

NATIONAL AUSTRALIA BANK LTD
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON DC 20549

FORM 6-K

REPORT OF FOREIGN ISSUER

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the month of December 2006

National Australia Bank Limited

ACN 004 044 937

(Registrant's Name)

Level 24

500 Bourke Street

MELBOURNE VICTORIA 3000

AUSTRALIA

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Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F ☒ x

Form 40-F ☐ o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ☐ o

No ☒ x

If ☒ Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82

National Australia Bank Limited

ABN 12 004 044 937

This annual financial report 2006 is lodged with the Australian Securities and Investments Commission and Australian Stock Exchange Limited.

National Australia Bank Limited is publicly listed in Australia and overseas and, as such, must meet regulatory requirements of all jurisdictions it operates in internationally. This report contains information prepared on the basis of the *Banking Act 1959 (Cth)*, *Corporations Act 2001 (Cth)*, Australian equivalents to International Financial Reporting Standards, United States generally accepted accounting principles and various disclosures rules of the Securities Exchange Commission.

To view a concise version of this report, visit www.nabgroup.com. Alternatively, to arrange for a copy to be sent to you free of charge, call Shareholder Services on 1300 367 647 from within Australia, or +61 3 9415 4299.

Nothing in this report is, or should be taken as, an offer of securities in National Australia Bank Limited for issue or sale, or an invitation to apply for the purchase of such securities. All figures in this document are in Australian dollars unless otherwise stated.

Cover: Commonwealth discus champion Scott Martin has serious talent. His determination to prove himself to push himself, to be the best that he could be in achieving gold in the Melbourne 2006 Commonwealth Games drew us to supporting him.

At NAB, we're inspired by people's potential to do amazing things. It's why we look to get behind people in all fields of endeavour on the sports ground, in business, and throughout their lives.

Your success, translates to our success and then to shareholder returns. Our involvement in the Melbourne 2006 Commonwealth Games, gave us the chance to unite key customers and stakeholders across all our businesses internationally whilst celebrating the spirit of achievement.

Table of contents

<u>Chairman's message</u>	2
<u>Group Chief Executive Officer's message</u>	3
<u>Presentation of information</u>	4
<u>Selected financial data</u>	5
<u>Business overview</u>	9
<u>Introduction</u>	9
<u>Strategy and corporate principles</u>	9
<u>Organisational structure and operating model</u>	9
<u>Australia Region</u>	9
<u>United Kingdom Region</u>	11
<u>New Zealand Region</u>	12
<u>nabCapital</u>	13
<u>Other</u>	13
<u>Employees</u>	13
<u>Economic outlook</u>	14
<u>Competition</u>	14
<u>Risk management</u>	15
<u>Introduction</u>	15
<u>Risk factors</u>	15
<u>Risk mitigation</u>	16
<u>Regulation of the financial services system</u>	20
<u>Changing regulatory environment</u>	22
<u>Certain legal proceedings</u>	23
<u>Liquidity, funding and capital resources</u>	24
<u>Financial review</u>	32
<u>Financial performance summary</u>	32
<u>Balance sheet summary</u>	33
<u>Return on average equity</u>	34
<u>Earnings and dividends per share</u>	34
<u>Net profit by segment</u>	35
<u>Net interest income</u>	40
<u>Net life insurance income</u>	43
<u>Other income</u>	43
<u>Significant revenue</u>	45
<u>Operating expenses</u>	45
<u>Charge to provide for doubtful debts</u>	46
<u>Significant expenses</u>	47
<u>Income tax expense</u>	47
<u>Gross loans and advances</u>	48
<u>Asset quality disclosures, charge to provide and provisions for doubtful debts</u>	49
<u>Deposits and other borrowings</u>	52
<u>Assets under management and administration</u>	53
<u>Cross border outstandings</u>	54
<u>Critical accounting policies</u>	54
<u>Accounting developments</u>	55
<u>Non-GAAP financial measures</u>	56
<u>Disclosure controls and procedures and internal control over financial reporting</u>	57
<u>Corporate governance</u>	58
<u>Report of the directors</u>	67
<u>Remuneration report</u>	78
<u>Financial report</u>	95
<u>Income statement</u>	96
<u>Balance sheet</u>	97
<u>Recognised income and expense statement</u>	98

Cash flow statement		99
Notes to the financial statements		101
<u>1</u>	<u>Principal accounting policies and explanation of transition to AIFRS</u>	101
<u>2</u>	<u>Segment information</u>	132
<u>3</u>	<u>Net interest income</u>	135
<u>4</u>	<u>Other income</u>	135
<u>5</u>	<u>Operating expenses</u>	137
<u>6</u>	<u>Income tax expense</u>	139
<u>7</u>	<u>Dividends and distributions</u>	140
<u>8</u>	<u>Earnings per share</u>	141
<u>9</u>	<u>Cash and liquid assets</u>	142
<u>10</u>	<u>Due from other banks</u>	142
<u>11</u>	<u>Trading and hedging derivative assets and liabilities</u>	143
<u>12</u>	<u>Trading securities</u>	145
<u>13</u>	<u>Investments - available for sale</u>	146
<u>14</u>	<u>Investments - held to maturity</u>	148
<u>15</u>	<u>Investments relating to life insurance business</u>	150
<u>16</u>	<u>Other financial assets at fair value</u>	151
<u>17</u>	<u>Loans and advances</u>	152
<u>18</u>	<u>Provisions for doubtful debts</u>	155
<u>19</u>	<u>Asset quality disclosures</u>	158
<u>20</u>	<u>Due from customers on acceptances/liability on acceptances</u>	159
<u>21</u>	<u>Property, plant and equipment</u>	160
<u>22</u>	<u>Investments in controlled entities and joint venture entities</u>	162
<u>23</u>	<u>Goodwill and other intangible assets</u>	162
<u>24</u>	<u>Deferred tax assets</u>	164
<u>25</u>	<u>Other assets</u>	165
<u>26</u>	<u>Due to other banks</u>	165
<u>27</u>	<u>Other financial liabilities at fair value</u>	166
<u>28</u>	<u>Deposits and other borrowings</u>	167
<u>29</u>	<u>Life policy liabilities</u>	168
<u>30</u>	<u>Current and deferred tax liabilities</u>	170
<u>31</u>	<u>Provisions</u>	170
<u>32</u>	<u>Bonds, notes and subordinated debt</u>	172
<u>33</u>	<u>Other debt issues</u>	175
<u>34</u>	<u>Defined benefit pension scheme assets and liabilities</u>	177
<u>35</u>	<u>Managed fund units on issue</u>	181
<u>36</u>	<u>Other liabilities</u>	181
<u>37</u>	<u>Contributed equity</u>	182
<u>38</u>	<u>Reserves</u>	186
<u>39</u>	<u>Retained profits</u>	188
<u>40</u>	<u>Minority interest in controlled entities</u>	188
<u>41</u>	<u>Shares, performance options and performance rights</u>	189
<u>42</u>	<u>Average balance sheets and related interest</u>	202
<u>43</u>	<u>Interest rate risk</u>	204
<u>44</u>	<u>Notes to the cash flow statement</u>	213
<u>45</u>	<u>Particulars in relation to controlled entities</u>	215
<u>46</u>	<u>Contingent liabilities and credit commitments</u>	216
<u>47</u>	<u>Financial risk management</u>	221
<u>48</u>	<u>Fair value of financial instruments</u>	225
<u>49</u>	<u>Operating leases</u>	227
<u>50</u>	<u>Capital expenditure commitments</u>	227
<u>51</u>	<u>Related party disclosures</u>	228
<u>52</u>	<u>Equity instrument holdings of key management personnel</u>	231
<u>53</u>	<u>Remuneration of external auditor</u>	235
<u>54</u>	<u>Fiduciary activities</u>	236
<u>55</u>	<u>Life insurance business disclosures</u>	236
<u>56</u>	<u>Capital adequacy</u>	242
<u>57</u>	<u>Reconciliation with US GAAP and other US GAAP disclosures</u>	244
<u>58</u>	<u>Derivative financial instruments - 2005 financial year</u>	257
<u>59</u>	<u>Events subsequent to balance date</u>	260
Directors declaration		261

<u>Independent audit report</u>	262
<u>Report of independent registered public accounting firm</u>	264
<u>Shareholder information</u>	267
<u>Glossary</u>	285

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.

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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

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 (AGAAP), which differs from AIFRS in certain respects (*as set out in note 1 in the financial report*).

This annual financial report does not include all of the requirements of the United States Securities and Exchange Commission (SEC) for an annual report on Form 20-F and will not be filed with the SEC as an annual report on Form 20-F. A separate annual report will be prepared and filed with the SEC on Form 20-F.

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 of the directors;

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
Income statement summary			
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)
Profit before income tax expense	7,275	5,428	6,416
Income tax expense	(2,134)	(1,592)	(1,814)
Net profit	5,141	3,836	4,602
Net profit attributable to minority interest	(749)	(559)	(610)
Net profit attributable to members of the Company	4,392	3,277	3,992
Dividends paid/payable (4)	2,554	1,905	2,454

	2006 \$m	Group 2006 (1) US\$m	2005 \$m
Balance sheet summary			
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 \$
Shareholder information			
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 depositary 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 %
Selected financial ratios			
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
Capital risk asset ratios (12)			
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
Selected financial data in accordance with US GAAP						
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 \$
Selected shareholder information in accordance with US GAAP						
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	n/a	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 %
Selected financial ratios in accordance with US GAAP					
Net income as a percentage of					
Average total assets (excluding statutory funds) (8)	1.1	1.0	0.8	1.0	1.0
Average equity	17.2	16.7	12.2	15.8	14.5
Total equity as percentage of total assets (excluding statutory funds) (8)	6.0	6.3	6.2	6.2	6.9

	2006 \$m	Group 2005 \$m
Reconciliations of non-GAAP measures (14)		
Net profit attributable to members of the Company	4,392	3,992
Adjusted for		
Significant revenue	(334)	(1,354)
Significant expenses		748
Income tax expense/(benefit) on significant items	96	(72)
Net profit attributable to members of the Company before significant items	4,154	3,314
Net profit to cash earnings before significant items reconciliation		
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)	
Cash earnings	4,252	3,931
Adjusted for		
Significant revenue	(402)	(1,354)
Significant expenses		748
Income tax expense/(benefit) on significant items	117	(72)
Cash earnings before significant items	3,967	3,253
Average ordinary shareholder funds reconciliation		
Total average equity (<i>refer to note 42 in the financial report</i>)	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)
Average ordinary shareholder funds	22,019	21,074

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

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

	2006	2005	Group 2004	2003	2002
United States dollar (per A\$1.00)					
Average (16)	0.7468	0.7655	0.7263	0.6167	0.5329
September 30	0.7461	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					
	November	October	September	August	July	June
United States dollar (per A\$1.00)						
High	0.7837	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.

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- (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. The 2006 final dividend of \$0.84 per ordinary share is not payable until December 12, 2006. Accordingly, the total US dollar dividend per ADS for 2006 cannot be determined until that date.*
- (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.

The Group operates 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 as the business continues towards obtaining internal model re-accreditation for its Market Risk systems from APRA. 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
By geographic region			
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
By line of business			
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% to be 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

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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, and closure of all governance and culture related remedial actions in April 2006. The Group is also at an advanced stage with its internal market risk model re-accreditation.

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, pensions 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.

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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
Average value for year		
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
Minimum value for year (2)		
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
Maximum value for year (2)		
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%	Rates down 1%	Rates up 1%	Rates down 1%
	\$m	\$m	\$m	\$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

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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

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.

Australia has issued a draft bill which is going through the legislative process, which is due for completion in late 2006 or early 2007. The Australian Government has also published a new bill which has just entered the legislative process. The bill implements the revised Financial Action Task Force 40 recommendations. The Group has been actively working with peer banks and external stakeholders in the development of the draft bill and the attendant rules. The implementation of the requirements within the bill 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 bill 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.

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				
	Less than 1 year \$m	1 to 3 year(s) \$m	3 to 5 years \$m	After 5 years \$m	Total \$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				
	Less than 1 year \$m	1 to 3 year(s) \$m	3 to 5 years \$m	After 5 years \$m	Total \$m
Contingent liabilities					
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
Other commercial commitments					
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

(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

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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.

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	4.25 - 5.00	4.75 - 5.25
Tier 1 ratio	6.25 - 7.00	7.00 - 7.50
Total capital ratio	10.00 - 10.50	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	5.4	5.5
Tier 1	7.3	7.9
Tier 2	3.9	3.6
Deductions	(0.4)	(1.0)
Total capital	10.8	10.5

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
Tier 1		
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)	
Total Tier 1 capital	23,404	22,779

	2006 \$m	2005 \$m
Tier 2		
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)
Total Tier 2 capital	12,354	10,424
Other deductions (8)	(1,351)	(2,922)
Total regulatory capital	34,407	30,281

- (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
Adjusted common equity		
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)
Adjusted common equity	17,043	15,923

-
- (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
Assets						
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	Credit		Risk	Risk-adjusted balance (1)	
	notional	equivalent		weights	2006	2005
	amount	amount		%	\$m	\$m
Off-balance sheet exposures						
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

	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)
Profit before income tax expense	7,275	6,416
Income tax expense	(2,134)	(1,814)
Net profit	5,141	4,602
Net profit attributable to minority interests	(749)	(610)
Net profit attributable to members of the Company	4,392	3,992

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 TrUEPrSSM 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
Assets		
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
Total assets	484,785	422,598
Liabilities		
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
Total liabilities	456,813	391,051
Total equity	27,972	31,547
Total liabilities and equity	484,785	422,598

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

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%

(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 is payable 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 will be 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

	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

	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

	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
Interest-earning assets (1)			
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
Interest-bearing liabilities (1)			
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
Group		
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
Geographical region		
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
Business segment		
Australia Region (3)		
Average interest-earning assets (4)	201,829	153,612
Net interest margin (%) (2)	2.38	2.48
United Kingdom Region (3)		
Average interest-earning assets (4)	52,423	48,608
Net interest margin (%) (2)	3.51	3.69
New Zealand Region (3)		
Average interest-earning assets (4)	31,003	28,665
Net interest margin (%) (2)	2.50	2.58
nabCapital		
Average interest-earning assets (4)	138,174	136,565
Net interest margin (%) (2)	0.68	0.37
Other (5)		
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

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 TrUEPrSSM

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 TrUEPrSSM 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
Average gross loans and advances		
Australia	180,426	162,055
Overseas	100,294	97,206
Total average gross loans and advances	280,720	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

Net impaired assets	873	711
Equity (parent entity interest)	27,804	25,323
Percentage of net impaired assets to equity	3.1%	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
	1,144	1,475
Europe		
Collective	690	613
Specific (1)	28	88
	718	701
New Zealand		
Collective	112	160
Specific (1)	18	35
	130	195
United States		
Collective	22	29
Specific (1)		13
	22	42
Asia		
Collective	6	4
Specific (1)	1	1
	7	5
Group		
Collective	1,838	2,064
Specific (1)	183	354
Total provisions for doubtful debts	2,021	2,418
Percentage of risk-weighted assets	0.63%	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

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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 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. The statistical provisioning method was applied to existing credit portfolios, which included loans and advances drawn down in the current year.

	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

(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

(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
By type		
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
By geography		
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
By investor		
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

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.

	Government and official institutions \$m	Banks and other financial institutions \$m	Commercial and industrial \$m	Other \$m	Total \$m	% of total assets
As at September 30, 2006						
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
As at September 30, 2005						
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.

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. The amount of the estimated loss is recognised using an allowance account and is included in the income statement.

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. To estimate these cashflows two key inputs are used in a statistical model, probability of default and the estimated loss given default (taking into account the level of collateral held). 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 use of such judgements and reasonable estimates is considered by management to be an essential part of the process and does not impact reliability.

The Group regularly reviews the method and assumptions used for estimating future cash flows to reduce any differences between loss estimates and actual loss experience.

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

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.