

The attached documents, provided to the House Economics Committee by Mrs Catherine Walter AM, were authorised for publication by the Committee on 13 May 2004 as evidence to its review of the Australian Prudential Regulation Authority *Annual Report 2003*:

- a letter from Mrs Walter to the National Australia Bank (NAB) Board dated 3 March 2004;
- a letter from Blake Dawson Waldron to the NAB Board dated 31 March 2004;
- a letter from Mrs Walter to the Chairman of the NAB's Board dated 15 April 2004; and
- a media statement by Mrs Walter dated 29 April 2004.

MEMO TO BOARD
3/3/04

3 March 2004

Chairman and Board Members,
National Australia Bank Limited.

I have come to the view that I must record in writing my conclusion that the PWC report cannot be represented to the market, regulators and shareholders as an independent report and my view that the actual process adopted in the investigation and preparation of the PWC report lacks legitimacy in serious respects.

I have expressed these views in previous Board meetings, but they have not commanded the support of the Board. I have concluded, for the reasons which I shall detail, that the long term interests of the Bank, as distinct from our individual interests as directors, are best served by my writing this memorandum.

Once the Board represented to the market that it intended to commission an investigation and report that would be fully independent of the Bank, it had a duty to do so. The appointment of PWC was of a firm which in the event was not independent of the Bank and PWC has failed to act independently.

I have many years experience in legal practice in the fields of banking, finance and corporate governance, including experience of legal and regulatory aftermaths of serious banking irregularities. I acted as a lead partner of the law firm assisting the Royal Commission into the Tricontinental insolvency (at the time the largest corporate insolvency in Australia).

Against the background of my professional experience, I have concluded that the process currently underway inside the Bank has failed to meet minimum standards, and as this memorandum attests, I am not willing to remain silent about this failure.

I believe the Board should immediately abort the current PWC report process and appoint a new expert to conduct an independent investigation (with appropriate probity protocols and procedures). That expert should report to an independent person not currently a Board member who will have responsibility for bringing relevant recommendations to the Board. We should advise the market accordingly.

Background

I have previously expressed the concerns I have outlined inside the Board and in conversations with the Chairman.

The steps I have taken to date include the following:

- When I first learned that management had appointed PWC when the losses were first detected, I suggested that it was not appropriate for PWC to report to a management group.
- I suggested that, as PWC had a 'strategic alliance' with NAB Internal Audit, it was likely that PWC would be investigating their own work.
- At my suggestion, Probity Advisors and reviewers of PWC's work were appointed (Blake Dawson Waldron and Deloitte). I made this suggestion after it became apparent that the Board did not share my view that PWC was conflicted.
- I have learnt that the PBRC had apparently received a report on 12 February 2004 from PWC, interpreting the terms of a minute of PBAC referring to a presentation to the Principal Board Audit Committee ('PBAC') by Jim Power of PWC on the Allied Irish Bank FX trading losses. PWC suggested to PBRC that the events at that meeting should not be construed as being as the minute records them. I consider that this reflects PWC's own bias as both witness and investigator and exemplifies the danger of PWC reviewing and reinterpreting their own work.
- I expressed concern that the Principal Board Risk Committee ('PBRC') was to be the body responsible for the conduct of the PWC investigation and report, because PBRC was itself responsible for risk generally from 29 August 2003, after which date over 90% of the losses were incurred and its position would necessarily be the subject of investigation and report; it was incongruous that the investigators should be expected to report to one of the bodies the subject of its investigation.
- I considered it inappropriate that other directors were excluded from the process of supervision of the investigation and report, this being a function which PBRC

appropriated to itself; to my mind it appeared that the Board committee with the greatest exposure had embarked upon a course of controlling the outcome. The process of receipt and supervision should in my view have been a whole Board function, conducted under strict, transparent and verifiable conditions of non -interference.

Notwithstanding my concerns, PWC has throughout the process reported regularly (in detail and in a manner not adequately disclosed to other directors), to PBRC. The incongruity is compounded by the fact that even the probity advisors have been required to report to PBRC.

The Principal Board has not even had a comprehensive written report as to the facts of the losses and remains uninformed as to the issues, save for any material which might have been presented at the Board meeting of 2 March 2004 of which I am unaware.

PWC Conflicts of Interest

PWC has many conflicts of interest which include the following:

- The PWC head investigator, Craig Hamer, is the PWC partner responsible for the NAB relationship which produced over \$17 million for PWC last year (more than double the revenue of our auditors KPMG).

This creates the perception that a report produced by PWC is unlikely to be critical of the incumbent Board, especially if elements of that incumbent Board are responsible for controlling the report process and some members of that Board have had substantial and repeated input into its various drafts.

- An initially appointed PWC partner, Tony Harrington considered himself conflicted and retired from his role because of his personal position in relation to the Bank. The head investigator for the PWC report, Craig Hamer, is I am informed, in precisely the same position in this respect as Tony Harrington, yet he has remained as head investigator for the PWC report.
- PWC have (and as has become obvious) many and deep involvements in the affairs of NAB, including in areas that are properly the key areas of the PWC investigation:
 - PWC has a 'strategic alliance' with Internal Audit involving approximately 1000 days (4

man years) of time a year and involvement in planning aspects of the Internal Audit process - Internal Audit is likely to be a key area of examination of any external independent report; a team including a PWC manager, Simi Slowiejczyk, was responsible for Internal Audit of the FX operation in January 2003

- Jim Power of PWC (see above) delivered a key report to Principal Board Audit Committee ('PBAC') on 6 May 2002 as to the application of the learnings of the Allied Irish Bank FX losses to NAB and the reasons why the circumstances of the Allied Irish Bank were inapplicable to NAB.
- PWC personnel worked on the Horizon technical system which ran FX options (late 2002) and also worked on the FX desk in November/December 2003 when losses rose from \$50 million to \$75 million.
- John Thorn (a non executive director of NAB) was, until June 2003, managing partner of PWC.

In the event, Deloitte have been appointed as a result of these and other conflicts to examine work which PWC have done within NAB which is taken up in the PWC report, but this awkward compromise does not address the wide ranging role and relationship PWC has with the bank. Nor does it achieve any positive solution. It does not deprive PWC of its control of the investigation process and its outcome. The fact that it was necessary to appoint Deloitte establishes that PWC are disqualified from appointment as lacking independence. The appointment of Deloitte did not arise from PWC volunteering their conflicts; it was re-active to my expressions of concern.

In any event, the terms of the role of Deloitte are, as I understand it, far from clear. Certainly the extent of their role has not been made clear at the Principal Board. I should say that the terms of the appointment of Blake Dawson Waldron are also not known to the Principal Board even though I had understood the decision was made (on 6 February 2004) that they should report to the Principal Board.

Independence Compromised

In addition to the concerns above, the process which has been followed taints the credibility of the investigation and any report arising from it. Instances of process failure include:

- PWC report to and are overseen by PBRC which is responsible for the framing and monitoring of their process including setting their terms of reference.

Since 29 August 2003 PBRC, by its charter from the Board, has been responsible for 'the identification assessment and management of the material risks faced by the various business units of the Group'. The PBRC met only once between 29 August 2003 and the FX losses being detected. That meeting took place on 21 November 2003. At that meeting PBRC received a presentation from Markets Division and, in particular, there was a PowerPoint presentation which had particular reference to 'VaR limit monitoring and excesses' and the way in which they were investigated by Market Risk and included as a matter arising 'overview of the Market Risk limit approval process for CIB Markets Division.' On the same day (before the meeting) an internal memo was sent by Australian Market Risk Unit to GM CIB Markets describing significant levels of breaches.

In the period from formation of the Risk Committee to the foreign exchange losses being identified, those losses increased from under \$10 million to \$175 million on 13 January 2004.

The PWC report drafts, which have been reviewed by members of PBRC, may make no or insufficient reference to these circumstances and related issues.

- At one time in the PWC process the Principal Board was informed that the PBRC proposed a '6 hour drafting session' with PWC to resolve the PWC report but this seems not to have occurred; it is plain however, from the events which I describe, that members of PBRC have been responsible for major input into the report and apparently for changes of focus and emphasis.
- I understand that there have been four drafts of the PWC report, reflecting dramatic differences and changes between drafts. These changes have followed input from PBRC members upon the previous drafts.

- I have been told that up until Friday 20 February 2004, PBRC had received at least two detailed 'status updates'. Those status updates, later versions of which were several times described as "drafts" or "draft reports" by the Chairman in conversation with me, were not oral but were written documents which contained elements of the structure and content of the proposed formal PWC report. Those 'status update' documents have been seen and commented on by members of PBRC and presumably those comments have been acted on by PWC. In other words it appears PBRC has actively intervened in a process set up and administered by PBRC, one responsibility of which is to pass judgment upon PBRC as to its responsibilities and function and to be presented to the markets and to regulators and shareholders as independent.
- At a Principal Board Meeting John Stewart indicated that he wished to refer certain future risk assessment work to Gene Ludwig of Promontory Financial Services who has assisted the Bank in relation to HomeSide. Gene Ludwig is a former United States Comptroller of the Currency. The Chairman said that he had already offered the work to PWC. When I sought to raise this issue as impinging on PWC's independence at a subsequent update meeting of the Board on 20 February 2004, the Chairman said there was "no arrangement" with PWC.
- PWC have compromised the independence of the investigation process in at least the following respects:
 - The chief investigator for PWC spoke to the Chairman in a late night telephone discussion on the night before (19/2/04) the day on which the Chairman was to provide evidence to PWC and APRA and by this time it would seem that PWC would also have provided to the Chairman at least one (possibly more) 'status update documents'. The Chairman informed a Board update meeting (20/2/04) that he had discussed with the head investigator before he was examined, aspects of the flow of information (what the Chairman described as a 'disconnect') between the Principal Board and Management as to the communications between APRA and NAB last year.

- The room in which the PWC team are preparing the report within NAB's premises is able to be accessed by a large number of people including PBRC members and members of Management whose conduct is the subject of the report.
- Much of the evidence has not been secured, PWC have not sought to limit the flow of relevant material among NAB personnel or certain Board members in a manner which prevents a common view being formed. The view has been expressed to me that the initial interview (before the appointment of PWC) where 20 executives were present when the four traders were first interrogated is likely to have tainted the integrity of the investigation
- I believe PWC have not completed their investigative work. To have prepared drafts of their report is, therefore, inconsistent with appropriate investigative process and runs the risk of bias and premature formation of opinions.
- Peter Duncan commented at the Board meeting on 2 March 2004 that the Chairman had had PWC "findings presented" to him at a number of PBRC meetings before he was interviewed. The Chairman cut him off by saying that he would take the advice of the probity advisers as to what if anything was further required in relation to this. It is apparent that he had not previously informed the probity advisers of all the relevant facts. In my view, there is nothing that can now be done by the probity advisers to make good this basic transgression.

Since 20 February 2004

Over the last ten days I have formed the view that the PWC process cannot be 'independent' in any relevant sense and is not the report which our shareholders or the regulators have the right to expect.

Some of the facts on which my conclusion is based are:

- On Saturday of last week (21/2/04) the Chairman circulated a note to directors (received on Monday (23/2/04)) which said:

"On the advice of our Probity Advisors, reinforced by recent leaks, the Risk Committee was presented with verbal update status by PwC on Friday but has not yet viewed any written material.

PWC are progressing well and I envisage giving directors a detailed update around 1 or 2 March 2004 following the next Risk Committee meeting on Friday 27 February"

A reasonable reader would consider that this meant that there was nothing written in existence at that time which had been made available to PBRC. As is set out above that is not the case.

- On 22 February 2004 the Chairman said to Michael Pascoe on Channel 7, who asked if the Chairman had had a 'peek' at the PWC report, that he was looking forward to seeing the first draft of the report in the next 'couple of weeks'. The Chairman said that he was receiving 'status updates' but the clear implication of this was that those 'status updates' were in the nature of oral statements as to progress, not written reports ('status update documents') as to the structure and content of the PWC independent report. Had the Chairman said that the 'status updates' were documents containing the material which they did contain, the impression the viewing public would have had would have been quite different.
- The Chairman told directors on 20 February 2004 that John Stewart was the point of reference for PWC for matters relevant to the directors. The Australian Financial Review of 20 February 2004 in an uncorrected report said that John Stewart was generally responsible for the PWC report. This Australian Financial Review report arose out of briefings to analysts and institutions by the Chairman and John Stewart during that week.
- On Friday 20 February 2004 without, as I understand it, any differentiation as to director matters and non-director matters a 'status update document' was provided to PBRC, as reported by the Chairman.

- On 23 and 24 February PWC provided to each of the members of PBRC (to John Stewart in the UK, to Ed Tweddell and Peter Duncan in Australia and to the Chairman in New York) copies of a 'status update document'. The 'status update document' was of some length. It contained both a PowerPoint presentation and matters which would be included in the final report, including 'wording'. The 'status update document' was substantial enough for it to take 2 hours to read and prepare comments on. According to the Chairman, all comments were to be oral. This oral process was said to be based on 'legal advice'. I spoke to the Chairman whilst he was in PWC's New York office reading the document and in that conversation he described it as "the draft report".

The comments made by the members of PBRC went far beyond matters of a mechanical or general nature. The Chairman has advised directors that he mentioned to the lead investigator of PWC that he wanted to see more robustness put into the portion of the report dealing with linkages between management and the board. The Chairman told the Board that these issues on which he said that he wanted more robustness in the report included at least 'Internal Audit 3 stars' and the APRA report. The Chairman said that, following his statements to PWC, PWC were 'going away to do that'. He said that he understood that Peter Duncan had made similar comments to PWC.

- I gather a conscious decision has been taken by PWC not to call the 'status update document', (the same document described contemporaneously by the Chairman to me as "the draft report") a document at all. The 'status update document' is manifestly a document. It is clear enough that it is a draft report in all but name. I believe that PBRC members have seen the substance of all of the reports and may be seen to have been responsible for major changes in them.
- As will be seen from the material set out above, PBRC comments were made on matters directly relevant to the position of directors. PWC did not report on those matters, as had been stated, to John Stewart but to PBRC members notwithstanding the interest of the PBRC members in the outcome - in addition extraordinary and detailed processes have apparently been engaged in dealing with the draft reports which appear unrelated to concerns about 'leaks'. I believe the process fails minimum standards of integrity required in such circumstances.

- After I raised my concerns about the matters set out above at our update on 27 February 2004 and expressed my view about the fact of the PWC report being compromised by the role of PBRC, the Chairman rang me and informed me that as a result of discussions with other directors at his instigation he intended to afford me the same opportunity on Monday 2 March 2004 to see the latest draft and have input in the way that PBRC members had enjoyed. The Chairman said the PWC Chief Investigator would contact me to arrange this.

In effect the Chairman was addressing my concerns about propriety of appointment and process by offering to include me in what I consider to be an exercise which could only further compromise the independence of the PWC report. I have not done so.

2 March 2004

In a meeting hi the Chairman's office with the Chairman and me before the Board meeting on 2 March 2004, Elizabeth Johnstone and Anne Dalton of Blake Dawson Waldron, the probity advisors, confirmed that:

- PwC had an actual (as opposed to an apparent) conflict as PwC personnel had been engaged in undertaking relevant work in Internal Audit in GIB and as they had a strategic alliance in respect of the provision of Internal Audit Services. They did not mention the numerous other problems which attend Craig Hamer's and PwC's roles, possibly they were not aware of them.
- As a result of the 'factual overlap' Deloitte were conducting a review of the overlap activities by reviewing documentation, conducting interviews and viewing relevant sections of the draft PwC investigation documentation.
- Elizabeth Johnstone commented hi particular on the Board's access to draft investigation documentation. She expressed the view that, consistent with the National's public statement regarding the independence of the investigation and the final PwC report, it was not appropriate for Board Members who had been notified of a forthcoming interview, to be briefed on any contents of the PwC final report or the investigation. Although Elizabeth was thinking of my position, as I had not been interviewed and it was intended to brief the board later that day on the contents of the

PWC final report, it was apparent from what she said that she had not been informed of the true facts relating to the involvement of PBRC members in reviewing and influencing drafts of the PWC report.

- I asked and was told that the directors interviewed were Charles Allen, Graham Kraehe and Frank Cicutto. I expressed surprise bearing in mind the pivotal events around 21/11 and the involvement of PBRC that the remaining directors on PBRC, namely Peter Duncan and Ed Tweddell, had not been interviewed.
- It was suggested that I should absent myself from the briefing by PWC of the contents of their report later that day and I indicated that I had been considering this matter myself and that I had in mind that I would attend to hear the report from the probity advisors in the earlier part of the meeting. I record here that the very proper course suggested to and adopted by me should have been applied to all directors. It was not; and, in my view, the process cannot now be credibly repaired.
- Once again, during this discussion, I referred to:
 - The conversation the chief investigator had had with the Chairman the night (19/2/04) before his interview wherein he had indicated to the Chairman that there were 'disconnects' between management and the board so far as APRA documentation was concerned.
 - The 2 hour session that the Chairman had had in New York working through the draft report and providing input to PWC. I said it would be interesting to compare the draft report prior to this input (and input from the other members of PBRC around the world at that time) with the draft that was being presented later that day. I said this because I was aware that the probity lawyers had seen 4 drafts of the document and they had said that those drafts had fundamentally changed over time.
- The Chairman said to me, in the absence of the probity advisors, that all the directors were in this together, that we needed to maintain board solidarity. He said that the report would not find anything against the directors. He said that on about 11 March he intended to announce to the market some changes, that we would

sack one executive, whom he named, and some of the senior executives would go at about the same time as part of John Stewart arranging his new team.

- I also expressed concern that the Chairman was dealing with management/director interface issues when he had said to directors that John Stewart was to be responsible for these matters. I repeated his comment that PWC should consider in more detail the 3 star audit issue and beef up the board/management interface.
- The Chairman asked me if I didn't trust my fellow directors and I said my sole concern was to have an independent report. The Chairman said he was 'absolutely committed to it being an independent report', there would be no 'influencing of conclusions'. It had 'to be independent and be seen to be independent'.

At 1:30pm the Chairman and I went into the Board meeting. Blake Dawson Waldron spoke to the probity issue in the way I have previously described and of the role of Deloitte. They quoted David Krasnostein, General Counsel, who was present at the board meeting, to have said earlier that it was important that Deloitte should not become 'the little speck on the camera lens that destroys a picture'.

I was alarmed by this graphic statement. To me it raised the prospect of a culture where demands of independence could not be allowed to dictate the process.

Finally I record my view that the Blake Dawson Waldron letter dated 2 March 2004:

- confirms that the full facts recorded here have not been disclosed to them;
- establishes that, had the full facts been disclosed to them, they would have advised that the involvement of members of PBRC breached the principles identified in paragraph 7 of their letter, and failed to meet the requirements of paragraph 8.

The BDW letter does not constitute advice that the processes which we know to have occurred were proper or that the steps adopted for dealing with PWC's lack of independence overcome the problem. I consider that any regulatory agency to whom the full facts became known would characterise any statement of independence as incorrect.

Perspective

As the only non-employee lawyer with substantial banking and governance experience with knowledge of what I believe to be the true facts, I have come to

the view that I must raise these issues and that the market should make its assessment of any report into the FX losses with full and transparent knowledge of all the facts, both as to the events and any investigation into them.

The issue is one of governance propriety, integrity, transparency and proper process. These are areas of critical importance to NAB at all times, but especially at the moment when failures of other processes fall for investigation and report. I believe that openness and transparency are impossible without a rigorous adherence to fundamental principles of integrity and good governance.

Catherine M Walter

BLAKE DAWSON WALDRON
L A W Y E R S

The Directors
National Australia Bank Limited
500 Bourke Street
MELBOURNE VIC 3000

Level 36
Grosvenor Place
225 George Street
Sydney NSW 2000

www.bdw.com

Tel + 61 2 9258 6000
Fax + 61 2 9258 6999

DX 355 Sydney

Locked Bag N6
PO Grosvenor Place
Sydney NSW 2000
Australia

Partners

Elizabeth Johnstone
Telephone (02) 9258 6443

Anne Dalton
Telephone (03) 9679 3364

Our reference
ATD:EMJ:13618999

31 March 2004

Dear Directors

Probity and Governance Advice
PricewaterhouseCoopers (PwC) Report into Foreign Exchange Losses

In our letter of 12 March 2004, we expressed the opinion, based on our observations and enquiries and having regard to the matters outlined in that letter, that PwC was reasonably likely to be regarded as being independent for the purpose of providing its report into foreign exchange losses at the National (the Report). In expressing this opinion we had regard to the matters raised in a letter from Mrs Catherine Walter dated 3 March 2004.

Mrs Walter has subsequently written to the Chairman on 16,17 and 21 March 2004 and issued a media statement dated 26 March 2004. In the light of the comments made by Mrs Walter in these letters and the media statement you have asked us to:

- A. amplify the steps taken by us in forming the opinion as to independence which we expressed in our letter of 12 March 2004; and
- B. comment (from a probity perspective) on the issues raised about which we have direct knowledge.

A. Matters taken into account in our opinion as to the "independence" of PwC

In expressing the opinion in our letter of 12 March 2004, we had regard to certain indicia of independence, drawn from established authority in other contexts and to good probity and governance practice. For an expert's report to be regarded as independent, it must satisfy four main tests. We set out below our comments in respect of the application of each test.

1. *The expert must disclose any information which readers need to assess for themselves the expert's impartiality*

At the commencement of our assignment, you informed us that the National has established commercial relationships with a number of major accounting firms. In the

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case of PwC, this included provision of seconded staff to the National and the establishment of a Strategic Alliance to provide internal audit services as required.

The Disclosure Statement published in the Report (p.iii) sets out relationships with the National. Prior to publication of the Report we satisfied ourselves of the accuracy and completeness of that information, first against the National's own records and secondly through interviews with National employees and PwC personnel. We are not aware of any information other than that set out in the Disclosure Statement which readers need to assess for themselves PwC's impartiality.

2. The expert's report must not be commissioned after shopping the brief around for an expert who will give a favourable report

We have made our own enquiries as to the circumstances surrounding the commissioning of the Report by the National on 16 January 2004. We are unaware of any evidence to support the view that the brief was assigned to PwC after approaches to other experts or on the basis that PwC would provide a favourable report.

3. The expert's report must not result from successive drafts circulated to and amended following discussion with those commissioning it, except to correct factual matters

We made our own enquiries as to the circumstances surrounding the provision of progress briefings during the course of the PwC investigation (including questioning of relevant persons) and whilst the Report was in preparation. High level "Status Update Briefings" with summaries of progress were provided by the PwC investigation team to the PBRC and later to the full board.

We established and monitored a protocol to ensure that PwC did not invite or consider amendments, other than corrections of factual matters. We reviewed the summary documents which were provided to members of the PBRC. We are not aware of any breach of that protocol or any inappropriate interference or direction by the PBRC or board.

4. The expert must be unbiased - the more extensive the relationship between the expert and the company, the greater the onus on the expert to demonstrate absence of bias

We tested for evidence of bias by interviewing the PwC investigation personnel and National directors and employees, attending meetings between them and attending the briefing by PwC of the board. No evidence of bias came to our attention.

We were aware that the majority of PwC investigation interviews had been attended by the regulator, Australian Prudential Regulatory Authority (APRA), which we are informed also received transcripts of all the interviews conducted by PwC.

APRA confirmed that it was utilising the resources of PwC to gain access to relevant information about the foreign exchange options trading and relevant aspects of the National's risk management framework. However, APRA advised that it would reach its own judgements on the basis of this information and its own investigations. We

were assured by APRA that the combined investigative work would not continue if APRA had concerns regarding the conduct of the investigation by PwC.

This provided to us some corroborative evidence that PwC were bringing an independent mind to bear in their investigations.

B. Issues raised by Mrs Walter - Summary

There is a large number of issues raised in this correspondence which call into question the procedural integrity of the process and the independence of the Report. We have prepared a table identifying these issues. They generally fall into the following categories:

(a) *Inappropriate direction from members of the Principal Board Risk Committee (PBRC) to PwC*

Protocols for the conduct by PwC of their investigations and enquiries were established by us. We are not aware of any occasion on which those protocols were not observed. We are not otherwise aware of any inappropriate interference or direction by members of the PBRC or the board generally.

(b) *Failure of PwC, Deloitte or BDW to take into account factual matters raised by Mrs Walter*

To the extent that Mrs Walter's comments relate to issues of procedural integrity, her comments fall into the following main categories: the role of PwC personnel working on National projects (including on Horizon software) and on secondment, the PBRC, reporting as to the consideration of certain APRA letters, and the role of Internal Audit. Mrs Walter raised these issues at various times during the period of our engagement. The issues were variously included in letters, interviews with us and Deloitte, in written responses, with PwC at the Board meetings of 9 and 11 March and with Deloitte at the Board meeting on 11 March. We are satisfied that this provided adequate opportunity for these issues to be taken into consideration by PwC and Deloitte in arriving at their conclusions. These matters were taken into consideration by us in our opinion of 12 March 2004.

(c) *Lack of full disclosure to BDW (and Deloitte) of all material facts such that our brief was "circumscribed"*

From the commencement of our engagement we had full and free access to documents, National staff and consultants. We were encouraged to be robust and rigorous in our work. No attempts were made to restrict or direct our review of material or interviews with staff. We obtained full cooperation at all times.

The same access was given to Deloitte in their review. In her letter of 21 March Mrs Walter states that Deloitte "had no access to PwC documents". At the Board meeting of 11 March, directors were given an opportunity to question Deloitte directly and to test whether they (Deloitte) considered that their own

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The Directors
National Australia Bank Limited

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work had been inappropriately restricted or directed in any way. To our observation, Deloitte were given full access to PwC's documents.

The above comments are a summary of an analysis we have undertaken of the issues raised by Mrs Walter in her letters of 3 and 21 March 2004 and the media release, to the extent they relate to the integrity of the process followed by PwC in completing the Report. Some of the issues raised by Mrs Walter in her letters (including all issues raised in her letters of 16 or 17 March 2004) are outside the scope of our retainer or our knowledge and we are therefore not in a position to comment on them. These are not matters in relation to the scope of the Report or the processes by which it was prepared.

In summary, there is nothing in Mrs Walter's letters to the Chairman dated 16,17 or 21 March 2004 or her media release dated 26 March which causes us to withdraw, amend or qualify our probity and governance opinion of 12 March 2004.

Yours faithfully


BLAKE DAWSON WALDRON

National Australia Bank Limited

Note: BDW provides the comments below on matters within the scope of our terms of engagement.

A Mrs Walter's letter of 3 March 2004

In relation to Mrs Walter's letter of 3 March 2004 we provide the following material. In doing so we adopt the headings used by Mrs Walter in that letter:

"Background"

Issue	Comment	Probity Position
1. "PwC suggested to PBRC that the events at the meeting (6 May 2002) should not be construed as being as the minutes record..." (Page 2, paragraph 4).	The material referred to by Mrs Walter was not in the <i>status update document viewed</i> by BDW on 27 February 2004 nor was it in the final PwC Report.	As a result of the appointment of Deloitte this aspect was of the investigation was not dealt with by PwC. There are no outstanding probity concerns arising from this issue.
2. "PBRC was to be the body responsible for the conduct of PwC investigation and report..."	As a result of questioning relevant persons and considering relevant documents, BDW understood that in the early stages of the PwC investigation, it was decided by the Board that PBRC was the appropriate body for PwC to report to. BDW is aware that this situation later changed and that PwC then reported to the full Board.	There are no outstanding probity concerns arising from this issue.
3. "Exclusion of other directors from the process of supervision of the investigation and report."	BDW was satisfied that all directors, (subject to those relevant directors having been interviewed by PwC prior to the update being given) had received appropriate update material and information as to the progress of the investigation and the PwC Report.	There are no outstanding probity concerns arising from this issue.
4. "Even the probity advisors have been required to report to PBRC."	BDW reported solely to the Board, and not to any committee of the Board (including PBRC).	This is a factual matter, which BDW can comment on. There are no outstanding probity concerns arising from this issue.
5. "The Principal Board has not even had a comprehensive written report as to the facts of the losses..."	This was provided by PwC to the Board meeting on 2 March 2004. Board members who were not able to attend that meeting were given the opportunity to receive a separate update.	This is a factual matter, which BDW can comment on. There are no outstanding probity concerns arising from this issue.

Mrs Walter's letter of 3 March 2004

"PwC Conflict of Interest"

Issue	Comment	Probity Position
1. "PwC-Head Investigator, Craig Hamer, is PwC partner responsible for NAB relationship..."	Reference is made to the Disclosure Statement in the PwC Report, which provided: <i>"One of the partners leading the investigation, Craig Hamer, is PwC's relationship partner for the National. His principal responsibility in this role is to ensure the overall quality of professional services provided to the National."</i> PwC Report, 12 March 2004, page (iii)	There are no outstanding probity concerns arising from this issue.
2. Craig Hamer - "is I am informed, in precisely the same position as Tony Harrington..."	BDW was aware of the issue Mrs Walter is apparently referring to and determined that it did not give rise to a probity concern.	There are no outstanding probity concerns arising from this issue.
3. "Strategic alliance of PwC with Internal Audit.	Reference is made to the Disclosure Statement in the PwC Report, which provided as follows: <i>"In February 2003 PwC was selected as a preferred (but not exclusive) third party provider of resources to the National's Internal Audit function".</i> PwC Report 12 March 2004, page (iii)	There are no outstanding probity concerns arising from this issue.
4. "Jim Power, of PwC... delivered a key report to Principal Board Audit Committee (PBAC) as to..."	Reference is made to the Disclosure Statement in the PwC Report which provided as follows: • <i>"Jim Power, a PwC partner, acted as Head of Internal Audit for CIB from 13 February 2002 to the end of October 2002"</i> PwC Report, 12 March 2004, page (iii); and • <i>"As Jim Power had a role in the preparation and presented to PBA C the AIB memorandum referred to in this section, it is not appropriate for us to give any opinion in respect of this section of our report. Accordingly, Deloitte have reviewed this section and have provided an opinion to the Bank in respect of this section. PwC have reviewed the Deloitte opinion."</i>	There are no outstanding probity concerns arising from this issue.

Mrs Walter's letter of 3 March 2004

Issue	Comment	Probity position
	<p>PwC Report, 12 March 2004, page 47.</p> <p>The Deloitte opinion dated 12 March 2004 made findings as follows: <i>"Matters regarding PwC work-The Allied Irish Bank Report"</i>. The Deloitte opinion concluded with:</p> <p><i>"Review Statement</i></p> <p><i>Based on our review, which is not an audit, except for the matters described in the findings section above, nothing has come to our attention that causes us to believe that the PwC report does not fairly and completely describe and assess the PwC Work in so far as it may be relevant to the matters dealt with in the PwC report."</i></p> <p>Deloitte Touche Tohmatsu 12 March 2004.</p>	
<p>5. "PwC personnel worked on the Horizon technical system... and also worked on the FX desk..."</p>	<p>Reference is made to the Disclosure Statement in the PwC Report and to the Deloitte opinion. The PwC Report provided as follows:</p> <ul style="list-style-type: none"> • <i>"PwC's assignments in relation to CIB, Risk Management, Internal Audit and relevant financial controls... These include: ...a review of CIB's overall IT security framework."</i> • <i>"A PwC resource was provided for two weeks in September 2002 to assist in the review of some aspects of the IT control environment supporting Horizon, the currency options trading system;"</i> • <i>"During 2002 and 2003, work performed included approximately 40 days of internal audit work in the area of foreign exchange trading. The work involved supervised execution of specific audit steps determined by the National."</i> <p>PwC Report, 12 March 2004, page (iii)</p>	<p>There are no outstanding probity concerns arising from this issue.</p>

Mrs Walter's letter of 3 March 2004

Issue	Comment	Probity Position
	<p>Annexure 1 to the Deloitte opinion of 12 March 2004 provided as follows:</p> <p><i>"Procedures Undertaken</i></p> <p><i>The Procedures we have undertaken in performing our review included:</i></p> <ol style="list-style-type: none"> 1. <i>Obtaining a complete list from the National of the people PwC seconded to Corporate & Institutional Banking (CIB), formally WFS, and Internal Audit (IA) from 1 January 2002 to 16 January 2004 including their roles and the assignments worked on. This list was considered along side a document provided by PwC.</i> 2. <i>Obtaining a complete list from the National of the FX system projects on which PwC have been engaged in any way, and the PwC staff who have worked on FX systems and controls from 1 January 2002 to 16 January 2004, and a description of these services. This list was considered along side a document provided by PwC.</i> 3. <i>Receiving from Blake Dawson Waldron, probity advisers to the National, all documents they considered relevant to our review. In addition, we obtained documents from the National that we considered relevant to our review. The documents included but were not limited to extracts of PBAC minutes, PBA Creports, Internal Audit reports and supporting work papers, internal audit plans and engagement letters for certain PwC staff seconded to the National.</i> 4. <i>Interviewing amongst others:</i> <ol style="list-style-type: none"> a. <i>Members of the PBAC</i> 	

Mrs Walter's letter of 3 March 2004

Issue	Comment	Probity Position
	<p><i>b. Staff of the National who attended PBA C meetings</i></p> <p><i>c Executive General Manager of Risk</i></p> <p><i>d. Head of Internal Audit</i></p> <p><i>e. Head of Internal Audit for CIB, formally WFS</i></p> <p><i>f. A PwC partner who had been seconded to the National and</i></p> <p><i>g. PwC investigation team members.</i></p> <p><i>Certain of the interviews were conducted face to face and others by written questions and answers."</i></p> <p>Deloitte Touche Tohmatsu 12 March 2004, page 3.</p>	
<p>6. "John Thorn, (a non executive director of NAB) was, until June 2003, managing partner of PwC."</p>	<p>Reference is made to the Disclosure Statement in the PwC Report which provided as follows:</p> <p><i>"John Thorn, a former senior partner of PwC who retired on 30 September 2003, was appointed to the Principal Board of the National, in October 2003. He was appointed to the Principal Board Audit Committee on 16 October 2003."</i></p> <p>PwC Report, 12 March 2004, page (iii)</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>7. "The terms of role of Deloitte are... far from clear."</p>	<p>The terms of engagement speak for themselves.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>8. "The terms of the appointment of Blake Dawson Waldron are also not known to the Principal Board..."</p>	<p>This document was provided to the Principal Board, members shortly after the Board meeting on 3 March 2004. .</p>	<p>There are no outstanding probity concerns arising from this issue.</p>

Mrs Walter's letter of 3 March 2004

"Independence Compromised"

Issue	Comment	Probity Position
1. "PwC report to and are overseen by PBRC which is responsible for the framing and monitoring of their process... PwC Report drafts... may have been reviewed by members of PBRC... the PwC report drafts may make no or insufficient reference to these circumstances..."	BDW observed that after the initial stage of the PwC investigation, PwC reported to the Board, not PBRC. In relation to how the PwC Report referred to a <i>circumstance</i> , that was a matter within the conduct of the investigation, and was a matter for PwC.	There are no outstanding probity concerns arising from this issue.
2. "There have been four drafts of the PwC Report, reflecting dramatic differences and changes between drafts... have followed input from PBRC members upon the previous drafts."	BDW is not aware that any PwC draft Reports were circulated to PBRC members. BDW was present at the Board meeting on 9 March 2004 when PwC presented to the Board the first draft of its final Report. BDW observed that "Status update documents" were "spoken to" or provided by PwC to PBRC (and Board) members in controlled circumstances prior to 9 March 2004.	There are no outstanding probity concerns arising from this issue.
3. "Status update document were seen and commented on by members of PBRC..."	See note above. In those status update sessions PBRC (and Board) members were given the opportunity to seek clarification on issues covered in the status update.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.
4. "Offering of 'future risk assessment work' to PwC and G. Ludwig."	The CEO gave an explanation in relation to this issue in the Board meeting of 4 March 2004.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.
5. "PwC compromise of the independence of the investigation process by:		
<ul style="list-style-type: none"> • "the chief investigator for PwC spoke to the Chairman... the day before the Chairman was ... to provide evidence to PwC and APRA..." 	BDW questioned relevant persons and was satisfied that there were no probity issues arising.	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> • "The room PwC occupies at the NAB premises is able to accessed by persons including PBRC and management." 	BDW was satisfied that the security arrangements were appropriate.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> • "Evidence is not secured..." 	BDW was satisfied this issue went to the forensic conduct of the investigation and was therefore a matter for PwC.	There are no outstanding probity concerns arising from this issue.

Mrs Walter's letter of 3 March 2004

Issue	Comment	Probity Position
<ul style="list-style-type: none"> "initial interview of twenty persons." 	BDW was satisfied this occurred prior to the appointment of PwC.	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> "... PwC have not completed investigation... draft Report-inconsistent with appropriate investigative processes." 	BDW was satisfied this issue went to the forensic conduct not integrity of the investigation. This was a matter for PwC.	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> "Peter Duncan commented at the Board meeting on 2 March..." 	BDW was present when these comments were made. This statement does not accord with BDW's recollection of those events.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.

"Since 20 February 2004"

Issue	Comment	Probity Position
1. "Chairman circulated note to directors on 21 February 2004... a reasonable reader would consider that this meant that there was nothing written in existence at that time..."	BDW cannot comment on this.	There are no outstanding probity concerns arising from this issue.
2. "... Michael Pascoe interview 22 February 2004..."	Please see comment on Issue 1 above.	There are no outstanding probity concerns arising from this issue
3. "Chairman's comment to Board on 20 February 2004 re John Stewart being "point of reference for PwC format as relevant to the directors... (APR on 20 February 2004)."	This matter related to a press report.	This is a factual matter which the Board has addressed and which BDW cannot comment on. There are no outstanding probity concerns arising from this issue.
4. "On 20 February 2004... a status update document was provided to PBRC."	BDW observed the circumstances to be that the "status updates" were given to the PBRC and BDW called for these documents. They were a Powerpoint presentation pack..	There are no outstanding probity concerns arising from this issue.
5. "23 and 24 February 2004 provision of 'status update document' to PBRC... and comments to PwC."	BDW was told by the Chairman and PwC that the document provided was the "status update document" as previously provided to other members on 20 February 2004.	There are no outstanding probity concerns arising from this issue.
6. "I believe the process fails minimum standards of	BDW was satisfied that the process had integrity.	There are no outstanding probity concerns arising from

Mrs Walter's letter of 3 March 2004

Issue	Comment	Probity Position
integrity..."		this issue.
7. "The Chairman... informed me he intended to afford me the same opportunity... to see the latest draft..."	BDW cannot comment as BDW was not present during the conversation.	There are no outstanding probity concerns arising from this issue.

2 March 2004

Issue	Comment	Probity Position
1. "At the meeting with the Chairman, Elizabeth Johnstone and Anne Dalton of Blake Dawson Waldron:		
<ul style="list-style-type: none"> "BDW confirmed that PwC had an actual conflict... they did not mention the numerous other problems which attend Craig Hamer's and PwC's roles, possibly they were not aware of them." 	BDW was aware of these issues	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> "It was apparent that she [Elizabeth Johnstone] had not been "informed of the true facts relating to the involvement of PBRC members..." 	<p>At the time of the discussion on 2 March 2004, BDW was still gathering information including the facts in relation to:</p> <ul style="list-style-type: none"> who had been interviewed by PwC, and the dates of those interviews, who was yet to be interviewed; what "update material" had been given to which PBRC or Board member relative to that persons interview; and the content of that material. <p>Subsequently, BDW ascertained the relevant information and BDW was then satisfied that there were no probity concerns arising.</p>	<p>This is a factual matter which BDW can comment on.</p> <p>There are no outstanding probity concerns arising from this issue.</p>
<ul style="list-style-type: none"> "I expressed surprise... that the remaining directors on PBRC... had not been interviewed." 	This was a matter for the PwC investigation.	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> The very proper course suggested to and adopted by me should have been 	BDW observed that the appropriate protocols were followed, namely that if a director had been notified by	There are no outstanding probity concerns arising from this issue.

Mrs Walter's letter of 3 March 2004

Issue	Comment	Probity Position
applied to all directors..."	PwC that they were required for an interview, and that such interview had not yet taken place, then that director was not present at the Board meeting when PwC first presented its draft final Report.	
2. "... the Chairman said to me... in the absence of the Probity Advisers..."	BDW is not able to comment on this matter as BDW was not present during the conversation.	This is a factual matter which BDW cannot comment on as it has no direct knowledge of it. There are no outstanding probity concerns arising from this issue.
3. "At 1:30pm the Chairman... BDW spoke to the probity issue and they quoted David Krasnostein... to have said that it was important that Deloitte should not become the little speck on the camera lens that destroys a picture..."	The analogy of the speck on the camera lens was used by BDW to illustrate the point that if the "independence issue" was not appropriately handled (by the separate Deloitte opinion) it had the capacity to affect the credibility of the whole investigation.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.

Mrs Walter's letter of 21 March 2004**B Mrs Walter's letter of 21 March 2004**

In relation to Mrs Walter's letter of 21 March 2004 we provide the following material:

Issue	Comment	Probity Position
<p>1. "I remind you that the substance of my memorandum of 3 March was as to:</p> <ul style="list-style-type: none"> • the inability of PwC to act without fear or favour and produce an unbiased and complete report;" 	<p>BDW stated in Board meetings of 4, 9, 11 and 26 March 2004 and in our opinion of 12 March 2004, that BDW saw no evidence to support this statement.</p>	<p>Having regard to the matters referred to in our opinion of 12 March there are no outstanding probity concerns arising from this issue.</p>
<ul style="list-style-type: none"> • "The involvement of yourself and other members of the PBRC in framing the PwC report direction and in particular the capacity to direct it away from PBRC and PwC matters;" 	<p>We refer to the above comment</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<ul style="list-style-type: none"> • "My many concerns as to the integrity of the investigation process." 	<ul style="list-style-type: none"> • Each of the concerns raised by Mrs Walters was tested. After testing we were satisfied that either, appropriate protocols were implemented to deal with these issues, or that no such issue, in fact, existed. 	<p>There are no outstanding probity concerns arising from these issues</p>
<p>2. "... Deloitte's position given their inability to access highly material documents,... they had no access to PwC documents."</p>	<p>On this issue BDW addressed the Board on 26 March 2004 to the following effect:</p> <p><i>" We do not believe that Deloitte was so 'circumscribed' in their Review and in particular that they were unable to 'access highly material documents... including PwC documents' which were required by them to complete their work. "</i></p>	<p>There are no outstanding probity concerns arising from this issue.</p>

Mrs Walter's letter of 21 March 2004

Issue	Comment	Probity Position
<p>3. "That the draft (of the PwC Report) of 23/24 February cannot be provided to me (Mrs Walter)."</p> <p>(Page 3, paragraph 1).</p>	<p>We understand that the document Mrs Walter is referring to is the status update document of 20 February 2004. BDW cannot otherwise comment on what was said..</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>4. "Nothing said by the probity advisers constitutes a finding that the conduct of yourself, PwC and PBAC engaged in was proper. In fact the probity advisers have made no findings as to probity."</p> <p>(Page 3, paragraph 2).</p>	<p>The probity opinion of 12 March 2004 stated that BDW were satisfied that the indicia of independence (including that the Report was not amended following successive drafts by those commissioning it) had been met.</p>	<p>This is a factual matter which BDW can comment on.</p> <p>There are no outstanding probity concerns arising from this issue.</p>
<p>5. "I have previously made it plain, in my letter of 17 March 2004, that I have not, whilst reserving the right to make a proper public disclosure if I considered it my duty."</p>	<p>This is not a matter for BDW to comment on as it is outside the scope of our engagement.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>6. "That I declined to be interviewed by PwC is invalid, as you know."</p> <p>(Last paragraph, page 3).</p>	<p>We observed the circumstances to be as follows:</p> <ul style="list-style-type: none"> • PwC sought to interview Mrs Walter in the same manner and following the same protocols as had been in place for all interviews. Most of the interviews were conducted jointly by PwC and APRA, without the provision of questions or documents in advance. Following those interviews transcripts were provided to the interviewees for the purpose of factual corrections being made; • Mrs Walter requested written questions and documents to be provided to her in advance; • After a delay of some days Mrs Walter agreed to be interviewed by PwC. on the basis of an oral interview and the provision of some topics in advance. 	<p>This is a factual matter which BDW can comment on.</p> <p>There are no outstanding probity concerns arising from this issue.</p>
<p>7. "Your statement that I sought to be involved in the drafting of the Report is invalid."</p> <p>(Page 4, paragraph 1).</p>	<p>BDW cannot comment on this issue as it occurred prior to our appointment.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>

Mrs Walter's letter of 21 March 2004

Issue	Comment	Probity Position
8. "They (the shareholders) should get a Report which fully addresses all matters (even if it is not the PwC Report which provides the information)."	This is not a matter on which BDW can comment as it is outside the scope of the terms of our engagement.	There are no outstanding probity concerns arising from this issue.
9. "I have read the PwC Report in full and believe that there are a number of matters which it either does not address or does not address adequately."	This is a comment on the final content of the PwC Report. It does not go to the integrity of the process in respect of the PwC report.	There are no outstanding probity concerns arising from this issue.
10. "The Board as a whole was not provided with adequate opportunity, in my opinion, to review or make decisions in a proper deliberative way as to the PwC Report, the PwC Report being provided to the Board on 9 and 11 March and released in final form on 12 March 2004."	The decision by the Board to release the Report on 12 March 2004 is not a matter we can comment on	There are no outstanding probity concerns arising from this issue.
11. "My concerns are intended to be helpful and to raise issues which, whether the analysis be done by the National itself or by a third party, should be considered so the issues which I have raised may be resolved in a final fashion." (Page 5, paragraph 1).	This is not a matter on which BDW can comment as it is outside the scope of the terms of our engagement.	There are no outstanding probity concerns arising from this issue.
12. "The PwC Report should have fully addressed the role and responsibility of PBRC..."	This is a matter for PwC in the conduct of its investigation and the compilation of its Report.	There are no outstanding probity concerns arising from this issue.

Mrs Walter's letter of 21 March 2004

Issue	Comment	Probity Position
<p>13. "The PwC Report could have vigorously analysed how the system failures of Horizon were introduced (example, the one hour window and the surrender function..."</p> <p>(Page 6, paragraph 3).</p>	<p>This is a matter for PwC in the conduct of its investigation and the compilation of its Report.</p> <p>Deloitte's terms of engagement required them to consider the actual workings of PwC personnel relative to the Horizon system. As stated by Deloitte in the Annexure to their Opinion, they considered the issue by:</p> <ul style="list-style-type: none"> • examining working papers of relevant PwC staff; • interviewing relevant National personnel; and • interviewing relevant PwC personnel. <p>Deloitte were satisfied that this issue that it did not fall within a category of an exception to their general opinion and thereby concluded that in respect of the Horizon issue <i>"nothing has come to our attention that causes us to believe that the PwC Report does not fairly and completely describe and assess the PwC work insofar as it may be relevant to the matters dealt with in the PwC Report."</i></p> <p>Deloitte opinion dated 12 March 2004.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>14. "The inability of VaR to measure the smile affect and the limit breaches to which this thereby gave rise, receives five separate comments in the PwC Report... the Deloitte opinion accompanying the PwC Report noted that PwC's Jim Power's responsibilities included following up the outstanding internal audit issues... this does not seem to have been considered in the PwC Report."</p> <p>(Page 6, paragraph 5).</p>	<p>This issue was not considered in the PwC Report because of conflict of interest. To avoid this conflict, Deloitte were engaged to provide a separate opinion in respect of this aspect of the PwC investigatio. Deloitte provided that opinion and in doing so made specific findings separate from the PwC Report in respect of Jim Power and his responsibility.</p> <p>(See Deloitte opinion dated 12 March 2004).</p>	<p>There are no outstanding probity concerns arising from this issue.</p>

Mrs Walter's letter of 21 March 2004

Issue	Comment	Probity Position
<p>15. "PwC found that there was 'a clear design flaw' in the risk model as risk could not mandate that limit breaches were to be... Were there any comments made at that meeting on its efficacy? Why did PwC not analysis PBRC's role in what occurred?" (Page 6, paragraph 6).</p>	<p>This is a matter for PwC in the conduct of its investigation and the compilation of its Report.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>16. "If the parallels with the Allied Irish Bank had been brought out by PwC's Jim Power who presented the PowerPoint presentation to PBAC... to enable to occur could have been addressed? The PwC Report does not explore this." (Page 6, last paragraph).</p>	<p>See note 14 above and the note on page 2 (point 4) above in relation to the Disclosure Statement.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>17. "APRA's letter of 4 November 2003... is referred to in the PwC Report as not having been distributed to the Chairman or PBAC... this striking omission reflects adversely upon the Report."</p>	<p>This is a matter for PwC in the conduct of its investigation and the compilation of its Report.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>
<p>18. "Internal audit is described as reporting only to PBAC... it is not described as reporting to PBRC..." (Page 7, paragraph 4).</p>	<p>This issue was raised by Mrs Walter in the "check fact" session on 9 March 2004. BDW was satisfied that PwC was cognisant of this issue prior to the release of its final Report.</p>	<p>There are no outstanding probity concerns arising from this issue.</p>

Mrs Walter's letter of 26 March 2004**C Mrs Walter's Press Release of 26 March 2004**

In relation to Mrs Walter's press release of 26 March 2004 we provide the following material

Issue	Comment	Probity Position
1 . "2. The scope of the PwC report: the process by which it was undertaken, the process by which the published report was finalised; and questions as to which individuals had input to that final report at which stage." (Page 2).	We refer to our opinion of 12 March 2004 and to the above comments.	There are no outstanding probity concerns arising from this issue.

Catherine Walter AM

PO Box 239
TOORAK VIC 3142

Direct Line (03)96791034
Facsimile (03) 9822 7448
Email cwalter@ozemail.com.au

15 April 2004

Mr Graham Kraehe
Chairman
National Australia Bank Ltd
FAX 8641 4915

Dear Graham

Corporate Governance

The bank released advice from Blake Dawson Waldron (**BDW**) to the directors dated 31 March 2004.

That advice was released on 1 April 2004 without any reference to me. I am not aware that the advice has been obtained or released by a decision of any relevant organ of the National. It is certainly not the result of a decision of the board of directors of the National of which I am aware.

In fact, I wrote to BDW (with copies to all the other directors of the National) on 30 March 2004 to the effect that I believed it was not proper for BDW to provide further advice when their role had been completed and was contained in their advice of 12 March 2004 (released with the PwC report). Further, as the matters which I had raised, may require the formation of a view as to credibility, which may ultimately only be determined by the shareholders of the bank, I thought it was not appropriate for BDW to involve themselves further in an issue among directors.

I have now analysed the advice prepared by BDW hi conjunction with my solicitor, Robert Paterson of Norton Gledhill.

Mr Paterson is a former Group General Counsel of the ANZ Bank and a former Managing Partner of BDW.

The result of that analysis is set out in the attached chart summary which considers each of the comments made by BDW. By its nature, that chart is detailed and requires careful analysis for it to be considered fully.

However, I believe a number of issues emerge clearly from that analysis which I would call upon my fellow directors to consider:

1. hi all material respects, the factual statements in my letters of 3 March 2004 and 21 March 2004 remain unchallenged and unrefuted by the BDW analysis. It will also be

apparent from the material sent out in the attachment that there are additional questions to be answered arising from the BDW advice.

2. I believe it is unfortunate that BDW have chosen to provide the advice they did. Their role was limited in terms of their retainer of 9 March 2004 and was reflected in their letter of 12 March 2004 (accompanying the PwC report).

BDW were not retained to provide general advice as to 'probity'. BDW were retained to advise whether, as they describe it variously in their letter of 12 March 2004, 'PwC might reasonably be regarded as independent' or the PwC report 'is reasonably likely to be regarded as independent'. BDW have never expressed a view as to the independence of PwC. Nor, have they, even yet, expressed a general view as to the 'probity' of the process.

Against that background, I believe reference to 'probity' in the BDW advice sits rather oddly and one wonders what 'probity' means to BDW.

3. The BDW advice is, in my view, *presented* as though it may refute what I have said. There is the constant reference to 'there is no outstanding probity concern arising from this issue'. But, an examination of the underlying content of the BDW advice reveals that it does not appear to seek to refute or deny the issues which I have raised in any material respect.

4. A number of examples taken from the attached chart summary demonstrate this:

- (a) The Chairman and PwC have stated to BDW that the draft report (status update document) provided to all members of PBRC on 23 and 24 February 2004 was precisely the same as the status update document of 20 February 2004.

The status update document of 20 February 2004 had apparently already been seen by all of the PBRC members. Why should the PBRC be provided with the same report again?

BDW did not deal at all with the substance of the statement in my memorandum of 3 March 2004 to the effect that the document provided to all members of PBRC on 23 and 24 February 2004 was a draft report, that it took two hours for the Chairman to read and that comments were subsequently made to the PwC Head Investigator (Craig Hamer) which may have caused the report to be changed in specific respects. Indeed, the Chairman identified to me (and it is referred to in my memorandum of 3 March 2004) some items in respect of which he had sought changes.

- (b) BDW state that PwC reported to the full board except for an 'initial' process. In fact, the full board received no report from PwC until 2 March 2004 (the day before my memorandum of 3 March 2004). At all material times, over the process of the provision of the PwC report, PwC reported to the PBRC and this was in accordance with the public statements of the company and the events.
- (c) I raised in my memorandum of 3 March 2004 the issue of a discussion between the Head Investigator of PwC and the Chairman, the night before the Chairman was to provide evidence to PwC and APRA. That was the evening of 19 February 2004. BDW say that they are satisfied there are 'no probity' issues

arising. Why are there none? What was the subject matter of the discussion, if any? Did it relate to information 'disconnects' between the board and management concerning the APRA letter of 4 November 2003 the bank's response to which noted the 'warm interest' of PBRC in market risk issues and which APRA letter was noted on its face by Chris Lewis (Executive General Manager - Risk Management) to be distributed to all the members of PBRC.

- (d) BDW do not appear to address in overview the major and manifold roles of PwC with the National. I believe those roles are so significant, when considered as a totality, that it may not have been possible for PwC to be independent of the National. As a result, even the full disclosure of all conflicts of interest may not be sufficient to address the degree of dependence PwC (and the Head Investigator) may have had on the National. This, in my view, must be a 'probity' issue which should have been addressed.
- (e) BDW make no comment on the statement in my letter of 21 March 2004 as to the draft PwC report of 9 March 2004 being altered (without any change in the underlying supporting material) in the final PwC report of 12 March 2004 by including the words in respect of PBAC:

'After reading the supporting papers, probing of management may have revealed the seriousness of some of the control breakdowns which existed in the currency options business'.

I note this statement is not found in the APRA report, which drew on the PwC report, presumably before the change was made. This is clearly a probity issue in my view.

The formulation of the statement in the PwC report, in its reference to 'reading the supporting papers' is also interesting. The APRA Report suggests that one member of PBAC did not *read the* APRA correspondence.

- (f) BDW state in relation to issues which I said PwC should have investigated, in particular the role of PBRC, that this is a matter for the PwC investigation and not for BDW who make no comment. In my memorandum of 3 March 2004 I expressly raised the conflict in PwC both reporting to and investigating PBRC. BDW have chosen not to make comment on this aspect of my memorandum of 3 March 2004 in their advice. BDW have also chosen not to comment on the specific matters raised in my letter of 21 March 2004 which go to the heart of the issue - on 21 November 2003 PBRC received a detailed presentation on market risk (including risk in foreign exchange markets). That detailed presentation in PowerPoint form included a treatment of the escalation process for limit breaches. This presentation was from the same officer (Tzu Ming Lau) who earlier the same day had sent a detailed memorandum to Ron Erdos, raising the issue of specific and repeated limit breaches. These issues of 21 November 2003 are not addressed in the PwC report or in the BDW advice.

Nor has BDW made any comment on the fact that PwC has not interviewed any member of PBRC (other than the chairman) when all members of the PBAC have been interviewed by PwC, with the exception of Peter Duncan, the crossover member of both PBAC and PBRC. I raised this matter specifically in my letter of 21 March 2004.

- (g) BDW fail to explain why a conflict experienced by one PwC Partner, Tony Harrington, who stepped down, should not (the same circumstances apparently being equally applicable) apply to Craig Hamer, the Head PwC Investigator.
- (h) In my view, the apparent failure of BDW to understand and describe the nature of the PwC and Deloitte retainers (and the limited scope of the Deloitte review) which recurs through their advice, reflects poorly on BDW. PwC were to address all matters including any areas where there was a conflict but they did not in my view. Deloitte was to report to Group Chief General Counsel and was only to review PwC material and then only on the basis of a constrained brief dependent upon the supply of information by BDW. The result, in my view, is omissions from the PwC report which are not and cannot be addressed by Deloitte.
- (i) The terms of the retainers for each of BDW and Deloitte were only settled after the work by Deloitte and BDW had been substantially completed. This suggests that the terms of their retainer were determined, after the event, by what BDW and Deloitte were able to say. If correct, this fails principles of propriety as set out by Brooking, J in *Phosphate Co-operative Co of Australia v Shears* [1998] 6 ACLC 1046 where he referred (among other things) to the 'danger of the engagement of an expert before the proposal on which he is to comment is properly formulated'.
- (o) Allied Irish Bank - report to PBAC of 6 May 2002. BDW appear to impliedly suggest as fact that there is no material in which PwC have sought to construe the events at the PBAC meeting of 6 May 2002 as not being as the minutes of PBAC record. In fact, in the PwC disclosure letter of 16 February 2002 (available to BDW), this was expressly stated by PwC in relation to Mr Jim Power (a Partner of PwC, who at that time was acting in the role of Head of Internal Audit for Wholesale Financial Services). That letter, a draft of which would, I believe, have been available to PBRC on 12 February 2004 expressly states that Mr Power and, it would seem, PwC do not believe the minutes correctly record the events at the PBAC meeting.
- (k) As a result of my calling last week for the PwC draft report of 9 March 2004 presented to the Board on that date, I have become aware of significant deletions from that draft which are not included in the final report of 12 March 2004. Those deletions relate to the report ('report') to PBAC on 6 May 2002 presented by Mr Jim Power, a PwC partner (with a detailed PowerPoint presentation under his name). The deletions are made against the background of the Deloitte report, which is critical of Mr Power's role in Internal Audit, and may be seen as seeking to down-play the deficiencies in the report to PBAC and the deficiencies in follow-up (for which I believe it is arguable that Mr Power and PwC may have been responsible).

The deletions made by PwC between 9 and 12 March include :

- (i) the fact that the request for comment within the Bank from Internal Audit seemed to 'infer that the comments should be considered in the context of a remote location, similar to what occurred in ABB';

- (ii) that other responses were received by Internal Audit 'that also raised questions over the National's procedures, and these are not reflected in the report' to PBAC;
- (iii) that matters identified in the report made to Allied Irish Bank (AIB) on the circumstances of AIB's forex losses from unauthorised trading (the 'AIB report') were overlooked in the report to PBAC when the 'National's systems could not calculate VaR for the currency options desk and other limit breaches were regularly occurring';
- (iv) reference to the control breakdowns in the back office referred to in the AIB report was deleted as were references to the failures of the National (by Operations) to properly match false transactions and to control surrender/cancelled trades;
- (v) deletion of reference to PwC having seen no evidence to explain Wholesale Financial Services and Group Risk Management collaborating to stress test and refine the control environment (notwithstanding that the report to PBAC said it was to happen), and also deletion of the reference to PwC not having 'identified any particular control refinements that were made as a result of it' [the collaboration];
- (vi) the deletion of criticism by PwC of the report to PBAC that it, the report, should have included more information in particular on the need to supervise the trading desk and the areas noted by Mr Bakhurst as not operating effectively (in relation to financial control inadequacies); and
- (vii) the deletion of the statement by PwC that 'many of the control weaknesses at AIB existed in the National's currency options business, and were exploited by the Traders'.

These deletions are not commented on by BDW, but I believe they should have been. Had the matters deleted been retained they would have tended, in my view, to have reduced the basis for criticism of PBAC and potentially implicated National management and Mr Power of PwC. At the same time as the deletions were made in the PwC report an addition was made to the PwC report from 9 March to 12 March to criticise the role of PBAC, without any apparent basis as there had been no change to the underlying material. That change made to the PwC report is as set out in (e) above - *'probing [by PBAC on (he report)] of management may have revealed the seriousness of some of the control breakdowns'*.

There are also other issues which one might have expected BDW to have identified and referred to if their role had been to protect the general propriety of the process. For example, I was told by the now Chairman that in early February he met with Phil Rivett (a co signing partner of the PwC report) in London. The now Chairman was I understand told by him that the circumstances surrounding the foreign exchange losses were similar to the Allied Irish Bank matter. The PwC report might then draw on and be framed by the Allied Irish Bank experience. When I drew to the attention of the now Chairman, upon his return to Australia, the report on Allied Irish Bank to PBAC made by Jim Power (a PwC partner), I believe the now Chairman and PwC re-visited

their approach to the PwC report. This matter may be verified or dispelled by an examination of the process of the preparation of the PwC report within PwC.

I have to raise these issues even though they do rather look back to the sorry state of affairs surrounding the PwC report. They are, however, important matters relevant for consideration by the bank's shareholders. In any event, you have given me no choice. You chose to release the BDW advice. It is necessary for me to respond.

To clear the air, I believe that there should be a full and detailed response to the matters raised in my memorandum of 3 March 2004 and my letter of 21 March 2004. This will demonstrate that there is a commitment to proper governance by the board.

The BDW advice, in my view, does not address, and was not intended to address, the issues which I have raised.

As other matters arise which are appropriate to draw to your attention and the attention of the wider stakeholders in the National I shall do so.

Yours sincerely,



BDW Advice to NAB - an analysis

Prepared by Catherine Walter with Robert Paterson of Norton
Gledhill

15 April 2004

Brief Description of Issue, identified by Page Number and Item Number in BDW's Table, or Other Identification where BDW don't deal with the Issue.	Response to BDW's Comments on the Issues (and BDW's failure to comment on some significant Issues) - For the text of BDW's Comments see their Letter of 31 March and supporting table, which are annexed to this Memorandum. Notes: 1. There are several places in this Memorandum where the page number and item number refer to BDW's Letter rather than the Table which supports it - the references are underlined in those cases. 2. "PwC" Report" means the final report as issued on 12 March 2004 with Deloitte's Report and BDW's opinion accompanying it. References to "report" are to drafts.	Conclusion
<p>Omission -- Significant items, relevant to PwC's own liability, which had appeared in the final draft of 9 March, were omitted from the PwC Report [of 12 March].</p> <p>The most significant omissions were:-</p> <p>Deletion of "Other responses were received that also raised questions over the National's procedures, and these are not reflected in the report." [ie the report to PBAC]</p> <p>Deletion of "These matters</p>	<p>In providing comments at 31 March BDW were alert to the Issue of changing drafts - their Letter of 31 March talks about "successive drafts" in point No. 3 on Page 2. and the Issue on which they comment on at Page 6, No. 2 of their Table states, at 3 March, that "there have been four drafts of the PwC report, reflecting dramatic differences and changes between drafts..".</p> <p>A final draft report was provided by PwC to the Principal Board on 9 March, It has to be assumed that BDW read that draft report. The PwC Report (which was presented and issued on 12 March) does not contain a number of significant items, relevant to PwC's own liability, which were in the draft of 9 March.</p> <p>BDW's comments give no indication that they have detected that there were significant omissions in the PwC Report or that they have considered the probity consequences of such omissions.</p> <p>The omitted material is very relevant to (a) PwC's own possible..</p>	<p>BDW, as probity adviser, should have compared the successive drafts of the report against each other, and the final draft against the PwC Report.</p> <p>Either, BDW did not check for differences between the 9 March draft report and the PwC Report, or they have dismissed without comment omissions which raise significant probity concerns.</p> <p>This very significant defect in BDW's material of 31 March casts doubt on the validity of their opinions in their letters of 12 and 31 March.</p>

[raised in the report obtained by AIB] were overlooked at a time when the National's systems could not calculate VaR for the currency options desk and other limit breaches were regularly occurring"

Deletion of references to control breakdowns in the back office, the failure to match false transactions and the failure to properly control surrendered/cancelled trades.

Deletion of references to (a) PwC having seen no evidence [notwithstanding that the report to PBAC said that it was to happen] of Wholesale Financial Services and Group Risk Management collaborating to stress test the control environment; and (b) PwC not having identified any particular control refinements that were made as a result of it [ie the collaboration]

Deletion of "It is difficult to see why the memorandum

liability for Mr Power's work; (b) the question of whether PBAC had been properly informed by Mr Power on the AIB matter and the relevance for National of the lessons from it; and (c) whether the comment on PBAC which was introduced by PwC between the draft of 9 March and the PwC Report* was an attempt to divert attention away from PwC and towards PBAC on matters which could involve a liability for PwC.

* that comment by PwC is "probing of management [by PBAC] may have revealed the seriousness of some of the control breakdowns" (the "Criticism of PBAC")

The deletion of the second of the sections quoted in the left column is particularly relevant to PBAC. PBAC did not know that "National's systems could not calculate VaR for the currency options desk" and that "other limit breaches were regularly occurring". If the report on AIB which PBAC had sought had dealt comprehensively with the issues which PwC in that quoted section refer to as being "overlooked" by the report and/or Mr Power in his presentation had advised PBAC that the systems inability to calculate VaR and the regular limit breaches were two outstanding issues with Internal Audit, then PBAC would have had an opportunity to take action on those matters at a time when such action could have prevented the losses.

Deloitte said: "The Memorandum [presented by Mr Power to PBAC] did not refer to these internal audit issues although, in our opinion, it is reasonable in the circumstances to expect that these issues would have been referred to in the Memorandum or presentation." and "the Memorandum...omitted to incorporate some of these factors which were potentially relevant to the National. Therefore, in our opinion, to the extent that these relevant matters were not canvassed in the Memorandum, it was

did not include more information on the need to supervise the desk and the areas noted by Mr Bakhurst as not operating effectively. Many of the control weaknesses at AIB existed in the National's currency options business and were exploited by the traders."

Deletion of a statement by PwC that "many of the control weaknesses at AIB existed in the National's currency options business, and were exploited by the Traders."

deficient"

Reduced to their essentials, in Mrs Walter's view, these were findings by Deloitte that:

Jim Power of PwC failed in his duty to bring two internal audit matters to the attention of PBAC;

Jim Power of PwC failed in his duty to warn PBAC concerning "a significant number of matters" which contributed to the AIB losses and "which were potentially relevant to the National";

Jim Power of PwC "contributed to the PBAC reaching the [erroneous] conclusion" expressed in the minutes that "the National has appropriate controls to identify control breakdowns on a timely basis" (as quoted by Deloitte - the minutes go on to say "to ensure that any losses are minimised").

These findings suggest to Mrs Walter the existence of a potential legal liability in damages of Jim Power and PwC for forex losses which could have been avoided if an adequate warning had been given by Jim Power to PBAC, which (a) had pro-actively requested the report, because of PBAC's Chairman's concern following the Allied Irish Bank forex losses that National might not have sufficient systems in place to avoid a similar event; and (b) had the power and the inclination to require changes at the National if it had been warned of the need for them).

A reader might well conclude that there was a connection between the omission of the above material from the PwC report (which...

	<p>had appeared in PwC's draft report of 9 March), the addition to the PwC Report of the Criticism of PBAC (which did not appear in the 9 March draft) and the fact that such omitted material was in conflict with the newly added Criticism of PBAC. Alternatively, it was necessary to add the Criticism of PBAC, to have somebody apparently responsible, if the omitted material was removed.</p> <p>Failure by BDW to comment on the omitted material and its significance, or to even show that they have considered it, leads to doubt about the validity of the conclusions in BDW's Letter of 31 March and accompanying Table.</p>	
<p>Page 1, No. 1</p> <p>PwC's suggestion that the events at the PBAC meeting at which Jim Power gave a presentation of AIB FX losses were not as the minutes record - PwC's challenge to the validity of the minutes was made in PwC's disclosure letter to National dated 16 February 2003</p>	<p>The Issue gives written evidence of what appears to be an attempt to challenge events by PwC - Mr Power is a partner of PwC who was seconded to National in 2002.</p> <p>The PBAC minute (6 May 2002) states "Mr Power noted that management acknowledged that treasury trading is a high risk function, however, the overall conclusion was that the National has appropriate controls to identify control breakdowns on a timely basis to ensure that any losses are minimised" The underlined words are repeated in a Board minute(6/7May 2002)</p> <p>The memorandum which had been supplied to PBAC before the meeting, and which was supplemented by a PowerPoint presentation by Mr Power in the meeting, said that "The National's operating model will not prevent a fraud however it is extremely unlikely..material fraud..would go undetected for an^ length of time". Contrast PwC's conclusion (PwC Report, page...</p>	<p>Deloitte's later appointment and work were an attempt to ensure independence.</p> <p>In particular, Deloitte's findings were at odds with PwC's as contained in PwC's disclosure letter of 16 February and the PwC Report. Deloitte found "At the time that Mr Power presented the Memorandum, his responsibilities as Acting Head of Internal audit for WFS included following up outstanding internal audit issues. The two internal audit issues [continuous limit breaches and incorrect VaR numbers because no volatility smile was used] had not been cleared by internal audit by 6 May 2002, the date of the PBAC meeting at which..</p>

49) that "Mr Rose's memorandum [Note: not Mr Power's presentation] clearly acknowledges that the National's operating model will not prevent fraud but would detect material fraud after a period of time."

Despite this memorandum and the minutes, PwC stated in respect of PBAC in the PwC Report that "probing of management may have revealed the seriousness of some of the control breakdowns which existed in the currency options business" (pages 3 and 29). This comment is susceptible of interpretation that PwC were trying to shift responsibility away from themselves when their own Mr Power had effectively given PBAC no cause for concern, as indicated in the minute quoted above. Further, this comment was not contained in a draft of the report submitted by PwC to the full Board on 9 March, and was added later. There was no change in the underlying fact situation from the draft report to the PwC Report which required the addition of these words.

It should be noted that PBAC did not know that National's systems could not calculate VaR for the currency options desk and that other limit breaches were regularly occurring. If the report on AIB which PBAC had sought had dealt comprehensively with the issues (which in their 9 March draft of the PwC report PwC refer to as being "overlooked") by the report (consisting of the memorandum and Mr Power's presentation) and/or the memorandum or Mr Power in his presentation had advised PBAC that the systems inability to calculate VaR and the regular limit breaches were two outstanding issues with Internal Audit, then PBAC would have had an opportunity to take action on those matters at a time when such action could have prevented the losses.

the Memorandum was presented by Mr Power. The Memorandum did not refer to these internal audit issues although, in our opinion, it is reasonable in the circumstances to expect that these issues would have been referred to in the Memorandum or presentation".

This different treatment of this Issue by PwC and Deloitte raises a concern that a tendency to challenge events may have existed and may have affected other matters in the Report. That is a reason why PwC should not have been appointed in a situation where many important matters on which they were to investigate and report upon involved them in substantial conflicts of interest.

This has to be a probity concern, contrary to BDW's conclusion.

	<p>The fact that PwC's challenging the correctness of the minute (in their disclosure letter of 16 February, a draft of which Mrs Walter believes would have been available to PBRC on 12 February 2004) did not lead to a similar comment in the "status update" of 27 February or the PwC Report doesn't alter the situation that evidence of a tendency to challenge events adverse to PwC on one issue may lead to a lack of confidence on other matters which were reported on (or were not reported on).</p> <p>For material on a related but separate issue see the first item in this analysis, on pages 1 to 3 of this document.</p>	
<p>Page 1, No. 2</p> <p>PBRC was to be the body responsible for the conduct of the PwC investigation and report.</p>	<p>BDW's comment is incorrect if by "early stages" BDW means for a small portion of the time which started on 16 January with PwC's appointment and ended when the PwC Report was delivered on 12 March. As announced by the former Chairman on 29 January, PwC reported to PBRC (he put it in terms of "presenting updates"). That situation continued until 2 March when the full Board became involved (although there has never been a formal decision about a change in reporting).</p>	<p>There is a probity concern with PBRC alone supervising the process of the investigation and report until a very late stage in the process.</p>
<p>Page 1, No. 3</p> <p>Exclusion of non-PBRC directors from the process of supervision of investigation and report.</p>	<p>There is no indication as to how BDW was satisfied. Obviously BDW have not ascertained that (a) the first time the full Board received a draft report was on 2 March; (b) while normally any Director can attend a meeting of PBRC, Directors who were not members of PBRC were prevented from attending certain meetings of PBRC relating to the PwC report process by express decision of the Board; and (c) two members of PBRC were not</p>	

	interviewed by PwC at all and yet were able to participate in updates which apparently dealt with the draft report in detail.	
<p>Page 1, No. 4</p> <p>Even the probity advisers have been required to report to PBRC.</p>	<p>If BDW reported to solely the Board, as they state, it was not apparent to the Board members who were not members of PBRC, who did not even see the terms of BDW's appointment until after 9 March, BDW having apparently been appointed on 6 February.</p> <p>Further, by reason of PwC's addressing their Report to the Chief General Counsel and BDW in their letter of 2 March to the Chairman noting "that it is appropriate for the Chairman and Chief General Counsel to ensure that the final Report is responsive to the scope of the investigation", it appears that PwC and BDW may have been reporting to the Chief General Counsel as well as to PBRC. Perhaps BDW should have investigated the extent and nature of PwC material which went through the Chief General Counsel's office.</p>	<p>BDW can comment on the facts as they know them but if the Board was unaware that BDW was reporting to the Board, the circumstances suggest that in fact BDW was reporting elsewhere. In the context that could only mean that BDW was reporting to PBRC (or the Chief General Counsel), either of which raises a probity concern.</p>
<p>Page 1, No. 5</p> <p>The Principal Board has not even had a comprehensive written report as to the facts of the losses [up to the Board meeting of 2 March].</p>	<p>The two comments made by BDW are correct. The point of the Issue is that the Principal Board, as a Board, was largely uninformed while PBRC was running the process. PBRC's sole control of the process, to the exclusion of Board members who were not members of PBRC, raises a probity concern. PBRC had the opportunity to tilt the emphasis of the report, to the extent that it criticised the Board and Board committees, away from PBRC and towards PBAC. Add this to other concerns detailed in this memorandum regarding PBRC's control of the process and it all amounts to a failure to satisfy BDW's requirement No. 3 on page 2</p>	<p>There has to be a probity concern here.</p>

	<p>of BDW's Letter of 31 March - for an independent report, namely one not resulting from circulated drafts commented on by those who had commissioned the report and one which has not been influenced to the advantage of the parties who were controlling the process.</p> <p>It is interesting to note that the draft of the PwC report which was submitted to the Board on 9 March stated that PwC "was appointed by the National's Chief Executive Officer and subsequently by the National's Principal Board Risk Committee". The PwC Report, which was issued three days later, replaces the underlined words with "which was ratified by the Principal Board" and then says "PwC provided status updates to National's Principal Board Risk Committee".</p>	
<p>Page 2, No. 1</p> <p>PwC head investigator Craig Hamer is PwC partner responsible for the NAB relationship.</p>	<p>As a matter of principle, is disclosure sufficient? Is the actual disclosure which was made sufficient? See below for some possible issues:-</p> <p>Is the description of "relationship partner" sufficient? Has Mr Hamer's remuneration/earnings/bonus entitlement depended on his maintaining the relationship with National? Does Mr Hamer actually do chargeable work for National, and if so what proportion of his billings does it represent?</p> <p>Did Mr Hamer or any one else in the PwC investigation team do any work on any of the matters described in its disclosure letter of 16 February to National? If they did, then their investigating the matters and having input into the reporting on them raises probity concerns.</p>	<p>The accumulation of matters which require disclosure leads to a very strong presumption that independence was not possible. That is a probity concern.</p>

	<p>Do PwC's prospects of continuing with Phase 2 of the "Super 12", Group-wide risk project (referred to in PwC's disclosure letter to National dated 16 February) depend on Mr Hamer's remaining on good terms with senior officers and directors of National?</p> <p>The question of adequacy of disclosure arises particularly when each disclosure is added to all the other disclosures. When does the accumulation of matters which are/should be disclosed eventually lead to the conclusion that PwC cannot be independent?</p>	
<p>Page 2, No. 2</p> <p>Craig Hamer is, I am informed, in precisely the same position as Tony Harrington [with regard to certain dealings with the National]. Tony Harrington considered himself conflicted and retired from the role of head investigator.</p>	<p>The "issue" to which BDW refer in their comment should have been disclosed, both by BDW and by PwC.</p> <p>PwC partially raise this Issue in their disclosure letter of 16 February, page 2, last two paragraphs. How can it possibly not give rise to a probity concern when (a) one PwC partner apparently considered it to be so serious that he considered himself conflicted, and retired from his role as Head Independence Partner; and (b) an impartial observer on becoming aware of the issue might reasonably conclude that Mr Hamer would find it difficult to give a very critical report if doing so might cause him detriment in his dealings with National or that a favourable report might cause him advantage in his dealings with National.</p> <p>PwC's apparent skirting around the matter in the PwC letter to National is unsatisfactory, but failing to disclose it at all to the shareholders and public in the Disclosure statement at page (iii) of the PwC Report suggests that it may be a real problem, which should not have been dismissed by BDW.</p>	<p>This has to be a probity concern. At least one PwC partner found it so for himself and his position was exactly the same as that of the Head Investigator.</p>

<p>Page 2, No. 3</p> <p>PwC has a "strategic alliance" with Internal Audit.</p>	<p>Is disclosure enough? Was the scope of the actual disclosure sufficient? Should PwC's disclosure have gone on to indicate the number of man years (1,000 man days for 2003), the dollar amount and the fact that, while contractually there is no exclusivity, in practice PwC is the key supplier?</p> <p>This must be considered having regard to the overall influence of PwC (eg heading Internal Audit for each of Technology and Wholesale Financial Services for key parts of 2002 - Mike Bridges and Jim Power) when these two areas were critical to the failings that were nascent at the time - for example, it appears that the PwC Report is inadequate in its treatment of the Technology issue.</p>	<p>This has to be a probity concern.</p>
<p>Page 2, No. 4</p> <p>Jim Power of PwC delivered a key report to PBAC on 6 May 2002 as to AIB FX losses and the reasons why the circumstances of AIB were inapplicable to NAB.</p>	<p>The comment BDW makes indicates that PwC and BDW may have misunderstood PwC's role in reporting on work done by Jim Power - BDW quote without questioning it that PwC didn't give "any opinion in respect of this section of our report". Refer to Deloitte's engagement letter, last paragraph on page 1, where it is clear that PwC were to do all the work, whether or not conflicted, and then Deloitte were to form a view "as to the fairness and completeness of the description and assessment in the PwC Report of work previously performed by PwC and/or their seconded staff for the National".</p> <p>Deloitte made some comments on Mr Power's involvement. The terms of Deloitte's engagement, as to their review role, leave it unclear whether a full investigation was required or whether their</p>	<p>This has to be a probity concern.</p>

role was supplementary, and limited by the "description and assessment in the PwC Report".

Deloitte had limited investigative powers - see "Out of Scope" on page 2 of their engagement letter- and they had to work "via BDW" - see the "Statement of Work" on page 2 - and they were to obtain "all relevant documents which BDW have determined are relevant to be examined" - Note that BDW are lawyers, not investigating accountants.

Further, by PwC's saying (PwC Report, pages 3 and 29) that PBAC by probing management further might have revealed the seriousness of control breakdowns when PwC's own Mr Power had effectively given PBAC no cause for concern, they may appear to be trying to shift responsibility away from themselves in a report which should be impartial.

PWC's treatment of Mr Power's involvement included (a) challenging the accuracy of the minute of the PBAC meeting at which Mr Power presented the AIB report (the reasonable conclusion arising from Mr Power's presentation was that PBAC had no cause for concern) - see comment above on Page 1, No. 1; (b) omitting to deal with Mr Power's report at that meeting (which Deloitte then dealt with) - see the comment above on BDW's page 1, No. 1; (c) omitting to deal with Mr Power's not alerting PBAC to a report involving two significant audit issues, namely continuing limit breaches and inaccurate VAR (which Deloitte then dealt with) - see comment on BDW's Page 13, No. 14; and (d) at the last minute, between 9 March and the issue of the PwC Report, inserting into the report a statement, in respect of PBAC, that probing of management may have revealed the seriousness of some of the control breakdowns.

	<p>A reasonable reader could conclude that this shows evidence of a lack of even handedness possibly motivated by self interest in a situation of conflict of interest, in which case there is a serious probity concern which has not been resolved by disclosure. Further, these treatments are in respect of issues which are known. There may well be other matters in the investigation or the PwC Report where similar treatment driven by self interest may have produced a less than independent report. These are probity concerns.</p>	
<p>Pages 3 to 5, No. 5</p> <p>PwC personnel worked on the Horizon technical system which ran FX options...and also worked on the FX desk in November/December 2003 when losses rose from \$50 million to \$75 million.</p>	<p>Is the disclosure mentioned by BDW sufficient?</p> <p>The PwC Report could have rigorously analysed how the system failures of Horizon were introduced (eg the one hour window and the surrender function) and why they were not detected (other than apparently by the traders). Could any PwC personnel working generally in Information Technology (Mike Bridge) and Internal Audit (Jim Power) or specifically on the Horizon system itself (Adam Ryan) have found them - or have been expected to find them?</p> <p>Interestingly, the PwC disclosure letter of 16 February as to Adam Ryan's secondment in September 2002 provides further insight into this. It indicates that Adam Ryan worked on Horizon including its "usability, architecture, application controls, control environment and maintainability". It also noted that the 2002 Internal Audit report on Wholesale Financial Services (Corporate and Institutional Banking) Information Technology (IT) noted "room for improvement in the areas of security, change and...</p>	<p>How can there not be a probity concern?</p>

	<p>problem management" Presumably this was in respect of part of the period when the PwC partner, Mike Bridge, was seconded (12 January 2001 to 5 February 2002) to head Internal Audit in IT. There is also a reference to PwC's Investigation team being concerned about Adam Ryan's work on "the approval process for two specific changes to the functionality of Horizon". Could anything have been learnt in this process anything learnt which was a common flaw with the surrender functionality?</p> <p>Given the above, how can there not be a probity concern with regard to this Issue?</p>	
<p>Page 5, No. 6</p> <p>John Thorn (a non-executive director of NAB) was, until June 2003, managing partner of PwC.</p>	<p>Is disclosure enough when this Issue is added to everything else?</p> <p>It would be useful to have an assurance from BDW that they had looked at whether Mr Hamer has, while they were colleagues, reported to Mr Thorn in Mr Thorn's roles (described in National's Annual Report for 2003, and Notice of Meeting) as Managing Partner and head of Global Audit and whether they had worked together closely for any length of time before Mr Thorn left PwC. One reason why this would be useful is that PwC seem to be minimising Mr Thorn's role in PwC by referring to him as simply a "former senior partner of PwC" in their Disclosure statement in the PwC Report, and that raises a concern that there may be a reason why they do that.</p>	<p>This may be a probity issue.</p>
<p>Omission. No comment by BDW on the penultimate</p>	<p>BDW fail to make any comment on this matter. BDW deal with the issues of relationship one by one and dismiss each because it</p>	<p>It is the totality of the PwC relationship with National which gives the greatest</p>

<p>paragraph on page 4 of Mrs Walter's letter of 3 March which makes the point that PwC has a "wide ranging role and relationship" with National.</p>	<p>has been disclosed and yet BDW make no comment as to how the totality of it may amount to an enormous conflict problem for PwC with National.</p> <p>As another measure of PwC's independence, the dollar value of PwC's billings to National should have been disclosed and would have assisted the shareholders and public to make an assessment. The changing and finally circumscribed terms of BDW's engagement result in an opinion which seems to require that each National shareholder makes an assessment as to whether they "may reasonably regard [PwC] as being independent for the purposes of providing the [PwC] Report" [BDW's words] and so it seems only reasonable that they should be provided with all relevant information to make that assessment.</p>	<p>concern as to whether PwC can possibly provide an independent report - BDW's failure to comment on it supports an inference that there is no valid contrary view.</p>
<p>Page 5, No. 7</p> <p>The terms of the role of Deloitte are..far from clear.</p>	<p>It is incorrect to suggest by implication that the terms were clear. Further, like those of BDW, the terms appear to have been changing until finally recorded in writing on 10 March. Despite representations on 3 March that further issues should be dealt by Deloitte (eg the PBRC reporting line, Horizon and the FX internal audit of 2003) their task was kept very limited - from the terms of their report it appears that they did not see it as involving much more than the Allied Irish Bank matter, and cursorily dealing with some aspects of Mr Power's responsibilities as Acting Head of Internal Audit for WFS.</p> <p>The Issue was raised on 3 March (in Mrs Walter's letter to the Board). Deloitte's engagement letter is dated 10 March. It is not a valid comment to dismiss the Issue by reference to a document which was created a week after the Issue was raised. As is clear...</p>	

	<p>from the comment on page 2, No. 4 above, the lack of clarity as to the exact roles of PwC and Deloitte appears to have had a serious negative impact on the Report(s). Further, there existed in this case a "danger of the engagement of an expert before the proposal on which he is to comment is properly formulated" - Brooking J in Phosphate Co-operative Co. of Australia Ltd v Shears [1988] 6 ACLC 1046</p>	
<p>Page 5, No. 8</p> <p>The terms of appointment of Blake Dawson Waldron are also not known to the Principal Board.</p>	<p>The Issue was raised on 3 March (in Mrs Walter's letter to the Board). It is not correct to dismiss the issue by reference to provisions of a document which was ultimately produced on a date which could not have been before 9 March - the date of BDW's engagement letter. The Issue was at 3 March and was absolutely correct at that date.</p> <p>It is inappropriate for BDW to use the word "shortly", when it was at least 6 days after the meeting of 3 March when the document was provided - use of "shortly" could be intended to have the reader infer that it was at a later time on 3 March.</p> <p>The changing and finally circumscribed terms of engagement of BDW which were finalised at a very late stage (9 March) is itself a probity concern - in the letter to shareholders of 24 February the Chairman said that BDW as probity advisers would "ensure that a high standard of governance is adhered to in producing an independent report for the Board". The process by which that became advice as to "whether PwC is reasonably likely to be regarded as being independent" should be disclosed. Did BDW find themselves unable to provide assurance that the PwC Report was "an independent report to the Board"?</p>	<p>There have to be probity concerns on these matters.</p>

<p>Page 6, No. 1</p> <p>PwC report to and are overseen by PBRC...PwC report drafts have been reviewed by members...the PwC report drafts may make no or insufficient reference to these circumstances [the circumstances being PBRC's responsibilities from 29 August 2003, its one meeting on 21 November, the presentation at that meeting and the internal memo (before the meeting) describing significant levels of breaches]</p>	<p>The stating of the words of the Issue by BDW in their Table is not correct because the word "may" has been inserted by BDW before "have been", presumably to cast doubt in the reader's mind as to whether drafts of the Report were reviewed by members of PBRC.</p> <p>BDW's first comment consists of two incorrect assertions: first, there was never any decision by the Board to change reporting from PBRC to the Board; and secondly; as the Board had no involvement until 2 March, and therefore PBRC had sole control of the process until then, use of the word "initially" is inappropriate. The period from 16 January to 2 March, in a process which was completed on 12 March, is not the "initial stage" as asserted by BDW - it is the overwhelming majority of the time.</p> <p>As summarised in the Issue in the left column, since "29 August 2003 PBRC...have been responsible for "the identification, assessment and management of the material risks faced by the various business units of the Group"...PBRC met only once between 29 August 2003 and the FX losses being detected....meeting took place on 21 November...at that meeting...there was a PowerPoint presentation which had particular reference to "VaR limit monitoring and excesses".</p> <p>Interestingly, the PwC Report deals very briefly on page 30 with PBRC's first meeting. It mentions but does not detail that "at the time of this meeting there was considerable discussion between the Markets Division and MR&PC about "the extent of limit and VaR breaches, particularly for the currency options desk" but does not...</p>	<p>Dismissing the concern by incorrectly indicating the length of time for which PBRC had control of the matter is not the way to deal with a probity concern. There remains a probity concern here.</p>
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	<p>indicate whether PBRC was made aware, or should have been made aware of that discussion. It makes no mention of (a) whether PBRC took any steps towards reviewing or setting VaR limits; or (b) the existence on that day (before the meeting) of an internal memorandum sent by Australian Market Risk Unit to GM CIB Markets describing significant levels of breaches.</p> <p>For material on a related but separate Issue see item re Page 6, No. 3.</p>	
<p>Omission No comment on penultimate paragraph on page 5 of Mrs Walter's letter of 3 March</p>	<p>BDW have omitted to comment on the proposed "6 hour drafting session" - page 5 of Mrs Walter's letter of 3 March, penultimate paragraph. In the event the session didn't occur, but the fact that it was proposed is evidence that the integrity of the process was doubtful. National has been accused by PwC of having an inappropriate culture (PwC Report pages 31 and 32) - a proposal to have a 6 hour drafting session on a supposedly independent report is evidence of the relevant parties (PwC and PBRC at least) having a culture contrary to what is required to achieve a properly independent report.</p>	<p>The fact that a proposed "6 hour drafting session" did not occur does not eliminate the probity concern which arises from the fact that the relevant persons contemplated that it should occur and that they apparently did not have a problem with that. The Issue raises a significant probity concern having regard to the fact that BDW, who, in Mrs Walter's view, should have known or enquired, have not denied that there were "dramatic differences" between PwC's drafts of the report and the PwC Report - (see also next item)</p>
<p>Page 6, No. 2</p> <p>There have been four drafts of the PwC report, reflecting dramatic differences and changes between drafts...have followed input from PBRC</p>	<p>That there were "dramatic differences" is not denied by BDW.</p> <p>BDW use the fact that they are "not aware" to answer this and the following allegations. This isn't an answer, unless they made all reasonable enquires so that their lack of awareness is a fully</p>	<p>The Issue raises very basic probity concerns, first as to the meagre content of BDW's comment and secondly because of the "dramatic differences" (not denied by BDW) between the draft</p>

<p>members upon the previous drafts.</p>	<p>informed one (as they might be expecting readers to infer), and then they should say that they have done so.</p> <p>Despite a considerable number of clear comments in Mrs Walter's letter which raise significant questions as to the role of PBRC in the PwC report - collectively suggesting that the PwC Report fails to satisfy the criteria to be independent - BDW either fail to comment on the issues or dismiss them.</p> <p>A further concern is that there may have been other even less apparent influences on the successive drafts of the report. The need is not apparent for the actual disclosure by PwC of the content of the report to "the National's Chief General Counsel, a partner and staff at one of the firms acting as the National's external legal advisors" (PwC Report, page (ii)) - if any of those persons had input other than correction of facts it would raise a further probity concern.</p> <p>Did BDW enquire as to whether any of those persons had provided input for the Report and if so what input? _____</p>	<p>reports and the PwC Report.</p>
<p>Page 6, No. 3</p> <p>"Status update" documents have been seen and commented on by members of PBRC and presumably those comments have been acted upon by PwC</p>	<p>This is an incomplete answer - it says what the PBRC members were given an opportunity to do. It makes no comment as to whether they were in addition doing something which they should not have been doing - namely, commenting on and influencing the content of the report. The BDW conclusion doesn't follow from the BDW comment, such as it is.</p> <p>One inference which could be made from the relative length of the sections of the PwC Report dealing with PBAC and PBRC (not less than 7 pages, including internal and external audit and APRA</p>	

	<p>in the context of PBAC, and 7 lines, respectively) when PBRC was responsible for risk while most of the losses were being incurred - a graph in the PwC Report would have shown this - is that the reporting to PBRC for the overwhelming majority of the time in which the investigations were made and the PwC Report was produced may have had a beneficial effect on the outcome for PBRC - this is a probity concern.</p> <p>Further, it is interesting to note that the draft report of 9 March 2004 contemplated in the section on PBRC a sub-section entitled "Group Risk forum" (possibly being a reference to the internal risk management committee which also met on 21 November 2003) but no such section appeared in the PwC Report.</p> <p>Further, BDW did not deal with all the issues raised in the Issue which is identified. Were the "status updates" drafts of the report or sections of it, did they give indications of the outcome of the report, what comments were made - were any apparently designed to influence the report (except as to correction of facts), did those comments eventually cause changes in the report, were any such changes significant? Is there any cause to think that this interaction between PwC and PBRC led to the PwC Report failing to be properly independent? BDW's standard conclusion is not convincing.</p> <p>For material on a related but separate Issue see item re Page 6, No. 1.</p>	
<p>Page 6, No 4</p> <p>Possible offering of future risk assessment work to Gene Ludwig. The Chairman said</p>	<p>It is not the CEO's response which is relevant, as asserted by BDW, but rather the Chairman's. Mrs Walter has said that in a Principal Board meeting the Chairman made the statement</p>	<p>At present there remains a probity concern.</p>

<p>that he had already offered the work to PwC.</p>	<p>indicated in the Issue. The prospect of the new Chairman's offering a lucrative engagement to PwC during the course of their..</p> <p>preparing an "independent" report, must raise a probity concern.</p> <p>Was Mr Hamer the PwC officer with whom the discussion took place? Did he know of the proposed task? If not, what precautions did PwC take to ensure that he did not know of the offer while he was engaged on the investigation and preparation of the Report? These are probity issues. BDW confidently assert that there are no outstanding probity concerns on this issue, but this does not appear convincing.</p>	
<p>Page 6, No. 5, first sub-point</p> <p>PwC compromised the independence of the investigation process in the following respect -- the chief investigator for PwC spoke to the Chairman..the day before the Chairman was...to provide evidence to PwC and APRA</p>	<p>Why were BDW satisfied? Was there a telephone conversation? What was discussed?</p> <p>Was the telephone conversation about the APRA letter of 4 November 2003 (which bore Chris Lewis' annotation "Arrange for distribution to PBRC along with response") in preparation for the Chairman's session with APRA and PwC the next day? If so was the Chairman seeking to find out what PwC would say about the letter? Who initiated the call? What was its purpose? Was it unusual for the Chairman to be speaking with Mr Hamer? There could well be probity issues and concerns among these.</p>	
<p>Page 6, No. 5, second sub-point</p> <p>PwC compromised the independence of the investigation process in the following respect - the room in</p>	<p>This is not an answer. BDW is saying "we are an expert, we are in a position of authority, trust us". They haven't said that the allegation is incorrect. There should have been 24 hour security.</p>	

<p>which the PwC team are preparing the report within NAB's premises is able to be accessed by a large number of people including PBRC members and members of Management whose conduct is the subject of the report</p>		
<p>Page 6, No 5, third sub-point</p> <p>PwC compromised the independence of the investigation process in the following respect - much of the evidence has not been secured, PwC have not sought to limit the flow of relevant material among NAB personnel or certain Board members..</p>	<p>BDW seem to think that the conduct of the investigation is not a matter for them. As they suggest they have oversight on probity issues, they should be extremely concerned at a situation which is likely to affect they integrity of the process and the final report.</p>	
<p>Page 7, No. 5, fourth sub-point</p> <p>Before PwC were appointed there was an initial interview...where 20 executives were present when the four traders were first interrogated. This is likely to have tainted the integrity of the investigation</p>	<p>BDW make no comment on the likely effect on the integrity of the report or the extra efforts which should have been required, or were made (if that is so), once (a) PwC; and (b) BDW were appointed to apparently ensure that integrity.</p> <p>Who was at the meeting? How was it conducted? Was there any exclusion of potential witnesses before other potential witnesses spoke? If so how was it determined who were potential witnesses? Were the proceedings recorded in any way? If so who had access to the record? Surely these are all matters bearing on the integrity</p>	

	of the investigation.	
	Did BDW upon its appointment make any enquiries as to these matters?	
Page 7, No. 5, fifth sub-point PwC compromised the independence of the investigation process in the following respect - PwC have not completed their investigative work...to have prepared drafts is..inconsistent with appropriate investigative process	How can conduct be separate from integrity? What is the distinction? BDW apparently think that there is one. Does BDW understand what shareholders and the public were expecting in terms of integrity of the Report (and the conduct of the process which produced it)? See the National's ASX announcement of 29 January and the Chairman's letter to shareholders dated 24 February. Two members of the PBRC had not yet been interviewed at the stage the Issue was raised (and in fact were not ever interviewed by PwC). Did they participate in update sessions? If so, had it then been determined that they would not be interviewed?. If so, who made that determination and how did they make it?	
Page 7, No. 5, sixth sub-point PwC compromised the independence of the investigation process in the following respect Peter Duncan commented at the Board Meeting on 2 March that the Chairman had had PwC findings presented to him at a number of PBRC meetings before he was interviewed. The	What is BDW's recollection if it is different to what is stated? Is BDW saying that Mrs Walter is incorrect in her recollection of the events at the meeting? If so, in what respects? Mrs Walter has been making detailed notes of these meetings. Would there be a probity issue for BDW if Mrs Walter's notes were the only contemporaneous notes in existence and they were contrary to BDW's recollection?	

Chairman cut him off..		
<p>Page 7, No. 1</p> <p>Chairman circulated a note to directors (21/2/04) ..a reasonable reader would consider that this meant that there was nothing written in existence at that time. As is set out above that is not the case.</p>	<p>Why cannot BDW comment? Do they not know? Has someone told them not to comment? Do they feel constrained for some reason from commenting? How can this not be a probity concern? BDW have to produce more than a mere assertion that "there are no outstanding probity concerns arising from this issue". If BDW's inability to comment is from lack of knowledge how can they make any valid conclusion on this matter?</p>	
<p>Page 7, No. 2</p> <p>Interview 22 February 2004. Michael Pascoe: "You have said the PwC report won't make pretty reading - have you had a peek at its progress". Chairman: We have regular updates on the progress and the status and we're looking forward to seeing the first draft in the next couple of weeks"</p>	<p>Why cannot BDW comment? Do they not know? Has someone told them not to comment? Do they feel constrained for some reason from commenting? How can this not be a probity concern? BDW have to produce more than a mere assertion that "there are no outstanding probity concerns arising from this issue". If their inability to comment is from lack of knowledge how can they make any valid conclusion on this matter?</p> <p>The obvious inference which a listener would make from what the Chairman said was that he/PBRC had not received written reports or drafts of the report, but only oral updates, and that it would be some time until the first draft of the report was submitted.</p> <p>The relevance is apparent if one compares the clear inference which viewers (including shareholders) would reasonably make from these statements, with the Issue which BDW deal with at Page 7, No.4, namely "On Friday 20 February without...any differentiation as to director and non-director matters a "status update document" was provided to PBRC". Also at Page 7, No. 5.</p>	<p>There has to be a probity concern here.</p>

	<p>there is an Issue of a document which was of considerable length - which took "2 hours to read and prepare comments on.", and contained "wording" and "matters which would be included in the final report".</p>	
<p>Page 7, No. 3</p> <p>Chairman told directors on 20 February 2004 that John Stewart was the point of reference for PwC for matters relevant to the directors.</p>	<p>This is an issue about the correctness of what National was telling shareholders and the public about the process which led to the PwC Report. Isn't that a probity issue? At the very least, if the shareholders were being told something which was incorrect, that fact would bear on the reliability of what BDW have been told on other matters? Why didn't BDW investigate it rather than dismissing it?_____</p>	
<p>Page 7, No. 4</p> <p>On Friday 20 February without...any differentiation as to director and non-director matters a "status update document" was provided to PBRC.</p>	<p>BDW's comment doesn't answer the allegation. The actual form of the document - "power point presentation" doesn't deal with what it contained. Why does BDW think that this is a proper answer?</p> <p>Further, if it were only a PowerPoint presentation then it becomes very relevant what was said by PwC and the PBRC members during the presentation. Was there a discussion? Were questions answered by PwC? Did anyone take notes or was the session otherwise recorded? If yes to the last question, the record should be produced.</p> <p>BDW correctly indicate in point No. 3 on page 2 of BDW's Letter which the table accompanies that "The expert's report must not result from successive drafts circulated to and amended following discussion with those commissioning it, except to correct factual</p>	

	<p>errors."</p> <p>It is a serious probity issue whether the PBRC had seen draft reports(s) or heard of their contents, commented on them and influenced the content of the report (other than by correcting factual matters). There cannot be an "independent" report if PBRC had such an involvement.</p>	
<p>Page 7, No. 5</p> <p>On 23 and 24 February PwC provided to each of the members of PBRC copies of a "status update document"...of some length...contained both a PowerPoint presentation and matters which would be included in the final report including "wording"...substantial enough to take 2 hours to read and prepare comments on</p>	<p>There are numerous points in this Issue. BDW's comment seems to be a summary dismissal. There should be a point by point answer by BDW.</p> <p>Further, BDW's comment doesn't make sense - why, when the document was "provided to PBRC"..on Friday 20 February" ,,as reported by the Chairman" (last paragraph on page 8 of Mrs Walter's letter), would the same document be provided again 3 or 4 days later to the same people - "ie each of the members of PBRC" as mentioned in the full version of the Issue. Who are "the other members" BDW refers to when the Issue is referring to "all members"? As the comment doesn't make sense it is hard to see how the conclusion is valid - it appears to be one of a number of automatic responses by BDW to Issues whether they appear to understand them or not.</p> <p>The document has only to be located and produced to eliminate suspicion that it was a comprehensive draft report. So long as the document is not produced, those seeking its production are justified in making the inferences that it was a draft report and therefore the PwC Report is not an "independent" report. Shareholders, regulators and the public have been led to believe that the PwC Report would be independent.</p>	<p>There has to be a probity concern here</p>

	<p>There is a record of PBRC members saying that PwC should "beef up" management/board interface, APRA and three star audit issues. That suggests that the PBRC members knew of the contents of a draft report. If their comments were communicated to PwC the PwC Report could no longer be considered to be "independent".</p>	
<p>Omission - Mrs Walter's letter, page 9, second paragraph which states (among other things) that "I believe that PBRC members have seen the substance of all of the reports and may be seen to have been responsible for major changes in them"</p>	<p>Why have BDW failed to comment on this? It is absolutely basic to the question of whether the PwC Report is an independent report.</p>	<p>Mrs Walter raised a serious probity concern. BDW did not answer.</p>
<p>Page 7, No. 6</p> <p>I believe that the process fails minimum standards of integrity required in such circumstances</p>	<p>BDW should say why it is satisfied. Otherwise it is just making an unsupported assertion, purporting to be from a position of authority.</p> <p>The "extraordinary and detailed processes...engaged in, in dealing with the draft documents which appear unrelated to concerns about leaks" [page 9 of Mrs Walter's memorandum of 3 March, last paragraph] should be explained. If there was a reason other than protection against leaks then the probity issues relating to that reason should be explained. Were the drafts of the report kept on any of National's computers, such as that of the Chief General Counsel (or those of its external lawyers)? If so who had access to them? Are they still available from National or PwC to enable a...</p>	

	comparison of different drafts to ascertain the extent to which the report may have been changed, and when?	
<p>Page 8, No. 7</p> <p>The Chairman...informed me that, he intended to afford me the same opportunity, to see the latest draft and have input in the way that PBRC members had enjoyed.. include me..in an exercise...further compromise the independence of the PwC report. I have not done so.</p>	<p>Why cannot BDW make an enquiry?</p> <p>The shareholders are expecting BDW to assure the probity of the investigation process and report. When an issue of probity arises surely BDW should investigate.</p> <p>In cases where BDW cannot comment because they were not present it is not clear how they can possibly reach a conclusion that there are no outstanding probity concerns arising from the issues - the issues relate to the vitally important point No. 3 on page 2 of their letter of 31 March.</p>	<p>How can BDW come to a conclusion when its comment appears to require the reader to infer that BDW has no knowledge on the matter. Without BDW having knowledge, how authoritative is BDW's conclusion?</p>
<p>Page 8, No. 1, first sub-point</p> <p>At the meeting on 2 March with the Chairman, Elizabeth Johnstone and Anne Dalton of Blake Dawson Waldron - BDW confirmed that PwC had an actual conflict.</p>	<p>It is not sufficient to say that BDW is aware of the issues - do the issues cause them any concern? If not, why not?</p> <p>Did Mr Hamer (or anyone else on the investigation team or the Independence group) do any work on any of the matters described in PwC's disclosure letter of 16 February? Has BDW asked about this? If so, what is the answer? If not, how could BDW as probity advisers not ask such a question?</p>	<p>If BDW is <u>not aware</u> of the issues how can it possibly conclude that "There are no outstanding probity concerns arising from this issue"? It may suggest that BDW's repeated conclusion is in fact an automatic response given without properly considering the matter.</p>
<p>Page 8, No. 1, second sub-point</p> <p>At the meeting on 2 March with the Chairman, Elizabeth</p>	<p>BDW's comment, in Mrs Walter's view, shows a complete lack of understanding of the Issues. The main issue is whether the PBRC</p>	<p>There is a significant probity concern here.</p>

<p>Johnstone and Anne Dalton of Blake Dawson Waldron - It was apparent from what she [Elizabeth Johnstone] said that she had not been informed of the true facts relating to the involvement of PBRC members in reviewing and influencing drafts of the PwC report</p>	<p>members had been reviewing the draft report and influencing its terms. BDW have chosen to deal with the question of who had been interviewed and what update material they had been given before interview. They miss the vitally important question of whether any members of PBRC, either pre- or post-interview, had been given draft reports (or the substance of draft reports) and had influenced the contents. This has to be a probity concern especially when the probity advisers appear not to have understood the issue.</p>	
<p>Page 8, No. 1, third sub-point</p> <p>At the meeting on 2 March with the Chairman, Elizabeth Johnstone and Anne Dalton of Blake Dawson Waldron I expressed surprise, that the remaining directors on PBRC, namely Peter Duncan and Ed Tweddell, had not been interviewed</p>	<p>This Issue was raised on 3 March. The investigation had been in progress since 16 January. PBRC was responsible for risk from 29 August 2003 and almost all the losses arose from unauthorised trades after that date.</p> <p>Why had PwC not interviewed two members of PBRC at a stage when they were producing close-to-final drafts of their report and providing them to the Board? Why did they not interview those PBRC members at all?</p> <p>Further, one of the two PBRC members who were not interviewed had been appointed to both PBRC and PBAC with a view to ensuring that between the two committees all relevant issues would be dealt with and nothing would be overlooked due to a lack of communication, or a misunderstanding as to what the other committee was doing. That director was the only director who could answer questions on a basis of knowledge of the proceedings of both committees and was in a position to give a balanced view as to their respective involvements of each committee in the matters which PwC was investigating and reporting on. Why was he not interviewed?</p>	<p>A number of probity concerns arise here - who decided whether a particular director would or would not be interviewed? When was that decision made? Did any PBRC members get updates while they were still liable to be interviewed? What was the reason for the decision not to interview the one common member of both committees?</p>

Page 8, No. 1, fourth sub-point

At the meeting on 2 March with the Chairman, Elizabeth Johnstone and Anne Dalton of Blake Dawson Waldron - the very proper course suggested to and adopted by me should have been applied to all directors.

This is only half an answer. What were the protocols? Were they just the 3 mentioned on pages 2 and 3 of BDW's Letter of 2 March?

The comment shows a complete lack of understanding of the Issues. The main issue is whether the PBRC members had been reviewing the draft report and influencing its terms. BDW have chosen to deal with the question of who had been interviewed and what update material they had been given before interview. They miss the vitally important question of whether any members of PBRC, either pre- or post-interview, had been given draft reports and had influenced the contents. This has to be a probity concern given the substantial amount of evidence that suggests that such reviews and influencing occurred.

The issue is capable of being determined by appropriate enquiry. There would be some records available to provide further light on these issues - Mr Hamer's time sheets (or diary or other working notes) should record with whom he had telephone calls; telephone records should reveal who made telephone calls to whom (at least for some categories of calls) and these might throw some light on the frequency and extent of consultations between PwC partners and PBRC members, which could be inferred to relate to the contents of the drafts of the report.

If the document (referred to at the comments on Page 7, No. 5 and Page 11, No. 3) which has not been produced, despite numerous requests, were produced and compared with the PwC Report that also might throw some light on whether there was any consultation

	between PwC and PBRC members as to the ultimate contents of the PwC Report?	
<p>Omission - Mrs Walter's letter, page 11, third paragraph with two sub-paragraphs During the discussion [on 2 March with the Chairman, Elizabeth Johnstone and Anne Dalton] I referred to..the conversation the chief investigator had with the Chairman the night before his interview...and the 2 hour session that the Chairman had had in New York working through the draft report and providing input to PwC_____</p>	<p>Depending on what is discussed, preparing a witness before interview can be a probity issue.</p> <p>In the context of a supposedly independent report, a two hour review by a member of the PBRC which commissioned the report and discussing a draft report with the head investigator, raises a probity concern. BDW themselves say "The expert's report must not result from successive drafts circulated to and amended following discussion with those commissioning it, except to correct factual matters."</p> <p>These are probity concerns. Why does BDW not deal with them ?</p>	<p>The failure to deal with a rational allegation leads to an inference that the allegation is correct.</p>
<p>Page 9, No. 2</p> <p>The Chairman said to me [2 March], in the absence of the probity advisers, that all directors were in this together, that we needed to maintain board solidarity..that the report would not find anything against the directors</p>	<p>BDW cannot avoid this significant issue by saying that it is not able to comment - it should have sought information on a matter which clearly involves probity.</p> <p>In cases where BDW cannot comment because they were not present it is not clear how they can possibly reach a conclusion that there are no outstanding probity concerns arising from the issues. The issues concerned relate among other things to the vitally important point No. 3 on page 2 of BDW's Letter of 31 March, namely commentary on circulated drafts.</p>	<p>If BDW are unable to comment, presumably because they doesn't have the required knowledge (as they invite the reader to infer), then how can they come to a definite conclusion?</p>

<p>Page 9, No. 3</p> <p>At 1.30 pm the Chairman and I went into the Board Meeting...BDW spoke to the probity issue..quoted David Krasnostein..important that Deloitte's should not become the little speck on the camera lens that destroys a picture. Blake Dawson Waldron letter dated 2 March..confirms that the full facts recorded here have not been disclosed to them..and had they been disclosed..they would have advised that the involvement of members of PBRC breached the principles they identified as necessary for an independent report."</p>	<p>There are a number of issues, each of which deserves a separate comment. BDW would be seen to be focussing the reader's attention on a minor issue.</p> <p>Serious omission the paragraph commencing "Finally I believe.." on page 11 of Mrs Walter's letter raise two important issues for BDW - whether "the full facts recorded here have not been disclosed to them" and "had the full facts been disclosed to them, they would have advised that the involvement of members of PBRC breached the principles they identified as necessary for an independent report." It is itself a matter of probity if probity advisers are not told all relevant facts.</p> <p>The way Deloitte's involvement was treated by PwC and National ensured that Deloitte did not even become "the little speck on the camera lens". Deloitte's role, investigative powers and access to material were severely limited by their terms of their engagement. Their separate report was not annexed to the PwC Report. PwC did not take up the Deloitte opinions in the PwC Report Notwithstanding Deloitte's comments on Mr Power's involvement (which support the view that Mr Power did not do all that he could to bring relevant matters to PBAC's attention) PwC then introduced into their report after 9 March suggestions that PBAC by probing management further might have revealed the seriousness of control breakdowns.</p>	<p>How can there be a greater probity concern than the probity adviser not having the information it should have? Why do BDW fail to comment on this?</p>
<p>Page 10, No. 1, first sub-point</p> <p>I remind you that the substance</p>	<p>Reference to earlier statements does not add to the authority BDW</p>	

<p>of my memorandum of 3 March was as to -the inability of PwC to act without fear or favour and produce an unbiased and complete report.</p>	<p>seek to support their assertion. Nor does the repetition of such statements. Reference to their opinion of 12 March could be construed as an attempt to "pull themselves up by their own bootstraps". Further, by reference to that opinion BDW is putting in issue whether that opinion is valid, as it was written, according to the references on it, by the same persons as wrote the opinion of 12 March.</p>	
<p>Page 10, No. 1, 2nd sub-point</p> <p>I remind you that the substance of my memorandum of 3 March was as to - the involvement of yourself and other members of the PBRC in framing the PwC report direction, in particular the capacity to direct it away from PBRC and PwC matters.</p>	<p>Reference to earlier statements does not add to the authority BDW seek to support their assertion. Nor does the repetition of such statements. Reference to their opinion of 12 March could be construed as an attempt to "pull themselves up by their own bootstraps". Further, by reference to that opinion BDW is putting in issue whether that opinion is valid, as it was written, according to the references, by the same persons as wrote the opinion of 12 March.</p>	
<p>Page 10, No. 1, third sub-point</p> <p>I remind you that the substance of my memorandum of 3 March was as to - my many concerns as to the integrity of the investigation process._____</p>	<p>What "testing" was done. Is there some recognised formal process of testing which was done?</p>	
<p>Page 10, No. 2</p> <p>..Deloitte's position, given their inability to access highly material documents, as I..</p>	<p>Reference to an earlier statement gives no greater authority. What is the reason for BDW's belief? An unsupported assertion of belief is valueless as a conclusion.</p>	

<p>understand it, they had no access to PwC documents.</p>	<p>Deloitte's engagement terms only became clear at the very last minute - 10 March. This in itself is a probity concern given what was expected to be Deloitte's role on matters which involved probity concerns. The proper test for determining whether the PwC documents were relevant was probably "did [a named PwC officer] work on this matter ?" and "if so, please produce his time sheets". As a commentary on how effective Deloitte was allowed to be, at the Board meeting on 11 March Deloitte was unable to answer the question as to whether PwC's head investigator had worked on any of the matters disclosed by PwC in their letter of 16 February to National as being "Relevant Assignments".</p> <p>If BDW were determining relevance of documents to be provided to Deloitte (as indicated in Deloitte's engagement letter), it would be useful if BDW would disclose their criteria for relevance and whether they had any disagreements with Deloitte as to what documents would be made available.</p> <p>Deloitte's letter of engagement is written to National's Chief General Counsel. The attitude of that officer to Deloitte's involvement is apparently encapsulated in his quoted comment about it being "important that Deloitte should not become the little speck on the camera lens that destroys a picture". BDW, through whom Deloitte had to work (statement of work on page 2 of Deloitte's letter of engagement) also wrote their letter of engagement to the Chief General Counsel. As Deloitte's role was almost entirely to do with issues of probity - the review of PwC's work on matters where PwC had conflicts of interest - it is a serious probity concern if Deloitte were rendered ineffective, or even hampered, in their work by the influence of an officer who expressed a view that they should not become "a little speck...that..</p>	<p>These are all matters which raise probity concerns.</p>
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	destroys a picture". To be meaningful BDW's conclusion would have to show that these matters had been considered objectively.	
<p>Page 11, No. 3</p> <p>The statement on 18 March 2004 that the draft which you saw in New York on 23/24 February 2004 and on which you made detailed comments to PwC cannot be provided to me is one that I cannot accept.</p>	<p>BDW correctly indicate in point No. 3 on page 2 of their Letter of 31 March that "The expert's report must not result from successive drafts circulated to and amended following discussion with those commissioning it, except to correct factual errors."</p> <p>Despite a considerable number of clear comments which raise significant questions as to the role of PBRC in the PwC report - collectively suggesting that the PwC report fails to satisfy the criteria to be independent - BDW either fail to comment on the questions, or dismiss them summarily.</p> <p>It is impossible to understand how BDW cannot comment on, and apparently show no interest in, the failure to produce the draft which the Chairman saw in New York on 23/24 February (and other PBRC members saw simultaneously in London and Australia) and which may (depending on its form and contents) be clear evidence that point No. 3 on page 2 of BDW's Letter of 31 March is not satisfied.</p>	
<p>Page 11, No. 4</p> <p>Nothing said by the probity advisers constitutes a finding that the conduct yourself, PwC and PBRC engaged in was proper. In fact the probity advisers have made no findings</p>	<p>BDW have used words which appear to have been very carefully chosen.</p> <p>BDW's opinion of 12 March does not say what they have set out in this comment. The words in brackets, namely "(including that the Report was not amended following successive drafts by those</p>	

<p>as to probity.</p>	<p>commissioning it)" do not appear in their opinion, as was implied by their use in BDW's comment.</p> <p>The words in BDW's opinion of 12 March are "On the basis of our observations and enquiries and having regard to: (a) the indicia of independence outlined in this opinion; (b) the Disclosure Statement; and (c) the fact that a separate firm has provided an opinion in respect of the conflicted area; we are satisfied that PwC may reasonably be regarded as being independent for the purposes of giving the Report."</p> <p>Further, even if BDW's opinion letter complies with the final terms of their engagement it falls short of what shareholders were promised, as late as 24 February by the Chairman.</p>	
<p>Page 11, No. 5</p> <p>I have previously made it plain, in my letter of 17 March, that I have not [briefed the press on confidential PwC material], whilst reserving my right to make a proper public disclosure if I considered it my duty.</p>	<p>The proper public disclosure has been instrumental in informing the market of the serious probity failings so that it can form its own view when the materials - eg the New York draft and whether any PwC people worked on National matters mentioned in their disclosure letter - are provided.</p>	
<p>Page 11, No. 6</p> <p>"statement in your letter that I declined to be interviewed by PwC is invalid, as you know...I pursued PwC over ten days seeking to provide my evidence..happy to provide you</p>	<p>If there was a delay of some days as asserted by BDW it was not Mrs Walter's fault, as indicated by her words in the left column, which BDW appear to have chosen to ignore.</p> <p>Mrs Walter initially sought an indication of topics with a view to preparing properly - the volume of material dealt with by PBAC</p>	

<p>with my e-mail records...proposal I made..for the taking of my evidence was one approved at the time by the bank's general counsel who subsequently changed his position.. I had not and had not sought a pre-briefing..other National personnel including yourself had been given pre-briefings.</p>	<p>was very substantial. She was also concerned that her answers should be complete and accurate. She identified these needs to PwC in writing.</p>	
<p>Page 11, No. 7</p> <p>Your statement that I sought to be involved in the drafting of the report is invalid.</p>	<p>The issue identified is not a probity issue and appears to have been identified to give BDW an opportunity to give a further repetitious conclusion which is unrelated to the issues.</p> <p>Further, if it occurred prior to BDW's engagement (and therefore presumably they are not concerned with it) how can they give an apparently definitive conclusion?</p> <p>In fact Mrs Walter said that if she had been involved, the process would have been different. As she had experience in similar major inquiries her views on the matter are informed and her participation could have prevented the problems which were created in this matter.</p>	
<p>Page 12, No. 8</p> <p>They [the shareholders] should get a report which fully addresses all matters (even if it</p>	<p>The issue identified is not a probity issue and appears to have been identified to give BDW an opportunity to give a further repetitious conclusion which is unrelated to the issues.</p>	

<p>is not the PwC Report which provides the information). It is the issue of providing a complete report to shareholders which I have pursued against trenchant board opposition in what I saw to be the best interests of shareholders.</p>	<p>Further, if it is outside the scope of BDW's engagement (and therefore presumably they are not concerned with it) how can they give an apparently definitive conclusion?</p> <p>In any case BDW's conclusion doesn't follow from their comment.</p> <p>Finally, BDW appear to show no concern that the shareholders did not get the "independent report" the Chairman's letter to shareholders of 24 February indicated would be produced.</p>	
<p>Page 12, No. 9</p> <p>I have read the PwC Report in full and believe that there are a number of matters which it either does not address or does not address adequately.</p>	<p>Are BDW only concerned with "process" and not the result of an independent report which is complete and accurate ? In this case where there were conflicts of interest for PwC and it was necessary to appoint both Deloitte and BDW surely any omission raises probity issues.</p>	
<p>Page 12, No. 10</p> <p>The Board as a whole was not provided with adequate opportunity, in my opinion, to review or make decisions in a proper, deliberative way as to the PwC report, the PwC report being provided to the Board on 9 and 11 March and released in its final form on 12 March.</p>	<p>The issue identified is not a probity issue and appears to have been identified to give BDW an opportunity to give a further repetitious conclusion which is unrelated to the issues.</p>	

<p>Page 12, No. 11</p> <p>My concerns are intended to be helpful and to raise issues which, whether the analysis be done by the National itself or by a third party, should be considered so the issues I have raised may be resolved in a final fashion.</p>	<p>The issue identified is not a probity issue and appears to have been identified to give BDW an opportunity to give a further repetitious conclusion which is unrelated to the issues.</p> <p>Further, if it is outside the scope of BDW's engagement (and therefore presumably they are not concerned with it) how can they give an apparently definitive conclusion?</p> <p>In any case BDW's conclusion doesn't follow from their comment.</p>	
<p>Page 12, No. 12</p> <p>The PwC Report should have fully addressed the role and responsibility of PBRC...which presided over risk generally at the time when losses ran from under \$10 million to \$175 million.</p>	<p>If PwC's Report "should have fully addressed" the issue of "role and responsibility of PBRC" the omissions, when PwC was responsible to and consulting with PBRC raise probity concerns. BDW cannot dismiss this by saying that it was a matter for PwC in its conduct of the investigation. Because PwC was conflicted its investigation the appointment of BDW was made and BDW should have closely observed both the process of the investigation and its outcome, the Report.</p>	<p>This must be a probity concern</p>
<p>Omission - Mrs Walter's letter of 21 March, page 6, second paragraph. It is a serious omission in my view that the PwC report contains no examination of why the critically important PBRC met only once between its</p>	<p>Given the input of PBRC into the report, is this not a probity issue which BDW could have identified and made comment on?</p>	<p>No explanation has been given, or criticism by PwC as to PBRC meeting only once between its appointment on 29 August 2003 and the discovery of the losses in January 2004.</p>

<p>establishment in August 2003 and the end of that year.</p>		
<p>Page 13. No. 13</p>	<p>It is not correct to say that "Deloitte's terms of engagement required them to consider the actual workings of PwC personnel relative to the Horizon system". The terms say no such thing. BDW appear to be giving their interpretation of what Deloitte's terms of engagement required. Whether Deloitte saw it the same way is not stated. As it impacts on what Deloitte had to do, or actually did, in respect of a serious matter where PwC had a conflict, it must be a probity concern, contrary to BDW's conclusion.</p> <p>Deloitte does not say that they "considered the issue" - that is BDW's interpretation of Deloitte's general words. Further, Deloitte does not say that they "were satisfied that this issue did not fall within a category of an exception" nor did they conclude "that in respect of the Horizon issue nothing has come to our attention..." - these are BDW's interpretations and to suggest that they are Deloitte's words is not correct.</p> <p>BDW do not deny that PwC's report "should have fully addressed the 'role and responsibility of PBRC' - PwC was reporting to and consulting with PBRC which raises the probity issue at point No. 3 on page 2 of BDW's letter of 31 March. BDW cannot then dismiss the issue by saying that it was a matter for PwC in the conduct of its investigation. Because PwC was conflicted, its investigation needed the appointment of BDW who should have closely supervised PwC's investigation and its outcome, the PwC Report.</p>	<p>This must be a probity concern</p>

	<p>There are real questions that still remain unanswered here. For example, the PwC Report refers to the custom built Horizon system being developed by a small software company which had also developed foreign exchange options systems at another Australian bank. Did PwC make enquiries as to whether the flaws in National's system existed in the other bank's option system? Did they make enquiries as to whether the traders had worked at the relevant other bank and thereby knew of the flaws?</p>	
<p>Page 13, No. 14</p> <p>The inability of VaR to measure the smile effect and the limit breaches to which this therefore gave rise, receives five separate comments in the PwC Report... the Deloitte opinion accompanying the PwC Report noted that PwC's Jim Power's responsibilities included following up the outstanding Internal Audit issues (relating to continuing limit breaches and incorrect VaR numbers as no volatility smile was being used)..This does not seem to have been considered in the PwC Report.</p>	<p>BDW claim that the omission by PwC was in order because Deloitte were to provide an opinion in respect of this aspect. Refer to Deloitte's engagement letter, last paragraph on page 1, where it is clear that PwC were to do all the work, whether or not conflicted, and then Deloitte were to form a view "as to the fairness and completeness of the description and assessment in the PwC Report of work previously performed by PwC and/or their seconded staff for the National".</p> <p>Further, Deloitte had limited investigative powers - see "Out of Scope" on page 2 of their engagement letter- and they had to work "via BDW" - see the "Statement of Work" on page 2 - and they were to obtain "all relevant documents which BDW have determined are relevant to be examined" - BDW are lawyers, not investigating accountants.</p>	<p>BDW appear to show that they haven't fully understood the roles of PwC and Deloitte on an important issue (and maybe this applies to other issues as well). Again, there has to be a probity concern here.</p>
<p>Page 14, No. 15</p> <p>PwC found that there was a</p>	<p>It is difficult to understand BDW's lack of involvement or interest</p>	<p>PwC's failure to raise a relevant matter</p>

<p>"clear design flaw" in the risk model as risk could not mandate that limit breaches were to be rectified by the business ...Interestingly the very extract of the graduated structure (as precisely quoted) and which PwC criticised was contained in the PowerPoint presentation made to PBRC at its 21/11/03 meeting. Were there any comments made at the meeting on its efficacy? Why did PwC not analyse PBRC's role in what occurred?</p>	<p>in how PwC did their work on this issue, even when the allegations raise questions which must bear on the probity of the PwC Report.</p>	<p>which relates to the body which was supervising PwC on the investigation and report (ie PBRC) raises a probity concern. The relevant facts are that evidence of the flaw in the risk model was contained in the PowerPoint presentation made to PBRC on 21 November 2003. That flaw was arguably a contributing factor to the losses. BDW confidently assert that there are no probity concerns arising from this, but their assertion is not convincing.</p>
<p>Page 14. No. 16</p> <p>If the parallels with the Allied Irish Bank had been brought out by PwC's Jim Power who presented the PowerPoint presentation to PBAC and who, as Deloitte notes, had responsibility for following up two 3 star reports on limit breaches and VaR difficulties (which were not known to PBAC) could it have been that in May 2002 the issues which were later to enable the forex..</p>	<p>BDW claim in their comment at Page 13, No. 14 that the omission by PwC was in order because Deloitte were to provide an opinion in respect of this aspect. Refer to Deloitte's engagement letter, last paragraph page 1, where it is clear that PwC were to do all the work, whether or not conflicted, and then Deloitte were to form a view "as to the fairness and completeness of the description and assessment in the PwC Report of work previously performed by PwC and/or their seconded staff for the National".</p> <p>A reference to the Disclosure statement doesn't assist.</p>	<p>BDW show that they haven't fully understood the roles of PwC and Deloitte on an important issue (and maybe this applies to other issues as well).</p>

<p>losses to occur could have been addressed? The PwC report does not explore this.</p>		
<p>Page 14, No. 17</p> <p>APRA's letter of 4 November 2003 is referred to in the PwC report as not having been distributed to the Chairman or PBAC. No mention is made of whether it was received by PBRC. No mention is made of Chris Lewis' endorsement on that letter "Arrange for Distribution to PBRC along with response", nor is there any reference to the Bank's response of 12 December 2003 notwithstanding that this response makes specific references to PBRC's "warm interest" in items contained in the earlier APRA letter. This striking omission reflects adversely on the report.</p>	<p>It is difficult to understand BDW's lack of involvement or interest in how PwC did their work on this issue, even when the allegations raise questions which must bear on the probity of the PwC report.</p> <p>Why if PwC haven't been influenced by PBRC in production of the Report do PwC (i) leave out PBRC when they say "A copy was not sent to the Chairman and has not been passed to PBAC." – after all PBRC had been responsible for risk since 29 August; (ii) make no reference to Chris Lewis' endorsement on the APRA letter of 4 November 2003 - "Arrange for distribution to PBRC along with response"; and (iii) make no reference to the letter of response by National to APRA dated 12 December 2003 which makes specific reference to PBRC's "warm interest" in items contained in APRA's letter, notwithstanding that PwC do quote other parts of this letter.</p> <p>There has to be a serious probity concern in this.</p>	<p>There has to be a serious probity concern in this.</p>
<p>Page 14, No. 18</p> <p>Internal Audit is described as reporting only to PBAC...It Is not described as reporting to..</p>	<p>This is only a partial answer by BDW. Mrs Walter proffered the document on more than one occasion - see paragraph 7 on page 7 of her letter of 21 March - and yet BDW purport to dismiss the</p>	

<p>PBRC although the Tripartite Agreement chart and Risk Committee's chart(proffered by me on more than one occasion) indicated it did report to PBRC</p>	<p>issue by reference to only one of those occasions. Copies of the two charts showing Internal Audit's reporting to PBRC are annexed</p>	
<p>Page 15, No. 1</p> <p>The scope of the PwC report; the process by which it was undertaken; the process by which the published report was finalised; and questions as to which individuals had input to that final report at which stage..need to be analysed fully to ensure problems do not arise in future.</p>	<p>As may be seen from the earlier comments in this memorandum, this Issue has not been addressed properly by BDW.</p>	<p>This matter has to be a probity concern.</p>

1.1 RISK COMMITTEE STRUCTURE

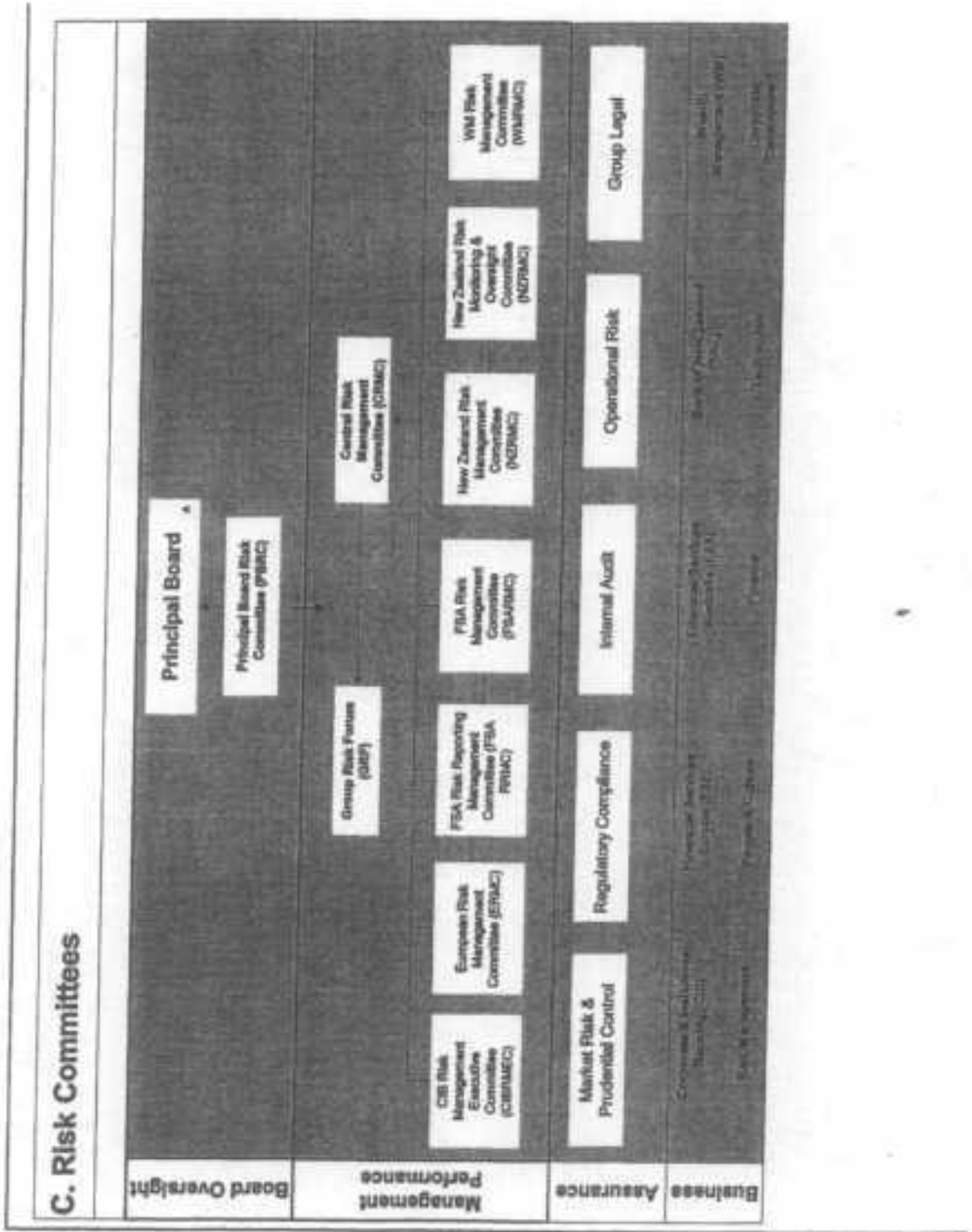
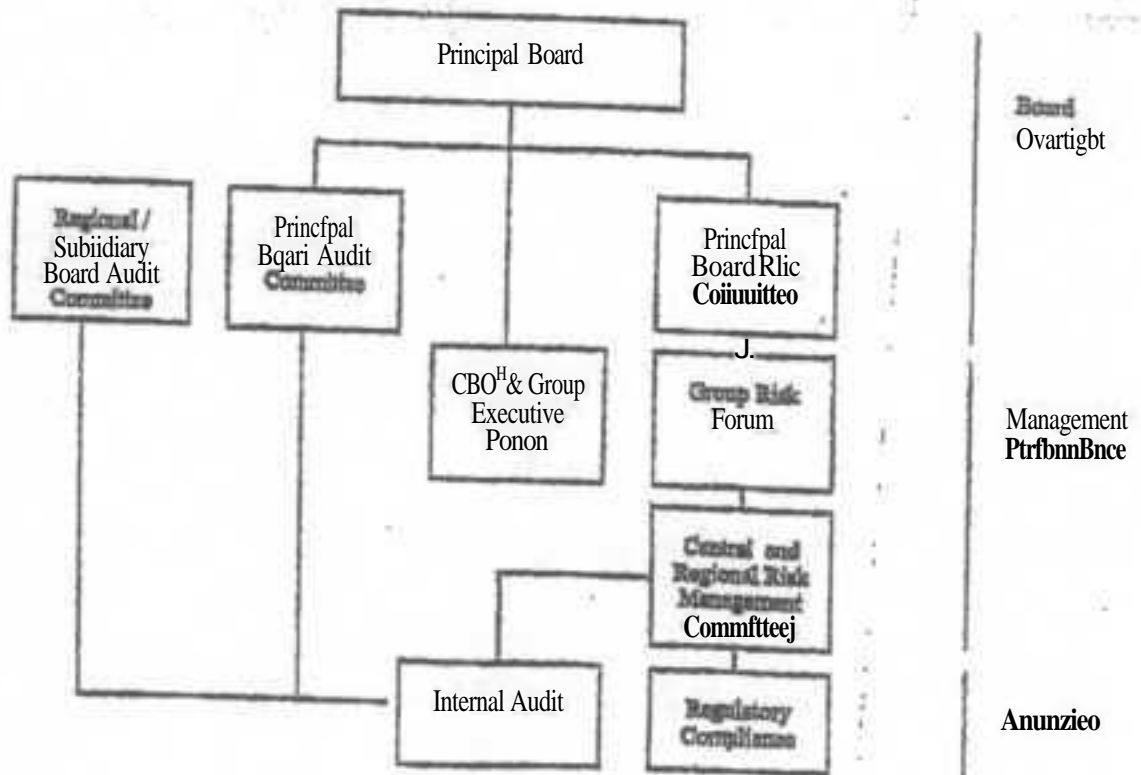


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*National Australia Bank Limited
Adequacy and Effectiveness of Compliance Functions
KPMG Assurance and Advisory
October 2003*



MEDIA STATEMENT

28 APRIL 2004

CONTRADICTIONS AS TO PWC REPORTS SHOULD BE EXPLAINED

Statement by Catherine Walter, National Australia Bank Ltd Director

I believe that apparently contradictory statements about the missing February 23 PwC draft report, and other reports, have raised further doubts about the effectiveness of investigations into the National forex losses and the withholding of information.

The apparent contradictions are contained in material and reported comments by the National, PwC and BDW and should be clarified before the May 21 EGMs so that shareholders are fully informed.

I believe the National simply cannot improve its business performance until it fully analyses what went wrong with the forex losses; makes appropriate leadership, cultural and systems changes to ensure similar problems don't arise again; and, fully and frankly commits itself to openness and transparency.

To put this in context, I have attached my statement of yesterday.

The apparently contradictory statements are as follows:

1. **Were there two documents of 20 February 2004 and 23 February 2004 as PwC are saying or only one of 20 February 2004 as the chairman and PwC are reported as having said to BDW?**
 - (a) BDW in its chart of 31 March 2004 (page 7) say in respect of the 23/24 February document considered by the Principal Board Risk Committee (TRBC¹) members:
"BDW was told by the Chairman and PwC that the document provided was the 'status update document'¹ as previously provided to other members on 20 February 2004'.
 - (b) PwC Communications Director John Noble is referred to in today's press (*The Australian*) as saying that the "the February 20 report was only a briefing in the form of a verbal update and Powerpoint presentation'. He said the February 23 draft was a working document. PwC have also said in a note of 13 April 2004 that there is a specific report dated 23 February 2004 that has been discussed with the Principal Board Risk Committee.
2. **Were BDW fully aware of the circumstances in which PBRC members reviewed the 23 February report as PwC appear to suggest or were BDW uninformed as appears to be the case from the BDW material?**
 - (a) BDWs position appears to be as follows:
 - (i) BDW have not themselves considered the 23 February 2004 PwC report or the review by the PBRC of that specific report because they appear quite unaware of that report (see 1(a) above);

(ii) BDW state in its chart of 31 March (page 6) that:

¹ BDW is not aware that any PwC draft reports were circulated to PBRC members. BDW was present at the Board meeting on 9 March 2004 when PwC presented to the Board the first draft of its final report BDW observed that 'status update documents' were 'spoken to or provided by PwC to PBRC (and Board) members in controlled circumstances prior to 9 March 2004.'

(b) PwC Communications Director John Noble in today's press (*The Australian*) is quoted as saying the February 23 draft was delivered under 'controlled conditions' as determined by probity lawyer BDW Mr Noble is also reported as saying that the document being sought by Mrs Walter was 'a working document and inconclusive. We [PwC] would never have the documents released halfway through the investigation¹. PwC are also reported in *The Age* today as apparently regarding the 23 February 2004 report as a working document which was 'inconclusive and did not contain final findings'.

On its face it would seem that BDW were unaware of the 23 February document. As a consequence, the 23 February document and its review by PBRC members could not have been 'observed' or considered by BDW as BDW were not present. The PBRC members considered the 23 February report in New York, London and Australia, BDW apparently relied upon what they were told by the Chairman and PwC. BDW appear to be of the view that no drafts (even "working drafts") of the PwC report were provided to PBRC members until 9 March 2003.

This appears to be at variance with PwC's position as reported in today's press.

3. As a matter of practice has PwC released to the National working drafts of the PwC report?

- (a) PwC is reported on ABC radio yesterday evening as saying it is standard risk management not to leave 'inconclusive investigative reports with clients.'
- (b) PwC in fact provided a draft report of 9 March 2004 to the National's Board which was incorporated in the corporate records of the National even though there was at least one more draft of the report prior to the final report of 12 March 2004 and even though there were significant changes to the PwC report between 9 March and 12 March.

For clarification please refer to attached pages 6 and 7 from BDW's 31 March 2004 chart.

Mrs Walter's letter of 3 March 2004

"Independence Compromised"

Issue	Comment	Probity Position
1. "PwC report to and are overseen by PBRC which is responsible for the framing and monitoring of their process... PwC Report drafts... may have been reviewed by members of PBRC... the PwC report drafts may make no or insufficient reference to these circumstances..."	BDW observed that after the initial stage of the PwC investigation, PwC reported to the Board, not PBRC. In relation to how the PwC Report referred to a <i>circumstance</i> , that was a matter within the conduct of the investigation, and was a matter for PwC.	There are no outstanding probity concerns arising from this issue.
2. "There have been four drafts of the PwC Report, reflecting dramatic differences and changes between drafts... have followed input from PBRC members upon the previous drafts."	BDW is not aware that any PwC draft Reports were circulated to PBRC members. BDW was present at the Board meeting on 9 March 2004 when PwC presented to the Board the first draft of its final Report. BDW observed that "Status update documents" were "spoken to" or provided by PwC to PBRC (and Board) members in controlled circumstances prior to 9 March 2004.	There are no outstanding probity concerns arising from this issue.
3. "Status update document were seen and commented on by members of PBRC..."	See note above. In those status update sessions PBRC (and Board) members were given the opportunity to seek clarification on issues covered in the status update.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.
4. "Offering of 'future risk assessment work' to PwC and G. Ludwig."	The CEO gave an explanation in relation to this issue in the Board meeting of 4 March 2004.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.
5. "PwC compromise of the independence of the investigation process by:		
<ul style="list-style-type: none"> • "the chief investigator for PwC spoke to the Chairman... the day before the Chairman was ... to provide evidence to PwC and APRA..." 	BDW questioned relevant persons and was satisfied that there were no probity issues arising.	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> • The room PwC occupies at the NAB premises is able to accessed by persons including PBRC and management." 	BDW was satisfied that the security arrangements were appropriate.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> • "Evidence is not secured..." 	BDW was satisfied this issue went to the forensic conduct of the investigation and was therefore a matter for PwC.	There are no outstanding probity concerns arising from this issue.

Mrs Walter's letter of 3 March 2004

Issue	Comment	Probity Position
<ul style="list-style-type: none"> "initial interview of twenty persons." 	BDW was satisfied this occurred prior to the appointment of PwC.	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> "... PwC have not completed investigation... draft Report... inconsistent with appropriate investigative processes." 	BDW was satisfied this issue went to the forensic conduct not integrity of the investigation. This was a matter for PwC.	There are no outstanding probity concerns arising from this issue.
<ul style="list-style-type: none"> "Peter Duncan commented at the Board meeting on 2 March..." 	BDW was present when these comments were made. This statement does not accord with BDW's recollection of those events.	This is a factual matter which BDW can comment on. There are no outstanding probity concerns arising from this issue.

"Since 20 February 2004"

Issue	Comment	Probity Position
1. "Chairman circulated note to directors on 21 February 2004... a reasonable reader would consider that this meant that there was nothing written in existence at that time..."	BDW cannot comment on this.	There are no outstanding probity concerns arising from this issue.
2. "... Michael Pascoe interview 22 February 2004..."	Please see comment on Issue 1 above.	There are no outstanding probity concerns arising from this issue
3. "Chairman's comment to Board on 20 February 2004 re John Stewart being "point of reference for PwC format as relevant to the directors... (APR on 20 February 2004)."	This matter related to a press report.	This is a factual matter which the Board has addressed and which BDW cannot comment on. There are no outstanding probity concerns arising from this issue.
4. "On 20 February 2004... a status update document was provided to PBRC."	BDW observed the circumstances to be that the "status updates" were given to the PBRC and BDW called for these documents. They were a Powerpoint presentation pack..	There are no outstanding probity concerns arising from this issue.
5. "23 and 24 February 2004 provision of 'status update document' to PBRC... and comments to PwC."	BDW was told by the Chairman and PwC that the document provided was the "status update document" as previously provided to other members on 20 February 2004.	There are no outstanding probity concerns arising from this issue.
6. "I believe the process fails minimum standards of	BDW was satisfied that the process had integrity.	There are no outstanding probity concerns arising from

MEDIA STATEMENT

27 April 2004

PwC DOCUMENT WITHHELD FROM DIRECTOR

Statement by Catherine Walter, National Australia Bank Ltd Director

Summary

In the course of preparation of a statement for shareholders for the EGMs on 21 May I have sought from National a copy of the draft PwC report (status update document) which was considered by the Principal Board Risk Committee ("PBRC") members on 23/24 February. Its relevance is the light it may throw on the extent and nature of changes to the report, which in turn is a factor indicating whether the final report is "independent" as shareholders were led to believe.

The National apparently did not keep a copy in its PBRC records and PwC are not willing to make a copy available to their client, the National. If the final report is truly independent, production of this draft can only assist in indicating that. Otherwise I am, and subsequently shareholders will be, left to draw inferences about the fact that it has been withheld.

Background/Detail

In view of the withholding of the draft PwC report I believe, in the interests of the shareholders' right to be informed, that it is appropriate to disclose the circumstances around this issue.

The Chairman was given a draft report (status update document) by PwC in New York on 23 February 2004; the CEO, Mr John Stewart was given a copy of the report in London by PwC; and, two PBRC members, Dr Ed Tweddell and Mr Peter Duncan were given a copy of the report in Australia.

BDW in their advice of 31 March 2004 say that they were "told by the Chairman and PwC" that "the document provided was the 'status update document' as previously provided.. on 20 February 2004" even though this was a document already seen by all of those same persons as members of the PBRC at the PBRC meeting of 20 February 2004. It is hard to understand why PwC would have the Chairman visit its New York office to see a document he had apparently already seen.

PwC have now confirmed, in correspondence with the Bank, that there is in fact a report dated 23 February 2004.

Indeed, as the Chairman had informed me that the report took two hours to read (and prepare comments on) and that he made specific comments about the report for consideration by PwC head investigator (Mr Craig Hamer), I had formed the impression that this was a substantial document. I was concerned to identify any ways in which it was different, if at all, from earlier and later documents.

The production of this report of 23 February 2004, and a comparison of it with the PwC draft report of 9 March 2004 and the final PwC report of 12 March 2004 (and with other relevant PwC drafts after 23 February 2004), should enable this to be verified or dispelled.

So as to be able to verify or dispel whether there were differences I requested a copy of the draft report from the Company Secretary, Mr Garry Nolan. He replied that it was not part of the corporate record and that he would ask PwC for a copy. He did so on April 8 2004. On April 13 PwC acknowledged, through its Senior Legal Counsel, Mr David McGlinchey, that the report had been discussed with the PRBC. However, he said: "...in accordance with our risk management procedures we do not provide copies of such working papers to clients."

Subsequently clarification was sought by Mr Nolan from the National's Chief General Counsel, Mr David Krasnostein, on the report sent to the Chairman in New York. Mr Krasnostein has indicated he "was not provided with a copy of any progress report by PwC that he was permitted to retain, other than the 9 March Draft Report...". The National has been placed in a position where it does not have available to it and to the directors important documents which have been presented to and form the basis of PBRC meetings and discussions with external consultants on an important matter.

This failure to provide a copy is unacceptable when shareholders are to be asked to make informed judgments on issues at EGMs and the document is relevant to determining an important issue. In my view there is no legal or customary basis for the PwC position, nor for the National's inability to make available to other Directors documents which have been presented to the PBRC Committee.

The only appropriate course of action now is for the National's board to take all steps to make available both the February 23 draft report and all other drafts, documents and materials.

While I have been very reluctant to make this issue public, given the forthcoming EGMs and the relevance of the draft report(s) to what shareholders have been told, I believe the market's and shareholders' rights to be informed over-rides other concerns.

Most importantly, whatever the contents of the draft report(s), the handling of this issue in my view is yet further evidence of the need for far-reaching renewal and restructure of the National's board.