

HEARTLAND — BANK —

Disclosure Statement

For the year ended 30 June 2017

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GENERAL INFORMATION

This Disclosure Statement has been issued by Heartland Bank Limited (the bank) and its subsidiaries (the banking group) for the year ended 30 June 2017 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the Order). The financial statements of the bank for the year ended 30 June 2017 form part of, and should be read in conjunction with, this Disclosure Statement.

Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

Name and address for service

The name of the Registered Bank is Heartland Bank Limited.

The bank's address for service is Level 3, Heartland House, 35 Teed Street, Newmarket, Auckland.

Details of incorporation

The bank was incorporated under the Companies Act 1993 on 30 September 2010.

Interests in 5% or more of voting securities of the bank

Name	Percentage held
Harrogate Trustee Limited	9.72%

No person has the ability to directly or indirectly appoint 25% or more of the Board of Directors (the Board) (or other persons exercising powers of management) of the bank.

PRIORITY OF CREDITORS' CLAIMS

In the event of the bank becoming insolvent or ceasing business, certain claims set out in legislation are paid in priority to others. These claims include secured creditors, taxes, certain payments to employees and any liquidator's costs. After payment of those creditors, the claims of all other creditors are unsecured and would rank equally, with the exception of holders of subordinated bonds and notes which rank below all other claims.

The loans sold to Heartland ABCP Trust 1 (ABCP Trust) are set aside for the benefit of investors in ABCP Trust. Loans held as receivables within Seniors Warehouse Trust (SW Trust) and ASF Settlement Trust (ASF Trust) are also set aside for the benefit of funders in these Trusts. See Note 24 - Structured entities for further details.

GUARANTEE ARRANGEMENTS

As at the date this Disclosure Statement was signed, no material obligations of the bank were guaranteed.

DIRECTORS

All Directors of the bank reside in New Zealand with the exception of Ellen Comerford who resides in Australia. Communications to the Directors can be sent to Heartland Bank Limited, 35 Teed Street, Newmarket, Auckland. The Directors of the bank and their details at the time this Disclosure Statement was signed were:

Name: Geoffrey Thomas Ricketts CNZM **Qualifications:** LLB (Hons), LLD (*honoris causa*), CF Inst D
Chairman - Board of Directors **Occupation:** Company Director

Type of director: Independent Non-Executive Director

External Directorships:

Asteron Life Limited, Highground Trust Limited, Janmac Capital Limited, Maisemore Enterprises Limited, MCF 1 Limited, MCF 2 Nexus Limited, MCF 3 Limited, MCF 5 Limited, MCF 6 Limited, MCF 7 Limited, MCF 8 Limited, MCF 9 Limited, MCF 10 Limited, MCF2 (Fund 1) Limited, MCF2A General Partner Limited, MCF2 GP Limited, Mercury Capital No.1 Fund Limited, Mercury Capital No. 1 Trustee Limited, Mercury Pharmacy Holdings Limited, Mercury Medical Holdings Limited, New Zealand Catholic Education Office Limited, NZCEO Finance Limited, O & E Group Services Limited, Oceania and Eastern Australia Pty Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, Oceania Capital Limited, Oceania Securities Limited, Quartet Equities Limited, Suncorp Group Holdings (NZ) Limited, Suncorp New Zealand Limited, Suncorp Group Services NZ Limited, The Centre for Independent Studies Limited, The Todd Corporation Limited, Todd Management Services Limited, Todd Offshore Limited, Vero Insurance New Zealand Limited, Vero Liability Insurance Limited.

Name: Ellen Frances Comerford **Qualifications:** BEc
Type of director: Independent Non-Executive Director **Occupation:** Company Director

External Directorships:

Cash Converters International Limited, Comerford Gohl Holdings Pty Limited, Hollard Holdings Australia Pty Limited, The Hollard Insurance Company Pty Limited.

Name: Edward John Harvey **Qualifications:** BCom, CA
Type of director: Independent Non-Executive Director **Occupation:** Company Director

External Directorships:

Ballance Agri-Nutrients Limited, Chalmers Properties Limited, Fiordland Pilot Services Limited, Investore Property Limited, Kathmandu Holdings Limited, New Zealand Opera Limited, Pomare Investments Limited, Port Otago Limited, South Freight Limited, Stride Holdings Limited, Stride Investment Management Limited, Stride Property Limited, Te Rapa Gateway Limited.

Name: Bruce Robertson Irvine **Qualifications:** BCom, LLB, FCA, CF Inst D, FNZIM
Type of director: Independent Non-Executive Director **Occupation:** Company Director

External Directorships:

Air Rarotonga Limited, Amaia Luxury Spa Limited, Avon Pacific Holdings Limited, B R Irvine Limited, Blackbyre Horticulture Limited, Bowdens Mart Limited, Bray Frampton Limited, Britten Motorcycle Company Limited, Canterbury Spinners Limited, Chambers @151 Limited, Clipper Investments (2002) Limited, Cockerill and Campbell (2007) Limited, Embassy Hotels Limited, Godfrey Hirst NZ Limited, Godfrey Hirst Australia Pty Limited, GZ Capital Limited, GZ NZ Limited, GZ RES Limited, Hansons Lane International Holdings Limited, House of Travel ESP Trustee Limited, House of Travel Holdings Limited, Janes Adventures Limited, Lake Angelus Holdings Limited, Lamanna Bananas (NZ) Limited, Lamanna Premier Pty Limited, Lamanna Limited, Limeloader Irrigation Limited, Market Fresh Wholesale Limited, Market Gardeners Limited, Market Gardeners Orders (Christchurch) Limited, Market Gardeners Orders Wellington Limited, MG Group Holdings Limited, MG Marketing Limited, MG New Zealand Limited, Monarch Hotels Limited, Noblesse Oblige Limited, PGG Wrightson Limited, Phimai Holdings Limited, Quitachi Limited, Rakon ESOP Trustee Limited, Rakon Limited, Rakon PPS Trustee Limited, Scenic Circle Group Limited, Scenic Circle Hotels Limited, Scenic Hotels (International) Limited, Scenic Circle MLC Cafe & Bar Limited, Skope Industries Limited, Southland Produce Markets Limited, Wavell Resources Limited.

Name: Graham Russell Kennedy MNZM J.P. **Qualifications:** BCom, FCA, ACIS, ACIM, CF Inst D
Type of director: Independent Non-Executive Director **Occupation:** Company Director

External Directorships:

Ashburton Aquatic Park Limited, Ashburton Central Limited, Avon Properties (2008) Limited, BK&P Trustees Limited, BK Riversdale Trustees Limited, Black Gnat Properties Limited, Black Quill Investments Limited, Bradford Group Holdings Limited, Cates Grain & Seed Limited, Concurrent Properties Limited, Crescent Custodians Limited, E & S Tekapo Limited, Earth & Sky GP Limited, Eastfield Investments Limited, Hornby Consortium Limited, Lake Extension Trust Limited, Norman Spencer Nominees Limited, NZ Express Transport (2006) Limited, Rural Transport Limited, Timaru Central Limited, Trevor Wilson Charities Limited, Trevor Wilson Charities (No. 2) Limited, Wilson Bulk Transport Limited.

Name: Sir Christopher Robert Mace KNZM **Qualifications:** CM Inst D
Type of director: Independent Non-Executive Director **Occupation:** Company Director

External Directorships:

Akitu Equities Limited, Akitu Capital Limited, Akitu Health Services Limited, Akitu Investments Limited, Goldburn Resources Limited, Helicopter Enterprises Limited, Janik Equities Limited, Janmac Capital Limited, J N S Capital Limited, Mace Capital Limited, Mace Construction Limited, Mace Developments Limited, Mace Enterprises Limited, Mace Investments Limited, Maisemore Enterprises Limited, National Institute of Water and Atmospheric Research Limited, Niwa Vessel Management Limited, Nuffield Forestry Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, Oceania Capital Limited, O & E Group Services Limited, Paroa Bay Station Limited, PPT Trustee (NZ) Limited, Quartet Equities Limited, Ryburn Lagoon Trust Limited, St. Just Enterprises Limited, The New Zealand Initiative Limited.

DIRECTORS (CONTINUED)

Name: Vanessa Cynthia May Stoddart

Qualifications: BCom/LLB (Hons), PG Dip in Prof Ethics

Type of director: Independent Non-Executive Director

Occupation: Company Director

External Directorships:

Alliance Group Limited, New Zealand Global Women Limited, The New Zealand Refinery Company Limited, The Warehouse Group Limited.

Name: Gregory Raymond Tomlinson

Qualifications: AME

Type of director: Non-Independent Non-Executive Director

Occupation: Company Director

External Directorships:

Argenta Limited, Chippies Vineyard Limited, Forte Health Group Limited, Forte Health Limited, Impact Capital Management Limited, Impact Capital Limited, Indevin Group Limited, Little Ngakuta Trust Company Limited, Lokoya Limited, Mountbatten Trustee Limited, Nearco Stud Limited, Ngakuta Trust Company Limited, Oceania Healthcare Holdings Limited, Pelorus Finance Limited, St Leonards Limited, The Icehouse Limited.

Name: Jeffrey Kenneth Greenslade

Qualifications: LLB

Type of director: Non-Independent Executive Director

Occupation: Chief Executive Officer of the bank

External Directorships:

Brew Greenslade & Company Limited.

Conflicts of interest policy

All Directors are required to disclose to the Board any actual or potential conflict of interest which may exist or is thought to exist upon appointment and are required to keep these disclosures up to date. The details of each disclosure made by a Director to the Board must be entered in the Interests Register.

Directors are required to take any necessary and reasonable measures to try to resolve the conflict and comply with the Companies Act 1993 on disclosing interests and restrictions on voting. Any Director with a material personal, professional or business interest in a matter being considered by the Board must declare their interest and, unless the Board resolves otherwise, may not be present during the boardroom discussions or vote on the relevant matter.

Interested transactions

There have been no transactions between the bank or any member of the banking group and any Director or immediate relative or close business associate of any Director which either has been entered into on terms other than those which would in the ordinary course of business of the bank or any member of the banking group be given to any other person of like circumstances or means, or could be reasonably likely to influence materially the exercise of the Directors' duties.

Audit committee composition

Members of the bank's Audit Committee as at the date of this Disclosure Statement are as follows:

Bruce Robertson Irvine (Chairperson)	Independent Non-Executive Director
Edward John Harvey	Independent Non-Executive Director
Graham Russell Kennedy	Independent Non-Executive Director
Geoffrey Thomas Ricketts	Independent Non-Executive Director

AUDITOR

KPMG

KPMG Centre

18 Viaduct Harbour Avenue

Auckland

CONDITIONS OF REGISTRATION

These conditions apply on and after 1 October 2016.

The registration of Heartland Bank Limited ("the bank") as a registered bank is subject to the following conditions:

1. That—

- (a) the Total capital ratio of the banking group is not less than 8%;
- (b) the Tier 1 capital ratio of the banking group is not less than 6%;
- (c) the Common Equity Tier 1 capital ratio of the banking group is not less than 4.5%;
- (d) the Total capital of the banking group is not less than \$30 million; and
- (e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and
- (f) the bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document "Application requirements for capital recognition or repayment and notification requirements in respect of capital" (BS16) dated November 2015 in respect of regulatory capital instruments.

For the purposes of this condition of registration, -

the Total capital ratio, the Tier 1 capital ratio, the Common Equity Tier 1 capital ratio and Total capital must be calculated in accordance with the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8(2)(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

a Tier 2 capital instrument is an instrument that meets the requirements of subsection 9(2)(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

1A. That—

- (a) the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in the document "Guidelines on a bank's internal capital adequacy assessment process ('ICAAP')" (BS12) dated December 2007;
- (b) under its ICAAP the bank identifies and measures its "other material risks" defined as all material risks of the banking group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015; and
- (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

1B. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:

- (a) according to the following table, limit the aggregate distributions of the bank's earnings to the percentage limit to distributions that corresponds to the banking groups buffer ratio:

Banking group's buffer ratio	Percentage limit to distributions of the banks' earnings
0% - 0.625%	0%
>0.625% - 1.25%	20%
>1.25% - 1.875%	40%
>1.875% - 2.5%	60%

- (b) prepare a capital plan to restore the banking group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and
- (c) have the capital plan approved by the Reserve Bank.

For the purposes of this condition of registration, -

"buffer ratio", "distributions", and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

2. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

In this condition of registration, the meaning of "material" is based on generally accepted accounting practice.

CONDITIONS OF REGISTRATION (CONTINUED)

3. That the banking group's insurance business is not greater than 1% of its total consolidated assets.

For the purposes of this condition of registration, the banking group's insurance business is the sum of the following amounts for entities in the banking group:

- (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and
- (b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity's insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

In determining the total amount of the banking group's insurance business—

- (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and
- (b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration,—

"insurance business" means the undertaking or assumption of liability as an insurer under a contract of insurance:

"insurer" and "contract of insurance" have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

4. That aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the banking group to all connected persons do not exceed the rating-contingent limit outlined in the following matrix:

Credit rating of the bank ¹	Connected exposure limit (% of the banking group's Tier 1 capital)
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15% of the banking group's Tier 1 capital.

For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank of New Zealand document entitled "Connected exposures policy" (BS8) dated November 2015.

5. That exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.

¹ This table uses the rating scales of Standard & Poor's, Fitch Ratings and Moody's Investor Service (Fitch Ratings' scale is identical to Standard & Poor's).

CONDITIONS OF REGISTRATION (CONTINUED)

6. That the bank complies with the following corporate governance requirements:
- (a) the board of the bank must have at least five directors;
 - (b) the majority of the board members must be non-executive directors;
 - (c) at least half of the board members must be independent directors;
 - (d) an alternate director,—
 - (i) for a non-executive director must be non-executive; and
 - (ii) for an independent director must be independent;
 - (e) at least half of the independent directors of the bank must be ordinarily resident in New Zealand;
 - (f) the chairperson of the board of the bank must be independent; and
 - (g) the bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the bank).

For the purposes of this condition of registration,—

“independent,”—

- (a) in relation to a person other than a person to whom paragraph (b) applies, has the same meaning as in the Reserve Bank of New Zealand document entitled “Corporate Governance” (BS14) dated July 2014; and
- (b) in relation to a person who is the chairperson of the board of the bank, means a person who—
 - (i) meets the criteria for independence set out in section 10 except for those in paragraph 10(1)(a) in BS14; and
 - (ii) does not raise any grounds of concern in relation to the person's independence that are communicated in writing to the bank by the Reserve Bank of New Zealand:

“non-executive” has the same meaning as in the Reserve Bank of New Zealand document entitled “Corporate Governance” (BS14) dated July 2014.

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:
- (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - (b) the Reserve Bank has advised that it has no objection to that appointment.
8. That a person must not be appointed as chairperson of the board of the bank unless:
- (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - (b) the Reserve Bank has advised that it has no objection to that appointment.
9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:
- (a) the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;
 - (b) the committee must have at least three members;
 - (c) every member of the committee must be a non-executive director of the bank;
 - (d) the majority of the members of the committee must be independent; and
 - (e) the chairperson of the committee must be independent and must not be the chairperson of the bank.

For the purposes of this condition of registration, “independent” and “non-executive” have the same meanings as in condition of registration 6.

10. That a substantial proportion of the bank's business is conducted in and from New Zealand.
11. That the banking group complies with the following quantitative requirements for liquidity-risk management:
- (a) the one-week mismatch ratio of the banking group is not less than zero percent at the end of each business day;
 - (b) the one-month mismatch ratio of the banking group is not less than zero percent at the end of each business day; and
 - (c) the one-year core funding ratio of the banking group is not less than 75 percent at the end of each business day.

For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled “Liquidity Policy” (BS13) dated July 2014 and “Liquidity Policy Annex: Liquid Assets” (BS13A) dated December 2011.

CONDITIONS OF REGISTRATION (CONTINUED)

12. That the bank has an internal framework for liquidity risk management that is adequate in the bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:
- (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
 - (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
 - (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and
 - (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

13. That no more than 10% of total assets may be beneficially owned by a SPV.

For the purposes of this condition,—

"total assets" means all assets of the banking group plus any assets held by any SPV that are not included in the banking group's assets:

"SPV" means a person—

- (a) to whom any member of the banking group has sold, assigned, or otherwise transferred any asset;
- (b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and
- (c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the banking group under a covered bond:

"covered bond" means a debt security issued by any member of the banking group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

14. That—

- (a) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:
 - (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and
 - (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and
- (b) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:
 - (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination;
 - (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and
 - (iii) the Reserve Bank has given the bank a notice of non-objection to the significant acquisition or business combination.

For the purposes of this condition of registration, "qualifying acquisition or business combination", "notification threshold" and "non-objection threshold" have the same meaning as in the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011.

15. That the bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the Reserve Bank, the bank can—

- (a) close promptly at any time of the day and on any day of the week and that effective upon the appointment of the statutory manager—
 - (i) all liabilities are frozen in full; and
 - (ii) no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;
- (b) apply a *de minimis* to relevant customer liability accounts;
- (c) apply a partial freeze to the customer liability account balances;
- (d) reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;
- (e) maintain a full freeze on liabilities not pre-positioned for open bank resolution; and
- (f) reinstate customers' access to some or all of their residual frozen funds.

For the purposes of this condition of registration, "*de minimis*", "partial freeze", "customer liability account", and "frozen and unfrozen funds" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

CONDITIONS OF REGISTRATION (CONTINUED)

16. That the bank has an Implementation Plan that—
- (a) is up-to-date; and
 - (b) demonstrates that the bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: "Open Bank Resolution Pre-positioning Requirements Policy" (BS 17).

For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

17. That the bank has a compendium of liabilities that—
- (a) at the product-class level lists all liabilities, indicating which are—
 - (i) pre-positioned for Open Bank Resolution; and
 - (ii) not pre-positioned for Open Bank Resolution;
 - (b) is agreed to by the Reserve Bank; and
 - (c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

For the purposes of this condition of registration, "compendium of liabilities", and "pre-positioned and non pre-positioned liabilities" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

18. That on an annual basis the bank tests all the component parts of its Open Bank Resolution solution that demonstrates the bank's prepositioning for Open Bank Resolution as specified in the bank's Implementation Plan.

For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

19. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 60%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
20. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 10% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
21. That the bank must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

In these conditions of registration,—

"banking group"—

means Heartland Bank Limited (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

"generally accepted accounting practice" has the same meaning as in section 8 of the Financial Reporting Act 2013.

In conditions of registration 19 to 21,—

"loan-to-valuation ratio", "non property-investment residential mortgage loan", "property-investment residential mortgage loan", "qualifying new mortgage lending amount in respect of property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans", and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated October 2016:

"loan-to-valuation measurement period" means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of March 2017.

PENDING PROCEEDINGS OR ARBITRATION

There are no pending legal proceedings or arbitrations concerning any member of the banking group at the date of this Disclosure Statement that may have a material adverse effect on the bank or the banking group.

CREDIT RATINGS

As at the date of signing this Disclosure Statement, the bank's credit rating issued by Fitch Australia Pty Ltd (Fitch Ratings) was BBB stable. This BBB credit rating was issued on 14 October 2015, following an upgrade from BBB- stable and is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars.

The following is a summary of the descriptions of the ratings categories for rating agencies for the rating of long-term senior unsecured obligations:

Fitch Ratings	Standard & Poor's	Moody's Investors Service	Description of Grade
AAA	AAA	Aaa	Ability to repay principal and interest is extremely strong. This is the highest investment category.
AA	AA	Aa	Very strong ability to repay principal and interest in a timely manner.
A	A	A	Strong ability to repay principal and interest although somewhat susceptible to adverse changes in economic, business or financial conditions.
BBB	BBB	Baa	Adequate ability to repay principal and interest. More vulnerable to adverse changes.
BB	BB	Ba	Significant uncertainties exist which could affect the payment of principal and interest on a timely basis.
B	B	B	Greater vulnerability and therefore greater likelihood of default.
CCC	CCC	Caa	Likelihood of default considered high. Timely repayment of principal and interest is dependent on favourable financial conditions.
CC - C	CC - C	Ca - C	Highest risk of default.
RD to D	D	-	Obligations currently in default.

Credit ratings from Fitch Ratings and Standard & Poor's may be modified by the addition of a plus or minus sign to show relative status within the major rating categories. Moody's Investors Service apply numerical modifiers 1, 2, and 3 to show relative standing within the major rating categories, with 1 indicating the higher end and 3 the lower end of the rating category.

OTHER MATERIAL MATTERS

There are no material matters relating to the business or affairs of the bank or the banking group that are not contained elsewhere in this Disclosure Statement which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which the bank or any member of the banking group is the issuer.

DIRECTORS' STATEMENTS

Each Director of the bank states that he or she believes, after due enquiry, that:

1. As at the date on which this Disclosure Statement is signed:
 - (a) the Disclosure Statement contains all the information that is required by the Order; and
 - (b) the Disclosure Statement is not false or misleading.

2. During the year ended 30 June 2017:
 - (a) the bank complied with all Conditions of Registration;
 - (b) credit exposures to connected persons were not contrary to the interests of the banking group; and
 - (c) the bank had systems in place to monitor and control adequately material risks of the banking group, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

This Disclosure Statement is dated 14 August 2017 and has been signed by all the Directors.



G. T. Ricketts (Chair - Board of Directors)



G. R. Kennedy



J. K. Greenslade



C. R. Mace



E. F. Comerford



V. C. M. Stoddart



E. J. Harvey



G. R. Tomlinson



B. R. Irvine

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2017

	NOTE	Jun 2017 \$000	Jun 2016 \$000
Interest income	2	278,279	265,475
Interest expense	2	115,169	118,815
Net interest income		163,110	146,660
Operating lease income	3	6,989	8,869
Operating lease expenses	3	5,195	6,230
Net operating lease income		1,794	2,639
Lending and credit fee income		3,005	3,339
Other income	4	3,343	4,923
Net operating income		171,252	157,561
Selling and administration expenses	5	71,684	69,872
Profit before impaired asset expense and income tax		99,568	87,689
Impaired asset expense	6	15,015	13,501
Profit before income tax		84,553	74,188
Income tax expense	7	23,745	20,024
Profit for the year		60,808	54,164
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss:			
Effective portion of changes in fair value of cash flow hedges, net of income tax		1,108	(708)
Movement in available for sale reserve, net of income tax		(353)	(208)
Movement in foreign currency translation reserve, net of income tax		761	(4,047)
Items that will not be reclassified to profit or loss:			
Movement in defined benefit reserve, net of income tax		(84)	(93)
Other comprehensive income / (loss) for the year, net of income tax		1,432	(5,056)
Total comprehensive income for the year		62,240	49,108
Earnings per share from continuing operations			
Basic earnings per share	8	12c	11c
Diluted earnings per share	8	12c	11c

Total comprehensive income for the year is attributable to owners of the bank.

The notes on pages 17 to 53 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2017

		Share Capital \$000	Treasury Shares Reserve \$000	Employee Benefits Reserve \$000	Foreign Currency Translation Reserve \$000	Available for Sale Reserve \$000	Defined Benefit Reserve \$000	Hedging Reserve \$000	Retained Earnings \$000	Total Equity \$000
Balance at 1 July 2016		421,377	(2,612)	3,878	(1,816)	962	1	(2,260)	78,811	498,341
Total comprehensive income / (loss) for the year										
Profit for the year		-	-	-	-	-	-	-	60,808	60,808
Other comprehensive (loss), net of income tax		-	-	-	761	(353)	(84)	1,108	-	1,432
Total comprehensive income / (loss) for the year		-	-	-	761	(353)	(84)	1,108	60,808	62,240
Contributions by and distributions to owners										
Dividends paid	14	-	-	-	-	-	-	-	(41,977)	(41,977)
Dividend reinvestment plan	14	10,590	-	-	-	-	-	-	-	10,590
Issue of share capital	14	40,003	-	-	-	-	-	-	-	40,003
Transaction costs associated with capital raising		(655)	-	-	-	-	-	-	-	(655)
Share based payments	25	-	-	1,053	-	-	-	-	-	1,053
Shares vested		1,813	-	(1,813)	-	-	-	-	-	-
Total transactions with owners		51,751	-	(760)	-	-	-	-	(41,977)	9,014
Balance at 30 June 2017		473,128	(2,612)	3,118	(1,055)	609	(83)	(1,152)	97,642	569,595
Balance at 1 July 2015		413,917	(272)	2,200	2,231	1,170	94	(1,552)	62,337	480,125
Total comprehensive income / (loss) for the year										
Profit for the year		-	-	-	-	-	-	-	54,164	54,164
Other comprehensive (loss), net of income tax		-	-	-	(4,047)	(208)	(93)	(708)	-	(5,056)
Total comprehensive income / (loss) for the year		-	-	-	(4,047)	(208)	(93)	(708)	54,164	49,108
Contributions by and distributions to owners										
Dividends paid	14	-	-	-	-	-	-	-	(37,690)	(37,690)
Dividend reinvestment plan	14	7,300	-	-	-	-	-	-	-	7,300
Share based payments	25	-	-	1,888	-	-	-	-	-	1,888
Shares vested		160	50	(210)	-	-	-	-	-	-
Treasury shares acquired		-	(2,390)	-	-	-	-	-	-	(2,390)
Total transactions with owners		7,460	(2,340)	1,678	-	-	-	-	(37,690)	(30,892)
Balance at 30 June 2016		421,377	(2,612)	3,878	(1,816)	962	1	(2,260)	78,811	498,341

The notes on pages 17 to 53 are an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION

As at 30 June 2017

	NOTE	Jun 2017 \$000	Jun 2016 \$000
Assets			
Cash and cash equivalents		57,040	84,154
Investments	9	318,698	236,435
Investment properties	10	4,909	8,384
Finance receivables	11	3,545,897	3,098,924
Operating lease vehicles	12	19,038	24,557
Other assets	15(a)	10,000	15,666
Intangible assets	15(b)	71,237	57,755
Deferred tax asset	7(c)	7,852	7,068
Total assets		4,034,671	3,532,943
Liabilities			
Borrowings	13	3,429,741	2,999,987
Current tax liabilities		9,856	6,754
Trade and other payables	15(c)	25,479	27,861
Total liabilities		3,465,076	3,034,602
Equity			
Share capital	14	473,128	421,377
Treasury shares		(2,612)	(2,612)
Retained earnings and other reserves		99,079	79,576
Total equity		569,595	498,341
Total equity and liabilities		4,034,671	3,532,943
Total interest earning and discount bearing assets		3,909,711	3,412,084
Total interest and discount bearing liabilities		3,425,685	2,998,578

The notes on pages 17 to 53 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 30 June 2017

	Jun 2017	Jun 2016
	\$000	\$000
Cash flows from operating activities		
Interest received	261,339	251,814
Operating lease income received	6,974	9,468
Lending, credit fees and other income received	6,325	7,940
Operating inflows	274,638	269,222
Payments to suppliers and employees	68,017	79,661
Interest paid	125,022	131,378
Taxation paid	21,695	20,297
Operating outflows	214,734	231,336
Net cash flows from operating activities before changes in operating assets and liabilities	59,904	37,886
Proceeds from sale of operating lease vehicles	7,678	7,933
Purchase of operating lease vehicles	(6,236)	(8,187)
Net movement in finance receivables	(441,400)	(251,734)
Net movement in deposits	285,551	186,120
Total cash provided (applied to) / from operating activities	(94,503)	(27,982)
Cash flows from investing activities		
Net proceeds from sale of investment properties	3,498	16,492
Proceeds from sale of office fit-out, equipment and intangible assets	-	784
Net decrease in investments	-	98,480
Total cash provided from investing activities	3,498	115,756
Purchase of office fit-out, equipment and intangible assets	15,180	12,700
Capital expenditure on investment properties	-	24
Net increase in investments	82,616	-
Purchase of MARAC Insurance Limited	-	2,300
Total cash applied to investing activities	97,796	15,024
Net cash flows (applied to) / from investing activities	(94,298)	100,732
Cash flows applied to financing activities		
Net increase in wholesale funding	153,726	1,637
Increase in share capital	39,348	-
Total cash provided from financing activities	193,074	1,637
Dividends paid	14	31,387
Total cash applied to financing activities	31,387	30,390
Net cash flows from / (applied to) financing activities	161,687	(28,753)
Net (decrease) / increase in cash held	(27,114)	43,997
Opening cash and cash equivalents	84,154	37,012
Cash impact of business acquisition (MARAC Insurance Limited)	-	3,145
Closing cash and cash equivalents	57,040	84,154

The notes on pages 17 to 53 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 30 June 2017

Reconciliation of profit after tax to net cash flows from operating activities

	Jun 2017 \$000	Jun 2016 \$000
Profit for the year	60,808	54,164
Add / (less) non-cash items:		
Depreciation and amortisation expense	2,376	2,153
Depreciation on lease vehicles	4,701	5,695
Capitalised net interest income	(32,221)	(25,548)
Impaired asset expense	15,015	13,501
Total non-cash items	(10,129)	(4,199)
Add / (less) movements in operating assets and liabilities:		
Finance receivables	(441,400)	(248,710)
Operating lease vehicles	818	(254)
Other assets	5,938	(2,456)
Gain on disposal of property, plant and equipment and intangibles	-	(322)
Current tax	3,102	(1,125)
Derivative financial instruments revaluation	(1,261)	(1,338)
Deferred tax expense	(784)	686
Deposits	285,551	186,120
Other liabilities	2,854	(10,548)
Total movements in operating assets and liabilities	(145,182)	(77,947)
Net cash flows (applied to) / from operating activities	(94,503)	(27,982)

The notes on pages 17 to 53 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

Basis of reporting

Reporting entity

The financial statements presented are the consolidated financial statements comprising Heartland Bank Limited (the bank) and its subsidiaries (the banking group). Refer to Note 23 - Significant subsidiaries for further details.

As at 30 June 2017 Heartland Bank Limited is a listed public company incorporated in New Zealand under the Companies Act 1993, a registered bank under the Reserve Bank of New Zealand Act 1989 and a FMC reporting entity for the purposes of the Financial Markets Conduct Act 2013 and the Financial Reporting Act 2013.

Basis of preparation

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP) and with the requirements of the Financial Reporting Act 2013. The financial statements comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards as appropriate for profit-oriented entities, and the Registered Bank Disclosure Statement (New Zealand Incorporated Registered Banks) Order 2014 (as amended). The financial statements also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

The financial statements are presented in New Zealand dollars which is the bank's functional and the banking group's presentation currency. Unless otherwise indicated, amounts are rounded to the nearest thousand.

The accounting policies adopted have been applied consistently throughout the periods presented in these financial statements. Certain comparative information has been restated to comply with the current year presentation.

The financial statements have been prepared on the basis of historical cost, except for financial instruments, land and buildings and investment property, which are measured at their fair values as identified in the accounting policies set out in the accompanying notes.

The financial statements have been prepared on a going concern basis after considering the banking group's funding and liquidity position.

Financial assets and liabilities

The banking group initially recognises finance receivables and borrowings on the date that they are originated. All other financial assets and liabilities (including assets and liabilities designated at fair value through profit or loss) are initially recognised on the trade date at which the banking group becomes a party to the contractual provisions of the instrument.

The banking group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the banking group is recognised as a separate asset or liability.

The banking group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

The banking group enters into transactions whereby it transfers assets recognised on its Statement of Financial Position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the Statement of Financial Position. Transfers of assets with the retention of all or substantially all risks and rewards include, for example, securitised assets and repurchase transactions.

Principles of consolidation

The consolidated financial statements of the banking group incorporate the assets, liabilities and results of all controlled entities. Controlled entities are all entities in which the bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Intercompany transactions, balances and any unrealised income and expense (except for foreign currency transaction gains or losses) between controlled entities are eliminated.

The assets and liabilities of entities whose functional currency is not the New Zealand dollar, are translated at the exchange rates ruling at balance date. Revenue and expense items are translated at the spot rate at the transaction date or a rate approximating that rate. Exchange differences are taken to the foreign currency translation reserve.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

Estimates and judgements

The preparation of the banking group's financial statements requires the use of estimates and judgement. This note provides an overview of the areas that involve a higher degree of judgement or complexity. Detailed information about each of these estimates and judgements is included in the relevant notes together with the basis of calculation for each affected item in the financial statements.

- **Provisions for impairment** - The effect of credit risk is quantified based on management's best estimate of future cash repayments and proceeds from any security held or by reference to risk profile groupings and historical loss data. Refer to Note 19(e) for further details.
- **Goodwill** - Determining the fair value of assets and liabilities of acquired businesses requires the exercise of management judgement. The carrying value of goodwill is tested annually for impairment, refer to Note 15(b).

The estimates and judgements used in the preparation of the banking group's financial statements are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity.

Performance

1 Segmental analysis

Segment information is presented in respect of the banking group's operating segments which are those used for the banking group's management and internal reporting structure.

All income received is from external sources. Certain selling and administration expenses, such as premises, IT and support centre costs are not allocated to operating segments and are included in Administration and Support (Admin & Support).

Operating segments

The banking group operates predominantly within New Zealand and Australia and comprises the following main operating segments:

Households	Providing both a comprehensive range of financial services to New Zealand families - including term, transactional and savings based deposit accounts together with mortgage lending (residential and reverse mortgage), motor vehicle finance and consumer finance - as well as reverse mortgage lending and other financial services to Australian families.
Business	Providing term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized businesses.
Rural	Providing specialist financial services to the farming sector primarily offering livestock finance, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.

The banking group's operating segments are different from the industry categories detailed in Note 19 - Asset quality. The operating segments are primarily categorised by sales channel, whereas Note 19 - Asset quality categorises exposures based on credit risk concentrations.

	Households	Business	Rural	Admin & Support	Total
	\$000	\$000	\$000	\$000	\$000
Jun 2017					
Net interest income	88,346	45,431	29,087	246	163,110
Net other income	4,514	1,629	139	1,860	8,142
Net operating income	92,860	47,060	29,226	2,106	171,252
Selling and administration expenses	13,980	8,195	4,356	45,153	71,684
Profit / (loss) before impaired asset expense and income tax	78,880	38,865	24,870	(43,047)	99,568
Impaired asset expense	10,321	4,377	317	-	15,015
Profit / (loss) before income tax	68,559	34,488	24,553	(43,047)	84,553
Income tax expense	-	-	-	23,745	23,745
Profit / (loss) for the year	68,559	34,488	24,553	(66,792)	60,808
Total assets	1,894,514	999,891	675,439	464,827	4,034,671
Total liabilities	-	-	-	3,465,076	3,465,076

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

1 Segmental analysis (continued)

	Households	Business	Rural	Admin & Support	Total
	\$000	\$000	\$000	\$000	\$000
Jun 2016					
Net interest income	79,320	41,061	26,111	168	146,660
Net other income	6,752	1,921	152	2,076	10,901
Net operating income	86,072	42,982	26,263	2,244	157,561
Selling and administration expenses	17,995	9,015	4,351	38,511	69,872
Profit / (loss) before impaired asset expense and income tax	68,077	33,967	21,912	(36,267)	87,689
Impaired asset expense	7,161	3,381	2,959	-	13,501
Profit / (loss) before income tax	60,916	30,586	18,953	(36,267)	74,188
Income tax expense	-	-	-	20,024	20,024
Profit / (loss) for the year	60,916	30,586	18,953	(56,291)	54,164
Total assets	1,672,199	907,205	552,461	401,078	3,532,943
Total liabilities	-	-	-	3,034,602	3,034,602

The Households segment includes non-current assets of \$520,571,783 which are located in Australia (2016: \$436,040,425) and has derived net operating income of \$10,969,104 from customers in Australia (2016: \$6,540,549). All other non-current assets and income have been derived from New Zealand.

2 Net interest income

Interest income and expense is recognised in profit or loss using the effective interest method. The effective interest rate is established on initial recognition of the financial assets and liabilities and is not revised subsequently. The calculation of the effective interest rate includes all yield related fees and commissions paid or received that are an integral part of the effective interest rate.

Interest on the effective portion of a derivative designated as a cash flow hedge is initially recognised in the hedging reserve. It is released to profit or loss at the same time as the hedged item or when the hedge relationship is subsequently deemed to be ineffective, should this occur.

	Jun 2017	Jun 2016
	\$000	\$000
Interest income		
Cash and cash equivalents	825	771
Investments	8,966	10,203
Finance receivables	268,488	254,501
Total interest income	278,279	265,475
Interest expense		
Retail deposits	87,018	85,955
Bank and securitised borrowings	25,714	31,232
Net interest expense on derivative financial instruments	2,437	1,628
Total interest expense	115,169	118,815
Net interest income	163,110	146,660

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

3 Net operating lease income

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term. Profits on the sale of operating lease vehicles are included as part of operating lease income. Current year depreciation and losses on the sale of operating lease vehicles are included as part of operating lease expenses.

	Jun 2017	Jun 2016
	\$000	\$000
Operating lease income		
Lease income	6,365	8,033
Gain on disposal of lease vehicles	624	836
Total operating lease income	6,989	8,869
Operating lease expense		
Depreciation on lease vehicles	4,701	5,695
Direct lease costs	494	535
Total operating lease expenses	5,195	6,230
Net operating lease income	1,794	2,639

4 Other income

Rental income from investment properties is recognised on a straight-line basis over the term of the relevant lease. Other items of income are recognised at the fair value of the consideration received or receivable, net of the amount of goods and services tax (GST) levied.

	Jun 2017	Jun 2016
	\$000	\$000
Rental income from investment properties	887	1,244
Insurance income	1,783	1,508
Gain on sale of investments	628	1,136
Other income	45	1,035
Total other income	3,343	4,923

5 Selling and administration expenses

	Jun 2017	Jun 2016
	\$000	\$000
Personnel expenses	40,766	39,051
Directors' fees	769	743
Superannuation	781	748
Audit and review of financial statements ¹	454	436
Other assurance services paid to auditor ²	44	43
Other fees paid to auditor ³	143	107
Depreciation - property, plant and equipment	1,361	1,081
Amortisation - intangible assets	1,015	1,072
Operating lease expense as a lessee	2,102	2,281
Legal and professional fees	1,698	2,352
Other operating expenses	22,551	21,958
Total selling and administration expenses	71,684	69,872

¹ Audit and review of financial statements includes fees paid for both the audit of annual financial statements and review of interim financial statements.

² Other assurance services paid to the auditor comprise review of regulatory returns, trust deed reporting, and other agreed upon procedure engagements.

³ Other fees paid to the auditor include professional fees in connection with regulatory advisory services, project quality assurance, accounting advice and an internal audit quality assurance review.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

6 Impaired asset expense

	NOTE	Jun 2017 \$000	Jun 2016 \$000
Non-securitised			
Individually impaired expense		4,505	1,072
Collectively impaired expense		9,199	11,186
Total non-securitised impaired asset expense		13,704	12,258
Securitised			
Individually impaired (benefit) / expense		-	(9)
Collectively impaired expense		1,311	1,252
Total securitised impaired asset expense		1,311	1,243
Total			
Individually impaired expense	19(e)	4,505	1,063
Collectively impaired expense	19(e)	10,510	12,438
Total impaired asset expense		15,015	13,501

7 Taxation

(a) Income tax expense

Income tax expense for the year comprises current tax and movements in deferred tax balances. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in equity or other comprehensive income.

	Jun 2017 \$000	Jun 2016 \$000
Income tax recognised in profit or loss		
Current tax		
Current year	25,025	18,850
Adjustments for prior year	(29)	208
Deferred tax		
Current year	(953)	1,722
Adjustments for prior year	(298)	(756)
Income tax expense recognised in profit or loss	23,745	20,024
Income tax recognised in other comprehensive income		
Current tax		
Fair value movements of available for sale investments and derivatives	(205)	172
Deferred tax		
Defined benefit plan	33	(36)
Fair value movements of cash flow hedges	(500)	(243)
Income tax expense / (benefit) recognised in other comprehensive income	(672)	(107)
Reconciliation of effective tax rate		
Profit before income tax	84,553	74,188
Prima facie tax at 28%	23,675	20,773
Higher tax rate for overseas jurisdiction	212	135
Plus tax effect of items not taxable / deductible	185	114
Adjustments for prior year	(327)	(548)
Utilisation of unrecognised tax losses	-	(450)
Total income tax expense	23,745	20,024

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

7 Taxation (continued)

(b) Current tax

Current tax is the expected tax receivable or payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to the tax receivable or payable in respect of previous years. Current tax for current and prior years is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

(c) Deferred tax

The banking group has recognised deferred tax assets, including those relating to the tax effects of income tax losses and credits available to be carried forward, to the extent that there are sufficient taxable temporary differences (deferred tax liabilities) relating to the same taxation authority and the same subsidiary against which the unused tax losses can be utilised.

Deferred tax assets comprise the following temporary differences:

	Jun 2017	Jun 2016
	\$000	\$000
Employee entitlements	1,323	1,038
Provision for impairment	7,601	5,797
Investment properties	1,044	1,358
Intangibles and property, plant and equipment	(342)	(177)
Deferred acquisition costs	(1,369)	(1,196)
Operating lease vehicles	(905)	(1,276)
Other temporary differences	500	1,524
Total deferred tax assets	7,852	7,068
Opening balance of deferred tax assets	7,068	8,707
Acquisition of subsidiaries	-	(952)
Movement recognised in profit or loss	1,251	(966)
Movement recognised in other comprehensive income	(467)	279
Closing balance of deferred tax assets	7,852	7,068

(d) Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST. As the banking group is predominantly involved in providing financial services, only a proportion of GST paid on inputs is recoverable. The non-recoverable proportion of GST is treated as part of the cost of acquisition of the asset or is expensed.

(e) Imputation credit account

	Jun 2017	Jun 2016
	\$000	\$000
Imputation credit account	5,799	2,388

8 Earnings per share

	Jun 2017			Jun 2016		
	Earnings per share	Net profit after tax	Weighted average no. of shares	Earnings per share	Net profit after tax	Weighted average no. of shares
	cents	\$000	000	cents	\$000	000
Basic earnings	12	60,808	493,177	11	54,164	473,360
Diluted earnings	12	60,808	496,725	11	54,164	481,215

Basic earnings per share is calculated by dividing the net profit attributable to shareholders by the weighted average number of fully paid shares less treasury shares. Diluted earnings per share includes partly paid shares.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

Financial Position

9 Investments

The banking group holds investments in bank bonds and floating rate notes, local authority stock, public securities, corporate bonds and equity investments. Equity investments are classified as being fair valued through profit or loss and the fair value is based on unobservable inputs. All other investments held are classified as being available for sale and are stated at fair value less impairment, if any. The fair values are derived by reference to published price quotations in an active market or modelled using observable market inputs.

	Jun 2017	Jun 2016
	\$000	\$000
Bank bonds and floating rate notes	237,416	181,786
Public sector securities and corporate bonds	16,055	8,530
Local authority stock	53,436	38,828
Equity investments	11,791	7,291
Total investments	318,698	236,435

10 Investment properties

Investment properties have been acquired through the enforcement of security over finance receivables and are held to earn rental income or for capital appreciation (or both).

Investment properties are initially recorded at their fair value, with subsequent changes in fair value recognised in profit or loss. Fair values are determined by qualified independent valuers or other similar external evidence, adjusted for changes in market conditions and the time since the last valuation.

	Jun 2017	Jun 2016
	\$000	\$000
Opening balance	8,384	24,513
Additional capital expenditure	-	24
Sales	(3,475)	(16,153)
Closing balance	4,909	8,384

11 Finance receivables

Finance receivables are initially recognised at fair value plus incremental direct transaction costs and are subsequently measured at amortised cost using the effective interest method, less any impairment loss.

Past due but not impaired assets are any assets which have not been operated by the counterparty within their key terms but are not considered to be impaired by the banking group.

Individually impaired assets are those loans for which the banking group has evidence that it will incur a loss, and will be unable to collect all principal and interest due according to the contractual terms of the loan.

Restructured assets are impaired assets where the banking group expects to recover all amounts owing although the original terms have been changed due to the counterparty's difficulty in complying with the original terms of the contract and the amended terms are not comparable with similar new lending.

Credit impairment provisions are made where events have occurred leading to an expectation of reduced future cash flows from certain receivables. These provisions are made in some cases against an individual loan and in other cases on a collective basis. When all appropriate collection and legal action has been performed and the loan is known to be uncollectible, it is written off against the related provision for impairment.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 30 June 2017

11 Finance receivables (continued)

	NOTE	Jun 2017 \$000	Jun 2016 \$000
Non-securitised			
Neither at least 90 days past due nor impaired		3,285,911	2,776,495
At least 90 days past due		33,047	20,058
Individually impaired		28,578	33,751
Gross finance receivables		3,347,536	2,830,304
Less provision for impairment		24,762	19,936
Less fair value adjustment for present value of future losses ¹		3,851	4,987
Total non-securitised finance receivables		3,318,923	2,805,381
Securitised			
Neither at least 90 days past due nor impaired		225,495	292,858
At least 90 days past due		2,582	1,897
Individually impaired		-	13
Gross finance receivables		228,077	294,768
Less provision for impairment		1,103	1,225
Total securitised finance receivables		226,974	293,543
Total			
Neither at least 90 days past due nor impaired		3,511,406	3,069,353
At least 90 days past due	19(b)	35,629	21,955
Individually impaired	19(c)	28,578	33,764
Gross finance receivables		3,575,613	3,125,072
Less provision for impairment	19(e)	25,865	21,161
Less fair value adjustment for present value of future losses ¹	19(a)	3,851	4,987
Total finance receivables		3,545,897	3,098,924

Refer to Note 19 - Asset quality for further analysis of finance receivables by credit risk concentration.

Finance lease receivables

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. Amounts due from finance leases are recognised as finance receivables at the amount of the banking group's net investment in the leases. The table below provides an analysis of finance lease receivables for leases of certain property and equipment in which the banking group is the lessor.

	Jun 2017 \$000	Jun 2016 \$000
Gross finance lease receivables		
Less than 1 year	23,628	26,810
Between 1 and 5 years	38,748	44,619
More than 5 years	-	-
Total gross finance lease receivables	62,376	71,429
Less unearned finance income	9,465	10,614
Less provision for impairment	156	132
Net finance lease receivables	52,755	60,683

¹ A fair value adjustment of \$8m for the present value of future losses was recognised on acquisition of New Sentinel Limited and Australian Seniors Finance Pty Limited. This fair value adjustment is being amortised over the estimated lifetime of the finance receivables acquired.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

12 Operating lease vehicles

Operating lease vehicles are stated at cost less accumulated depreciation.

Operating lease vehicles are depreciated on a straight line basis over their expected life after allowing for any residual values. The estimated lives of these vehicles vary up to five years. Vehicles held for sale are not depreciated but are tested for impairment.

	Jun 2017 \$000	Jun 2016 \$000
Cost		
Opening balance	35,728	42,186
Additions	6,236	8,187
Disposals	(13,827)	(14,645)
Closing balance	28,137	35,728
Accumulated depreciation		
Opening balance	11,171	12,188
Depreciation charge for the year	4,701	5,695
Disposals	(6,773)	(6,712)
Closing balance	9,099	11,171
Opening net book value	24,557	29,998
Closing net book value	19,038	24,557

The future minimum lease payments receivable under non-cancellable operating leases not later than one year is \$5,022,000 (2016: \$6,362,000), within one to five years is \$3,644,000 (2016: \$5,071,000) and over five years is nil (2016: nil).

13 Borrowings

Bank borrowings and deposits are initially recognised at fair value including incremental direct transaction costs. They are subsequently measured at amortised cost using the effective interest method.

	Jun 2017 \$000	Jun 2016 \$000
Deposits	2,573,980	2,282,876
Subordinated bonds	3,378	3,378
Subordinated notes	21,180	-
Bank borrowings	616,838	429,304
Securitised borrowings	214,365	284,429
Total borrowings	3,429,741	2,999,987

Deposits rank equally and are unsecured. The subordinated bonds and notes rank below all other general liabilities of the banking group.

Securitised borrowings held by investors in Heartland ABCP Trust 1 (ABCP Trust) rank equally with each other and are secured over the securitised assets of that trust. Securitised borrowings comprise notes issued by ABCP Trust and drawings under the ABCP Trust's bank facilities. The ABCP Trust has bank facilities of \$300 million (2016: \$350 million) which mature on 2 February 2018.

The banking group has an Australian bank facility provided by Commonwealth Bank of Australia (CBA bank facility) totalling AUD \$600 million, with AUD \$440 million drawn (2016: AUD \$363 million). The CBA bank facility is secured over the shares in Australian Seniors Finance Pty Limited (ASF) and the assets of the ASF group (comprising ASF, the ASF Settlement Trust and the Seniors Warehouse Trust). The CBA bank facility has a maturity date of 30 September 2019.

The banking agreements include covenants for the provision of information, attainment of minimum financial ratios and equity, compliance with specified procedures and certification of due performance by ASF Group.

On 7 April 2017, the bank issued subordinated notes. For further information regarding the subordinated notes and bonds disclosed above refer to Note 26 - Capital Adequacy.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

14 Share capital and dividends

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

	Jun 2017	Jun 2016
	Number of shares 000	Number of shares 000
Issued shares		
Opening balance	476,469	469,890
Shares issued during the year	32,860	213
Dividend reinvestment plan	6,907	6,366
Closing balance	516,236	476,469
Less treasury shares	(2,299)	(2,299)
Net closing balance	513,937	474,170

On 15 December 2016, the bank issued 13,698,630 fully paid new ordinary shares at \$1.46 per share. On 15 March 2017, the bank issued 13,700,681 fully paid new ordinary shares at \$1.46 per share. Other shares issued during the period relate to staff share schemes.

Under the dividend reinvestment plan, the bank issued 3,573,104 new shares at \$1.4766 per share on 7 October 2016 and 3,334,049 new shares at \$1.5939 per share on 7 April 2017 (June 2016: 3,711,076 new shares at \$1.1100 per share on 2 October 2015 and 2,655,142 new shares at \$1.1980 per share on 5 April 2016).

The shares have equal voting rights, rights to dividends and distributions and do not have a par value.

Dividends paid

	Jun 2017			Jun 2016		
	date declared	cents per share	\$000	date declared	cents per share	\$000
Final dividend	16/08/2016	5.0	24,041	18/08/2015	4.5	21,145
Interim dividend	21/02/2017	3.5	17,936	23/02/2016	3.5	16,545
Total dividends paid		8.5	41,977		8.0	37,690

On 14 August 2017, the Board declared a final dividend for the 2017 financial year of 5.5 cents per Ordinary Share, payable on 21 September 2017 to registered shareholders at 7 September 2017. This final dividend has not been recognised within these financial statements.

15 Other balance sheet items

(a) Other assets

Derivative financial assets consist of interest rate swaps and foreign exchange options. Interest rate swaps are held to manage the banking group's exposure to interest rate repricing risk arising from deposits, commercial paper issuance, current and future floating rate bank debt and investments. Foreign exchange options are used to manage the banking group's exposure to foreign exchange rate risk.

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight line basis to write off the net cost or other revalued amount of each asset over its expected useful life to its estimated residual value.

	Jun 2017	Jun 2016
	\$000	\$000
Derivative financial assets	-	148
Trade receivables	101	5,452
GST receivable	1,128	795
Prepayments	822	622
Property, plant and equipment	7,949	8,649
Total other assets	10,000	15,666

(b) Intangible assets

Intangible assets with finite useful lives

Software acquired or internally developed by the banking group is stated at cost less accumulated amortisation and any accumulated impairment losses. Subsequent expenditure on software assets is capitalised only when it increases the future economic value of that asset. Amortisation of software is on a straight line basis, at rates which will write off the cost over their estimated economic lives. All other expenditure is expensed immediately as incurred.

Goodwill

Goodwill arising on acquisition represents the excess of the cost of the acquisition over the banking group's interest in the fair value of the identifiable net assets. Goodwill that has an indefinite useful life is not subject to amortisation and is tested for impairment annually. Goodwill is carried at cost less accumulated impairment losses.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

15 Other balance sheet items (continued)

(b) Intangible assets (continued)

	Jun 2017 \$000	Jun 2016 \$000
Computer software		
Cost	31,543	18,539
Accumulated amortisation	5,449	5,927
Net carrying amount of computer software	26,094	12,612
Net carrying amount of goodwill	45,143	45,143
Total intangible assets	71,237	57,755

A significant portion of the computer software costs relate to the core banking system replacement which the bank brought into use in May 2017. The expected useful life of the new core banking system has been determined to be ten years.

Goodwill was tested for impairment as at 30 June 2017. In assessing impairment, an internal valuation model was developed to indicate the value of the business. This value was compared to the net assets of the banking group. There was no indication of impairment and no impairment losses have been recognised against the carrying amount of goodwill for the year ended 30 June 2017 (30 June 2016: nil).

The banking group's management and Board of Directors have assessed that goodwill should be allocated to the banking group as a cash-generating unit, as this is the cash generating unit at which goodwill is assessed for impairment and to which any future economic benefit will arise.

(c) Trade and other payables

Derivative financial liabilities consist of interest rate swaps held to manage the banking group's exposure to interest rate repricing risk arising from fixed rate mortgage loans.

Annual leave entitlements are accrued at amounts expected to be paid. Long service leave is accrued by calculating the probable future value of entitlements and discounting back to present value. Obligations to defined contribution superannuation schemes are recognised as an expense when the contribution is paid.

	Jun 2017 \$000	Jun 2016 \$000
Derivative financial liabilities	3,349	5,866
Trade payables	10,697	12,988
Insurance liability	5,927	5,235
Employee benefits	5,506	3,772
Total trade and other payables	25,479	27,861

(d) Related party transactions

Heartland Cash and Term PIE Fund and some key management personnel invested in the bank's deposits. The investments of Heartland Cash and Term PIE Fund are detailed in Note 24 - Structured entities.

Transactions with key management personnel

Key management personnel, being directors of the bank and those Executives reporting directly to the Chief Executive Officer and their immediate relatives, have transacted with the banking group during the year as follows:

	Jun 2017 \$000	Jun 2016 \$000
Transactions with key management personnel		
Interest income	8	104
Interest expense	(691)	(460)
Key management personnel compensation:		
Short-term employee benefits	(5,020)	(5,064)
Share-based payment expense	(813)	(848)
Total transactions with key management personnel	(6,516)	(6,268)
Due (to) / from key management personnel		
Finance receivables	71	1,428
Borrowings - deposits	(9,153)	(26,526)
Total due (to) / from key management personnel	(9,082)	(25,098)

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

16 Fair value

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the banking group determines fair value using other valuation techniques.

The banking group measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (derived from prices).
- Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The banking group recognises transfers between levels of the fair value hierarchy as at the end of the reporting period during which the change has occurred.

(a) Financial instruments measured at fair value

The following methods and assumptions were used to estimate the fair value of each class of financial asset and liability measured at fair value on a recurring basis in the Statement of Financial Position.

Investments

Investments in public sector securities and corporate bonds are classified as being available for sale and are stated at fair value, with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using observable market inputs (Level 2 under the fair value hierarchy). Refer to Note 9 - Investments for more details.

Investments valued under Level 2 of the fair value hierarchy are valued either based on quoted market prices or dealer quotes for similar instruments, or discounted cash flows analysis.

Investments in unlisted equity securities are classified as being fair valued through profit or loss and are valued under Level 3 of the fair value hierarchy, with the fair value being based on unobservable inputs.

Finance receivables

Fixed rate reverse mortgage loans classified as finance receivables are stated at fair value with the fair value being based on present value of future cash flows discounted using observable market interest rates (Level 2 under the fair value hierarchy).

Derivative items

Interest rate swaps are classified as held for trading and are recognised in the financial statements at fair value. Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are determined on the basis of discounted cash flow analysis using observable market prices and adjustments for counterparty credit spreads. (Level 2 under the fair value hierarchy).

The following table analyses financial instruments measured at fair value at the reporting date by the level in the fair value hierarchy into which each fair value measurement is categorised. The amounts are based on the values recognised in the Statement of Financial Position.

	Level 1 \$000	Level 2 \$000	Level 3 \$000	Total \$000
Jun 2017				
Investments	306,907	-	11,791	318,698
Finance receivables	-	11,211	-	11,211
Total assets measured at fair value	306,907	11,211	11,791	329,909
Derivative liabilities held for risk management	-	3,349	-	3,349
Total liabilities measured at fair value	-	3,349	-	3,349
Jun 2016				
Investments	229,144	-	7,291	236,435
Finance receivables	-	21,884	-	21,884
Derivative assets held for risk management	-	148	-	148
Total assets measured at fair value	229,144	22,032	7,291	258,467
Derivative liabilities held for risk management	-	5,866	-	5,866
Total liabilities measured at fair value	-	5,866	-	5,866

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

16 Fair value (continued)

(b) Financial instruments not measured at fair value

The following methods and assumptions were used to estimate the fair value of each class of financial assets and liabilities not recognised at fair value but for which fair value is calculated for disclosure purposes under Level 2 or 3 of the fair value hierarchy.

Cash and cash equivalents and other financial assets and liabilities

The fair value of all cash and cash equivalents and other financial assets and liabilities is considered equivalent to their carrying value due to their short term nature.

Finance receivables

The fair value of the banking group's finance receivables is calculated using a valuation technique which assumes the banking group's current weighted average lending rates for loans of a similar nature and term.

The current weighted average lending rate used to fair value finance receivables with a fixed interest rate was 8.72% (2016: 8.65%). Finance receivables with a floating interest rate are deemed to be at current market rates. The current amount of credit provisioning has been deducted from the fair value calculation of finance receivables as a proxy for future losses. Prepayment rates have not been factored into the fair value calculation as they are not deemed to be material.

Borrowings

The fair value of deposits, bank borrowings and other borrowings is the present value of future cash flows and is based on the current market interest rates payable by the banking group for debt of similar maturities. The current market rate used to fair value borrowings was 2.93% (2016: 3.29%).

Other financial assets and financial liabilities

The banking group has not disclosed the fair values for financial instruments such as short-term trade receivables and payables, because their carrying amounts are a reasonable approximation of fair values.

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorised.

	Level 1	Level 2	Level 3	Total Fair Value	Total Carrying Value
	\$000	\$000	\$000	\$000	\$000
Jun 2017					
Cash and cash equivalents	57,040	-	-	57,040	57,040
Finance receivables	-	-	3,300,325	3,300,325	3,307,712
Finance receivables - securitised	-	-	227,166	227,166	226,974
Other financial assets	-	-	101	101	101
Total financial assets	57,040	-	3,527,592	3,584,632	3,591,827
Borrowings	-	3,220,344	-	3,220,344	3,215,376
Borrowings - securitised	-	214,365	-	214,365	214,365
Other financial liabilities	-	-	22,130	22,130	22,130
Total financial liabilities	-	3,434,709	22,130	3,456,839	3,451,871
Jun 2016					
Cash and cash equivalents	84,154	-	-	84,154	84,154
Finance receivables	-	-	2,780,211	2,780,211	2,783,497
Finance receivables - securitised	-	-	295,063	295,063	293,543
Other financial assets	-	-	5,452	5,452	5,452
Total financial assets	84,154	-	3,080,726	3,164,880	3,166,646
Borrowings	-	2,727,417	-	2,727,417	2,715,558
Borrowings - securitised	-	284,429	-	284,429	284,429
Other financial liabilities	-	-	21,995	21,995	21,995
Total financial liabilities	-	3,011,846	21,995	3,033,841	3,021,982

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

16 Fair value (continued)

(c) Classification of financial instruments

The following tables summarise the categories of financial instruments and the carrying value and fair value of all financial instruments of the banking group:

	Held for trading	Fair value through profit or loss	Loans and receivables	Available for sale	Financial liabilities at amortised cost	Total Carrying Value	Total Fair Value
	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Jun 2017							
Cash and cash equivalents	-	-	57,040	-	-	57,040	57,040
Investments	-	11,791	-	306,907	-	318,698	318,698
Finance receivables	-	-	3,318,923	-	-	3,318,923	3,311,536
Finance receivables - securitised	-	-	226,974	-	-	226,974	227,166
Other financial assets	-	-	101	-	-	101	101
Total financial assets	-	11,791	3,603,038	306,907	-	3,921,736	3,914,541
Borrowings	-	-	-	-	3,215,376	3,215,376	3,220,344
Borrowings - securitised	-	-	-	-	214,365	214,365	214,365
Derivative financial liabilities	3,349	-	-	-	-	3,349	3,349
Other financial liabilities	-	-	-	-	22,130	22,130	22,130
Total financial liabilities	3,349	-	-	-	3,451,871	3,455,220	3,460,188
Jun 2016							
Cash and cash equivalents	-	-	84,154	-	-	84,154	84,154
Investments	-	7,291	-	229,144	-	236,435	236,435
Finance receivables	-	-	2,805,381	-	-	2,805,381	2,802,095
Finance receivables - securitised	-	-	293,543	-	-	293,543	295,063
Derivative financial assets	148	-	-	-	-	148	148
Other financial assets	-	-	5,452	-	-	5,452	5,452
Total financial assets	148	7,291	3,188,530	229,144	-	3,425,113	3,423,347
Borrowings	-	-	-	-	2,715,558	2,715,558	2,727,417
Borrowings - securitised	-	-	-	-	284,429	284,429	284,429
Derivative financial liabilities	5,866	-	-	-	-	5,866	5,866
Other financial liabilities	-	-	-	-	21,995	21,995	21,995
Total financial liabilities	5,866	-	-	-	3,021,982	3,027,848	3,039,707

Risk Management

17 Enterprise risk management program

The board of directors (the Board) sets and monitors the banking group's risk appetite across five primary risk domains; credit, liquidity, market (including interest rate), operational & compliance, and general business risk. Management are, in turn, responsible for ensuring appropriate structures, policies, procedures, and information systems are in place to actively manage these risk domains. Collectively, these processes are known as the banking group's Enterprise Risk Management Programme (RMP). The banking group periodically subjects all risk processes to hindsight and internal audit, and all accounting systems are subject to regular internal and external audits.

Role of the Board and the Board Risk Committee

The Board, through its Board Risk Committee (BRC) is responsible for oversight and governance of the development of the RMP. The role of the BRC is to assist the Board to formulate its risk appetite, understand the risks the banking group faces and to ensure that all policy and decisions are made in accordance with the banking group's corporate values and guiding principles. The BRC has the following specific responsibilities:

- To advise the Board on the formulation of the Board's Risk Appetite Statement at least annually.
- To review reports from management concerning the RMP in the context of the Risk Appetite Statement in order to assure the Board of the programme's effectiveness.
- To review reports from management concerning transactions involving risks in excess of the CRO's authority limits in order to recommend to the Board any appropriate approvals or provide such approval where the BRC has delegated authority.
- To review reports from management concerning changes anticipated in the economic, business and regulatory environment (including consideration of emerging trends) and other factors considered relevant to the Risk Appetite Statement, in order to monitor them and advise the Board of any new risks or opportunities that could have a significant financial, regulatory or reputational impact.
- To review reports from management concerning the Bank's internal compliance policies in order to advise the Board of their effectiveness and recommend their approval or variation (or, where the BRC has been delegated authority, as set out in the Policy Register, to itself approve or vary them).

The BRC consists of four non-executive, independent directors. In addition the CRO and CFO attend the BRC meetings, and the CEO and directors who are not members of the BRC are entitled to attend BRC meetings. The BRC meets at least bi-monthly to review identified risk issues, and reports directly to the Board. A member of the BRC sits on the Audit Committee and vice versa.

Audit Committee and Internal Audit

The banking group has an internal audit function, the objective of which is to provide independent, objective assurance over the internal control environment. In certain circumstances, Internal Audit will provide risk and control advice to Management provided the work does not impede the independence of the Internal Audit function. The function assists the bank in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal audit is allowed full, free and unfettered access to any and all of the organisation's records, personnel and physical properties deemed necessary to accomplish its activities.

A regular cycle of review has been implemented to cover all areas of the business, focused on assessment, management and control of risks. The audit plan takes into account cyclical review of various business units and operational areas, as well as identified areas of higher identified risk. The audit methodology is designed to meet the International Standards for the Professional Practice of Internal Auditing of The Institute of Internal Auditors.

Each audit has specific audit procedures tailored to the area of business that is being reviewed. The audit procedures are updated during each audit to reflect any process changes. Audit work papers are completed to evidence the testing performed in accordance with the audit procedures.

Audit reports are addressed to the manager of the relevant area that is being audited in addition to other relevant stakeholders within the bank. Management comments are obtained from the process owner(s) and are included in the report.

The internal audit function has a direct reporting line, and accountability to the Audit Committee of the bank and administratively to the CFO. A schedule of all outstanding internal control issues is maintained and presented to the Audit Committee to assist the Audit Committee to track the resolution of previously identified issues. Any issues raised that are categorised as high risk are specifically reviewed by internal audit during a follow-up review once the issue is considered closed by management. The follow-up review is performed with a view to formally close out the issue.

The Audit Committee focuses on financial reporting and application of accounting policies as part of the internal control and risk assessment framework. The Audit Committee monitors the identification, evaluation and management of all significant risks through the banking group. This work is supported by internal audit, which provides an independent assessment of the design, adequacy and effectiveness of internal controls. The Audit Committee receives regular reports from internal audit.

17 Enterprise risk management program (continued)

Audit Committee and Internal Audit (continued)

Charters for both the BRC and the Audit Committee ensure suitable cross representation to allow effective communication pertaining to identified issues with oversight by the Board. The CRO has a direct reporting line to the Chairman of the Board. The Head of Internal Audit has a direct reporting line to the Chairman of the Audit Committee.

Asset and Liability Committee (ALCO)

The ALCO comprises the CEO (Chair), Deputy CEO, CFO, CRO, COO and Treasurer. The ALCO has responsibility for overseeing aspects of the banking group's financial position risk management. The ALCO usually meet monthly, and provides reports to the BRC. ALCO's specific responsibilities include decision making and oversight of risk matters in relation to:

- Market risk (including non-traded interest rate risk and the investment of capital)
- Liquidity risk (including funding)
- Foreign exchange rate risk
- Balance sheet structure
- Capital management

Executive Risk Committee (ERC)

The ERC comprises the CEO (Chair), Deputy CEO, CFO, CRO, COO, Head of Internal Audit, Head of Retail and Consumer, Head of Rural, Head of Business, Head of Human Resources and Group General Counsel. The ERC has responsibility for overseeing all risk aspects not considered by ALCO, including that the internal control environment is managed so that residual risk is consistent with the banking group's risk appetite. The ERC usually meets monthly, and provides its minutes to the BRC. ERC specific responsibilities include decision making and oversight of the following risk categories:

- Operational and compliance risk
- Credit risk
- Strategic risk
- Legal and governance risk
- Business risk

Operational & compliance risk

Operational & compliance risk is the risk arising from day to day operational activities in the execution of the banking group's strategy which may result in direct or indirect loss. Operational & compliance risk losses can occur as a result of fraud, human error, missing or inadequately designed processes, failed systems, damage to physical assets, improper behaviour or from external events. The losses range from direct financial losses, to reputational damage, unfavourable media attention, loss of staff or clients or as a breach of laws or banking regulations. Where appropriate, risks are mitigated by insurance.

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational & compliance risk, the banking group operates a "three lines of defence" model which outlines principles for the roles, responsibilities and accountabilities for operational & compliance risk management:

- The first line of defence is the business line management of the identification, management and mitigation of the risks associated with the products and processes of the business. This accountability includes regular testing and certification of the adequacy and effectiveness of controls and compliance with the banking group's policies.
- The second line of defence is the Risk & Compliance function, responsible for the design and ownership of the Operational & Compliance Risk Framework. It incorporates key processes including Risk and Control Self-Assessment (RCSA), incident management, independent evaluation of the adequacy and effectiveness of the internal control framework, and the self-certification process.
- The third line of defence is audit. Internal Audit is responsible for independently assessing how effectively the banking group is managing its risk according to stated risk appetite.

The banking group's exposure to operational & compliance risk is governed by a policy approved by the Board and managed by the ERC. This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ERC must conform to this.

Market risk

Market risk is the risk that market interest rate risks or foreign exchange rates will change and impact on the banking group's earnings due to either mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates. Refer Note 21 - Interest rate risk for further details regarding interest rate risk.

17 Enterprise risk management program (continued)

Foreign exchange rate risk

Foreign exchange risk is the risk that the banking group's earnings and shareholder equity position are adversely impacted from changes in foreign exchange rates. The banking group has exposure to foreign exchange translation risks through its Australian subsidiaries (which have a functional currency of AUD), in the forms of profit translation risk and balance sheet translation risk.

Profit translation risk is the risk that deviations in exchange rates have a significant impact on the reported profit. Balance sheet translation risk is the risk that whilst the foreign currency value of the net investment in a subsidiary may not have changed, when translated back to the New Zealand dollars (NZD), the NZD value has changed materially due to movements in the exchange rates. Foreign exchange revaluation gains and losses are booked to the Foreign currency translation reserve. Substantial foreign exchange rate movements in any given year may have an impact on other comprehensive income. The banking group manages this risk by setting and approving the foreign exchange rate for the upcoming financial year and entering into hedging contracts to manage the foreign exchange translation risks.

18 Credit risk

Credit risk is the risk that a borrower will default on any type of debt by failing to make payments which it is obligated to make. The risk is primarily that of the lender and includes loss of principal and interest, disruption to cash flows and increased collection costs.

Credit risk is managed to achieve sustainable risk-reward performance whilst maintaining exposures within acceptable risk "appetite" parameters. This is achieved through the combination of governance, policies, systems and controls, underpinned by commercial judgement as described below.

To manage this risk the ERC oversees the formal credit risk management strategy. The ERC reviews the Banking Group's credit risk exposures typically on a monthly basis to ensure consistency with the banking group's credit policies to manage all aspects of credit risk. The credit risk management strategies ensure that:

- Credit origination meets agreed levels of credit quality at point of approval.
- Sector and geographical risks are actively managed.
- Industry concentrations are actively monitored.
- Maximum total exposure to any one debtor is actively managed.
- Changes to credit risk are actively monitored with regular credit reviews.

The BRC also oversees the banking group's credit risk exposures typically on a quarterly basis to ensure that not only is the banking group achieving consistency with its own credit policies but that overall risk metrics are in line with risk appetite set by the board.

The banking group has adopted a detailed Credit Risk Framework. The Framework is the overarching Credit Risk document and is supported further by Lending Standards that provide criteria for finance products within each business sector. The combination of the Credit Risk Framework and Lending Standards guides credit assessment, credit risk grading, documentation standards, legal procedures and compliance with regulatory and statutory requirements.

The BRC has authority from the Board for approval of all credit exposures. Lending authority has been provided to the Banking Group's Credit Committee, for delegation through the business units under a detailed Delegated Lending Authority framework. Application of credit discretions in the business operation are monitored through a defined review and hindsight structure as outlined in the Credit Risk Oversight Policy. Delegated Lending Authorities are provided to individual officers with due cognisance of their experience and ability. Larger and higher risk exposures require approval of senior management, the Credit Risk Committee and ultimately through to the BRC.

The banking group employs a comprehensive process of hind sighting loans to ensure that credit policies and the quality of credit processes are maintained.

Reverse mortgage loans and negative equity risk

Reverse mortgage loans are a form of mortgage lending targeted toward the seniors market. These loans differ to conventional mortgages in that they typically are not repaid until the borrower ceases to reside in the property. Further, interest is not required to be paid, it is capitalised with the loan balance and is repayable on termination of the loan. As such, there are no incoming cash flows and therefore no default risk to manage during the term of the loan. Credit risk becomes 'negative equity' risk through the promise by the banking group to customers that they can reside in their property for 'as long as they wish' and repayment of their loan is limited to the net sale proceeds of their property.

The banking group's exposure to negative equity risk is managed by Credit Risk Policy in conjunction with associated lending standards specific for this product. Both New Zealand and Australia reverse mortgage operations are similarly aligned. The policy is managed and reviewed periodically to ensure appropriate consistency across locations.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

18 Credit risk (continued)

(a) Maximum exposure to credit risk at the relevant reporting dates

The following table represents the maximum credit risk exposure, without taking account of any collateral held. The exposures set out above are based on net carrying amounts as reported in the Statement of Financial Position.

	Jun 2017 \$000	Jun 2016 \$000
Cash and cash equivalents	57,040	84,154
Investments	306,907	229,144
Finance receivables	3,545,897	3,098,924
Derivative financial assets	-	148
Other financial assets	101	5,452
Total on balance sheet credit exposures	3,909,945	3,417,822

(b) Concentration of credit risk by geographic region

	Jun 2017 \$000	Jun 2016 \$000
Auckland	944,446	833,411
Wellington	217,921	188,299
Rest of North Island	1,037,873	884,611
Canterbury	485,844	501,829
Rest of South Island	571,251	487,511
Australia:		
Queensland	124,535	113,912
New South Wales	229,715	189,868
Victoria	113,674	90,326
Western Australia	23,602	18,120
South Australia	19,280	16,860
Rest of Australia	10,838	10,387
Rest of the world ¹	152,260	103,934
	3,931,239	3,439,068
Collective provision	(17,443)	(16,259)
Less acquisition fair value adjustment for present value of future losses	(3,851)	(4,987)
Total on balance sheet credit exposures	3,909,945	3,417,822

(c) Concentration of credit risk by industry sector

	Jun 2017 \$000	Jun 2016 \$000
Agriculture	757,004	627,670
Forestry and Fishing	79,973	52,451
Mining	19,006	14,897
Manufacturing	76,445	85,831
Finance & Insurance	395,804	334,626
Wholesale trade	38,146	35,737
Retail trade	150,795	140,604
Households	1,717,407	1,494,985
Property and Business services	347,776	400,240
Transport and storage	179,016	142,459
Other Services	169,867	109,568
	3,931,239	3,439,068
Collective provision	(17,443)	(16,259)
Less acquisition fair value adjustment for present value of future losses	(3,851)	(4,987)
Total on balance sheet credit exposures	3,909,945	3,417,822

¹ These overseas assets are primarily NZD-denominated investments in AA+ and higher rated securities issued by offshore supranational agencies ("Kauri Bonds").

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

18 Credit risk (continued)

(d) Commitments to extend credit

	Jun 2017	Jun 2016
	\$000	\$000
Undrawn facilities available to customers	120,948	147,903
Conditional commitments to fund at future dates	153,166	114,855

As at 30 June 2017 there is \$219,000 of undrawn lending commitments available to counterparties for whom drawn balances are classified as individually impaired (2016: nil).

(e) Credit exposures to connected persons

	Jun 2017
Credit exposures to non-bank connected persons at year end (\$000's)	-
Credit exposures to non-bank connected persons at year end (% of total Tier 1 Capital)	0.00%
Peak credit exposures to non-bank connected persons during the year (\$000's)	-
Peak credit exposures to non-bank connected persons during the year (% of total Tier 1 Capital)	0.00%

Credit exposure concentrations are derived in accordance with the bank's conditions of registration, BS2A and BS8 and disclosed on the basis of actual credit exposures and calculated on a gross basis (net of individual credit impairment allowances and excluding advances of a capital nature). The banking group does not have credit exposures to connected persons other than non-bank connected persons. Peak end-of-day credit exposures to non-bank connected persons have been calculated using the banking group's Tier 1 capital at 30 June 2017.

The rating-contingent limit, which is applicable to the banking group, based on the Conditions of Registration imposed by the RBNZ is 15%. There have been no rating-contingent limit changes during the accounting period. Within the rating-contingent limit there is a sub-limit of 15% of Tier 1 capital, which applies to the aggregate credit exposure to non-bank connected persons.

There are no individual credit impairment allowances against credit exposures to non-bank connected persons as at 30 June 2017.

Exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessments, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.

The banking group does not have any contingent exposures to connected persons arising from risk lay-off arrangements as at balance date.

(f) Credit exposure to individual counterparties

At 30 June 2017 the banking group did not have any period end or peak end-of-day credit exposures over 10% of equity to individual counterparties (not being members of groups of closely related counterparties) or groups of closely related counterparties (excluding central government of any country with a long-term credit rating of A- or A3 or above, or its equivalent, or any bank with a long-term credit rating of A- or A3 or above, or its equivalent, and connected persons) (2016: nil).

The peak aggregate end-of-day credit exposure is determined by taking the maximum end-of-day aggregate amount of credit exposure over the period. The amount is then divided by the banking group's equity as at the end of the quarter. Credit exposures disclosed are based on actual exposures. The credit rating is applicable to an entity's long term senior unsecured obligations payable in New Zealand, in New Zealand dollars.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

19 Asset quality

The disclosures in this note are categorised by the following credit risk concentrations:

Rural	Lending to the farming sector primarily livestock, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers. Includes lending to individuals and small to medium enterprises.
Other Corporate	Business lending other than rural lending.
Residential	Lending secured by a first ranking mortgage over a residential property used primarily for residential purposes either by the mortgagor or a tenant of the mortgagor.
All Other	This relates primarily to consumer lending to individuals.

(a) Finance receivables by credit risk concentration

	NOTE	Rural \$000	Other Corporate \$000	Residential \$000	All Other \$000	Total \$000
Jun 2017						
Neither at least 90 days past due nor impaired		823,851	997,264	959,268	731,023	3,511,406
At least 90 days past due	19(b)	10,846	10,769	303	13,711	35,629
Individually impaired	19(c)	2,313	25,550	714	-	28,577
Fair value adjustment for present value of future losses	11	-	-	(3,851)	-	(3,851)
Provision for impairment	19(e)	(4,149)	(12,987)	(2,469)	(6,260)	(25,865)
Total net finance receivables		832,861	1,020,596	953,965	738,474	3,545,896

Jun 2016						
Neither at least 90 days past due nor impaired		655,340	922,699	854,183	637,131	3,069,353
At least 90 days past due	19(b)	4,293	12,630	588	4,444	21,955
Individually impaired	19(c)	22,667	11,097	-	-	33,764
Fair value adjustment for present value of future losses	11	-	-	(4,987)	-	(4,987)
Provision for impairment	19(e)	(4,464)	(10,065)	(3,046)	(3,586)	(21,161)
Total net finance receivables		677,836	936,361	846,738	637,989	3,098,924

(b) Past due but not impaired

Jun 2017						
Less than 30 days past due		33,898	38,584	731	23,796	97,009
At least 30 and less than 60 days past due		13,222	19,630	253	9,827	42,932
At least 60 but less than 90 days past due		6,836	5,759	-	4,138	16,733
At least 90 days past due		10,846	10,769	303	13,711	35,629
Total past due but not impaired		64,802	74,742	1,287	51,472	192,303

Jun 2016						
Less than 30 days past due		10,822	20,470	1,522	20,162	52,976
At least 30 and less than 60 days past due		4,837	5,835	719	5,283	16,674
At least 60 but less than 90 days past due		3,051	3,104	-	2,394	8,549
At least 90 days past due		4,293	12,630	588	4,444	21,955
Total past due but not impaired		23,003	42,039	2,829	32,283	100,154

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

19 Asset quality (continued)

(c) Individually impaired assets

	Rural \$000	Other Corporate \$000	Residential \$000	All Other \$000	Total \$000
Jun 2017					
Opening	22,667	11,097	-	-	33,764
Additions	5,607	30,006	714	-	36,327
Deletions	(25,403)	(13,971)	-	-	(39,374)
Write offs	(558)	(1,582)	-	-	(2,140)
Closing gross individually impaired assets	2,313	25,550	714	-	28,577
Less: provision for individually impaired assets	1,005	7,288	129	-	8,422
Total net impaired assets	1,308	18,262	585	-	20,155
Jun 2016					
Opening	1,562	23,836	224	-	25,622
Additions	23,135	11,781	-	-	34,916
Deletions	(1,420)	(13,120)	(224)	-	(14,764)
Write offs	(610)	(11,400)	-	-	(12,010)
Closing gross individually impaired assets	22,667	11,097	-	-	33,764
Less: provision for individually impaired assets	869	4,033	-	-	4,902
Total net impaired assets	21,798	7,064	-	-	28,862

(d) Credit risk grading

The banking group's receivables are monitored either by account behaviour or a regular assessment of their credit risk grade based on an objective review of defined risk characteristics. The portfolio risk is regularly refreshed based on current information.

The banking group classifies finance receivables as Behavioural or Judgemental.

The Behavioural portfolio consists of consumer, retail and reverse mortgage receivables and usually relates to financing of or the acquisition of a single asset.

Consumer loans are typically introduced by vendors of the asset financed and are smaller in value than Judgemental loans. Consumer and retail loans are risk graded based on arrears status.

Consumer and retail loans are classified as either not in arrears, active, arrangement, non-performing / repossession or recovery, as described below:

- Active – loans for which the arrears category has reached 5 days overdue.
- Arrangement – 5 to 34 days overdue accounts for which arrangements have or are in the process of being made for arrears to be repaid.
- Non-performing / Repossession – residential mortgage loans that are greater than 90 days past due / other loans for which security has or is in the process of being repossessed.
- Recovery loans – loans for which security has been sold and shortfalls are being sought from the customer or where other recovery action is being taken.

The banking group also lends funds on its reverse mortgage product which is considered behavioural but has no arrears characteristics. These loans are assessed on origination against a pre-determined criteria supported by an actuarial assessment of future losses. The assumptions embedded in that assessment are reviewed annually against actual experience.

The Judgemental portfolio consists mainly of Business and Rural lending. Judgemental loans relate to loans where an on-going and detailed working relationship with the customer has been developed.

Judgemental loans are individually risk graded based on loan status, financial information, security and debt servicing ability. Exposures in the Judgemental portfolio are credit risk graded by an internal risk grading mechanism.

In the Judgemental portfolio, grade 1 is the strongest risk grade for undoubted risk and grade 9 represents the weakest risk grade where a loss is probable. Grade 10 reflects loss accounts written off.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 30 June 2017

19 Asset quality (continued)

(d) Credit risk grading (continued)

	Rural	Other Corporate	Residential	All Other	Total
	\$000	\$000	\$000	\$000	\$000
Jun 2017					
Judgemental portfolio					
Grade 1 - Very Strong	715	-	-	-	715
Grade 2 - Strong	2,871	18,699	4,989	-	26,559
Grade 3 - Sound	21,753	57,231	776	-	79,760
Grade 4 - Adequate	93,858	238,616	2,403	916	335,793
Grade 5 - Acceptable	471,820	256,139	2,581	1,683	732,223
Grade 6 - Monitor	129,743	36,412	-	-	166,155
Grade 7 - Substandard	13,871	13,798	-	-	27,669
Grade 8 - Doubtful	1,071	15,520	158	-	16,749
Grade 9 - At risk of loss	11	2,545	-	-	2,556
Total Judgemental portfolio	735,713	638,960	10,907	2,599	1,388,179
Behavioural portfolio					
Not in arrears	95,727	369,655	948,780	681,646	2,095,808
Active	3,716	13,920	362	36,849	54,847
Arrangement	647	2,168	107	15,590	18,512
Non-performing / Repossession	154	836	-	3,966	4,956
Recovery	48	757	-	4,084	4,889
Total Behavioural portfolio	100,292	387,336	949,249	742,135	2,179,012
Provision for collectively impaired assets	(3,144)	(5,699)	(2,340)	(6,260)	(17,443)
Fair value adjustment for present value of future losses	-	-	(3,851)	-	(3,851)
Total finance receivables	832,861	1,020,597	953,965	738,474	3,545,897
Jun 2016					
Judgemental portfolio					
Grade 1 - Very Strong	936	-	-	-	936
Grade 2 - Strong	5,398	18,904	13,897	-	38,199
Grade 3 - Sound	16,523	74,133	1,132	-	91,788
Grade 4 - Adequate	90,431	176,588	2,098	-	269,117
Grade 5 - Acceptable	405,299	293,812	1,712	-	700,823
Grade 6 - Monitor	79,468	46,375	-	-	125,843
Grade 7 - Substandard	414	20,020	-	-	20,434
Grade 8 - Doubtful	11,495	5,409	-	-	16,904
Grade 9 - At risk of loss	10,223	1,965	-	-	12,188
Total Judgemental portfolio	620,187	637,206	18,839	-	1,276,232
Behavioural portfolio					
Not in arrears	58,015	295,448	833,201	602,911	1,789,575
Active	817	5,838	1,522	17,650	25,827
Arrangement	607	3,056	1,209	10,008	14,880
Non-performing / Repossession	230	1,186	-	5,070	6,486
Recovery	85	1,171	-	5,914	7,170
Total Behavioural portfolio	59,754	306,699	835,932	641,553	1,843,938
Provision for collectively impaired assets	(3,595)	(6,032)	(3,046)	(3,586)	(16,259)
Fair value adjustment for present value of future losses	-	-	(4,987)	-	(4,987)
Total finance receivables	676,346	937,873	846,738	637,967	3,098,924

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

19 Asset quality (continued)

(e) Provision for impairment

Credit impairment provisions are made where events have occurred leading to an expectation of reduced future cash flows from certain receivables. These provisions are made in some cases against an individual loan and in other cases on a collective basis.

Bad debts provided for are written off against individual or collective provisions. Amounts required to bring the provisions to their assessed levels are recognised in profit or loss. Any future recoveries of amounts provided for are recognised in profit or loss.

Collective provisioning

The term collectively impaired asset refers to an asset where an event has occurred of which past history indicates that there is an increased possibility that the banking group will not collect all of its principal and interest as it falls due. No losses have yet been identified on these individual loans within the collectively impaired asset grouping, and history would indicate that only a small portion of these loans will eventually not be recovered. The banking group provides fully for its expected losses on collectively impaired assets.

Collective provisions are assessed with reference to risk profile groupings and historical loss data. Other judgemental factors including economic and credit cycle considerations are also taken into account in determining appropriate loss propensities to be applied. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the wider economic environment, interest rates and their effect on customer spending, unemployment levels, payment behaviour and bankruptcy rates.

No provisions are applied to loans that are newly written and loans that remain within their contractual terms, except where the banking group becomes aware of an event that might alter its view of the risk of a particular deal or group of deals.

Individual provisioning

Specific impairment provisions are made where events have occurred leading to an expectation of reduced future cash flows from certain receivables. For individually significant loans for which the assessed risk grade is considered a "potential loss", an individual assessment is made of an appropriate provision for credit impairment.

Credit impairments are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held (discounted at the loan's original effective interest rate). All relevant considerations that have a bearing on the expected future cash flows are taken into account, including the business prospects for the customer, the likely realisable value of collateral, the banking group's position relative to other claimants, the reliability of customer information and the likely cost and duration of the work-out process. Subjective judgements are made in this process. Furthermore, judgement can change with time as new information becomes available or as work-out strategies evolve, resulting in revisions to the impairment provision as individual decisions are taken. Changes in judgement could have a material impact on the financial statements.

Adequacy of the collective provision levels for each risk grouping is measured against historical loss experience at least annually. Adequacy of individual provisions is assessed in respect of each loan on a material development or at least quarterly.

For Behavioural loans, excluding reverse mortgage loans, arrears drive provision outcomes. Each arrears classification carries a provision for potential loss based on historical experience for that classification in the same portfolio.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 30 June 2017

19 Asset quality (continued)

(e) Provision for impairment (continued)

	Rural	Other Corporate	Residential	All Other	Total
	\$000	\$000	\$000	\$000	\$000
Jun 2017					
Provision for individually impaired assets					
Opening provision for individually impaired assets	869	4,033	-	-	4,902
Impairment loss for the year					
- charge / (credit) for the year	694	3,682	129	-	4,505
- recoveries	-	1,155	-	-	1,155
- write offs	(558)	(1,582)	-	-	(2,140)
Closing provision for individually impaired assets	1,005	7,288	129	-	8,422
Provision for collectively impaired assets					
Opening provision for collectively impaired assets	3,595	6,032	3,046	3,586	16,259
Impairment loss for the year					
- charge / (credit) for the year	(46)	1,485	(632)	9,703	10,510
- recoveries	23	119	-	63	205
- write offs	(428)	(1,937)	(74)	(7,092)	(9,531)
Closing provision for collectively impaired assets	3,144	5,699	2,340	6,260	17,443
Total provision for impairment	4,149	12,987	2,469	6,260	25,865
Jun 2016					
Provision for individually impaired assets					
Opening provision for individually impaired assets	817	14,394	-	-	15,211
Impairment loss for the year					
- (credit) / charge for the year	662	401	-	-	1,063
- recoveries	-	638	-	-	638
- write offs	(610)	(11,400)	-	-	(12,010)
Closing provision for individually impaired assets	869	4,033	-	-	4,902
Provision for collectively impaired assets					
Opening provision for collectively impaired assets	1,356	4,588	1,763	2,494	10,201
Impairment loss for the year					
- charge / (credit) for the year	2,258	3,397	1,301	5,482	12,438
- recoveries	-	195	70	8	273
- write offs	(19)	(2,148)	(88)	(4,398)	(6,653)
Closing provision for collectively impaired assets	3,595	6,032	3,046	3,586	16,259
Total provision for impairment	4,464	10,065	3,046	3,586	21,161

(f) Other assets under administration

Other assets under administration are any loans, not being individually impaired or 90 days or more past due, where the customer is in any form of voluntary or involuntary administration, including receivership, liquidation, bankruptcy or statutory management. As at 30 June 2017, the banking group had assets under administration of \$1,203,000 (2016: \$3,017,000).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

20 Liquidity risk

Liquidity risk is the risk that the banking group is unable to meet its payment obligations as they fall due. The timing mismatch of cash flows and the related liquidity risk is inherent in all banking operations and is closely monitored by the banking group.

Management of liquidity risk is designed to ensure that the banking group has the ability to generate or obtain sufficient cash in a timely manner and at a reasonable price to meet its financial commitments on a daily basis.

The banking group's exposure to liquidity risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ALCO must conform to this. The objective of the ALCO is to derive the most appropriate strategy for the banking group in terms of the mix of assets and liabilities given its expectations of future cash flows, liquidity constraints and capital adequacy. The banking group employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies.

The banking group holds the following financial assets for the purpose of managing liquidity risk:

	Jun 2017 \$000	Jun 2016 \$000
Cash and cash equivalents	57,040	84,154
Investments	306,907	229,144
Undrawn committed bank facilities	85,000	66,000
Total liquidity	448,947	379,298

Contractual liquidity profile of financial assets and liabilities

The following tables present the banking group's financial assets and liabilities by relevant maturity groupings based upon contractual maturity date. The amounts disclosed in the tables represent undiscounted future principal and interest cash flows. As a result, the amounts in the tables below may differ to the amounts reported on the balance sheet.

The contractual cash flows presented below may differ significantly from actual cash flows. This occurs as a result of future actions by the banking group and its counterparties, such as early repayments or refinancing of term loans and borrowings. Deposits and other public borrowings include customer savings deposits and transactional accounts, which are at call. History demonstrates that such accounts provide a stable source of long term funding for the banking group.

The banking group does not manage its liquidity risk on a contractual liquidity basis.

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
Jun 2017							
Financial assets							
Cash and cash equivalents	57,040	-	-	-	-	-	57,040
Investments	-	45,849	21,418	112,861	137,419	11,791	329,338
Finance receivables	-	511,529	446,008	748,085	1,275,773	4,285,026	7,266,421
Finance receivables - securitised	-	60,792	54,489	85,155	95,528	-	295,964
Other financial assets	-	101	-	-	-	-	101
Total financial assets	57,040	618,271	521,915	946,101	1,508,720	4,296,817	7,948,864
Financial liabilities							
Borrowings	836,829	1,163,751	513,671	114,221	729,587	-	3,358,059
Borrowings - securitised	-	2,727	215,474	-	-	-	218,201
Derivative financial liabilities	-	3,349	-	-	-	-	3,349
Other financial liabilities	-	22,130	-	-	-	-	22,130
Total financial liabilities	836,829	1,191,957	729,145	114,221	729,587	-	3,601,739
Net financial (liabilities) / assets	(779,789)	(573,686)	(207,230)	831,880	779,133	4,296,817	4,347,125
Undrawn facilities available to customers	120,948	-	-	-	-	-	120,948
Undrawn committed bank facilities	85,000	-	-	-	-	-	85,000

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

20 Liquidity risk (continued)

Contractual liquidity profile of financial assets and liabilities (continued)

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
Jun 2016							
Financial assets							
Cash and cash equivalents	84,154	-	-	-	-	-	84,154
Investments	-	11,309	18,198	87,931	135,611	7,291	260,340
Finance receivables	-	633,012	391,671	509,539	846,984	2,894,517	5,275,723
Finance receivables - securitised	-	91,886	72,257	96,767	69,537	-	330,447
Derivative financial assets	-	148	-	-	-	-	148
Other financial assets	-	5,452	-	-	-	-	5,452
Total financial assets	84,154	741,807	482,126	694,237	1,052,132	2,901,808	5,956,264
Financial liabilities							
Borrowings	718,587	862,159	552,208	208,556	465,204	-	2,806,714
Borrowings - securitised	-	4,646	285,236	-	-	-	289,882
Derivative financial liabilities	-	5,866	-	-	-	-	5,866
Other financial liabilities	-	21,995	-	-	-	-	21,995
Total financial liabilities	718,587	894,666	837,444	208,556	465,204	-	3,124,457
Net financial (liabilities) / assets	(634,433)	(152,859)	(355,318)	485,681	586,928	2,901,808	2,831,807
Undrawn facilities available to customers	147,903	-	-	-	-	-	147,903
Undrawn committed bank facilities	66,000	-	-	-	-	-	66,000

Undrawn committed bank facilities of \$85.0 million (2016: \$66.0 million) were available to be drawn down on demand. To the extent drawn, \$85.0 million is contractually repayable in 6-12 months' time upon facility expiry.

21 Interest rate risk

The banking group's market risk is derived primarily of exposure to interest rate risk, predominantly from raising funds through the retail and wholesale deposit market, the debt capital markets and committed and uncommitted bank funding, securitisation of receivables, and offering loan finance products to the commercial and consumer market in New Zealand and Australia.

Interest rate risk is the risk that the value of assets or liabilities will change because of changes in interest rates or that market interest rates may change and thus alter the margin between interest-earning assets and interest-bearing liabilities. Interest rate risk for the banking group refers to the risk of loss due to holding assets and liabilities that may mature or re-price in different periods.

The banking group's exposure to market risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ALCO must conform to this. The objective of the ALCO is to derive the most appropriate strategy for the banking group in terms of the mix of assets and liabilities given its expectations of the future and the potential consequences of interest rate movements, liquidity constraints and capital adequacy.

To manage this market risk, the banking group measures sensitivity to interest rate changes by frequently testing its position against various interest rate change scenarios to assess potential risk exposure. The banking group also manages interest rate risk by:

- Monitoring maturity profiles and seeking to match the re-pricing of assets and liabilities (physical hedging);
- Monitoring interest rates daily and regularly (at least monthly) reviewing interest rate exposure; and
- Entering into forward rate agreements and interest rate swaps and options to hedge against movements in interest rates.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

21 Interest rate risk (continued)

Contractual repricing analysis

The interest rate risk profile of financial assets and liabilities that follows has been prepared on the basis of maturity or next repricing date, whichever is earlier.

	0-3 Months \$000	3-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2+ Years \$000	Non-interest bearing \$000	Total \$000
Jun 2017							
Financial assets							
Cash and cash equivalents	57,020	-	-	-	-	20	57,040
Investments	55,929	7,886	9,937	112,747	120,408	11,791	318,698
Finance receivables	2,376,633	138,837	208,917	313,010	281,413	113	3,318,923
Finance receivables - securitised	56,584	27,195	45,529	46,485	51,181	-	226,974
Other financial assets	-	-	-	-	-	101	101
Total financial assets	2,546,166	173,918	264,383	472,242	453,002	12,025	3,921,736
Financial liabilities							
Borrowings	1,981,205	576,129	491,038	111,863	47,736	7,405	3,215,376
Borrowings - securitised	214,365	-	-	-	-	-	214,365
Other financial liabilities	3,349	-	-	-	-	22,130	25,479
Total financial liabilities	2,198,919	576,129	491,038	111,863	47,736	29,535	3,455,220
Effect of derivatives held for risk management	423,403	(44,010)	(85,588)	(166,735)	(127,070)	-	-
Net financial assets / (liabilities)	770,650	(446,221)	(312,243)	193,644	278,196	(17,510)	466,516
Jun 2016							
Financial assets							
Cash and cash equivalents	84,062	-	-	-	-	92	84,154
Investments	54,307	1,458	11,894	49,897	111,588	7,291	236,435
Finance receivables	2,101,228	91,075	153,873	227,382	231,629	194	2,805,381
Finance receivables - securitised	42,587	36,733	63,314	86,479	64,430	-	293,543
Other financial assets	148	-	-	-	-	5,452	5,600
Total financial assets	2,282,332	129,266	229,081	363,758	407,647	13,029	3,425,113
Financial liabilities							
Borrowings	1,555,497	380,170	529,796	183,094	59,726	7,275	2,715,558
Borrowings - securitised	284,429	-	-	-	-	-	284,429
Other financial liabilities	5,866	-	-	-	-	21,995	27,861
Total financial liabilities	1,845,792	380,170	529,796	183,094	59,726	29,270	3,027,848
Effect of derivatives held for risk management	235,387	(28,241)	(54,756)	(81,230)	(71,160)	-	-
Net financial assets / (liabilities)	671,927	(279,145)	(355,471)	99,434	276,761	(16,241)	397,265

The tables above illustrate the periods in which the cash flows from interest rate swaps are expected to occur and affect profit or loss.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the banking group's financial assets and liabilities to various standard and non standard interest rate scenarios. Standard scenarios which are considered on a monthly basis include a 100 basis point parallel fall or rise in the yield curve. There is no material impact on profit or loss in terms of a fair value change from movements in market interest rates. Furthermore there is no material cash flow impact on the Statement of Cash Flows from a 100 basis point change in interest rates.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

22 Concentrations of funding

(a) Concentration of funding by industry

	Jun 2017 \$000	Jun 2016 \$000
Finance	1,049,237	852,433
Other	2,380,504	2,147,554
Total borrowings	3,429,741	2,999,987

(b) Concentration of funding by geographical area

Auckland	993,573	849,276
Wellington	203,652	155,248
Rest of North Island	550,787	520,764
Canterbury	843,919	800,893
Rest of South Island	224,155	206,748
Overseas ¹	613,655	467,058
Total borrowings	3,429,741	2,999,987

Other Disclosures

23 Significant subsidiaries

Significant subsidiaries / Joint arrangements	Country of incorporation and place of business	Nature of business	Proportion of ownership interest and voting power held	
			Jun 2017	Jun 2016
VPS Properties Limited	New Zealand	Investment property holding company	100%	100%
Heartland Australia Group Pty Limited	Australia	Financial services	100%	100%
MARAC Insurance Limited	New Zealand	Insurance services	100%	100%

24 Structured entities

A structured entity is one which has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity. Structured entities are created to accomplish a narrow and well-defined objective such as the securitisation or holding of particular assets, or the execution of a specific borrowing or lending transaction. Structured entities are consolidated where the substance of the relationship is that the banking group controls the structured entity.

(a) Heartland Cash and Term PIE Fund (Heartland PIE Fund)

The banking group controls the operations of Heartland PIE Fund which is a portfolio investment entity that invests in the bank's deposits. Investments of Heartland PIE Fund are represented as follows:

	Jun 2017 \$000	Jun 2016 \$000
Deposits	93,998	80,527

(b) Heartland ABCP Trust 1 (ABCP Trust)

The banking group has securitised a pool of receivables comprising commercial and motor vehicle loans to ABCP Trust.

The banking group continues to recognise the securitised assets and associated borrowings in the Statement of Financial Position through the holding of subordinated debt of the ABCP Trust and the receipt of deferred purchase consideration from that trust. Whilst the bank has those interests in the ABCP Trust, the loans sold to the Trust are set aside for the benefit of investors in the ABCP Trust and bank depositors have no recourse to these assets. The ABCP Trust's material assets and liabilities are represented as follows:

	NOTE	Jun 2017 \$000	Jun 2016 \$000
Cash and cash equivalents - securitised		9,272	15,208
Finance receivables - securitised	11	226,974	293,543
Borrowings - securitised	13	(214,365)	(284,429)
Derivative financial liabilities - securitised		(1,042)	(2,833)

¹ Included in Overseas funding is the CBA bank facility totalling \$462 million (2016: \$379 million), refer to Note 13 - Borrowings for more information.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

24 Structured entities (continued)

(c) Seniors Warehouse Trust (SW Trust) and ASF Settlement Trust (ASF Trust)

SW Trust and ASF Trust form part of ASF's reverse mortgage business and were both set up by ASF, as asset holding entities. The Trustee for both Trusts is ASF Custodians Pty Limited and the Trust Manager is ASF. The reverse mortgage loans held by the Trusts are set aside for the benefit of the funder and bank depositors have no recourse to these assets. The balances of SW Trust and ASF Trust are represented as follows:

	Jun 2017	Jun 2016
	\$000	\$000
Cash and cash equivalents	9,126	2,503
Finance receivables - Reverse mortgage loans	520,572	434,688
Borrowings - CBA	(462,298)	(379,299)
Derivative financial liabilities	(547)	(2,083)

25 Staff share ownership arrangements

The banking group operates a number of share-based compensation plans that are equity settled. The fair value determined at the grant date is expensed on a straight line basis over the vesting period, based on the banking group's estimate of equity instruments that will eventually vest, with a corresponding increase in equity. At the end of each reporting period, the banking group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the employee benefits reserve.

(a) Share-based compensation plan details

Heartland LTI Net Share Settled Plan (LTI Plan)

The LTI Plan was allotted under three tranches (referred to as the 2013, 2014 and 2015 tranches). Under the LTI Plan participants were granted an option to acquire shares in the bank. The number of shares granted upon exercise of the options is based on the difference between the market price of the shares on the exercise date and the reference price.

The options are subject to the participants' continued employment with the banking group for the service period of 3 years which begins on 1 July 2014 for the 2015 plan. Participants in the 2015 tranche will be able to exercise their options between September 2017 and 1 July 2019.

2015 Special Grant (LTI SG)

Participants of the LTI SG were able to exercise options in the period beginning on the date the market price of Heartland shares was equal to \$1.50 and ending on 1 July 2017. Market price was calculated based on the VWAP of a Heartland share for the 10 business days immediately before (but excluding) the exercise date for those options. The options were subject to the participants' continued employment with the banking group for the service period of 3 years which began on 1 July 2014. Following exercise a lock up period until 1 July 2020 applies during which participants are restricted from disposing of shares.

The reference price was the amount by which the market price of Heartland shares, at the time of exercise, exceeded \$1.00 (based on a volume weighted average price of Heartland shares for the prior 20 business days), plus the aggregate amount of cash dividends (cents per Heartland share) paid by the bank in the period from 1 April 2015 until and including the date the options were exercised. However, for the purpose of calculating the settlement amount, the market price of Heartland shares was capped at \$1.50 and any increase above this amount was disregarded.

Senior Executive Scheme (SES)

The SES was established in June 2016 as a replacement of the LTI Plan and LTI SG for certain affected participants only (Senior Executives). Under the SES, Senior Executives forfeited their options under the 2014 and 2015 tranches of the LTI Plan and the LTI SG and purchased Heartland shares with proceeds from a settlement amount paid to them by the bank. The shares are unable to be sold or otherwise disposed of by the Senior Executive until 30 June 2019. Until then, if the Senior Executive ceases their employment with the bank, the bank has a call option requiring the Senior Executive to give the shares back to the bank for no consideration.

The SES has been treated as a modification of the Senior Executive entitlements under the 2014 and 2015 tranches of the LTI Plan and the LTI SG. The incremental fair value granted is \$0.49 million based on the value of shares acquired under the SES less the fair value of the benefits forfeited under the 2014 and 2015 tranches of the LTI Plan and the LTI SG.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

25 Staff share ownership arrangements (continued)

Heartland Performance Rights Plan 2016 (PR Plan 2016)

The PR Plan 2016 was established to enhance the alignment of participants' interests with those of the bank's shareholders. Under the PR Plan 2016 participants are issued performance rights which will entitle them to receive shares in the bank.

The number of performance rights offered is determined by the participant's LTI value over the volume weighted average of the sales prices (VWAP) of the bank's ordinary shares on the NZX Main Board for the 10 business days immediately before (and including) the issue date. The issue date is 31 August 2016. Performance rights do not entitle participants to dividends or voting rights.

The performance rights are issued subject to the participants' continued employment with the banking group until the measurement date and the bank achieving its Total Shareholder Return (TSR) target. The measurement date is defined as 10 business days following the date on which the bank announces its full year results for the financial year ended 2019. The TSR target has been set at an annual rate of 11%, compounding and is determined primarily by share price movements and cash dividends. Performance rights will vest on the measurement date where these criteria have been met.

	PR Plan Number of rights	SES Number of shares	LTI SG Number of options	LTI Plan Number of options
1 July 2016	-	1,858,676	1,302,101	17,455,079
Granted ¹	888,300	-	-	-
Exercised ²	-	-	(1,302,101)	(9,912,296)
Forfeited	-	-	-	(50,030)
30 June 2017	888,300	1,858,676	-	7,492,753
1 July 2015	-	-	5,208,403	13,451,715
Granted	-	-	-	9,246,957
Committed but not granted	-	-	-	2,026,121
Exercised	-	-	-	(540,414)
Modified to SES	-	1,858,676	(3,906,302)	(6,415,127)
Forfeited	-	-	-	(314,173)
30 June 2016	-	1,858,676	1,302,101	17,455,079

¹ The fair value of performance rights granted during the period under the PR Plan is \$0.453 million. This fair value was derived using the Monte Carlo model. The key inputs used in the model are:

- Volatility 20.88% (calculated based on the historical movement in Heartland's shares)
- Risk free rate 2.35% p.a.
- Estimated option life 2.4 years
- Measurement date 7 October 2019
- VWAP on Issue Date \$1.5259
- Forecast dividends of 8.92 cent p.a.
- Share price at valuation date \$1.66

² Weighted average share price on exercise was \$1.54 (2016: \$1.24).

(b) Effect of share-based payment transactions

	Jun 2017 \$000	Jun 2016 \$000
Award of shares	86	132
SES	328	1,406
LTI SG	99	163
LTI Plan	415	187
PR Plan	125	-
Total expense recognised	1,053	1,888

As at 30 June 2017, \$0.98 million of share scheme awards remain unvested and not expensed (30 June 2016: \$1.51 million). This expense will be recognised over the vesting period of the awards.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

25 Staff share ownership arrangements (continued)

(c) Number of options / rights outstanding at 30 June 2017

	Rights Outstanding 000	Options Outstanding 000	Remaining life years
LTI SG	-	-	-
LTI Plan - 2013 tranche	-	-	-
LTI Plan - 2014 tranche	-	-	-
LTI Plan - 2015 tranche	-	7,493	2
PR Plan - 2016	888	-	2
	888	7,493	

26 Capital adequacy

The banking group is subject to regulation by the RBNZ. The RBNZ has set minimum regulatory capital requirements for banks that are consistent with the internationally agreed framework developed by the Basel Committee on Banking Supervision. The resulting Basel II and III requirements define what is acceptable as capital and provide for methods of measuring the risks incurred by the banking group.

The banking group's Conditions of Registration prescribes minimum capital adequacy ratios calculated in accordance with the Capital Adequacy Framework (Standardised Approach) BS2A.

The banking group has adopted the Basel II standardised approach per RBNZ BS2A to calculate its regulatory requirements. Basel II is made up of the following three Pillars:

- Pillar 1 sets out the minimum capital requirements for credit, market and operational and compliance risks.
- Pillar 2 is designed to ensure that banks have adequate capital to support all risks (not just those set out under Pillar 1 above) and is enforced through the requirement for supervisory review.
- Pillar 3 outlines the requirements for adequate and transparent disclosure.

Basel III was developed in order to strengthen the regulation, supervision and risk management of the banking sector. The measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress; improve risk management and governance; and strengthen banks' transparency and disclosures. The requirements that impact capital are as follows:

- The level of capital required to be held by banks increased through the introduction of new minimum capital requirements for Common Equity Tier 1 (CET1) capital, Additional Tier 1 (AT1) capital and Total capital as a percentage of risk-weighted-assets (RWA's).
- A capital conservation buffer held over and above the minimum capital ratio requirements used to absorb losses during periods of financial and economic stress.
- A counter-cyclical capital buffer be held and to be used at the RBNZ's discretion, to assist in attaining the macro-prudential goal of protecting the banking sector from periods of extraordinary excess aggregate credit growth.
- Strengthen the calculation of RWAs, particularly in respect of counterparty credit risk.

The Basel III requirements have not effected the banking group's minimum capital requirements as the banking group's Conditions of Registration prescribe minimum capital requirements higher than the Basel III requirements.

The capital adequacy tables set out on the following pages summarise the composition of regulatory capital and the capital adequacy ratios for the banking group as at 30 June 2017.

Internal Capital Adequacy Assessment Process (ICAAP)

The bank has an ICAAP which complies with the requirements in 'Guidelines on a Bank's Internal Capital Adequacy Assessment Process ("ICAAP")' BS12 and is in accordance with its Conditions of Registration.

The Board has overall responsibility for ensuring the banking group has adequate capital in relation to its risk profile and establishes minimum internal capital levels and limits above the regulatory minimum. The banking group has established a Capital Management Policy (CMP) to determine minimum capital levels for tier one and total capital under Basel III and in accordance with its Conditions of Registration. The documented process ensures that the banking group has sufficient available capital to meet minimum capital requirements, even in stressed events. It describes the risk profile of the banking group and the risk appetite and tolerances under which it operates, and assesses the level of capital held against the material risks of the bank (both Pillar One and Pillar Two).

The ICAAP identifies the additional capital required to be held against other material risks, being concentration risk, strategic / business risk, reputational risk, regulatory risk and model risk. See Note 26(l) for further details.

Compliance with minimum capital levels is monitored by ALCO and reported to the Board monthly. The ICAAP and CMP is reviewed annually by the Board.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

26 Capital adequacy (continued)

(a) Capital

	Jun 2017 \$000
Tier 1 Capital	
CET1 capital	
Paid-up ordinary shares issued by the banking group plus related share premium	473,128
Retained earnings (net of appropriations)	97,642
Accumulated other comprehensive income and other disclosed reserves	(120)
Less deductions from CET1 capital	
Intangible assets	(71,237)
Deferred tax assets	(7,852)
Hedging reserve	1,152
Defined benefit superannuation fund assets	(406)
Total CET1 capital	492,307
Additional Tier 1 Capital	
Nil	-
Total Tier 1 Capital	492,307
Tier 2 Capital	
Subordinated bonds	970
Subordinated notes	15,060
Foreign currency translation reserve	(1,055)
Total Tier 2 Capital	14,975
Total Capital	507,282

(b) Capital structure

The following details summarise each instrument included within Total Capital. None of these instruments are subject to phase-out from eligibility as capital under the RBNZ's Basel III transitional arrangements.

Ordinary shares

In accordance with BS2A, ordinary share capital is classified as CET1 capital. The ordinary shares have no par value. Each ordinary share of the bank carries the right to vote on a poll at meetings of shareholders, the right to an equal share in dividends authorised by the Board and the right to an equal share in the distribution of the surplus assets of the bank in the event of liquidation.

Retained earnings

Retained earnings is the accumulated profit or loss that has been retained in the banking group. Retained earnings is classified as CET1 capital.

Reserves classified as CET1 capital

<i>Treasury shares reserve</i>	The treasury shares reserve comprises shares in Heartland Bank Limited held by the bank.
<i>Employee benefits reserve</i>	The employee benefits reserve comprises employee share options which have been recognised as an expense but not yet been exercised and converted into ordinary shares. These are scheduled to vest on 30 June 2017 and 30 June 2019 depending on the employee share option plan the options relate to.
<i>Available for sale reserve</i>	The available-for-sale reserve comprises the changes in the fair value of available-for-sale securities, net of tax. These changes are recognised in profit or loss as other income when the asset is either derecognised or impaired.
<i>Defined benefit reserve</i>	The defined benefit plan reserve represents the excess of the fair value of the assets of the defined benefit superannuation plan over the net present value of the defined benefit obligations.
<i>Hedging reserve</i>	The hedging reserve comprises the fair value gains and losses associated with the effective portion of designated cash flow hedging instruments.

Foreign currency translation reserve

The foreign currency translation reserve represents the differences in translation which arise when converting the financial statements of the Australian controlled entities from their functional currency into the presentational currency. It constitutes Tier 2 capital of the banking group.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

26 Capital adequacy (continued)

(b) Capital structure (continued)

Subordinated bonds and notes

Heartland's 2018 Subordinated Bonds (the Bonds) constitute Tier 2 Capital of the banking group. The Bonds had an issue period from 12 July 2013 to 15 December 2013 and have a maturity date of 15 December 2018. The Bonds pay quarterly interest in arrears at a rate of 6.5% per annum, provided the bank will be solvent immediately after the payment is made. The bank may elect to repay the Bonds prior to 15 December 2018 if a regulatory event or tax event occurs and provided it will be solvent immediately after the repayment and the Reserve Bank has consented to the repayment. The Bonds are subordinated to all other general liabilities of the banking group and are denominated in New Zealand dollars.

Heartland's 2027 Subordinated Unsecured Convertible Notes (the Notes) constitute Tier 2 Capital of the banking group. The Notes had an issue date of 7 April 2017 and have a maturity date of 7 April 2027. The Notes pay quarterly interest in arrears at a rate of BBSW+4.15% per annum, provided the bank will be solvent immediately after the payment is made. The bank may elect to repay some or all of the Notes on the First Optional Redemption Date (7 April 2022) or on any scheduled Interest Payment Date thereafter, as well as if a regulatory event or tax event occurs. Early repayment may only be made provided the bank will be solvent immediately after the repayment and the Reserve Bank has consented to the repayment. The Notes are subordinated to all other general liabilities of the banking group and are denominated in Australian dollars.

If the Reserve Bank or a Statutory Manager requires the bank to convert all or part of the Bonds, or to convert or write off (if conversion is not able to be effected) all or part of the Notes, the Bonds or Notes will be converted or written off (as applicable) and could in each case be reduced to zero to comply with the Reserve Bank's loss absorbency requirements. The bank has not had any defaults of principal, interest or other breaches with respect to the Bonds or Notes.

(c) Credit risk

(i) On balance sheet exposures

	Total exposure after credit risk mitigation \$000	Average risk weighting %	Risk weighted exposure \$000	Minimum Pillar 1 capital requirement \$000
Jun 2017				
Cash and gold bullion	20	0%	-	-
Multilateral development banks	63,684	0%	-	-
Multilateral development banks	75,571	20%	15,114	1,209
Public sector entities	57,998	20%	11,600	928
Banks	136,435	20%	27,287	2,183
Banks	7,850	50%	3,925	314
Banks	19,369	100%	19,369	1,550
Corporates	3,020	50%	1,510	121
Welcome Home Loans - loan to value ratio (LVR) <= 90% ¹	4,090	35%	1,432	115
Welcome Home Loans - LVR > 90% ¹	1,127	50%	564	45
Reverse Residential mortgages <= 60% LVR	885,278	50%	442,639	35,411
Reverse Residential mortgages 60 <= 80% LVR	32,829	80%	26,263	2,101
Reverse Residential mortgages > 80% LVR	4,641	100%	4,641	371
Past due residential mortgages	2,645	100%	2,645	212
Other past due assets - provision > 20%	9,846	100%	9,846	788
Other past due assets - provision < 20%	54,027	150%	81,041	6,483
Non property investment mortgage loan < 80% LVR	35,780	35%	12,523	1,002
Non property investment mortgage loan 80 < 90% LVR	4,275	50%	2,138	171
Non property investment mortgage loan 90 < 100% LVR	1,797	75%	1,348	108
Non property investment mortgage loan > 100% LVR	1,757	100%	1,757	141
Property Investment Mortgage Loan < 80% LVR	12,517	40%	5,007	401
Property Investment Mortgage Loan 80 < 90% LVR	1,545	70%	1,082	87
Property Investment Mortgage Loan 90 < 100% LVR	1,792	90%	1,613	129
Property Investment Mortgage Loan > 100% LVR	2,390	100%	2,390	191
All other equity holdings	11,791	400%	47,164	3,773
Other assets	2,523,102	100%	2,523,102	201,848
Not risk weighted assets	79,495	0%	-	-
Total on balance sheet exposures	4,034,671		3,246,000	259,682

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

26 Capital adequacy (continued)

(c) Credit risk (continued)

(ii) Off balance sheet exposures

	Total exposure	Average credit conversion factor	Credit equivalent amount	Average risk weight	Risk weighted exposure	Minimum Pillar 1 capital requirement ¹
	\$000	\$000	\$000	%	\$000	\$000
Jun 2017						
Direct credit substitute	10,903	100%	10,903	100%	10,903	872
Commitments with certain drawdown	13,747	100%	13,747	50%	6,874	550
Other commitments where original maturity is more than one year	79,755	50%	39,878	100%	39,878	3,190
Other commitments where original maturity is less than or equal to one year	180,612	20%	36,122	100%	36,122	2,890
Market related contracts²						
Interest rate contracts	197,877	n/a	-	20%	-	-
Interest rate contracts	294,585	0.5%	1,473	20%	295	24
Total off balance sheet exposures	777,479		102,123		94,072	7,526

(d) Additional mortgage information - LVR range

	On balance sheet exposures	Off balance sheet exposures ³	Total exposures
	\$000	\$000	\$000
Jun 2017			
Does not exceed 80%	971,075	13,746	984,821
Exceeds 80% and not 90%	12,001	-	12,001
Exceeds 90%	9,388	-	9,388
Total exposures	992,464	13,746	1,006,210

At 30 June 2017 \$1.12 million relating to Welcome Home loans, whose credit risk is mitigated by the Crown is included in "Exceeds 90% residential mortgages". Other loans in the exceeds 90% LVR range are primarily business and rural lending where residential mortgage security is only a part of the total security. For capital adequacy calculations only the value of first mortgages over residential property is included in the LVR calculation, in accordance with BS2A. All new residential mortgage loans are in respect of non property investments lending and have a loan-to-valuation ratio of less than or equal to 80%.

(e) Reconciliation of mortgage related amounts

	Jun 2017 \$000
Loans and advances - loans with residential mortgages	992,464
On balance sheet residential mortgage exposures subject to the standardised approach	992,464
Off balance sheet mortgage exposures subject to the standardised approach	13,746
Total residential exposures subject to the standardised approach	1,006,210

(f) Credit risk mitigation

As at 30 June 2017 the banking group had \$5.21 million of Welcome Home Loans, whose credit risk was mitigated by the Crown. Other than this the banking group does not have any exposures covered by eligible collateral, guarantees and credit derivatives.

(g) Operational Risk

	Implied risk weighted exposure	Aggregate capital charge
	\$000	\$000
Operational risk	213,546	17,084

Operational risk is calculated based on the previous 12 quarters of the banking group.

¹ The LVR classification above is calculated in line with the bank's Pillar 1 Capital requirement which includes capital relief for Welcome Home loans that are guaranteed by the Crown.

² The credit equivalent amount for market related contracts was calculated using the current exposure method.

³ Off balance sheet exposures means unutilised limits.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 30 June 2017

26 Capital adequacy (continued)

(h) Market risk

Market risk is the risk that market interest rate risks or foreign exchange rates will change and impact on the banking group's earnings due to either mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates.

		Implied risk weighted exposure	Aggregate capital charge
		\$000	\$000
Market risk end-of-period capital charge	Interest rate risk only	122,825	9,826
Market risk peak end-of-day capital charge	Interest rate risk only	122,825	9,826
Market risk end-of-period capital charge	Foreign currency risk only	65,952	5,276
Market risk peak end-of-day capital charge	Foreign currency risk only	65,952	5,276

Peak end-of-day aggregate capital charge at the end of the period is derived by following the risk methodology for measuring capital requirements within Part 10 of the Standardised Approach. Peak end-of-day aggregate capital charge is derived by determining the maximum end of month capital charge over the reporting period. Based on the portfolio of the banking group's risk exposures, it is considered by management that the difference between end of month aggregate capital charge and end-of-day aggregate capital charge is insignificant.

(i) Total capital requirements

	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement
	\$000	\$000	\$000
Total credit risk and equity			
On balance sheet	4,034,671	3,246,000	259,682
Off balance sheet	777,479	94,072	7,526
Operational risk	n/a	213,546	17,084
Market risk	n/a	188,777	15,102
Total	n/a	3,742,395	299,394

(j) Capital ratios

	Jun 2017	Jun 2016
	%	%
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.15%	13.79%
Minimum Common Equity Tier 1 Capital as per Conditions of Registration	4.50%	4.50%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.15%	13.79%
Minimum Tier 1 Capital as per Conditions of Registration	6.00%	6.00%
Total Capital expressed as a percentage of total risk weighted exposures	13.56%	13.78%
Minimum Total Capital as per Conditions of Registration	8.00%	8.00%
Buffer ratio		
Buffer ratio	5.56%	5.78%
Buffer ratio requirement	2.50%	2.50%

(k) Solo capital adequacy

	Jun 2017	Jun 2016
	%	%
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	14.55%	15.78%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	14.55%	15.78%
Total Capital expressed as a percentage of total risk weighted exposures	15.03%	15.77%

For the purposes of calculating capital adequacy on a solo basis, subsidiaries which are both wholly owned and wholly funded by the bank are to be consolidated with the bank. Therefore, capital adequacy on a solo basis is calculated based on the bank and its subsidiaries excluding ABCP Trust, SW Trust and ASF Trust.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

26 Capital adequacy (continued)

(l) Capital for other material risks

In addition to the material risks included in the calculation of the capital ratios, the banking group has identified other material risks to be included in the capital allocation (being concentration risk, strategic/business risk, reputational risk, regulatory and model risk). As at 30 June 2017, the banking group has made an internal capital allocation of \$104.89 million to cover these risks (2016: \$85.83m).

27 Insurance business, securitisation, funds management, other fiduciary activities

Insurance business

The banking group conducts insurance business through its subsidiary MARAC Insurance Limited (MIL).

The banking group's aggregate amount of insurance business comprises the total consolidated assets of MIL of \$12.70 million, which is 0.31% of the total consolidated assets of the banking group.

The banking group's objective is to minimise the insurance risk to within acceptable levels through policies and procedures implemented by management. Should adverse conditions arise, these policies and procedures are expected to mitigate the impact of the conditions on the banking group.

Marketing and distribution of insurance products

The banking group markets and distributes term life insurance and general insurance covering risks such as redundancy, bankruptcy or suspension of employment. The insurance products are either underwritten by MIL, a subsidiary of the banking group, or sold by MIL on behalf of other parties who underwrite those products themselves. There have been no material changes in the banking group's marketing and distribution of insurance products since the reporting date of the previous disclosure statement.

Securitisation

As at 30 June 2017, the banking group had securitised assets amounting to \$227 million (2016: \$296 million). These assets have been sold to ABCP Trust (a special purpose vehicle investing in motor vehicle, truck and trailer and commercial loans originated by the banking group and funded through the issuance of commercial paper and also through liquidity facilities). Note 24 - Structured entities provides further information on the securitised assets.

The bank received fees for various services provided to the securitisation vehicles on an arm's length basis, including servicing fees. These fees were recognised as earned. All securitisation vehicles form part of the banking group.

In July 2016, the Trust Manager of ABCP Trust changed from the bank to an external third party, AMAL New Zealand Limited. The residual beneficiary of the ABCP Trust also changed from the bank to Heartland Trust. There have been no other material changes to the banking group's involvement in the securitisation activities.

Funds management and other fiduciary activities

The banking group, through Heartland PIE Fund Limited, controls, manages and administers the Heartland Cash and Term PIE Fund and its products (Heartland Call PIE and Heartland Term Deposit PIE). Note 24 - Structured entities has further details. The Heartland Cash and Term PIE Fund deals with the bank in the normal course of business, in the bank's capacity as Registrar of the Fund and also invests in the bank's deposits. The banking group provides investment advice to a number of clients, which includes the provision of other fiduciary activities. The banking group is considered to control the Heartland Cash and Term PIE Fund, and as such the Heartland Cash and Term PIE Fund is consolidated within the financial statements of the banking group. There have been no material changes in the banking group's involvement in funds management and other fiduciary activities since the reporting date of the previous disclosure statement.

Risk management

The banking group has in place policies and procedures to ensure that the fiduciary activities identified above are conducted in an appropriate manner. It is considered that these policies and procedures will ensure that any difficulties arising from these activities will not impact adversely on the banking group. The policies and procedures include comprehensive and prominent disclosure of information regarding products, and formal and regular review of operations and policies by management and internal and external auditors. Further information on the banking group's risk management policies and practices is included in Note 17 - Risk management policies.

Provision of financial services and asset purchases

Over the accounting period, financial services provided by the banking group to entities which were involved in the activities above (including trust, custodial, funds management and other fiduciary activities) were provided on arm's length terms and conditions and at fair value.

Any assets purchased from such entities have been purchased on arm's length terms and conditions and at fair value.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2017

27 Insurance business, securitisation, funds management, other fiduciary activities (continued)

Peak aggregate funding to entities

The banking group did not provide any funding to entities conducting funds management and other fiduciary activities, or insurance product or marketing and distribution activities described in this note, during the year (2016: nil).

The bank provided funding to ABCP Trust, which is a member of the banking group involved in securitisation activities. This funding is provided to facilitate the purchase of asset backed securities from the banking group in order to support the securitisation facility.

	Total Trusts					
	Jun 2017		Jun 2016			
Peak end-of-day aggregate amount of funding provided (\$000s)	88,580		85,525			
Peak end-of-day aggregate amount of funding provided as a percentage of the banking group's Tier 1 Capital as at the end of the year	18.0%		19.6%			
	Seniors Warehouse Trust		ASF Settlement Trust		ABCP Trust	
	Jun 2017	Jun 2016	Jun 2017	Jun 2016	Jun 2017	Jun 2016
Peak end-of-day aggregate amount of funding provided (\$000s)	51,979	52,507	3,980	4,157	32,621	28,861
Peak end-of-day aggregate amount of funding provided as a percentage of the total assets of the individual entity as at the end of the year	10.1%	12.2%	68.6%	66.5%	13.8%	10.7%

For this purpose, peak ratio information was derived by determining the maximum end-of-day aggregate amount of funding and then dividing that amount by the amount of the entity's assets or the banking group's Tier 1 Capital (as the case required) as at the end of the year.

28 Contingent liabilities and commitments

	Jun 2017	Jun 2016
	\$000	\$000
Letters of credit, guarantee commitments and performance bonds	10,903	12,873
Total contingent liabilities	10,903	12,873
Undrawn facilities available to customers	120,948	147,903
Conditional commitments to fund at future dates	153,166	114,855
Total commitments	274,114	262,758

29 Application of new and revised accounting standards

(a) New standards and interpretations adopted

No new standards and amendments to standards have been adopted from 1 July 2016 in the preparation of these financial statements.

(b) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 30 June 2017, and have not been applied in preparing these financial statements. The new standards identified which may have an effect on the financial statements of the banking group are:

Standard and description	Effective for annual years beginning on or after:	Expected to be initially applied in year ending:
NZ IFRS 9 <i>Financial Instruments</i> , which specifies how an entity should classify and measure financial assets and liabilities and provides a principles-based approach to hedge accounting to align hedge accounting more closely with risk management.	1 January 2018	30 June 2018
NZ IFRS 16 <i>Leases</i> , contains guidance on identification, recognition, measurement, presentation, and disclosure of leases by lessees and lessors.	1 January 2019	30 June 2020

The bank is in the process of assessing the full impact of the application of NZ IFRS 9. The key change affecting the bank is that NZ IFRS 9 requires entities to recognise expected credit losses based on forward looking information. It is not yet practical to reliably estimate the financial impact of the changes under NZ IFRS 9 or NZ IFRS 16 on the bank.

30 Events after the reporting date

There have been no material events after the reporting date that would affect the interpretation of the financial statements or the performance of the banking group.

HISTORICAL SUMMARY OF FINANCIAL STATEMENTS

Statements of Comprehensive Income

	Audited	Audited	Audited	Audited	Audited
For the year ended	30 Jun 17	30 Jun 16	30 Jun 15	30 Jun 14	30 Jun 13
	\$000	\$000	\$000	\$000	\$000
Interest income	278,279	265,475	260,468	210,297	206,349
Interest expense	115,169	118,815	126,041	101,221	110,895
Net interest income	163,110	146,660	134,427	109,076	95,454
Other net income	8,142	10,901	10,280	13,079	11,433
Total operating income before other gains	171,252	157,561	144,707	122,155	106,887
Employee benefits	41,547	39,799	40,401	35,765	33,861
Other operating expenses	30,137	30,073	28,002	28,974	36,486
Profit before impairment and tax	99,568	87,689	76,304	57,416	36,540
Impaired asset expense	15,015	13,501	12,105	5,895	22,527
Decrease in fair value of investment properties	-	-	-	1,203	5,101
Net profit before tax	84,553	74,188	64,199	50,318	8,912
Share of joint arrangement profit	-	-	137	486	504
Profit before income tax	84,553	74,188	64,336	50,804	9,416
Income tax expense / (benefit)	23,745	20,024	16,173	14,765	2,504
Net profit after tax attributable to owners of the entity	60,808	54,164	48,163	36,039	6,912
Other comprehensive income for the year net of tax					
Effective portion of changes in fair value of cash flow hedges, net of tax	1,108	(708)	(2,709)	1,111	1,056
Net change in available-for-sale reserve, net of tax	(353)	(208)	898	(12)	276
Movement in foreign currency translation reserve, net of income tax	761	(4,047)	2,136	95	-
Net change in defined benefit reserve, net of income tax	(84)	(93)	50	3	462
Total comprehensive income for the year, net of tax	62,240	49,108	48,538	37,236	8,706
Dividends paid to equity holders	41,977	37,690	30,188	19,930	13,591

Statements of Financial Position

	Audited	Audited	Audited	Audited	Audited
As at	30 Jun 17	30 Jun 16	30 Jun 15	30 Jun 14	30 Jun 13
	\$000	\$000	\$000	\$000	\$000
Total assets	4,034,671	3,547,181	3,359,259	3,016,888	2,504,627
Individually impaired assets	28,578	33,764	25,622	27,617	69,301
Total liabilities	3,465,076	3,048,840	2,879,134	2,564,266	2,134,085
Total equity	569,595	498,341	480,125	452,622	370,542

Historical financial information has been taken from the audited financial statements of the banking group.



Independent auditor's report

To the shareholders of Heartland Bank Limited



Report on the financial statements

Opinion

In our opinion, the accompanying financial statements (excluding supplementary information relating to capital adequacy) of Heartland Bank Limited (the "bank") and its subsidiaries (the "banking group") on pages 12 to 53:

- i. give a true and fair view of the banking group's financial position as at 30 June 2017 and its financial performance and cash flows for the year ended on that date; and
- ii. comply with New Zealand Generally Accepted Accounting Practice, which in this instance means New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS") and International Financial Reporting Standards.

In our opinion, the supplementary information (excluding supplementary information relating to capital adequacy) that is required to be disclosed in accordance with schedules 4, 7, 13, 14, 15 and 17 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order"):

- i. has been prepared, in all material respects, in accordance with the guidelines issued pursuant to section 78(3) of the Reserve Bank of New Zealand Act 1989 and any conditions of registration;
- ii. is in accordance with the books and records of the banking group in all material respects; and
- iii. fairly states the matters to which it relates in accordance with those schedules.

We have audited the accompanying financial statements and supplementary information (excluding supplementary information relating to capital adequacy) which comprise:

- the statement of financial position as at 30 June 2017;
- the statements of comprehensive income, changes in equity and cash flows for the year then ended;
- notes, including a summary of significant accounting policies and other explanatory information; and
- the information that is required to be disclosed in accordance with schedules 4, 7, 13, 14, 15 and 17 of the Order.



Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (“ISAs (NZ)”). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the bank and banking group in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants’ *Code of Ethics for Professional Accountants* (the “IESBA Code”), and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our responsibilities under ISAs (NZ) are further described in the ‘Auditor’s responsibilities for the audit of the financial statements (excluding supplementary information relating to capital adequacy)’ section of our report.

Our firm has also provided other services to banking group in relation to assurance services, accounting advisory services, other advisory services and agreed upon procedures engagements. Subject to certain restrictions, partners and employees of our firm may also deal with the banking group on normal terms within the ordinary course of trading activities of the business of the banking group. These matters have not impaired our independence as auditor of the banking group. The firm has no other relationship with, or interest in, the banking group.



Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole. The materiality for the financial statements as a whole was set at \$4,200,000 determined with reference to a benchmark of the banking group’s profit before tax. We chose the benchmark because, in our view, it is the key measure of the banking group’s performance.

We agreed with the Audit Committee that we would report misstatements identified during our audit, to them, above \$210,000 as well as misstatements below that amount that in our view, warranted reporting for qualitative reasons.



Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements in the current period. We summarise below those matters, the audit procedures completed to address those matters, and our findings, in order that the shareholders may better understand the process by which we arrived at our audit opinion. Our procedures were undertaken in the context of and solely for the purpose of our statutory audit opinion on the financial statements as a whole and we do not express discrete opinions on separate elements of the financial statements.

The key audit matter**How the matter was addressed in our audit and our findings**

Provision for impairment of finance receivables

Refer to notes 11 and 19 to the financial statements.

The provision for impairment of finance receivables is considered to be a key audit matter owing to the financial significance of finance receivables, and the high degree of complexity and judgement applied by management in determining the provision. There is a high level of subjectivity involved in estimating the provision for impairment.

The provision for impairment of finance receivables comprises a provision for both individually and collectively impaired assets.

The provision for individually impaired assets is based on management's judgement in determining when a 'potential loss' or impairment event has occurred for a specific finance receivable, with the assessment of expected future cash flows being inherently uncertain and judgemental. The provision for individually impaired assets for 'rural' and other 'corporate' loans is of particular audit focus, owing to its financial significance and inherent uncertainties of expected future cash flows, which may include estimated timing and proceeds from the future sale of assets securing the debt, in addition to repayments from borrowers.

The provision for collectively impaired assets is determined based on the bank's classification of lending. Finance receivables are classified as either 'judgemental' or 'behavioural':

- judgemental loans are individually risk graded based on an internal model, incorporating loan status, financial information, security and debt servicing ability; and
- behavioural loans consist of 'consumer', 'retail' and 'reverse mortgage' receivables. Behavioural loans are classified based on their arrears status.

Based on the assigned risk grading or arrears status, an estimate of the likelihood of default and the potential loss given default will be applied to determine the collective provision based on historical loss data.

Additionally management apply judgement in the determination of provision overlays where historic losses are not considered to be an accurate reflection on future market conditions.

Our audit procedures, amongst others, included:

- Testing key controls over arrears calculations, customer loan ratings, annual loan reviews, credit risk reviews and model validations.
- Evaluating credit assessments for a sample of 'rural' and other 'corporate' loans that are either individually above \$10 million or on management's credit watchlist. This included inspection of the latest correspondence with the borrower, assessment of the provision estimates prepared by credit risk officers, and consideration of the resolution strategy. With support from our debt advisory and Agri-sector specialists, we challenged the assumptions based on our experience and industry knowledge. We assessed collateral values by comparing them to valuations performed by independent valuers.
- Testing key inputs used in the collective provision calculation for significant portfolios. This included the loan rating for judgemental loans and arrears profile for behavioural loans including comparison to historic losses.
- Benchmarking collective provision rates against the historic losses incurred by the banking group, and comparator analysis against other relevant banks and finance companies.
- Assessing management's judgement in the application of overlays by applying sensitivities to assumptions underlying the overlays, and evaluating current economic and climatic conditions linked to the overlays, including actuarial inputs.

The estimates and assumptions used to determine the provision for impairment of finance receivables are reasonable, with no evidence of management bias or influence identified from our procedures.

We did not identify any material issues or exceptions from our procedures.

We assessed the design and tested the operating effectiveness of key controls which support the assessment of the provision for impairment of finance receivables, including manual financial controls, and IT controls relating to both the existing and new core banking systems. Where we noted either design or operating effectiveness issues, we performed additional compensating control tests and substantive audit procedures.

The key audit matter

How the matter was addressed in our audit and our findings

Valuation of intangible assets, comprising goodwill and other intangible assets

Refer to note 15(b) to the financial statements.

The valuation of goodwill and other intangible assets is a key audit matter owing to the high level of management judgement required in assessing the inputs into management's valuation model which supports the assessment of impairment.

The most significant judgements applied by management in their assessment of impairment include forecast cash flows, discount rates applied, and the assumptions underlying forecast growth, in particular, net interest income and lending asset growth.

Other intangible assets include capitalised software, the majority of which relates to the development of the new Oracle core banking system. Management judgement is required in assessing the extent to which the newly implemented system is operating effectively and that it will generate sufficient benefits to support the carrying value of these capitalised costs.

Our audit procedures, amongst others, included:

- Benchmarking the valuation of goodwill against the bank's market capitalisation and published analyst reports.
- With support from our valuation specialists, testing the key assumptions and estimates used to determine the recoverable value, including those relating to discount rates, growth assumptions, and terminal growth rates. This included comparing the banking group's assumptions to external data, such as economic growth projections and interest rates.
- Comparing the cash flow forecasts to board approved business plans. We also compared previous forecasts to actual results to assess the performance of the business and the accuracy of forecasting.
- Evaluating the recognition criteria applied to the costs incurred and capitalised relating to the Oracle core banking system during the financial year against the requirements of the accounting standards.
- Assessing management's evaluation of indicators that capitalised software intangible assets may be impaired. In assessing this, we compared the assumptions underlying the estimated future benefits to our understanding of the business and relevant economic and industry factors.
- Assessing the design and testing the operating effectiveness of general IT controls relating to the new core banking system.

The estimates and assumptions support the carrying value of goodwill and other intangible assets. We did not identify any indicators of impairment to goodwill or other intangible assets.

Other information

The directors, on behalf of the banking group, are responsible for the other information included in the bank's disclosure statement. Other information comprises the information required to be included in the disclosure statement in accordance with schedule 2 of the Order. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.



Report on other legal and regulatory requirements

In accordance with the requirements of clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order, we report that:

- we have obtained all the information and explanations we have required; and
- in our opinion, proper accounting records have been kept by the banking group, as far as appears from our examination of those records.



Responsibilities of directors for the financial statements and supplementary information (excluding supplementary information relating to capital adequacy)

The directors, on behalf of the banking group, are responsible for:

- the preparation and fair presentation of the financial statements in accordance with clause 24 of the Order, NZ IFRS and International Financial Reporting Standards;
- the preparation and fair presentation of supplementary information (excluding the supplementary information relating to capital adequacy), in accordance with schedules 2, 4, 7, 13, 14, 15 and 17 of the Order;
- implementing necessary internal control to enable the preparation of financial statements that are fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.



Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding supplementary information relating to capital adequacy)

Our objective is:

- to obtain reasonable assurance about whether the financial statements, including the financial statements prepared in accordance with clause 24 of the Order, and supplementary information (excluding the supplementary information relating to capital adequacy), in accordance with schedules 4, 7, 13, 14, 15 and 17 of the Order as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (NZ) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial statements.

A further description of our responsibilities for the audit of these financial statements is located at the New Zealand External Reporting Board (the "XRB") website at:

https://www.xrb.govt.nz/Site/Auditing_Assurance_Standards/Current_Standards/Page1.aspx

This description forms part of our auditor's report.



Report on the supplementary information related to capital adequacy

Review conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy, disclosed in note 26 to the financial statements, is not, in all material respects:

- i. prepared in accordance with the banking group's conditions of registration; and
- ii. disclosed in accordance with schedule 9 of the Order.

We have reviewed the supplementary information relating to capital adequacy, as disclosed in note 26 to the financial statements for the year ended 30 June 2017. The supplementary information relating to capital adequacy comprises the information that is required to be disclosed in accordance with schedule 9 of the Order.



Basis for conclusion on the supplementary information relating to capital adequacy

A review of the supplementary information relating to capital adequacy, in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* ("NZ SRE 2410") issued by the XRB, is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. Our responsibilities under that standard are further described in the 'Auditor's responsibilities for the review of the supplementary information relating to capital adequacy' section of our report.

As the auditor of Heartland Bank Limited, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.



Responsibilities of directors for the supplementary information relating to capital adequacy

The directors are responsible for the preparation of supplementary information relating to capital adequacy that is required to be disclosed under schedule 9 of the Order and prepared in accordance with the Capital Adequacy Framework (Standardised Approach) (BS2A) and described in note 26 to the financial statements.



Auditor's responsibilities for the review of the supplementary information relating to capital adequacy

Our responsibility is to express a conclusion on the supplementary information relating to capital adequacy based on our review. We conducted our review in accordance with NZ SRE 2410. As the auditor of Heartland Bank Limited, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements, and plan and perform the review to obtain limited assurance about whether the capital adequacy information is, in all material respects:

- prepared in accordance with the banking group's conditions of registration; and
- disclosed in accordance with schedule 9 of the Order.



A review of the capital adequacy information in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with ISAs (NZ). Accordingly we do not express an audit opinion on the supplementary information relating to Capital Adequacy disclosures.



Use of this auditor's report

This report is made solely to the shareholders as a body. Our work has been undertaken so that we might state to the shareholders those matters we are required to state to them in the auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the shareholders for our work, this report, or any of the opinions or conclusions we have formed.

Jamie Munro

For and on behalf of

KPMG

Auckland

14 August 2017