



NATIONAL AUSTRALIA BANK SUBMISSION

Inquiry into the Regulation of Auditing
in Australia

28 October 2019

1. Introduction

The National Australia Bank Limited (NAB) Group welcomes the opportunity to provide a submission to the Inquiry into Regulation of Auditing in Australia (the Inquiry) of the Parliamentary Joint Committee on Corporations and Financial Services (the Committee). The NAB Group thanks the Committee for accepting this submission.

It is not the NAB Group's intention to address all terms of reference of the Inquiry, but rather to provide details of the NAB Group's approach which may best assist the Committee in its Inquiry.

2. NAB's external auditor

EY has been the external auditor for the NAB Group since 31 January 2005. This appointment is made in accordance with section 327A of the *Corporations Act 2001* (Cth). As the NAB Group's external auditor, EY is subject to the NAB Group External Auditor Independence Policy (Independence Policy) which is designed to safeguard and protect the independence of the external audit opinion.

In accordance with the Independence Policy, and to foster open communication, the external auditor has direct and unfettered access to all NAB information and to the NAB Group's Board Audit Committee (BAC).¹ The BAC also has direct access to communicate with the external auditor, independent of the NAB Group's management.

3. The value of an independent external audit

Engagement of the NAB Group's external auditor must also satisfy applicable rules and legislation, including both regulatory rules and rules of the auditing profession in the countries in which NAB operates. For the NAB Group, this includes, but is not limited to, rules and regulations of Australia, the United Kingdom, New Zealand, some markets in Asia and the United States.

Such rules and legislation exist because of the importance of external financial reports reflecting a true and fair view.

The independence of the external auditor and the external audit process is critical. An independent audit provides confidence in the financial statements for the users of those statements including shareholders and customers, and is important for the NAB Group's capital and debt raising activities.

4. NAB policies, procedures and controls to safeguard independence

NAB's Independence Policy, and supporting controls and procedures in place, is designed to ensure that the independence of the external auditor is maintained and safeguarded.

Consistent with the *Corporations Act 2001*, the Independence Policy sets a general standard against which independence is assessed. This standard is that the auditor will not be independent if:

- the external auditor or a professional member of the external audit team is not capable of exercising objective and impartial judgement in relation to the conduct of any audit, review or attest procedures; or

¹ The BAC is appointed and authorised by the Board of Directors (Board) to assist the Board in fulfilling its statutory, fiduciary and regulatory responsibilities and to provide an objective, non-executive review of the effectiveness of the NAB Group's financial reporting, regulatory reporting and tax risk management frameworks.

- that a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that any such person is not capable of exercising objective and impartial judgment in relation to the conduct of any audit service.

The safeguards in the Independence Policy help protect against the risk of:

- Self-interest of the external auditor – a mutual or conflicting interest between the external auditor and the NAB Group;
- Self-review – placing the external auditor in the position of auditing their own work;
- Advocacy – placing the external auditor in the position of being an advocate for the NAB Group;
- Management – the external auditor acting as management or an employee of the NAB Group;
- Familiarity – the external auditor or its partners having an inappropriately close or longstanding relationship with the NAB Group; and
- Intimidation – the external auditor or its partners being subject to undue influence or coercion in respect of the NAB Group’s audit.

Audit Partner Rotation

Partner rotation is a key element of maintaining independence. Since EY commenced as the NAB Group’s external auditor on 31 January 2005, three lead audit partners have rotated off in accordance with the *Corporations Act 2001*. The rotation of lead audit partner provides fresh perspective from an independent person.

Financial and business relationships with the external auditor

The Independence Policy prohibits the external auditor and key people involved with the audit from having any direct financial interest or any material indirect financial interest, including investments, in the NAB Group. The Independence Policy also generally prohibits such people from having investments in the NAB Group along with any other financial relationship with the NAB Group, such as any banking or wealth products. This applies for any individual or reciprocal business relationships.

Board appointments and employment relationships with the external auditor

The Independence Policy prohibits NAB from engaging any current EY partner, professional employee or certain family members on the NAB Board, and places restrictions on engaging former EY audit team members in certain roles within NAB.

The NAB Group monitors all EY employees (current and previous) applying for Financial Reporting oversight roles or Senior Officer roles in the Group through its recruitment process. All applicants (and, if applicable, their immediate family members) must also self-declare any previous involvement on the statutory audit if applying for a role with the NAB Group. If this is the case, any potential appointments are reviewed from an independence perspective before an appointment is made.

5. Permissible services

The Independence Policy specifies that the external auditor may only provide a service to the NAB Group if: (1) the service does not impair the independence of the external auditor having regard to the standards discussed above; and (2) the service is not expressly prohibited by the Independence Policy or law.

5.1 Categories of Service – Audit, audit-related, taxation-related and non-audit services

The Independence Policy defines various categories of services. These are:

- Audit services – consists of the statutory audit or review of NAB or NAB Group entities.
- Audit-related services – includes services that the external auditor is not required by law to undertake, but for which the information largely derives from audited financial records; services where there is a significant overlap with the audit process; and regulatory reviews and assurance services required by statute, regulation or regulatory compliance obligations.
- Taxation-related services – includes certain types of non-prohibited taxation services.
- Non-audit services – any services that are not audit, audit-related or taxation-related services. The Independence Policy only permits non-audit services to be provided by the external auditor with the approval of the BAC Chair.²

The Independence Policy also sets out a list of expressly prohibited services which include appraisal or valuation services, actuarial services, human resources, and legal services.

5.2 Service Approval Process

The BAC has delegated authority to the Group Chief Financial Officer and Deputy Group Chief Financial Officer as the authorities to approve services to be performed by the external auditor up to a specified fee amount (\$500,000) and which meet each of the following requirements.

- The proposed service is permissible in accordance with the Independence Policy and is not a prohibited service.
- Group Financial Governance, Corporate Advisory Legal or the external auditor have not identified any potential threats to the independence of the external auditor arising from the proposed service.

The BAC must approve all services above the specified fee amount and receive biannual reports from management on all services provided by the external auditor under direct approval from BAC and those services approved by management under delegated authority.

Unless the BAC approves otherwise, fees paid for the provision of audit-related, taxation-related and non-audit services must not exceed fees paid for audit services in any year. Details of the services provided by the external auditor to the NAB Group and the fees paid or payable for such services are set out in the Report of the Directors and Note 33 'Remuneration of external auditor' in the NAB Group's 2018 Annual Financial Report.

5.3 Review under Prudential Standard CPS 220

NAB understands the Committee's interest in the 2018 CPS 220 report prepared by EY for NAB.

5.3.1 About CPS 220

CPS 220 is an APRA Prudential Standard that outlines requirements for risk management. The standard sets out requirements for an annual review of the risk management framework and (at paragraph 45) asks that a comprehensive review be undertaken every three years by "operationally independent, appropriate trained and competent person".

² Should this be the case, the service must still meet the NAB Group's auditor independence requirements.

In 2018 when NAB's comprehensive review fell due, NAB undertook a commercial tender for a third-party expert to bring a best practice view to NAB's risk management framework.

5.3.2 NAB approach to CPS 220 review

The 2018 CPS 220 Report was presented to the NAB Group Chief Risk Officer and at a NAB Board Risk Committee workshop attended by all non-executive Board directors. For reasons of good practice, NAB also provided this report to APRA. NAB directors continue to receive progress updates on the actions being undertaken to address EY's findings.

In accordance with the Independence Policy, EY's engagement was reviewed prior to appointment and was approved by the BAC. The primary objective of this review was to ensure adherence to the requirements of the Independence Policy. Key matters considered in providing approval for the service under the Independence Policy were as follows:

- The CPS 220 opinion and associated work was assessed against the APRA requirement that the report be undertaken by a "operationally independent, appropriate trained and competent person" and EY was able to complete the work under this requirement;
- EY had not provided or performed any work which may have conflicted their opinion on the CPS review report; and
- Having regard to the general standard of independence outlined above, the performance of the CPS 220 review was not for the personal benefit of EY, would not place EY in a position of self-review of their own work on the statutory audit or in a position of advocacy for the NAB Group, and would not result in EY acting in a NAB Group management capacity.

EY prepared this prudential report under CPS 220 for the NAB Group while also conducting the statutory audit for the NAB Group. The CPS 220 service was classified as an audit-related service (see 5.1 for definition) in NAB's 2018 statutory accounts, as the work was assurance in nature and required under prudential standards. EY had performed CPS 220 reviews for other major banks and financial institutions, so access to this experience and insight was a key factor in NAB's decision to engage EY.

6. Conclusion

The NAB Group recognises the value of independence in the audit process, and acknowledges the important role that an external auditor undertakes. NAB believes it has in place the appropriate policies and controls to adhere to these requirements.