HEARTLAND BANK

RESULT.

Financial Report 2017

This Annual Report of Heartland Bank Limited (Heartland) is dated 27 September 2017 and comprises this Financial Report and the accompanying Annual Review. The Annual Report is signed on behalf of the Board of Directors by:

Geoffrey Ricketts
Chair of the Board

Jeff Greenslade
Chief Executive Officer

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[1] As a registered bank, Heartland is required to prepare quarterly Disclosure Statements. Heartland's financial statements for the year ended 30 June 2017 (reporting period) are contained in its Disclosure Statement for the same reporting period.

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
Chairman – Board of Directors
Type of director: Independent Non-Executive Director
Qualifications: LLB (Hons), LLD (honoris causa), CF Inst D
Occupation: Company 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
Type of director: Independent Non-Executive Director
Qualifications: BEc
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
Type of director: Independent Non-Executive Director
Qualifications: BCom, CA
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
Type of director: Independent Non-Executive Director
Qualifications: BCom, LLB, FCA, CF Inst D, FNZIM
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.
Type of director: Independent Non-Executive Director
Qualifications: BCom, FCA, ACIS, ACIM, CF Inst D
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.

DIRECTORS (CONTINUED)

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.

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 groups 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 groups 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.

CONDITIONS OF REGISTRATION (CONTINUED)

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.

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.

CONDITIONS OF REGISTRATION (CONTINUED)

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.

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.

CONDITIONS OF REGISTRATION (CONTINUED)

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.

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.

CONDITIONS OF REGISTRATION (CONTINUED)

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

$000	Note	June 2017	June 2016
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 59 are an integral part of these financial statements.

Statement of Changes in Equity

For the year ended 30 June 2017

$000	Note	Share capital	Treasury shares reserve	Employee benefits reserve	Foreign currency translation reserve	Available for sale reserve	Defined benefit reserve	Hedging reserve	Retained earnings	Total equity
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 income / (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 59 are an integral part of these financial statements.

Statement of Financial Position

As at 30 June 2017

$000	Note	June 2017	June 2016
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 59 are an integral part of these financial statements.

Statement of Cash Flows

For the year ended 30 June 2017

$000	Note	June 2017	June 2016
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 from 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	30,390
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 59 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

$000	Note	June 2017	June 2016
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 59 are an integral part of these financial statements.

Notes to the Consolidated 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 Consolidated Financial Statements

For the year ended 30 June 2017

BASIS OF REPORTING (CONTINUED)

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.

1. Segmental analysis (continued)

$000	Households	Business	Rural	Admin & Support	Total
June 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**

$000	Households	Business	Rural	Admin & Support	Total
June 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.

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

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.

$000	June 2017	June 2016
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**

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.

$000	June 2017	June 2016
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.

$000	June 2017	June 2016
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

$000	June 2017	June 2016
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.

6. Impaired asset expense

$000	Note	June 2017	June 2016
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**

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

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.

$000	June 2017	June 2016
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**

(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).

7. Taxation (continued)

(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:

$000	June 2017	June 2016
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

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

8. Earnings per share

	June 2017			June 2016		
	Earnings per share cents	Net profit after tax $000	Weighted average no. of shares 000	Earnings per share cents	Net profit after tax $000	Weighted average no. of shares 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 Consolidated 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.

$000	June 2017	June 2016
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.

$000	June 2017	June 2016
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.

11. Finance receivables (continued)

$000	Note	June 2017	June 2016
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.

$000	June 2017	June 2016
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 $8 million 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.

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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.

$000	June 2017	June 2016
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.

$000	June 2017	June 2016
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.

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.

000s	June 2017 Number of shares	June 2016 Number of shares
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

	June 2017			June 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.

$000	June 2017	June 2016
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**

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For the year ended 30 June 2017

15. Other balance sheet items (continued)

(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.

$000	June 2017	June 2016
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.

$000	June 2017	June 2016
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**

15. Other balance sheet items (continued)

(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:

$000	June 2017	June 2016
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)**

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.

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

16. Fair value (continued)

(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.

$000	Level 1	Level 2	Level 3	Total
June 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**
June 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**

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.

$000	Level 1	Level 2	Level 3	Total fair value	Total carrying value
June 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**
June 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 Consolidated 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:

$000	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
June 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**
June 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 programme

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.

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17. Enterprise risk management programme (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.

17. Enterprise risk management programme (continued)

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.

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.

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For the year ended 30 June 2017

18. Credit risk (continued)

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.

(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 below are based on net carrying amounts as reported in the Statement of Financial Position.

$000	June 2017	June 2016
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

$000	June 2017	June 2016
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**

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

18. Credit risk (continued)

(c) Concentration of credit risk by industry sector

$000	June 2017	June 2016
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**

(d) Commitments to extend credit

$000	June 2017	June 2016
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

	June 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.

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

18. Credit risk (continued)

(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.

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

$000	Note	Rural	Other corporate	Residential	All other	Total
June 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**
June 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**

19. Asset quality (continued)

(b) Past due but not impaired

$000	Rural	Other corporate	Residential	All other	Total
June 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**
June 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**

(c) Individually impaired assets

$000	Rural	Other corporate	Residential	All other	Total
June 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**
June 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**

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

19. Asset quality (continued)

(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.

19. Asset quality (continued)

$000	Rural	Other corporate	Residential	All other	Total
June 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**

$000	Rural	Other corporate	Residential	All other	Total
June 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**

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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.

19. Asset quality (continued)

$000	Rural	Other corporate	Residential	All other	Total
June 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**

$000	Rural	Other corporate	Residential	All other	Total
June 2016					
Provision for individually impaired assets					
Opening provision for individually impaired assets	817	14,394	–	–	15,211
Impairment loss for the year					
Charge / (credit) 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).

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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:

$000	June 2017	June 2016
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.

20. Liquidity risk (continued)

$000	On demand	0-6 months	6-12 months	1-2 years	2-5 years	5+ years	Total
June 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

$000	On demand	0-6 months	6-12 months	1-2 years	2-5 years	5+ years	Total
June 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.

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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.

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.

$000	0-3 months	3-6 months	6-12 months	1-2 years	2+ years	Non-interest bearing	Total
June 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**

21. Interest rate risk (continued)

$000	0-3 months	3-6 months	6-12 months	1-2 years	2+ years	Non-interest bearing	Total
June 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.

22. Concentrations of funding

(a) Concentration of funding by industry

$000	June 2017	June 2016
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

$000	June 2017	June 2016
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**

[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 Consolidated Financial Statements

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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	
			June 2017	June 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:

$000	June 2017	June 2016
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:

$000	Note	June 2017	June 2016
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)

(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:

$000	June 2017	June 2016
Cash and cash equivalents – securitised	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 tranch 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 Consolidated 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

$000	June 2017	June 2016
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.

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 affected 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.

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

26. Capital adequacy (continued)

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.

(a) Capital

$000	June 2017
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**

26. Capital adequacy (continued)

(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

Treasury shares reserve	The treasury shares reserve comprises shares in Heartland Bank Limited held by the bank.
Employee benefits reserve	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.
Available for sale reserve	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.
Defined benefit reserve	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.
Hedging reserve	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.

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.

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For the year ended 30 June 2017

26. Capital adequacy (continued)

(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
June 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**

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.

26. Capital adequacy (continued)

(c) Credit risk (continued)

(ii) Off balance sheet exposures

	Total exposure $000	Average credit conversion factor $000	Credit equivalent amount $000	Average risk weight %	Risk weighted exposure $000	Minimum Pillar 1 capital requirement $000
June 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 contracts[1]						
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 $000	Off balance sheet exposures[2] $000	Total exposures $000
June 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

$000	June 2017
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**

1 The credit equivalent amount for market related contracts was calculated using the current exposure method.
2 Off balance sheet exposures means unutilised limits.

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

26. Capital adequacy (continued)

(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

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

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

(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.

$000		Implied risk weighted exposure	Aggregate capital charge
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

$000	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement
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**

26. Capital adequacy (continued)

(j) Capital ratios

%	June 2017	June 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

%	June 2017	June 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.

(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: $85.83 million).

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.

Notes to the Consolidated Financial Statements

For the year ended 30 June 2017

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

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.

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	
	June 2017	June 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	
	June 2017	June 2016	June 2017	June 2016	June 2017	June 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

$000	June 2017	June 2016
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 Financial Instruments, 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 Leases, 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

$000 For the year ended	Audited 30 June 2017	Audited 30 June 2016	Audited 30 June 2015	Audited 30 June 2014	Audited 30 June 2013
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 income 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

$000 As at	Audited 30 June 2017	Audited 30 June 2016	Audited 30 June 2015	Audited 30 June 2014	Audited 30 June 2013
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 59:

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.

Independent Auditor's Report

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.

Independent Auditor's Report

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 relating to capital inadequacy

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.

KPMG

Jamie Munro
For and on behalf of KPMG
Auckland

14 August 2017

Corporate Governance

The Board and management of Heartland are committed to ensuring that Heartland's corporate governance policies and practices reflect current best practice, in the interests of Heartland's shareholders and other stakeholders.

This corporate governance statement describes Heartland's policies and practices as at 30 June 2017, which comply with the corporate governance requirements of the NZX Main Board Listing Rules and are consistent with the principles contained in the *NZX Corporate Governance Best Practice Code*.

The NZX has recently released a new NZX Corporate Governance Code (the NZX Code), which Heartland will be required to report against, instead of the FMA Guidelines, in its next Annual Report. However, this corporate governance statement also highlights the areas in which Heartland's policies and practices already comply with the new NZX Code.

Heartland's Constitution, Board and Board Committee charters and key governance codes and policies are available on Heartland's shareholder website, shareholders.heartland.co.nz.

PRINCIPLE 1 – CODE OF ETHICAL BEHAVIOUR

Directors set high standards of ethical behaviour, model this behaviour, and hold management accountable for delivering these standards throughout the organisation.

Heartland expects its directors and staff to act honestly and in good faith, and in the best interests of Heartland at all times. They must act with the care, diligence and skill expected of a director or staff member of a registered bank which issues securities and accepts funds from the general public, and has its shares publicly traded on the NZX Main Board.

Directors and staff are required to act honestly and fairly in all dealings with Heartland's shareholders, customers, investors and service providers.

Each director and staff member has an obligation, at all times, to comply with the spirit as well as the letter of the law, to comply with the principles of Heartland's Code of Conduct, the Directors' Code of Conduct and Heartland's Constitution, and to exhibit a high standard of ethical behaviour.

Codes of conduct

Heartland's Code of Conduct and Directors' Code of Conduct set out the ethical and behavioural standards expected of Heartland's directors and employees. The Codes of Conduct are available on Heartland's shareholder website, shareholders.heartland.co.nz.

Insider trading policy

The Board continually assesses whether any matters under consideration are likely to materially influence Heartland's share price and therefore whether additional trading restrictions should be imposed on directors and senior employees of Heartland.

All directors and senior employees of Heartland are required to obtain consent before buying or selling shares in Heartland and to certify that their decision to buy or sell shares has not been made on the basis of inside information.

The Insider Trading Policy is available on Heartland's shareholder website, shareholders.heartland.co.nz.

Gender diversity

Heartland considers diversity in all its forms a strength, and is committed to supporting initiatives which foster diversity at all levels of the organisation. The following table shows the gender diversity of directors and staff of Heartland as at 30 June 2017 in comparison to as at 30 June 2016.

			As at 30 June 2017			As at 30 June 2016
Positions	Female	Male	Total	Female	Male	Total
Directors	2 (22.2%)	7 (78.8%)	9	1 (12.5%)	7 (87.5%)	8
Officers	1 (25.0%)	3 (75.0%)	4	2 (28.6%)	5 (71.4%)	7
Senior Executives	5 (25.0%)	15 (75.0%)	20	5 (27.8%)	13 (72.2%)	18
All Staff	170 (48.3%)	182 (51.7%)	352	157 (44.9%)	193 (55.1%)	350

"Officers" are J K Greenslade and all persons who report directly to him in an executive capacity.

"Senior Executives" are all persons who report directly to one of J K Greenslade's direct reports.

In order to articulate its commitment to diversity, Heartland has developed a *Diversity and Inclusion Policy*. The Board will consider, on the recommendation of the Diversity Committee, the appropriate measurable objectives to be set in order to enhance diversity at Heartland, and progress made in relation to those measurable objectives will be reported in the next Annual Report. The new NZX Code includes a recommendation that every issuer should develop and publish a diversity policy. Heartland's *Diversity and Inclusion Policy* is available on Heartland's shareholder website, shareholders.heartland.co.nz.

PRINCIPLE 2 – BOARD COMPOSITION AND PERFORMANCE

There is a balance of independence, skills, knowledge, experience and perspectives among directors to ensure an effective Board.

Role of the Board

The Board of Directors is responsible for corporate governance and setting Heartland's overall strategic direction. The Board charter regulates Board procedure and describes the Board's role and responsibilities in detail. The Board establishes objectives, strategies and an overall policy framework within which the business is conducted. Day-to-day management is delegated to the Chief Executive Officer (and, in the case of risk management, to the Chief Risk Officer). The Board regularly monitors and reviews management's performance in carrying out its delegated duties.

The Board schedules regular meetings at which it receives briefings on key strategic and operational issues from management.

Board processes

The Board held ten meetings during the year ended 30 June 2017. The following table shows attendance by each director at the meetings of the Board and Board Committees of which he or she was a member. As the Corporate Finance Committee is a newly formed committee, no meetings were held during the year ended 30 June 2017.

	Board		Audit Committee		Risk Committee		Corporate Governance, People, Remuneration and Nominations Committee (formerly Governance, Remuneration & Capital Committee)	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
J K Greenslade	10	10	–	–	–	–	–	–
E F Comerford	5	5	–	–	3	3	–	–
N Greer (resigned 25/7/16)	1	0	–	–	–	–	–	–
E J Harvey	10	10	5	5	9	9	–	–
B R Irvine	10	9	5	5	–	–	10	10
G R Kennedy	10	10	5	5	9	9	–	–
C R Mace	10	10	–	–	9	9	–	–
G T Ricketts	10	10	5	4	–	–	10	10
V C M Stoddart	8	7	–	–	5	4	7	6
G R Tomlinson	10	10	–	–	–	–	10	7

All of the then serving members of the Board attended the Annual Meeting held on 22 November 2016.

Board membership, size and composition

The NZX Main Board Listing Rules provide that the number of directors must not be fewer than three. Subject to this limitation, the size of the Board is determined from time to time by the Board.

As at 30 June 2017, the Board comprised nine directors, being an independent Chairman, the Chief Executive Officer and seven non-executive directors. The Board encourages rigorous discussion and analysis when making decisions.

The Board recognises the need to have a range of complementary skills, knowledge and experience in order to support the implementation of its strategic priorities, and for the Board to have a balance of skills and attributes in order to support diversity of thought at board level. With this in mind, the Board regularly reviews its composition and formally assesses its collective skills, knowledge and experience using a skills matrix developed specifically for Heartland. This exercise provides an opportunity to reflect on and discuss current Board composition, as well as succession planning. The current Board comprises directors with a mix of qualifications, skills and attributes who hold diverse business, governance and industry experience.

PRINCIPLE 2 – BOARD COMPOSITION AND PERFORMANCE (CONTINUED)

Set out below is a table summarising the skills, knowledge and experience of the Board of Heartland as at 30 June 2017. The results of the assessment are provided as the average score across all of the directors for a particular category. Each director possesses a unique range of skills across the different categories, and there are a broad range of individual scores within each category. For example, within the category 'Australian experience', the individual scores range from 1 to 5.

Details regarding the scoring system are also provided below.

Level	Descriptor	Summary of skill/experience
0	No skills/experience	Limited-to-no skills/experience and exposure (either as a Senior Manager or Non-Executive Director (NED) or a combination of both).
1	Basic skills/experience	Basic level of exposure and skills/experience (either as a Senior Manager or NED or a combination of both).
2	Moderate skills/experience	Adequate exposure and skills/experience (either as a Senior Manager or NED or a combination of both).
3	Proficient skills/experience	Full capability and experience to draw upon and contribute to Board (either as a Senior Manager or NED or a combination of both).
4	Strong skills/experience	Extensive skills and experience over a significant amount of time and multiple companies (either as a Senior Manager or NED or a combination of both).
5	Expert skills/experience	Deep subject matter expertise across all facets of the relevant skill/experience (either as a Senior Manager or NED or a combination of both).

Table of Board skills

Category	Description	Average score
Risk management	Risk management frameworks, setting risk appetite, building and adapting organisational risk culture, regulatory relationships, assessing the effectiveness of senior leadership.	3.75
Governance and compliance	Implementing organisation-wide governance and compliance systems, processes and frameworks, regulatory compliance, assessing the effectiveness of senior leadership.	4.00
Capital/Financial/M&A acumen	Implementation of financial and capital management strategies, corporate finance restructuring, capital raisings within risk appetite/ICAAP, M&A experience.	4.00
Corporate strategy	Reviewing and setting organisational strategy, organic growth opportunities, merger and acquisition opportunities (including joint ventures).	4.00
Leadership	Driving engagement and enablement, evaluating employee and executive performance, strategic workforce planning, succession, leading organisation change and talent development.	4.00
Remuneration	Detailed executive remuneration matters (including scorecard target setting), incentive arrangements, staff superannuation. Understanding of the relevant legislative/contractual framework for remuneration.	3.75
Health and safety	Implementing health, safety and wellbeing strategies, proactive identification and prevention of health and safety risks.	3.75
Government relations/policy	Interaction with Government, Regulators, and Reserve Bank at all levels, influencing public policy decisions and outcomes.	3.50
Banking	Domestic and/or international experience in banking, including the regulatory landscape for banks.	3.50
Liquidity and funding	Broad experience in funding and liquidity strategies and management, regulatory requirements and options available to registered banks.	3.25
Issues/Crisis management	For example, credit rating downgrade, social media events, regulatory breaches or changes and other reputational events.	4.00
Related industries/insurance	Broad experience across industries related to banking, funds management, reverse mortgages, consumer finance, general insurance.	3.00
Customer data/CRM	Experience in driving strategic insights from the collection and analysis of customer data, experience in customer relationship management, cloud computing and software delivery.	3.00
Digital and information technology	Understanding digital distribution and latest innovations and technologies disrupting traditional distribution processes. Domestic and/or international experience in IT strategies, IT networks, cloud computing and software delivery.	3.00
RBNZ/Regulatory compliance	Experience relating to RBNZ compliance regime and other applicable compliance with regulatory bodies (e.g. Australia).	3.50
Australian experience	Experience in banking/financial and related markets. Experience with regulatory bodies including APRA, ASIC, ASX.	3.50
Corporate emotional intelligence (EQ)	Personal attributes relevant to the Board environment including communication skills, the ability to constructively challenge, championing an environment that effectively deals with complex issues and continually seeking to "lift the bar".	3.75

PRINCIPLE 2 – BOARD COMPOSITION AND PERFORMANCE (CONTINUED)

Nomination and appointment of directors

Procedures for the appointment and removal of directors are governed by Heartland's Constitution.

A director is appointed by ordinary resolution of the shareholders, although the Board may fill a casual vacancy, in which case the appointed director retires at the next Annual Meeting but is eligible for re-election. Nominations for election as a director may be made by shareholders up until a closing date, which must not be more than two months before the date of the Annual Meeting.

On appointment, each director signs a letter which sets out Heartland's written expectations, including, among other things, its expectations regarding the time commitment required to perform the role effectively. Directors are also provided with access to a *Director's Corporate Governance Manual*, which includes key information for Heartland's directors, including relevant charters and policies.

Independence of directors

A director is considered to be independent if that director is not an executive of Heartland and if the director has no direct or indirect interest or relationship that could reasonably influence, in a material way, the director's decisions in relation to Heartland.

The Board determined that, as at 30 June 2017, E F Comerford, E J Harvey, B R Irvine, G R Kennedy, C R Mace, G T Ricketts and V C M Stoddart were the independent directors.

Board performance assessment

The Board undertakes a formal review of its own, its committees' and individual directors' performance at least annually, and – as noted above – will regularly review its composition using a skills matrix. This is to ensure it has a range of complementary skills, knowledge and experience in order to effectively govern Heartland, to monitor its performance, and to support the implementation of its strategic priorities – in the interests of its shareholders and other stakeholders.

PRINCIPLE 3 – BOARD COMMITTEES

The Board uses committees where this enhances effectiveness in key areas while still retaining Board responsibility.

Board committees

As at 30 June 2017, the Board had four permanently constituted committees, each of which is tasked with working with management in its specific area of responsibility and reporting its findings and recommendations to the Board. Each of these committees has a charter which sets out the committee's objectives, membership, procedures and responsibilities. A committee does not take action or make decisions on behalf of the Board unless it is specifically mandated to do so. The charter of each Board committee is available on Heartland's shareholder website, shareholders.heartland.co.nz.

Other ad hoc Board committees are established for specific purposes from time to time.

Audit Committee

Membership is restricted to non-executive directors, with at least three members, the majority of whom must be independent. The Chair of the Audit Committee must be an independent director who is not the Chair of the Board.

As at 30 June 2017, the members of the Audit Committee were B R Irvine (Chair), E J Harvey, G R Kennedy and G T Ricketts.

The role of the Audit Committee is to advise and provide assurance to the Board in order to enable the Board to discharge its responsibilities in relation to the oversight of:

- The integrity of financial control, financial management and external financial reporting.
- The internal audit function.
- The independent audit process.

PRINCIPLE 3 – BOARD COMMITTEES (CONTINUED)

Risk Committee

Membership of the Risk Committee is restricted to non-executive directors, with at least three members, the majority of whom must be independent. The Chair of the Risk Committee must be an independent director who is not the Chair of the Board.

As at 30 June 2017, the members of the Risk Committee were E J Harvey (Chair), E F Comerford, G R Kennedy, C R Mace and V C M Stoddart.

The role of the Risk Committee is to advise and provide assurance to the Board in order to enable the Board to discharge its responsibilities in relation to the oversight of:

- The formulation of its risk appetite, as defined in the Risk Appetite Statement.
- The monitoring of the effectiveness of the Enterprise Risk Management Framework (ERMF).
- Assurance that all risks within the key risk categories which are relevant to Heartland and its subsidiaries have been appropriately identified, managed and reported to the Board in accordance with the ERMF.

Corporate Governance, People, Remuneration and Nominations Committee

The Corporate Governance, People, Remuneration and Nominations Committee is required to have at least three directors, the majority of whom must be independent.

As at 30 June 2017, the members of the Corporate Governance, People, Remuneration and Nominations Committee were G T Ricketts (Chair), B R Irvine, G R Tomlinson and V C M Stoddart.

The role of the Corporate Governance, People, Remuneration and Nominations Committee includes advising and making recommendations to the Board regarding:

- Corporate governance matters.
- People strategy, including organisation structure, performance, succession planning, development, culture, diversity, health and safety, remuneration strategy and policies and any other strategic people initiatives.
- Remuneration of the directors, Chief Executive Officer and senior executives.
- The performance of the Chief Executive Officer including setting and review of annual KPIs.
- Director and senior executive appointments, Board composition and succession planning.

Corporate Finance Committee

The Corporate Finance Committee is required to have at least three directors, the majority of whom must be independent, and one of whom will be the Chief Executive Officer.

As at 30 June 2017, the members of the Corporate Finance Committee were G T Ricketts (Chair), E F Comerford, J K Greenslade, B R Irvine and G R Tomlinson.

The role of the Corporate Finance Committee is to advise and make recommendations to the Board regarding the oversight of the management of Heartland's financial resources and major financial strategies and transactions.

PRINCIPLE 4 – REPORTING AND DISCLOSURES

The Board demands integrity in both financial reporting and in the timeliness and balance of corporate disclosures.

The Board is committed to ensuring the highest standards are maintained in financial reporting and disclosure of all relevant information.

The Audit Committee oversees the quality and timeliness of all financial reports, including all disclosure documents issued by Heartland or any of its subsidiaries.

The Chief Executive Officer and Chief Financial Officer are required to certify to the Audit Committee that the financial statements of Heartland and its subsidiaries present a true and fair view of Heartland and comply with all relevant accounting standards.

PRINCIPLE 5 – REMUNERATION

The remuneration of directors and executives is transparent, fair and reasonable.

Non-executive directors' remuneration

Total remuneration available to non-executive directors of Heartland and its subsidiaries is determined by shareholders. The current aggregate approved amount by shareholders is $1,200,000 per annum.

Heartland's policy is to pay directors' fees in cash. There is no requirement for directors to take a portion of their remuneration in shares and there is no requirement for directors to hold shares in Heartland. However, as at 30 June 2017 a number of the directors held shares, or a beneficial interest in shares, in Heartland (see the Directors' Disclosures section of this Annual Report for further details).

Senior executive remuneration

The objective is to provide competitive remuneration that aligns executives' remuneration with shareholder value and rewards the executives' achievement of Heartland's strategies and business plans.

All senior executives receive a base salary and are also eligible to participate in short-term and, in some cases, long-term incentive plans under which they are rewarded for achieving key performance and operating results.

Heartland has developed a *Remuneration Policy* which explains its approach to setting remuneration in more detail. The *Remuneration Policy* is available on Heartland's shareholder website, shareholders.heartland.co.nz. The development of a remuneration policy is one of the recommendations in the new NZX Code.

Disclosure of the CEO's remuneration is included in the Directors' Disclosures section of this Annual Report, and follows the template for the reporting of CEO remuneration developed by the New Zealand Shareholders' Association.

PRINCIPLE 6 – RISK MANAGEMENT

The Board has a sound understanding of the key risks faced by the business. The Board regularly verifies that Heartland has appropriate processes that identify and manage potential and relevant risks.

The Board ensures that Heartland has an Enterprise Risk Management Framework (ERMF) in place which is a proactive and dynamic enterprise-wide framework to identify, understand, manage and communicate all risks that may impact Heartland's business objectives.

The Board delegates implementation, oversight and formulation of standards contained in the ERMF to the Chief Risk Officer. Risk is a standing agenda item for Board meetings during which the Chief Risk Officer's report is considered by the Board. In addition, the Risk Committee reviews reports from management concerning the ERMF in order to assure the Board of the programme's effectiveness.

The Board undertakes a regular review, at least annually, of the Risk Committee's performance, objectives and responsibilities, including to ensure that there are appropriate processes in place to identify and manage potential and relevant risks.

The Board communicates its risk appetite in a clear Risk Appetite Statement (RAS) in order to guide management in how much risk it wishes to accept in pursuit of its business and strategic objectives. Heartland has identified five major risk categories which are inherent in its day-to-day activities and recognises that the long term success of Heartland is directly impacted by the ability of management to effectively identify, understand and manage these risks. Each risk category has its own Risk Management Framework. This Risk Management Framework clearly articulates the methodology for managing the risk category. The strategy for managing each risk category includes active monitoring through regular senior management, Executive and Board committee meetings which are ultimately reported through to the Board to ensure it has a sound understanding of the key risks faced by the business.

Heartland also has in place insurance cover for insurable liability and general business risk.

PRINCIPLE 7 – AUDITOR

The Board ensures the quality and independence of the external audit process.

The Audit Committee is responsible for overseeing the external, independent audit of Heartland's financial statements. The Audit Committee ensures that the level of non-audit work undertaken by the auditor does not jeopardise their independence.

Heartland's *External Auditor Independence Policy* provides guidelines to ensure that non-audit related services do not conflict with the independent role of the external auditor, and the Audit Committee ensures that non-audit work undertaken by the auditor is in accordance with that Policy. That Policy also sets out guidelines in relation to the tenure and re-appointment of the external auditor, which the Audit Committee ensures are complied with. Refer to Heartland's shareholder website, shareholders.heartland.co.nz, for a copy of the *External Auditor Independence Policy*.

The external auditor monitors its independence and reports to the Audit Committee bi-annually to confirm that it has remained independent in the previous six months, in accordance with Heartland's *External Auditor Independence Policy* and the external auditor's policies and professional requirements. There have been no threats to auditor independence identified during the year ended 30 June 2017.

Heartland also has an internal audit function which is independent of the external auditor. The Audit Committee approves the annual internal audit programme, which is developed in consultation with management of Heartland.

PRINCIPLE 8 – SHAREHOLDER RIGHTS & RELATIONS

The Board fosters constructive relationships with shareholders that encourage them to engage with Heartland.

The Board is committed to maintaining a full and open dialogue with all shareholders, as outlined in the *Shareholder Communications Policy* and the *Disclosure Policy*, both of which are available on Heartland's shareholder website, shareholders.heartland.co.nz. Heartland keeps shareholders informed through:

- Periodic and continuous disclosure to NZX.
- Information provided to analysts and media during briefings.
- Heartland's shareholder website (shareholders.heartland.co.nz).
- The Annual Meeting, at which shareholders' have the opportunity to ask questions.
- Annual and half year reports.

The Board encourages full participation of shareholders at the Annual Meeting to ensure a high level of accountability. Heartland's external auditor also attends the Annual Meeting and is available to answer questions relating to the external audit.

PRINCIPLE 9 – STAKEHOLDER INTERESTS

The Board respects the interests of stakeholders within the context of Heartland's ownership type and its fundamental purpose.

Heartland has a wide range of stakeholders and aims to manage its business in a way which builds sustainable value and produces positive outcomes for stakeholders. As a listed entity which is a registered bank, Heartland recognises its responsibility to respect and balance the interests of its stakeholders (including customers, staff, regulators and shareholders).

Directors' Disclosures

DIRECTORS

The following persons were directors of Heartland and its subsidiaries during the year ended 30 June 2017.

Company	Directors	
Heartland Bank Limited	Ellen Frances Comerford	Independent Director (appointed 1 January 2017)
	Jeffrey Kenneth Greenslade	Non-Independent Director
	Nicola Jean Greer	Independent Director (resigned 25 July 2016)
	Edward John Harvey	Independent Director (re-elected 22 November 2016)
	Bruce Robertson Irvine	Independent Director (re-elected 22 November 2016)
	Graham Russell Kennedy	Independent Director
	Christopher Robert Mace	Independent Director
	Geoffrey Thomas Ricketts	Independent Director
	Vanessa Cynthia May Stoddart	Independent Director (appointed 3 October 2016)
	Gregory Raymond Tomlinson	Non-Independent Director
ASF Custodians Pty Limited	Andrew John Ford	
	Richard Glenn Udovenya	
Australian Seniors Finance Pty Limited	Andrew John Ford	
	Richard Glenn Udovenya	
Heartland Australia Holdings Pty Ltd	Ellen Frances Comerford	(appointed 7 February 2017)
	Christopher Patrick Francis Flood	
	Andrew John Ford	
Heartland Australia Group Pty Ltd	Ellen Frances Comerford	(appointed 7 February 2017)
	Christopher Patrick Francis Flood	
	Andrew John Ford	
Heartland NZ Trustee Limited	Philippa Rosemary Drury	(appointed 28 April 2017)
	Christopher Patrick Francis Flood	(appointed 28 April 2017)
	Jeffrey Kenneth Greenslade	(resigned 28 April 2017)
Heartland PIE Fund Limited	Jeffrey Kenneth Greenslade	
	Bruce Robertson Irvine	
MARAC Insurance Limited	Andrew James Aitken	
	Christopher Patrick Francis Flood	
	Christopher Robert Mace	
	Sarah Elizabeth Ann Smith	
Seniors Finance Custodians Pty Limited	Andrew John Ford	
	Richard Glenn Udovenya	
Seniors Finance Pty Limited	Andrew John Ford	
	Richard Glenn Udovenya	
Sentinel Custodians Limited	Christopher Patrick Francis Flood	
VPS Properties Limited	Christopher Patrick Francis Flood	

INTERESTS REGISTER

The following are the entries in the Interests Register of Heartland (and its subsidiaries) made during the year ended 30 June 2017.

Indemnification and insurance of directors

Heartland has given indemnities to, and has effected insurance for, directors of Heartland and its subsidiaries to indemnify and insure them in respect of any liability for, or costs incurred in relation to, any act or omission in their capacity as directors, to the extent permitted by the Companies Act 1993. The cost of the insurance premiums to Heartland and its subsidiaries for the year ended 30 June 2017 was $81,793.75 (including GST).

Directors' Disclosures

Share dealings by directors

Details of individual directors' share dealings as entered in the Interests Register of Heartland under Section 148(2) of the Companies Act 1993 during the year ended 30 June 2017 are as follows (all dealings are in ordinary shares unless otherwise specified):

J K Greenslade

No. of shares	Nature of relevant interest	Acquisition/ disposal	Consideration	Date of acquisition/ disposal
729,353	Issue of shares under the share settled options plan	Acquisition	$1,086,589.82	9 September 2016
3,317	Allotment of new ordinary shares under Share Purchase Plan	Acquisition	$4,842.82	15 March 2017

E J Harvey

No. of shares	Nature of relevant interest	Acquisition/ disposal	Consideration	Date of acquisition/ disposal
3,054	Allotment of shares under the Dividend Reinvestment Plan	Acquisition	$4,509.54	7 October 2016
3,317	Allotment of shares under Share Purchase Plan	Acquisition	$4,842.82	15 March 2017
2,111	Allotment of shares under the Dividend Reinvestment Plan	Acquisition	$3,364.72	7 April 2017

B R Irvine

No. of shares	Nature of relevant interest	Acquisition/ disposal	Consideration	Date of acquisition/ disposal
3,317	Allotment of shares under the Share Purchase Plan	Acquisition	$4,842.82	15 March 2017
3,317	Allotment of shares under the Share Purchase Plan	Acquisition	$4,842.82	15 March 2017

G R Kennedy

No. of shares	Nature of relevant interest	Acquisition/ disposal	Consideration	Date of acquisition/ disposal
2,212	Allotment of shares under the Share Purchase Plan	Acquisition	$3,229.52	15 March 2017
3,317	Allotment of shares under the Share Purchase Plan	Acquisition	$4,842.82	15 March 2017

C R Mace

No. of shares	Nature of relevant interest	Acquisition/ disposal	Consideration	Date of acquisition/ disposal
3,317	Allotment of shares under the Share Purchase Plan	Acquisition	$4,842.82	15 March 2017
3,317	Allotment of shares under the Share Purchase Plan	Acquisition	$4,842.82	15 March 2017

G T Ricketts

No. of shares	Nature of relevant interest	Acquisition/ disposal	Consideration	Date of acquisition/ disposal
3,317	Allotment of shares under the Share Purchase Plan	Acquisition	$4,842.82	15 March 2017

G R Tomlinson

No. of shares	Nature of relevant interest	Acquisition/ disposal	Consideration	Date of acquisition/ disposal
1,360,767	Allotment of shares under Share Placement	Acquisition	$1,986,719.82	15 December 2016
607,928	Allotment of shares under the Dividend Reinvestment Plan	Acquisition	$968,976.43	7 April 2017

General notice of disclosure of interest in the interests register

Details of directors' general disclosures entered in the relevant interests register under Section 140 of the Companies Act 1993 during the year ended 30 June 2017 are as follows:

E F Comerford	Initial disclosure of directorships of Cash Converters International Limited, Comerford Gohl Holdings Pty Limited, Hollard Holdings Australia Pty Limited, The Hollard Insurance Company Pty Limited
G R Kennedy	Appointed director to Wilson Bulk Transport from 22 March 2017 and Earth & Sky GP Limited from 12 September 2016
B R Irvine	Ceased directorship of Christchurch City Holdings, Christchurch City Networks Limited, CCHL2, CCHL4 and CCHL5 on 1 April 2017
C R Mace	Ceased directorship of Pukeha Farms Limited on 29 September 2016
G T Ricketts	Ceased directorship of AAI Limited on 22 September 2016, Macmine Investments Limited on 9 September 2016 and MCF4 Limited on 27 January 2017 Appointed director to Mercury Pharmacy Holdings Limited from 14 December 2016 and Mercury Medical Holdings Limited from 14 December 2016
V C M Stoddart	Initial disclosure of directorships of Alliance Group Limited, New Zealand Global Women Limited, The New Zealand Refinery Company Limited, The Warehouse Group Limited

Details of directors' general disclosures entered in the relevant interest register under Section 140 of the Companies Act 1993 prior to 1 July 2016 can be found in earlier Annual Reports.

Specific disclosures of interest in the interests register

There were no specific disclosures of interests in transactions entered into by Heartland or its subsidiaries during the period 1 July 2016 to 30 June 2017.

Information used by directors

No director of Heartland or its subsidiaries disclosed use of information received in his or her capacity as a director that would not otherwise be available to that director.

DIRECTORS' RELEVANT INTERESTS

Set out in the table below are the shares, and options which are convertible into shares, in which each director of Heartland had a relevant interest as at 30 June 2017.

Director	Number of ordinary shares – beneficial	Number of ordinary shares – non-beneficial[1]	Number of options
J K Greenslade	3,005,930	Nil	Nil
E J Harvey	105,418	6,118,046	Nil
B R Irvine	461,032	6,118,046	Nil
G R Kennedy	501,357	6,118,046	Nil
C R Mace	13,296,362	6,118,046	Nil
G T Ricketts	12,293,045	6,118,046	Nil
G R Tomlinson	50,193,047	Nil	Nil

[1] The non-beneficial interest in the 6,118,046 shares arises from those directors being a trustee of the Heartland Trust, which held 6,118,046 shares in Heartland as at 30 June 2017.

Directors' Disclosures

DIRECTORS' REMUNERATION

The current total directors' fee pool for the non-executive directors of Heartland and its subsidiaries approved by shareholders at the Annual Shareholder Meeting held on 22 November 2016 is $1,200,000 per annum.

The table below sets out the fees payable to the non-executive directors of Heartland for the year ended 30 June 2017 based on the position(s) held.

	Position	Fees (per annum)
Board of Directors	Chair	$150,000
	Deputy Chair	$110,000
	Member	$100,000
Audit Committee	Chair	$15,000
	Member	Nil
Risk Committee	Chair	$15,000
	Member	Nil
Corporate Governance, People, Remuneration and Nominations Committee	Chair	$15,000
	Member	Nil
Corporate Finance Committee	Chair	Nil
	Member	Nil

It is noted that the above fee schedule was implemented on 1 October 2016. For the period from 1 July 2016 to 30 September 2016, the fee schedule disclosed in Heartland's 2016 Annual Report was applied.

The total remuneration and value of other benefits received by each non-executive director who held office in Heartland and its subsidiaries during the year ended 30 June 2017 is set out in the table below. Directors' fees exclude GST where appropriate. In addition to these amounts, Heartland meets costs incurred by directors, which are incidental to the performance of their duties. This includes providing directors with telephone concessions and paying the cost of directors' travel. As these costs are incurred by Heartland to enable directors to perform their duties, no value is attributable to them as benefits to directors for the purposes of the above tables.

The table below sets out the fees paid to each non-executive director of Heartland and its subsidiaries for the year ended 30 June 2017.

Director	Board fees	Audit Committee	Risk Committee	Corporate Governance, People, Remuneration and Nominations Committee	Other	Total remuneration
A J Aitken					$32,000[(1)]	$32,000
E F Comerford	$50,000				A$25,000[(2)]	$77,116
P Drury					$3,500[(3)]	$3,500
E J Harvey	$93,750	$1,875	$16,250 (Chair)			$111,875
B R Irvine	$103,750 (Deputy Chair)	$15,000 (Chair)		$1,250		$120,000
G R Kennedy	$93,750	$1,875	$2,500			$98,125
C R Mace	$93,750		$2,500		$11,250[(4)]	$107,500
G T Ricketts	$143,750 (Chair)	$1,875		$13,750 (Chair)		$159,375
V C M Stoddart	$75,000					$75,000
G R Tomlinson	$93,750			$1,250		$95,000
R G Udovenya					A$33,000[(5)]	$35,792
Total						**$915,283[(6)]**

Notes

(1) Fees paid to A J Aitken as a director of MARAC Insurance Limited

(2) Fees paid to EF Comerford as a director of Heartland Australia Group Pty Limited and Heartland Australia Holdings Pty Ltd

(3) Fees paid to P Drury as a director of Heartland NZ Trustee Limited

(4) Fees paid to CR Mace as Chair of MARAC Insurance Limited

(5) Fees paid to RG Udovenya as a director of ASF Custodians Pty Limited, Australian Seniors Finance Pty Limited, Seniors Finance Custodians Pty Limited and Seniors Finance Pty Limited

(6) For the purposes of this table, A$ fees have been converted to NZ$ using an exchange rate of $1.08464.

REMUNERATION AND/OR OTHER BENEFITS FROM THE COMPANY AND ITS SUBSIDIARIES TO EXECUTIVE DIRECTORS

The remuneration for the Executive Director (being, in Heartland's case, the CEO) includes a fixed remuneration component, a variable remuneration component comprising short-term incentives (**STIs**) and long-term incentives (**LTIs**), and other benefits. LTIs are offered to selected employees (including the CEO) in order to incentivise them to enhance long term shareholder value.

LTI schemes

Set out below is a summary of the grants made to the CEO under the relevant historic, and current, LTI schemes relating to the periods covered in this section.

Historic schemes

- Heartland made grants to the CEO under a cash entitlement scheme (**Cash Scheme**) in November 2012, and the 2012 long term executive share plan loan scheme (the **Original Share Scheme**) in September 2012, both of which have now fully vested.
- Under the net share settled options scheme (the **Option Scheme**), grants were made to the CEO in August 2013 (the **FY13 Options**), August 2014 (the **FY14 Options**) and October 2015 (the **FY15 Options**). A separate grant was made (the **Special Options**) in April 2015. The FY13 Options vested in June 2015. The FY14 Options, FY15 Options and Special Options were all extinguished in June 2016, in consideration for participation in the Senior Executive Scheme described below.

Senior Executive Scheme

Under the Senior Executive Scheme, the CEO agreed to forfeit his FY14 Options, FY15 Options and Special Options, resulting in the CEO acquiring Heartland shares on market. This arrangement was made in recognition that those options had achieved their objectives and should be capped in value, and that the most straightforward way to achieve that result would be to exchange them for shares.

Beneficial title to those shares vest over time. If the CEO remains employed by Heartland until the earlier of 30 June 2019 or the occurrence of a change of control event, he will be entitled to beneficial ownership of all of those shares. If he leaves before 30 June 2019, he will be entitled to retain the proportion of those shares that correlate to the period of his service. For the purposes of this disclosure, Heartland has treated the shares as vesting in three equal tranches in FY17, FY18 and FY19, with the economic value at the date of vesting being a product of the number of shares which are treated as vesting in that period and the share price on the final trading day of the relevant period.

Performance Rights Scheme

Under the Performance Rights Scheme which was implemented in FY17, the CEO was issued performance rights which, subject to continued employment during the service period and satisfaction of performance criteria, will each vest into up to one Heartland share.

CEO remuneration disclosures

In FY17, the CEO received a fixed salary, a variable remuneration component comprising STI and LTI, and other benefits as detailed in the below tables. The tables also show a detailed comparison between FY16 and FY17 and a summary of the CEO's total remuneration and LTI over the last five financial years.

CEO remuneration (FY17 and FY16)

Financial year	Salary	Benefits	Subtotal	At risk pay			Total
				STI	LTI	Subtotal	
FY17	$989,200	$10,800[1]	$1,000,000	$1,000,000	$736,489[2]	$1,736,489	$2,736,489
FY16	$889,200	$10,800[3]	$900,000	$800,000[4]	$0	$800,000	$1,700,000

1 Motor vehicle.

2 This represents the value of the Senior Executive Scheme shares which are being treated as vesting in FY17. For further information, see the Senior Executive Scheme section.

3 Motor vehicle.

4 This comprises cash payments of $600,000 and $200,000 respectively which were paid in FY17 in relation to performance during FY16.

Directors' Disclosures

Five year summary of total CEO remuneration[1]

Financial year	Total remuneration paid	Span of LTI performance period
FY17	$2,736,489	FY17[2]
FY16	$1,700,000	N/A
FY15	$2,652,538[3]	FY13 – FY15[4]
FY14	$1,460,583[5]	FY12 – FY14[6]
FY13	$1,120,000	N/A

1 There were no maximum STI or LTI limits for these periods, so Heartland has not reported the percentage STI / LTI against maximum.
2 The service period for the Senior Executive Scheme shares which are being treated as vesting in FY17 was FY17 – however, the service periods for the FY14 Options, FY15 Options and Special Options which were exchanged for shares under the Senior Executive Scheme spanned FY14 to FY17. For further information, see the Senior Executive Scheme section.
3 This includes the value of the Cash Scheme ($647,000). It also includes the value of the FY13 Options ($667,809), which has been calculated as if those options were settled on the final date of the service period (rather than when they were actually exercised).
4 The service period for the Cash Scheme was FY13 – FY15 (though it was settled prior to the end of that service period) and for the FY13 Options was FY13 – FY15.
5 This includes the value of the grants made under the Original Share Scheme ($260,583), which has been calculated as at the final date of the service period (rather than the date that the shares subsequently vested).
6 The service period for the Original Share Scheme was FY12 – FY14.

Five year summary of CEO LTI

Financial year LTI granted	Fair value total cost to Company on date of issue[7]	Span of LTI performance period	Financial year LTI vested	Economic value at date of vesting ($)
FY17[8]	$204,000	FY17 – FY19	–	–
FY16	$1,127,168	N/A	–	–
FY15[9]	$987,085	FY15 – FY17	FY17[10]	$736,489[11]
FY14[12]	$268,751	FY14 – FY16	FY17[13]	$736,489[14]
FY13[15]	$431,911	FY13 – FY15	FY15 and FY17	$1,305,358

7 The total Fair Value Total Cost to Company on date of issue will not reconcile with disclosures in previous Annual Reports, as those disclosures amortised the cost of LTI grants over the relevant service periods rather than recognising the total costs of each grant in the year that grant was made.
8 See the Performance Rights Scheme section for information in relation to this grant.
9 Special Options and FY15 Options.
10 The FY14 Options, FY15 Options and Special Options were all extinguished in consideration for the Senior Executive Scheme shares, which vest in three equal tranches in FY17, FY18 and FY19. For further information, see the Senior Executive Scheme section.
11 It is not possible to ascribe an economic value at date of vesting to the Special Options and FY15 Options, as they (together with the FY14 Options) were all extinguished in consideration for the Senior Executive Scheme shares. However, the economic value of the first tranche of Senior Executive Scheme shares was $736,489, using the basis described in the Senior Executive Scheme section.
12 FY14 Options.
13 See note 10 above.
14 See note 11 above.
15 FY13 Options and Cash Scheme.

Breakdown of CEO at risk pay (FY17)

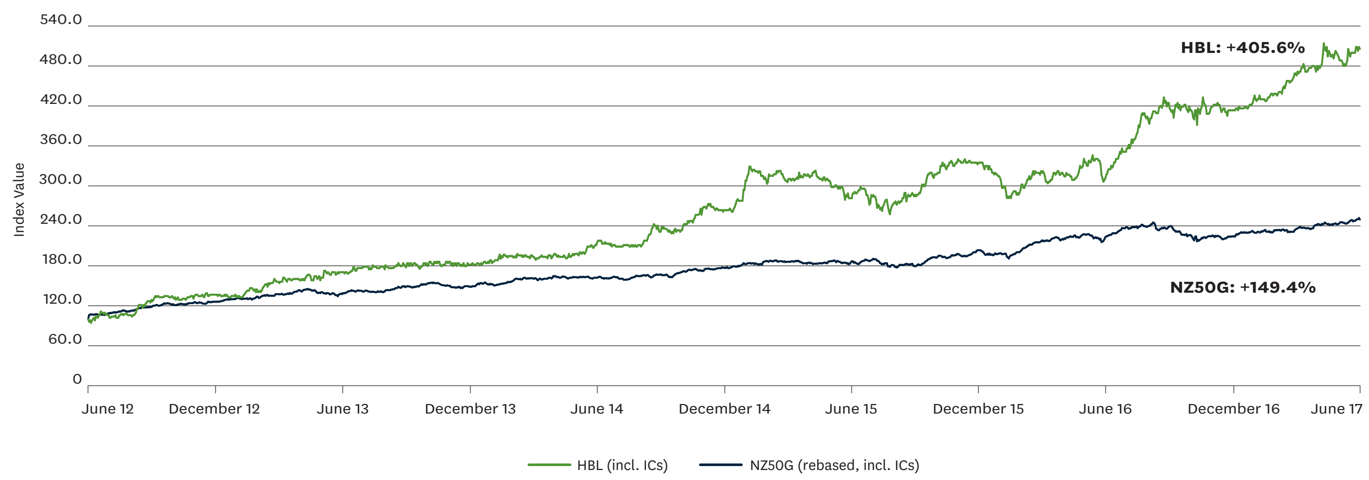
	Description	Performance measures	Percentage achieved
STI	Up to 100% of base salary based on the achievement of financial and non-financial measures	Based on achievement of company KPIs and individual KPIs	100%
LTI	60% of base salary in an award under the Performance Rights Scheme	100% weighting based on achievement of TSR target set at date of grant	TBC*

* Next LTI grant vests in 2019, this is when the amount that vests will be determined based on achievement of TSR target.

CEO grant under Performance Rights Scheme (FY17)

Type of scheme interest	Basis of award	Face value of award and % of award vesting at threshold	Length of vesting period	Summary of performance measures and targets
Performance rights	A number of performance rights equal to 60% of base salary divided by the Heartland volume weighted average share price on 31 August 2016	$600,000 face value 100% vesting at threshold performance	1 July 2017 to 30 June 2019	Continued employment during, and achievement of the hurdle rate of Total Shareholder Return over, the service period (1 July 2017 to 30 June 2019)

Five year summary of Heartland's TSR performance



The above five year total shareholder return (**TSR**) performance graph is provided to aid comparability between Heartland's performance and the remuneration information provided in this section. TSR has been calculated including the benefit of imputation credits. A comparison is shown against the NZX50 Index which measures the performance of the 50 largest eligible stocks listed on the NZX Main Board by float-adjusted market capitalisation.

CEO remuneration as a multiple of staff remuneration

The CEO's salary as a multiple of the staff average is 11 times, and his total remuneration as a multiple of the staff average is 27 times.

Executive Remuneration

The number of employees of Heartland and its subsidiaries (including former employees), other than directors, who received remuneration, including non-cash benefits, in excess of $100,000 during the year ended 30 June 2017 is set out in the remuneration bands detailed below.

Remuneration	Number of staff
$100,000 to $109,999	16
$110,000 to $119,999	11
$120,000 to $129,999	10
$130,000 to $139,999	9
$140,000 to $149,999	9
$150,000 to $159,999	11
$160,000 to $169,999	6
$170,000 to $179,999	6
$180,000 to $189,999	5
$190,000 to $199,999	2
$200,000 to $209,999	3
$210,000 to $219,999	1
$240,000 to $249,999	2
$270,000 to $279,999	1
$290,000 to $299,999	1
$310,000 to $319,999	2
$320,000 to $329,999	1
$330,000 to $339,999	2
$340,000 to $349,999	1
$360,000 to $369,999	1
$380,000 to $389,999	1
$390,000 to $399,999	1
$460,000 to $469,999	1
$560,000 to $569,999	1
$620,000 to $629,999	1
$660,000 to $669,999	1
$1,390,000 to $1,399,999	1
Total	**107**

Shareholder Information

SPREAD OF SHARES

Set out below are details of the spread of shareholders of Heartland as at 31 July 2017 (being a date not more than two months prior to the date of this Annual Report).

Size of holding	Number of shareholders	Total shares	% of issued shares
1-1,000 shares	1,059	634,326	0.12%
1,001-5,000 shares	2,775	7,899,633	1.53%
5,001-10,000 shares	2,130	16,063,918	3.11%
10,001-50,000 shares	4,182	93,385,768	18.07%
50,001-100,000 shares	684	47,220,251	9.14%
100,001 shares and over	470	351,480,434	68.03%
Total	**11,300**	**516,684,330**	**100.00%**

TWENTY LARGEST SHAREHOLDERS[1]

Set out below are details of the 20 largest shareholders of Heartland as at 31 July 2017 (being a date not more than two months prior to the date of this Annual Report).

Rank	Shareholder	Total shares	% of issued shares
1	Harrogate Trustee Limited	50,193,047	9.71%
2	FNZ Custodians Limited	24,686,747	4.78%
3	Citibank Nominees (NZ) Ltd	22,112,655	4.28%
4	Oceania & Eastern Limited	12,293,045	2.38%
5	Accident Compensation Corporation	11,525,872	2.23%
6	Philip Maurice Carter	10,806,607	2.09%
7	HSBC Nominees (New Zealand) Limited	10,441,987	2.02%
8	National Nominees New Zealand Limited	8,859,205	1.71%
9	Forsyth Barr Custodians Ltd	8,634,494	1.67%
10	Investment Custodial Services Limited	8,087,160	1.57%
11	Leveraged Equities Finance Limited	7,363,698	1.43%
12	JPMORGAN Chase Bank	6,630,976	1.28%
13	Heartland Trust	6,118,046	1.18%
14	HSBC Nominees (New Zealand) Limited	6,071,143	1.18%
15	New Zealand Permanent Trustees Limited	4,625,000	0.90%
16	Jarden Custodians Limited	4,500,000	0.87%
17	Bnp Paribas Nominees NZ Limited	4,463,735	0.86%
18	Custodial Services Limited	3,805,231	0.74%
19	Custodial Services Limited	3,088,932	0.60%
20	Jeffrey Kenneth Greenslade & Sarah Ormond Greenslade	3,005,930	0.58%
Total		**217,13,510**	**42.06%**

[1] Any person wishing to acquire an interest in 10% or more of Heartland's shares must obtain the consent of the Reserve Bank of New Zealand before they do so.

SUBSTANTIAL PRODUCT HOLDERS

As at 30 June 2017, the following product holders were substantial product holders in Heartland.

Name	Number of shares	Class of shares	Total number of shares in class
Harrogate Trustee Limited and Gregory Raymond Tomlinson	50,193,047	Ordinary	516,684,330

Other Information

AUDITOR'S FEES

KPMG has continued to act as auditor of Heartland and its subsidiaries. The amount payable by Heartland and its subsidiaries to KPMG as audit fees during the year ended 30 June 2017 was $498,000. The amount of fees payable to KPMG for non-audit work during the year ended 30 June 2017 was $143,000. These non-audit fees were primarily for accounting advisory services and they complied with Heartland's External Auditor Independence Policy.

CREDIT RATING

As at the date of this Annual Report, Heartland had a Fitch Australia Pty Limited long-term credit rating of BBB (outlook stable).

DONATIONS

The total amount of donations made by Heartland during the year ended 30 June 2017 was $15,000.

EXERCISE OF NZX DISCIPLINARY POWERS

NZX Limited did not exercise any of its powers under Listing Rule 5.4.2 in relation to Heartland during the year ended 30 June 2017.

NZX WAIVERS

Set out below is a summary of all waivers granted to Heartland by NZX, or relied on by Heartland, within the 12 month period preceding 30 June 2017.

Director nominations

Heartland has relied on a waiver from Listing Rule 3.3.5 to the extent it prohibited Heartland from imposing a precondition on the nomination of a director to its Board. A waiver was required because Heartland is a registered bank and, before any person can be appointed as a director, that person must satisfy certain requirements of the Reserve Bank of New Zealand (**RBNZ**).

Satisfaction of these requirements is therefore a precondition to Heartland accepting any director nomination. The effect of this precondition is that the RBNZ must provide its non-objection to the proposed appointment of any nominee before the closing date for director nominations. Heartland has relied on this waiver in respect of any director nominations for its 2017 Annual Meeting. The waiver was granted on the conditions that:

- satisfaction of the RBNZ's requirements is the only precondition to Heartland accepting a director nomination;
- the waiver, its conditions and their implications are clearly and prominently disclosed in Heartland's annual report for each year the waiver is relied on;
- Heartland gives not less than 30 business days' notice of the closing date for director nominations;
- Heartland gives an overview of the RBNZ's requirements in the same notice; and
- Heartland assists any prospective nominee with the administrative steps required to meet the RBNZ's requirements by providing the necessary documentation to be completed by the nominee, procuring a New Zealand criminal history check and submitting all information to the RBNZ for assessment.

Issue of subordinated unsecured convertible notes

Heartland was granted the below waivers from certain Listing Rules in relation to the issue of A$20 million of subordinated unsecured convertible notes (**Notes**) on 7 April 2017. One of the key terms of the notes is that they will be required to convert into fully paid shares in Heartland in the event a non-viability trigger event occurs. While a non-viability trigger event will only occur in an extreme and remote regulatory circumstance, a conversion of the Notes into shares will have the effect of diluting the voting rights of existing shareholders. It is not possible to determine the extent of this dilution because the number of shares to be issued on a conversion is not capped and is determined by reference to Heartland's share price and the A$/NZ$ exchange rate at the time of conversion.

NZX WAIVERS (CONTINUED)

Listing Rule 7.12.2

NZX waived the requirement for Heartland to give at least 10 business days' prior notice of a conversion of the Notes in the event a non-viability trigger event occurs. If a conversion is required, it must occur immediately under RBNZ Banking Standards, which means that Heartland will be unable to give at least 10 business days' prior notice. Instead, Heartland must give this notice as soon as practicable, but in any event before trading opens on the business day after the conversion occurs.

Listing Rule 7.3.1 and 7.5.1

NZX waived the requirement for Heartland to seek shareholder approval for the issue of shares if a conversion of the Notes is required. In order to comply with RBNZ Banking Standards, there must not be any legal or other impediment to the issue of shares upon a conversion – the issue must occur immediately. Heartland will therefore not be able to seek shareholder approval under these Listing Rules. These waivers were granted on the conditions that:

- the full terms and conditions of the Notes are released to NZX on their issue date (including disclosure that conversion is potentially dilutionary for existing shareholders because the terms and conditions do not include a cap on the maximum number of shares that may be issued on conversion);
- the waivers, their conditions and their implications are disclosed in any offer document for Heartland shares and Heartland's annual report (including disclosure that conversion is potentially dilutionary for existing shareholders because the terms and conditions do not include a cap on the maximum number of shares that may be issued on conversion); and
- details of the Notes on issue are contained in Heartland's full year and half year disclosure statements in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended from time to time).

Listing Rules 9.1.1 and 9.2.1

NZX waived the requirement for Heartland to seek shareholder approval for a major transaction and for a material transaction involving related parties. These waivers were granted on the basis that, at the time the Notes were issued, Heartland was not able to determine whether the issue of shares upon a conversion of the Notes required approval under these Listing Rules. In relation to a material transaction involving related parties, the waiver was also granted on the basis that any related parties will participate on the exact same terms as all other Note holders. In addition, Heartland must ensure that there is no legal or other impediment to the issue of shares upon a conversion (as explained above), so will be unable to comply with the requirement to seek shareholder approval under these Listing Rules. This waiver was granted on the conditions that:

- the full terms and conditions of the Notes are released to NZX on their issue date (including disclosure that conversion is potentially dilutionary for existing shareholders because the terms and conditions do not include a cap on the maximum number of shares that may be issued on conversion); and
- the waivers, their conditions and their implications are disclosed in the Information Memorandum, any offer document for Heartland shares, and Heartland's Annual Report.

Corporate Directory

Directors

Geoffrey Ricketts	Chair and Independent Non-Executive Director
Bruce Irvine	Deputy Chair and Independent Non-Executive Director
Jeff Greenslade	Executive Director and Chief Executive Officer
Ellie Comerford	Independent Non-Executive Director
John Harvey	Independent Non-Executive Director
Graham Kennedy	Independent Non-Executive Director
Chris Mace	Independent Non-Executive Director
Vanessa Stoddart	Independent Non-Executive Director
Greg Tomlinson	Non-Executive Director

Executive Team

Jeff Greenslade	Chief Executive Officer
Chris Flood	Deputy Chief Executive Officer
Laura Byrne	Chief Operations Officer
Mel Cadman	Head of Retail
Chris Cowell	Head of Digital Execution
Andrew Dixson	Head of Business Advisory and Funding
Michael Drumm	General Counsel
Andrew Ford	CEO Heartland Seniors Finance Australia
Kent Fraser	Treasury Manager
Peter Griffin	Head of Business
Darryl Harnett	Head of Consumer
Richard Lorraway	Chief Risk Officer
David Mackrell	Chief Financial Officer
Rochelle Moloney	Head of Corporate Communications
Ben Russell	Head of Rural
Sarah Selwood	Head of Human Resources
Sarah Smith	Head of Business Enablement
Ashley Weyers	Head of IT
Lydia Zulkifli	Head of Digital Strategy

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