613	k(i)	474			13,087
Other financial liabilities at fair value	1,487	k(v),n	311	xi	9,295	11,093
Hedging derivatives		k(ii)(iv)	(25)	xiii	2,938	2,913
Deposits and other borrowings	212,557	p	54	xi	(8,347)	204,264
Liability on acceptances	27,627	t	(202)			27,425
Life policy liabilities	42,123	q	378	xv	431	42,932
Current tax liabilities	145	s	(1)			144
Provisions	1,847					1,847
Due to controlled entities						
Bonds, notes and subordinated debt	41,490	k(iii)	235	xi	(530)	41,195
Other debt issues	1,559	o	879			2,438
Defined benefit pension scheme liabilities	985					985
Managed fund units on issue				xii	6,224	6,224
Deferred tax liabilities	1,226	s	150			1,376
Other liabilities	11,070	k(i), p	(151)	xiv	(2,938)	7,981
<b>Total liabilities</b>	<b>391,051</b>		<b>2,102</b>		<b>6,655</b>	<b>399,808</b>
<b>Net assets</b>	<b>31,547</b>		<b>(1,313)</b>		<b>(6,224)</b>	<b>24,010</b>
<b>Equity</b>						
Contributed equity	10,828					10,828
Reserves	814	k(iv), u	(420)			394
Retained profits	13,681		(893)			12,788
Total equity (parent entity interest)	25,323		(1,313)			24,010
Minority interest in controlled entities	6,224			xiii	(6,224)	
<b>Total equity</b>	<b>31,547</b>		<b>(1,313)</b>		<b>(6,224)</b>	<b>24,010</b>





## Company balance sheet reconciliation

	AGAAP (1) Sep 30, 04 \$m	Ref	Transition \$m	Ref	Reclassification \$m	AIFRS Oct 1, 04 \$m
<b>Assets</b>						
Cash and liquid assets	4,253					4,253
Due from other banks	21,059			v	93	21,152
Trading derivatives	17,279					17,279
Trading securities	23,699			vi	9	23,708
Investments - available for sale	3,978					3,978
Investments - held to maturity	5,383					5,383
Investments relating to life insurance business						
Other financial assets at fair value						
Hedging derivatives						
Loans and advances	156,035	v	(17)	ii	(124)	155,894
Due from customers on acceptances	16,266					16,266
Property, plant and equipment	878	v	(1)	i, ii	(149)	728
Due from controlled entities	32,244	e	12			32,256
Investments in controlled entities and joint venture entities	11,432	v	16	vi	(9)	11,439
Goodwill and other intangible assets				i	378	378
Regulatory deposits	93			v	(93)	
Deferred tax assets	810	d	90			900
Other assets	2,358	a	55	ii	(105)	2,308
<b>Total assets</b>	<b>295,767</b>		<b>155</b>			<b>295,922</b>
<b>Liabilities</b>						
Due to other banks	40,256					40,256
Trading derivatives	15,181					15,181
Other financial liabilities at fair value				iv	840	840
Hedging derivatives						
Deposits and other borrowings	145,696					145,696
Liability on acceptances	16,266					16,266
Life policy liabilities						
Current tax liabilities	55					55
Provisions	629					629
Due to controlled entities	18,004					18,004
Bonds, notes and subordinated debt	31,449					31,449
Other debt issues	350					350
Defined benefit pension scheme liabilities		a	98			98
Managed fund units on issue						
Deferred tax liabilities	685	d	78			763
Other liabilities	6,108			iv	(840)	5,268
<b>Total liabilities</b>	<b>274,679</b>		<b>176</b>			<b>274,855</b>
<b>Net assets</b>	<b>21,088</b>		<b>(21)</b>			<b>21,067</b>
<b>Equity</b>						
Contributed equity	9,216					9,216
Reserves	50	e, g, j	19			69
Retained profits	11,822		(40)			11,782
Total equity (parent entity interest)	21,088		(21)			21,067
Minority interest in controlled entities						
<b>Total equity</b>	<b>21,088</b>		<b>(21)</b>			<b>21,067</b>

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## Company income statement reconciliation

For the year ended September 30, 2005	AGAAP \$m	Measurement Ref	\$m	Reclassification Ref	\$m	AIFRS \$m
Interest income	15,539			vii	(18)	15,521
Interest expense	(11,337)					(11,337)
Net interest income	4,202				(18)	4,184
Premium and related revenue						
Investment revenue						
Claims expense						
Change in policy liabilities						
Policy acquisition and maintenance expense						
Investment management expense						
Net life insurance income						
Gains less losses on financial instruments at fair value				viii	506	506
Other operating income	5,732	v	13	vii, viii	(436)	5,309
Significant revenue						
Net profit/(loss) from the sale of National Europe Holdings (Ireland) Limited	(41)					(41)
Total other income	5,691		13		70	5,774
Personnel expenses	(2,206)	a, e	(63)			(2,269)
Occupancy-related expenses	(324)	v	(1)		48	(277)
General expenses	(1,432)	v	(1)	vii	(100)	(1,533)
Charge to provide for doubtful debts	(294)					(294)
Significant expenses						
Restructuring costs	(499)					(499)
Reversal of prior years restructuring provision	6					6
Foreign currency options trading (losses)/reversal	34					34
Total operating expenses	(4,715)		(65)		(52)	(4,832)
<b>Profit before income tax expense</b>	5,178		(52)			5,126
Income tax expense	(865)	d	(8)			(873)
<b>Net profit</b>	4,313		(60)			4,253
Net profit attributable to minority interest – Life insurance business						
<b>Net profit attributable to members of the Company</b>	4,313		(60)			4,253

## Company balance sheet reconciliation

As at 30 September, 2005	AGAAP (1) \$m	Transition \$m	Ref	Measurement \$m	Reclassification \$m	AIFRS \$m
<b>Assets</b>						
Cash and liquid assets	3,334					3,334
Due from other banks	16,158				67	16,225
Trading derivatives	13,416					13,416
Trading securities	14,092				9	14,101
Investments - available for sale	3,231				3	3,234
Investments - held to maturity	2,425					2,425
Investments relating to life insurance business						
Other financial assets at fair value						
Hedging derivatives						
Loans and advances	175,783	(17)	c, v	1	(138)	175,629
Due from customers on acceptances	27,612					27,612
Property, plant and equipment	840	(1)	v		(73)	766
Due from controlled entities	29,595	12		34		29,641
Investments in controlled entities and joint venture entities	11,017	16			(12)	11,021
Goodwill and other intangible assets			b, f		341	341
Regulatory deposits	67				(67)	
Deferred tax assets	918	90	c, d	(58)		950
Other assets	2,756	55	a, b, c, h, v	4	(130)	2,685
<b>Total assets</b>	<b>301,244</b>	<b>155</b>		<b>(19)</b>		<b>301,380</b>
<b>Liabilities</b>						
Due to other banks	32,605					32,605
Trading derivatives	11,642					11,642
Other financial liabilities at fair value	(201)				838	637
Hedging derivatives						
Deposits and other borrowings	144,842					144,842
Liability on acceptances	27,612					27,612
Life policy liabilities						
Current tax liabilities	20		d	(1)		19
Provisions	1,137		a, v			1,137
Due to controlled entities	13,729					13,729
Bonds, notes and subordinated debt	38,108					38,108
Other debt issues	328					328
Defined benefit pension scheme liabilities		98	a	3		101
Managed fund units on issue						
Deferred tax liabilities	984	78	b, c, d	(46)		1,016
Other liabilities	6,338		c, d, v	(14)	(838)	5,486
<b>Total liabilities</b>	<b>277,144</b>	<b>176</b>		<b>(58)</b>		<b>277,262</b>
<b>Net assets</b>	<b>24,100</b>	<b>(21)</b>		<b>39</b>		<b>24,118</b>
<b>Equity</b>						
Contributed equity	10,511		i	21		10,532
Reserves	45	19	a, e, g, j	77		141
Retained profits	13,544	(40)		(59)		13,445
Total equity (parent entity interest)	24,100	(21)		39		24,118
Minority interest in controlled entities						
<b>Total equity</b>	<b>24,100</b>	<b>(21)</b>		<b>39</b>		<b>24,118</b>

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## Company balance sheet reconciliation

	AIFRS Sep 30, 05 \$m	Ref	Transition \$m	Ref	Reclassification \$m	AIFRS Oct 1, 05 \$m
<b>Assets</b>						
Cash and liquid assets	3,334					3,334
Due from other banks	16,225					16,225
Trading derivatives	13,416	k(i)	61	ix,l	74	13,551
Trading securities	14,101			x	(6,432)	7,669
Investments - available for sale	3,234					3,234
Investments - held to maturity	2,425					2,425
Investments relating to life insurance business						
Other financial assets at fair value		k(v)	36	ix	399	435
Hedging derivatives		k(ii)(iv)	124			124
Loans and advances	175,629	k(iii), l, m, p	1,773	ix,l	(364)	177,038
Due from customers on acceptances	27,612	m,t	(293)	x	6,433	33,752
Property, plant and equipment	766					766
Due from controlled entities	29,641					29,641
Investments in controlled entities and joint venture entities						
	11,021					11,021
Goodwill and other intangible assets	341					341
Regulatory deposits						
Deferred tax assets	950	s	192			1,142
Other assets	2,685	v	1	ix	(110)	2,576
<b>Total assets</b>	<b>301,380</b>		<b>1,894</b>			<b>303,274</b>
<b>Liabilities</b>						
Due to other banks	32,605					32,605
Trading derivatives	11,642	k(i)	158	xiv	169	11,969
Other financial liabilities at fair value	637	k(v),n	94	xii	716	1,447
Hedging derivatives		k(iv)	(42)	xiv	2,741	2,699
Deposits and other borrowings	144,842			xii	(717)	144,125
Liability on acceptances	27,612	t	(202)			27,410
Life policy liabilities						
Current tax liabilities	19					19
Provisions	1,137					1,137
Due to controlled entities	13,729	o,p	1,726			15,455
Bonds, notes and subordinated debt	38,108	k(iii)	235			38,343
Other debt issues	328					328
Defined benefit pension scheme liabilities	101					101
Managed fund units on issue						
Deferred tax liabilities	1,016	s	109			1,125
Other liabilities	5,486	v	5	xiv	(2,909)	2,582
<b>Total liabilities</b>	<b>277,262</b>		<b>2,083</b>			<b>279,345</b>
<b>Net assets</b>	<b>24,118</b>		<b>(189)</b>			<b>23,929</b>
<b>Equity</b>						
Contributed equity	10,532					10,532
Reserves	141	k(iv)	(25)			116
Retained profits	13,445		(164)			13,281
Total equity (parent entity interest)	24,118		(189)			23,929
Minority interest in controlled entities						
<b>Total equity</b>	<b>24,118</b>		<b>(189)</b>			<b>23,929</b>



## 2 Segment information

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. The Group results are based on the business segments as reviewed separately by the chief operating decision maker, the Group Chief Executive Officer, as well as other members of senior management.

The Group's business is organised into four operating segments, three of which are managed along regional lines: Australia Region, United Kingdom Region and New Zealand Region, which include banking and wealth management products; as well as nabCapital (which is managed globally). nabCapital comprises Markets, Corporate Loan Portfolio, Structured Products, Credit Products, Financial Institutions and a Support Services unit, to provide products across the Group's business base. The Group's Other business segment includes Corporate Centre, Group Funding, and other unallocated items which are not considered to be separate reportable operating segments.

Revenues, expenses and tax directly associated with each business segment are included in determining their result. Transactions between business segments are based on agreed recharges between segments operating within the same country and are normally at arm's length between segments operating in different countries.

### Business segments

Year ended September 30, 2006	Australia Region \$m	United Kingdom Region \$m	New Zealand Region \$m	nabCapital \$m	Other \$m	Inter-segment eliminations \$m	Total Group \$m
Net interest income (1)	4,839	1,840	775	937	295		8,686
Non-interest income (2)	10,017	1,106	527	576	122		12,348
Significant revenue		348		(7)	(7)		334
Inter-segment revenue/(expenses)	53	38	(2)	3	80	(172)	
Total revenue after interest expense	14,909	3,332	1,300	1,509	490	(172)	21,368
Other expenses (3)	(10,244)	(2,059)	(684)	(600)	(506)		(14,093)
Inter-segment (expenses)/revenue	(55)	(43)	(40)	(134)	100	172	
Total expenses excluding interest expense	(10,299)	(2,102)	(724)	(734)	(406)	172	(14,093)
Profit/(loss) before income tax expense	4,610	1,230	576	775	84		7,275
Income tax (expense)/benefit	(1,346)	(362)	(187)	(157)	(82)		(2,134)
Net profit/(loss)	3,264	868	389	618	2		5,141
Net profit attributable to minority interest	(749)						(749)
Net profit/(loss) attributable to members of the Company	2,515	868	389	618	2		4,392
Total assets (4)	278,815	64,439	33,624	146,127	19,930	(58,150)	484,785
Total liabilities (4)	269,813	57,600	31,101	136,377	20,072	(58,150)	456,813
Goodwill	3,659	511	264				4,434
Acquisition of property, plant and equipment and intangible assets	851	448	276	2			1,577
Depreciation and amortisation of plant and equipment and intangible assets	424	181	77	42	49		773
Non-cash expenses other than depreciation and amortisation	460	325	55	(16)	6		830



Year ended September 30, 2005	Australia Region \$m	United Kingdom Region \$m	New Zealand Region \$m	nabCapital \$m	Other \$m	Inter-segment eliminations \$m	Total Group \$m
Net interest income (1)	3,837	1,794	739	502	72		6,944
Non-interest income (2)	11,758	1,199	538	931	(99)		14,327
Significant revenue		1,258			96		1,354
Inter-segment revenue/(expenses)	90	50	14	(4)	83	(233)	
Total revenue after interest expense	15,685	4,301	1,291	1,429	152	(233)	22,625
Significant expenses	(406)	(217)	(14)	(83)	(28)		(748)
Other expenses (3)	(11,327)	(2,202)	(774)	(635)	(523)		(15,461)
Inter-segment (expenses)/revenue	(50)	(50)	(49)	(131)	47	233	
Total expenses excluding interest expense	(11,783)	(2,469)	(837)	(849)	(504)	233	(16,209)
Profit/(loss) before income tax expense	3,902	1,832	454	580	(352)		6,416
Income tax (expense)/benefit	(1,311)	(202)	(147)	(77)	(77)		(1,814)
Net profit/(loss)	2,591	1,630	307	503	(429)		4,602
Net profit attributable to minority interest	(610)						(610)
Net profit/(loss) attributable to members of the Company	1,981	1,630	307	503	(429)		3,992
Total assets (4)	247,403	52,068	31,576	151,390	(1,234)	(58,605)	422,598
Total liabilities (4)	241,352	42,295	30,282	143,224	(7,497)	(58,605)	391,051
Goodwill	3,945	496	326				4,767
Acquisition of property, plant and equipment and intangible assets	1,065	465	258	5			1,793
Depreciation and amortisation of plant and equipment and intangible assets	508	241	136	38	40		963
Non-cash expenses other than depreciation and amortisation	909	455	51	141	60		1,616

(1) *Net interest income includes interest on capital employed by business segments. It is impracticable to disclose gross interest revenue on a business segment basis due to the Group's business segmental management reporting system's usage of net interest income as an operating measure rather than gross interest income and gross interest expense.*

(2) *Non-interest income consists of life insurance income (premium and related revenue and investment revenue), gains less losses on financial instruments at fair value, other operating income and net profit from the sale of the Custom Fleet business.*

(3) *Other expenses consists of life insurance expenses (claims expense, change in policy liabilities, policy acquisition and maintenance expense and investment management expense), personnel expenses, occupancy-related expenses, general expenses, charge to provide for doubtful debts and net loss from the sale of the MLC Asia businesses.*

(4) *Total assets and total liabilities for the business segments represent average September balances in accordance with how senior management views the business segments. Consolidation adjustments have been included within the Other segment to align total assets and total liabilities to the Group's balance sheet.*



**Geographical segments**

The Group has operations in Australia (the Company's country of domicile), Europe, New Zealand, the US and Asia. The allocation of revenue and assets is based on the geographical location in which transactions are booked. There are no material inter-segment transactions.

	2006 \$m	2006 %	Group 2005 \$m	2005 %
<b>Total revenue</b>				
Australia	26,787	70.1	24,968	67.9
Europe	6,671	17.4	7,402	20.1
New Zealand	3,603	9.4	3,526	9.6
US	414	1.1	361	1.0
Asia	760	2.0	527	1.4
Total revenue	38,235	100.0	36,784	100.0
<b>Profit before income tax expense</b>				
Australia	4,901	67.3	3,759	58.6
Europe	1,470	20.2	2,049	31.9
New Zealand	699	9.6	565	8.8
US	128	1.8	115	1.8
Asia	77	1.1	(72)	(1.1)
Total profit before income tax expense	7,275	100.0	6,416	100.0
<b>Net profit</b>				
Australia	3,398	66.0	2,260	49.1
Europe	1,062	20.7	1,847	40.1
New Zealand	485	9.4	441	9.6
US	126	2.5	117	2.6
Asia	70	1.4	(63)	(1.4)
Total net profit	5,141	100.0	4,602	100.0
<b>Total assets</b>				
Australia	329,377	67.9	284,910	67.4
Europe	102,139	21.1	85,627	20.3
New Zealand	44,017	9.1	40,147	9.5
US	5,424	1.1	6,969	1.6
Asia	3,828	0.8	4,945	1.2
Total assets	484,785	100.0	422,598	100.0
<b>Total liabilities</b>				
Australia	306,932	67.2	254,305	65.0
Europe	90,605	19.8	79,618	20.4
New Zealand	35,786	7.8	30,073	7.7
US	11,709	2.6	16,765	4.3
Asia	11,781	2.6	10,290	2.6
Total liabilities	456,813	100.0	391,051	100.0
<b>Acquisition of property, plant and equipment and intangible assets</b>				
Australia	850	53.9	1,057	58.9
Europe	450	28.5	468	26.1
New Zealand	276	17.5	258	14.4
Asia	1	0.1	10	0.6