HEARTLAND BANK

Disclosure Statement

For the year ended 30 June 2016

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GENERAL INFORMATION

This Disclosure Statement has been issued by Heartland Bank Limited (the bank) and its subsidiaries (the banking group) for the year ended 30 June 2016 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 2016 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.

On 31 December 2015, there was a change to the composition of the banking group as a result of an amalgamation of companies.

Prior to 31 December 2015, the banking group comprised the company that was then known as “Heartland Bank Limited” (Former Heartland Bank) together with its subsidiaries. At that stage, Former Heartland Bank was wholly owned by a company then known as “Heartland New Zealand Limited” (Heartland New Zealand). On 31 December 2015, Former Heartland Bank amalgamated, by way of short form amalgamation, with Heartland New Zealand (the Amalgamation). Heartland New Zealand continued as the amalgamated company (with Former Heartland Bank being struck off the register of companies), but changed its name to “Heartland Bank Limited”.

As a result of the Amalgamation, Heartland Bank Limited became a registered bank under the Reserve Bank of New Zealand Act 1989 and the banking group expanded to include the company that is now known as Heartland Bank Limited. Refer to the Reporting entity note within the notes to the financial statements for further detail.

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

Name and address for service

The name of the Registered Bank is Heartland Bank Limited.

The bank's address for service is 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	10.12%
FNZ Custodians Limited	5.04%

No person has the ability to directly or indirectly appoint 25% or more of 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 each other.

The loans sold to the Heartland ABCP Trust 1 (ABCP Trust) are set aside for the benefit of investors in the ABCP Trust (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. 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
Chairman - Board of Directors
Type of director: Independent Non-Executive Director
Qualifications: CNZM, LLB (Hons), LLD *(honoris causa),* F Inst D
Occupation: Company Director
External Directorships:
AAI Limited, Asteron Life Limited, Highground Trust Limited, Janmac Capital Limited, Macmine Investments Limited, Maisemore Enterprises Limited, MCF 1 Limited, MCF 2 Nexus Limited, MCF 3 Limited, MCF 4 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, 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, SBGH Limited, Suncorp Group Limited, Suncorp Group Holdings (NZ) Limited, Suncorp Group New Zealand Limited, Suncorp Group Services NZ Limited, Suncorp Insurance Holdings Limited, Suncorp Life and Superannuation Limited, Suncorp Life Holdings Limited, Suncorp Metway 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: 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, Avon Pacific Holdings Limited, B R Irvine Limited, Blackbyre Horticulture Limited, Bowdens Mart Limited, Bray Frampton Limited, Britten Motorcycle Company Limited, Canterbury Spinners Limited, CCHL (2) Limited, CCHL (4) Limited, CCHL (5) Limited, Chambers @151 Limited, Christchurch City Holdings Limited, Christchurch City Networks Limited, Cockerill and Campbell (2007) 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, Lake Angelus Holdings Limited, Lamanna Bananas (NZ) Limited, Lamanna Bananas 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, Noblesse Oblige Limited, PGG Wrightson Limited, Phimai Holdings Limited, Quitachi Limited, Rakon ESOP Trustee Limited, Rakon Limited, Rakon PPS Trustee Limited, Scenic Circle Hotels Limited, Skope Industries Limited, Southland Produce Markets Limited, Wavell Resources Limited.

Name: Graham Russell Kennedy
Type of director: Non-Independent Non-Executive Director
Qualifications: J. P., 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, Earth & Sky 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.

Name: Sir Christopher Robert Mace
Type of director: Independent Non-Executive Director
Qualifications: KNZM, CM Inst D
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, Pukeha Farms Limited, Quartet Equities Limited, Ryburn Lagoon Trust Limited, St. Just Enterprises Limited, The New Zealand Initiative Limited.

DIRECTORS (CONTINUED)

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, Oceania Healthcare 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 November 2015.

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

1. That—

   (a) the Total capital ratio of the banking group is not less than 8%;

   (b) the Tier 1 capital ratio of the banking group is not less than 6%;

   (c) the Common Equity Tier 1 capital ratio of the banking group is not less than 4.5%;

   (d) the Total capital of the banking group is not less than $30 million; and

   (e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and

   (f) the bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document "Application requirements for capital recognition or repayment and notification requirements in respect of capital" (BS16) dated November 2015 in respect of regulatory capital instruments.

   For the purposes of this condition of registration, -

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

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

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

1A. That—

   (a) the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in the document "Guidelines on a bank's internal capital adequacy assessment process ('ICAAP')" (BS12) dated December 2007;

   (b) under its ICAAP the bank identifies and measures its "other material risks" defined as all material risks of the banking group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015; and

   (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

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

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

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

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

   (c) have the capital plan approved by the Reserve Bank.

   For the purposes of this condition of registration, -

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

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

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

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

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

   (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and

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

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

   (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and

   (b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

   For the purposes of this condition of registration,—

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

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

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

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

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

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

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

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

CONDITIONS OF REGISTRATION (CONTINUED)

6. That the bank complies with the following corporate governance requirements:

   (a) the board of the bank must have at least five directors;

   (b) the majority of the board members must be non-executive directors;

   (c) at least half of the board members must be independent directors;

   (d) an alternate director,—

      (i) for a non-executive director must be non-executive; and

      (ii) for an independent director must be independent;

   (e) at least half of the independent directors of the bank must be ordinarily resident in New Zealand;

   (f) the chairperson of the board of the bank must be independent; and

   (g) the bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the bank).

   For the purposes of this condition of registration,—

   "independent,"—

   (a) in relation to a person other than a person to whom paragraph (b) applies, has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014; and

   (b) in relation to a person who is the chairperson of the board of the bank, means a person who—

      (i) meets the criteria for independence set out in section 10 except for those in paragraph 10(1)(a) in BS14; and

      (ii) does not raise any grounds of concern in relation to the person's independence that are communicated in writing to the bank by the Reserve Bank of New Zealand:

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

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:

   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

   (b) the Reserve Bank has advised that it has no objection to that appointment.

8. That a person must not be appointed as chairperson of the board of the bank unless:

   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

   (b) the Reserve Bank has advised that it has no objection to that appointment.

9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:

   (a) the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;

   (b) the committee must have at least three members;

   (c) every member of the committee must be a non-executive director of the bank;

   (d) the majority of the members of the committee must be independent; and

   (e) the chairperson of the committee must be independent and must not be the chairperson of the bank.

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

10. That a substantial proportion of the bank's business is conducted in and from New Zealand.

11. That the banking group complies with the following quantitative requirements for liquidity-risk management:

   (a) the one-week mismatch ratio of the banking group is not less than zero percent at the end of each business day;

   (b) the one-month mismatch ratio of the banking group is not less than zero percent at the end of each business day; and

   (c) the one-year core funding ratio of the banking group is not less than 75 percent at the end of each business day.

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

CONDITIONS OF REGISTRATION (CONTINUED)

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

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

    For the purposes of this condition,—

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

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

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

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

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

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

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

CONDITIONS OF REGISTRATION (CONTINUED)

16. That the bank has an Implementation Plan that—

    (a) is up-to-date; and

    (b) demonstrates that the bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: "Open Bank Resolution Pre-positioning Requirements Policy" (BS 17).

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

17. That the bank has a compendium of liabilities that—

    (a) at the product-class level lists all liabilities, indicating which are—

        (i) pre-positioned for Open Bank Resolution; and

        (ii) not pre-positioned for Open Bank Resolution;

    (b) is agreed to by the Reserve Bank; and

    (c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

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

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

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

19. That, for a loan-to-valuation measurement period, the total of the bank’s qualifying new mortgage lending amount in respect of APIL with a loan-to-valuation ratio of more than 70%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of APIL 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 ANPIL 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 ANPIL arising in the loan-to-valuation measurement period.

21. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of non-Auckland loans with a loan-to-valuation ratio of more than 80%, must not exceed 15% of the total of the qualifying new mortgage lending amount in respect of non-Auckland loans arising in the loan-to-valuation measurement period.

22. 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 bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

In these conditions of registration,—

“banking group”—

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

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

In conditions of registration 19 to 22,—

"ANPIL", APIL", "loan-to-valuation ratio", "non-Auckland loan", "qualifying new mortgage lending amount in respect of [...]" 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 November 2015.

"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 April 2016.

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 the 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 2016:

   (a) the bank complied with all conditions of the 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 the banking group's material risks, 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 16 August 2016 and has been signed by all the Directors.

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

B. R. Irvine

J. K. Greenslade

G. R. Kennedy

E. J. Harvey

G. R. Tomlinson

C. R. Mace

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2016

	NOTE	Jun 2016 $000	Jun 2015 $000
Interest income	2	265,475	260,468
Interest expense	2	118,815	126,041
Net interest income		**146,660**	**134,427**
Operating lease income	3	8,869	10,350
Operating lease expenses	3	6,230	7,087
Net operating lease income		**2,639**	**3,263**
Lending and credit fee income		3,339	3,077
Other income	4	4,923	3,940
Net operating income		**157,561**	**144,707**
Selling and administration expenses	5	69,872	68,403
Profit before impaired asset expense and income tax		**87,689**	**76,304**
Impaired asset expense	6	13,501	12,105
Operating profit		**74,188**	**64,199**
Share of joint arrangement profit		-	137
Profit before income tax		**74,188**	**64,336**
Income tax expense	7	20,024	16,173
Profit for the year		**54,164**	**48,163**
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		(708)	(2,709)
Movement in available for sale reserve, net of income tax		(208)	898
Movement in foreign currency translation reserve, net of income tax		(4,047)	2,136
Items that will not be reclassified to profit or loss:			
Movement in defined benefit reserve, net of income tax		(93)	50
Other comprehensive (loss) / income for the year, net of income tax		**(5,056)**	**375**
Total comprehensive income for the year		**49,108**	**48,538**
Earnings per share from continuing operations			
Basic earnings per share	8	11c	10c
Diluted earnings per share	8	11c	10c

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

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

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2016

	NOTE	Share Capital $000	Treasury Shares Reserve $000	Employee Benefits Reserve $000	Foreign Currency Translation Reserve $000	Available for sale Reserve $000	Defined benefit Reserve $000	Hedging Reserve $000	Retained Earnings $000	Total Equity $000
Balance at 1 July 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**
Balance at 1 July 2014		**406,142**	**(926)**	**1,476**	**95**	**272**	**44**	**1,157**	**44,362**	**452,622**
Total comprehensive income / (loss) for the year										
Profit for the year		-	-	-	-	-	-	-	48,163	48,163
Other comprehensive income / (loss), net of income tax		-	-	-	2,136	898	50	(2,709)	-	375
Total comprehensive income / (loss) for the year		**-**	**-**	**-**	**2,136**	**898**	**50**	**(2,709)**	**48,163**	**48,538**
Contributions by and distributions to owners										
Dividends paid	14	-	-	-	-	-	-	-	(30,188)	(30,188)
Dividend reinvestment plan	14	7,621	-	-	-	-	-	-	-	7,621
Share based payments	25	-	-	1,491	-	-	-	-	-	1,491
Shares vested		138	629	(767)	-	-	-	-	-	-
Treasury shares sold		16	25	-	-	-	-	-	-	41
Total transactions with owners		**7,775**	**654**	**724**	**-**	**-**	**-**	**-**	**(30,188)**	**(21,035)**
Balance at 30 June 2015		**413,917**	**(272)**	**2,200**	**2,231**	**1,170**	**94**	**(1,552)**	**62,337**	**480,125**

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

STATEMENT OF FINANCIAL POSITION

As at 30 June 2016

	NOTE	Jun 2016 $000	Jun 2015 $000
Assets			
Cash and cash equivalents		84,154	37,012
Investments	9	236,435	329,338
Investment properties	10	8,384	24,513
Finance receivables	11	3,113,957	2,862,070
Operating lease vehicles	12	24,557	29,998
Other assets	15(a)	14,871	12,119
Investment in joint arrangement		-	4,383
Intangible assets	15(b)	57,755	51,119
Deferred tax asset	7(c)	7,068	8,707
Total assets		**3,547,181**	**3,359,259**
Liabilities			
Borrowings	13	2,999,987	2,825,245
Current tax liabilities		6,754	7,869
Trade and other payables	15(c)	42,099	46,020
Total liabilities		**3,048,840**	**2,879,134**
Equity			
Share capital	14	418,765	413,645
Retained earnings and reserves		79,576	66,480
Total equity		**498,341**	**480,125**
Total equity and liabilities		**3,547,181**	**3,359,259**

Total interest earning and discount bearing assets	3,427,117	3,221,246
Total interest and discount bearing liabilities	3,005,853	2,834,100

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

STATEMENT OF CASH FLOWS

For the year ended 30 June 2016

	Note	Jun 2016 $000	Jun 2015 $000
Cash flows from operating activities			
Interest received		251,814	243,729
Operating lease income received		9,468	8,951
Lending, credit fees and other income received		7,940	7,017
Operating inflows		**269,222**	**259,697**
Payments to suppliers and employees		79,661	60,346
Interest paid		131,378	126,179
Taxation paid		20,297	9,956
Operating outflows		**231,336**	**196,481**
Net cash flows from operating activities before changes in operating assets and liabilities		**37,886**	**63,216**
Proceeds from sale of operating lease vehicles		7,933	7,386
Purchase of operating lease vehicles		(8,187)	(11,544)
Net movement in finance receivables		(251,734)	(259,871)
Net movement in deposits		186,120	362,590
Total cash provided (applied to) / from operating activities		**(27,982)**	**161,777**
Cash flows from investing activities			
Net proceeds from sale of investment properties		16,492	9,375
Proceeds from sale of office fit-out, equipment and intangible assets		784	4,885
Net decrease in investments		98,480	-
Total cash provided from investing activities		**115,756**	**14,260**
Purchase of office fit-out, equipment and intangible assets		12,700	6,344
Capital expenditure on investment properties		24	-
Net increase in investments		-	89,581
Purchase of MARAC Insurance Limited	23	2,300	-
Total cash applied to investing activities		**15,024**	**95,925**
Net cash flows from / (applied to) investing activities		**100,732**	**(81,665)**
Cash flows applied to financing activities			
Net increase in wholesale funding		1,637	-
Total cash provided from financing activities		**1,637**	**-**
Dividends paid	14	30,390	22,567
Net decrease in wholesale funding		-	57,877
Total cash applied to financing activities		**30,390**	**80,444**
Net cash flows applied to financing activities		**(28,753)**	**(80,444)**
Net increase / (decrease) in cash held		**43,997**	**(332)**
Opening cash and cash equivalents		37,012	37,344
Cash impact of business acquisition (MARAC Insurance Limited)	23	3,145	-
Closing cash and cash equivalents		**84,154**	**37,012**

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

STATEMENT OF CASH FLOWS
For the year ended 30 June 2016

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

	Jun 2016 $000	Jun 2015 $000
Profit for the year	**54,164**	**48,163**
Add / (less) non-cash items:		
Depreciation and amortisation expense	2,153	2,010
Depreciation on lease vehicles	5,695	6,375
Impaired asset expense	13,501	12,105
Total non-cash items	**21,349**	**20,490**
Add / (less) movements in operating assets and liabilities:		
Finance receivables	(264,969)	(275,274)
Operating lease vehicles	(254)	(5,078)
Other assets	(2,446)	2,997
Gain on disposal of property, plant and equipment and intangibles	(322)	(98)
Current tax	(1,125)	8,996
Derivative financial instruments revaluation	(1,338)	1,326
Deferred tax expense / (benefit)	686	(3,420)
Deposits	173,807	360,545
Other liabilities	(7,534)	3,130
Total movements in operating assets and liabilities	**(103,495)**	**93,124**
Net cash flows from operating activities	**(27,982)**	**161,777**

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

Basis of reporting

Reporting entity

On 31 December 2015, Former Heartland Bank was amalgamated, by way of short form amalgamation, with its ultimate parent, Heartland New Zealand. Heartland New Zealand has continued as the amalgamated company but has changed its name from Heartland New Zealand Limited to Heartland Bank Limited. Refer to General Information contained within the Disclosure Statement for further details.

As a result of the Amalgamation, all of Heartland New Zealand's subsidiaries which were previously sitting outside of Former Heartland Bank, were brought into the banking group. The most significant of these businesses was the Australian reverse mortgage business. Other strategic investments, such as shareholdings in Harmoney Corp Limited, Ora HQ Limited and MARAC Insurance Limited, were also brought into the banking group.

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. Unless otherwise stated, comparatives presented are for the consolidated group of the company previously known as Heartland New Zealand Limited.

As at 30 June 2016 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 Reporting Act 2013 and Financial Markets Conduct 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 or 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 Heartland Bank Limited 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.

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 involved 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)(ii).

The estimates and judgements used in the preparation of the banking groups 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, except those transactions with related parties, refer to Note 15(d) - Related party transactions. 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 comprises the following main operating segments:

Households Providing a comprehensive range of financial services to New Zealand families (including term, transactional and savings based deposit accounts together with mortgage lending (residential and home equity release), motor vehicle finance and consumer finance) and some specific financial services to Australian seniors (home equity release mortgage lending).

Business Providing term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized New Zealand 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 than 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.

During the period ended 30 June 2016, the following changes were made to the banking group's operating segments:
- a business unit previously reported in the Household division was moved to the Business division.
- lending through Harmoney, which was previously reported in the Business division, was moved to the Household division.
- the non-core property segment was moved into the Business division.

Comparative information has been restated to be consistent with the current reporting period.

	Households $000	Business $000	Rural $000	Admin & Support $000	Total $000
Jun 2016					
Net interest income	79,320	41,061	26,111	168	146,660
Net other income	6,752	1,921	152	2,076	10,901
Net operating income	**86,072**	**42,982**	**26,263**	**2,244**	**157,561**
Other selling and administration expenses	17,995	9,015	4,351	38,511	69,872
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	1,687,232	907,205	552,461	400,283	**3,547,181**
Total liabilities	-	-	-	3,048,840	**3,048,840**

1 Segmental analysis (continued)

	Households $000	Business $000	Rural $000	Admin & Support $000	Total $000
Jun 2015					
Net interest income	70,765	38,666	23,884	1,112	134,427
Net other income	5,823	2,112	135	2,210	10,280
Net operating income	**76,588**	**40,778**	**24,019**	**3,322**	**144,707**
Other selling and administration expenses	20,071	7,480	4,878	35,974	68,403
Selling and administration expenses	**20,071**	**7,480**	**4,878**	**35,974**	**68,403**
Profit / (loss) before impaired asset expense and income tax	**56,517**	**33,298**	**19,141**	**(32,652)**	**76,304**
Impaired asset expense	5,879	5,716	510	-	12,105
Operating profit / (loss)	**50,638**	**27,582**	**18,631**	**(32,652)**	**64,199**
Share of joint arrangement profit	-	-	-	137	137
Profit / (loss) before income tax	**50,638**	**27,582**	**18,631**	**(32,515)**	**64,336**
Income tax expense	-	-	-	16,173	16,173
Profit / (loss) for the year	**50,638**	**27,582**	**18,631**	**(48,688)**	**48,163**
Total assets	1,600,547	828,362	487,673	442,677	**3,359,259**
Total liabilities	-	-	-	2,879,134	**2,879,134**

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 if the hedge relationship is subsequently deemed to be ineffective.

	Jun 2016 $000	Jun 2015 $000
Interest income		
Cash and cash equivalents	771	2,458
Investments	10,203	9,919
Finance receivables	254,501	248,091
Total interest income	**265,475**	**260,468**
Interest expense		
Retail deposits	85,955	82,526
Bank and securitised borrowings	31,232	43,294
Net interest expense on derivative financial instruments	1,628	221
Total interest expense	**118,815**	**126,041**
Net interest income	**146,660**	**134,427**

Included within the banking group's interest income on finance receivables is $1,664,000 (2015: $1,157,000) on individually impaired assets.

3 Net operating lease income

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

	Jun 2016 $000	Jun 2015 $000
Operating lease income		
Lease income	8,033	9,430
Gain on disposal of lease vehicles	836	920
Total operating lease income	**8,869**	**10,350**
Operating lease expense		
Depreciation on lease vehicles	5,695	6,375
Direct lease costs	535	712
Total operating lease expenses	**6,230**	**7,087**
Net operating lease income	**2,639**	**3,263**

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.

	NOTE	Jun 2016 $000	Jun 2015 $000
Rental income from investment properties		1,244	1,478
Insurance income		1,508	-
Gain on sale of investments		1,136	583
Management fees	15(d)	-	500
Other income		1,035	1,379
Total other income		**4,923**	**3,940**

5 Selling and administration expenses

	Jun 2016 $000	Jun 2015 $000
Personnel expenses	39,051	39,619
Directors' fees	743	917
Superannuation	748	782
Audit and review of financial statements[1]	436	431
Other assurance services paid to auditor [2]	43	23
Other fees paid to auditor [3]	107	125
Depreciation - property, plant and equipment	1,081	777
Amortisation - intangible assets	1,072	1,233
Operating lease expense as a lessee	2,281	2,001
Legal and professional fees	2,352	2,318
Other operating expenses	21,958	20,177
Total selling and administration expenses	**69,872**	**68,403**

[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

	NOTE	Jun 2016 $000	Jun 2015 $000
Non-securitised			
Individually impaired expense		1,072	7,153
Collectively impaired expense		11,186	4,051
Total non-securitised impaired asset expense		**12,258**	**11,204**
Securitised			
Individually impaired (benefit) / expense		(9)	53
Collectively impaired expense		1,252	848
Total securitised impaired asset expense		**1,243**	**901**
Total			
Individually impaired expense	19(e)	1,063	7,206
Collectively impaired expense	19(e)	12,438	4,899
Total impaired asset expense		**13,501**	**12,105**

7 Taxation

(a) Income tax expense

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

	Jun 2016 $000	Jun 2015 $000
Income tax recognised in profit or loss		
Current tax		
Current year	18,850	18,755
Adjustments for prior year	208	(195)
Deferred tax		
Current year	1,722	(2,209)
Adjustments for prior year	(756)	(178)
Income tax expense recognised in profit or loss	**20,024**	**16,173**
Income tax recognised in other comprehensive income		
Current tax		
Fair value movements of available for sale investments	172	349
Deferred tax		
Defined benefit plan	(36)	19
Fair value movements of cash flow hedges	(243)	(1,052)
Income tax (benefit) / expense recognised in other comprehensive income	**(107)**	**(684)**
Reconciliation of effective tax rate		
Profit before income tax	74,188	64,336
Prima facie tax at 28%	20,773	18,014
Higher tax rate for overseas jurisdiction	135	92
Plus / (minus) tax effect of items not taxable / deductible	114	(141)
Adjustments for prior year	(548)	(283)
Utilisation of unrecognised tax losses	(450)	(1,509)
Total income tax expense	**20,024**	**16,173**

7 Taxation (continued)

(b) Current tax

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

(c) Deferred tax

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

Deferred tax assets comprise the following temporary differences:

	Jun 2016 $000	Jun 2015 $000
Employee entitlements	1,038	1,229
Provision for impairment	5,797	6,633
Investment properties	1,358	1,473
Intangibles and property, plant and equipment	(177)	(399)
Deferred acquisition costs	(1,196)	-
Operating lease vehicles	(1,276)	(1,543)
Other temporary differences	1,524	1,314
Total deferred tax assets	**7,068**	**8,707**
Opening balance of deferred tax assets	**8,707**	**5,287**
Acquisition of subsidiaries	(952)	-
Movement recognised in profit or loss	(966)	2,387
Movement recognised in other comprehensive income	279	1,033
Closing balance of deferred tax assets	**7,068**	**8,707**

(d) Goods and services tax (GST)

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

(e) Imputation credit account

	Jun 2016 $000	Jun 2015 $000
Imputation credit account	2,388	3,484

8 Earnings per share

The calculation of basic and diluted earnings of 11c per share at 30 June 2016 (2015: 10c per share) is based on the profit for the year of $54,164,000 (2015: $48,163,000), and a weighted average number of shares on issue of 473,359,905 (2015: 466,643,607).

Financial Position

9 Investments

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

	Jun 2016 $000	Jun 2015 $000
Bank bonds and floating rate notes	181,786	244,505
Public sector securities and corporate bonds	8,530	31,275
Local authority stock	38,828	46,839
Equity investments	7,291	6,719
Total investments	**236,435**	**329,338**

10 Investment properties

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

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

	Jun 2016 $000	Jun 2015 $000
Opening balance	24,513	24,888
Acquisitions	-	9,000
Additional capital expenditure	24	-
Sales	(16,153)	(9,375)
Closing balance	**8,384**	**24,513**

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.

	NOTE	Jun 2016 $000	Jun 2015 $000
Non-securitised			
Neither at least 90 days past due nor impaired		2,785,927	2,552,302
At least 90 days past due		20,070	33,459
Individually impaired		33,751	25,567
Restructured assets		3,281	3,881
Gross finance receivables		**2,843,029**	**2,615,209**
Less provision for impairment		19,936	24,511
Less fair value adjustment for present value of future losses[1]		4,987	6,242
Total non-securitised finance receivables		**2,818,106**	**2,584,456**
Securitised			
Neither at least 90 days past due nor impaired		295,166	276,944
At least 90 days past due		1,897	1,516
Individually impaired		13	55
Gross finance receivables		**297,076**	**278,515**
Less provision for impairment		1,225	901
Total securitised finance receivables		**295,851**	**277,614**
Total			
Neither at least 90 days past due nor impaired		3,081,093	2,829,246
At least 90 days past due	19(b)	21,967	34,975
Individually impaired	19(c)	33,764	25,622
Restructured assets	19(a)	3,281	3,881
Gross finance receivables		**3,140,105**	**2,893,724**
Less provision for impairment	19(e)	21,161	25,412
Less fair value adjustment for present value of future losses[1]	19(a)	4,987	6,242
Total finance receivables		**3,113,957**	**2,862,070**

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

Finance lease receivables

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

	Jun 2016 $000	Jun 2015 $000
Gross finance lease receivables		
Less than 1 year	29,710	32,484
Between 1 and 5 years	50,030	66,835
More than 5 years	-	68
Total gross finance lease receivables	**79,740**	**99,387**
Less unearned finance income	10,614	14,315
Less provision for impairment	132	170
Net finance lease receivables	**68,994**	**84,902**

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

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 operating lease vehicles vary up to five years. Vehicles held for sale are not depreciated but are tested for impairment.

	Jun 2016 $000	Jun 2015 $000
Cost		
Opening balance	42,186	43,595
Additions	8,187	11,544
Disposals	(14,645)	(12,953)
Closing balance	**35,728**	**42,186**
Accumulated depreciation		
Opening balance	12,188	12,300
Depreciation charge for the year	5,695	6,375
Disposals	(6,712)	(6,487)
Closing balance	**11,171**	**12,188**
Opening net book value	29,998	31,295
Closing net book value	**24,557**	**29,998**

The future minimum lease payments receivable under non-cancellable operating leases not later than one year is $6,362,000 (2015: $7,961,000), within one to five years is $5,071,000 (2015: $6,225,000) and over five years is nil (2015: nil).

13 Borrowings

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

	Jun 2016 $000	Jun 2015 $000
Deposits	2,282,876	2,097,458
Subordinated bond	3,378	3,378
Bank borrowings	429,304	465,779
Securitised borrowings	284,429	258,630
Total borrowings	**2,999,987**	**2,825,245**

Deposits rank equally and are unsecured. The Subordinated bonds 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 $350 million (2015: $350 million) in relation to the ABCP Trust, which mature on 1 February 2017.

The banking group has an Australian bank facility provided by Commonwealth Bank of Australia (CBA bank facility) totalling $379 million (2015: $466 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.

14 Share capital and dividends

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

	Jun 2016 Number of shares 000	Jun 2015 Number of shares 000
Issued shares		
Opening balance	469,890	463,266
Shares issued during the year	213	-
Dividend reinvestment plan	6,366	6,624
Closing balance	**476,469**	**469,890**

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

14 Share capital and dividends (continued)

Under dividend reinvestment plans, the bank issued 3,711,076 new shares at $1.110 per share on 2 October 2015 and 2,655,142 new shares at $1.198 per share on 5 April 2016 (3,680,052 new shares at $1.015 on 3 October 2014 and 2,943,636 new shares at $1.320 on 7 April 2015).

Dividends paid

	Jun 2016			Jun 2015		
	date declared	cents per share	$000	date declared	cents per share	$000
Final dividend	18/08/2015	4.5	21,145	25/08/2014	3.5	16,394
Interim dividend	23/02/2016	3.5	16,545	23/02/2015	3.0	13,794
Total dividends paid		**8.0**	**37,690**		**6.5**	**30,188**

15 Other balance sheet items

(a) Other assets

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

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

	Jun 2016 $000	Jun 2015 $000
Derivative financial assets	148	59
Trade receivables	5,452	5,546
Prepayments	622	1,092
Property, plant and equipment	8,649	5,422
Total other assets	**14,871**	**12,119**

(b) Intangible assets

(i) Intangible assets with definite 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.

	Jun 2016 $000	Jun 2015 $000
Computer Software Cost	12,612	5,976

(ii) 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.

	Jun 2016 $000	Jun 2015 $000
Goodwill	45,143	45,143

Goodwill was tested for impairment as at 30 June 2016. 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 2016 (30 June 2015: 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.

15 Other balance sheet items (continued)

(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.

	NOTE	Jun 2016 $000	Jun 2015 $000
Derivative financial liabilities		5,866	6,407
Trade payables		12,988	14,808
GST payable		14,238	16,571
Insurance liability		5,235	-
Due to related parties	15(d)	-	2,448
Employee benefits		3,772	5,786
Total trade and other payables		**42,099**	**46,020**

(d) Related party transactions

On 17 July 2015, MARAC Insurance Limited (MARAC Insurance) became a wholly owned subsidiary of the bank. Previously, MARAC Insurance was a wholly owned subsidiary of MARAC JV Holdings Limited which the bank held as a joint arrangement. As a result, from 17 July 2015, related party transactions and balances with MARAC Insurance are eliminated on consolidation of the banking group. Refer to Note 23 for more details.

MARAC Insurance, 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.

	Jun 2016 $000	Jun 2015 $000
Transactions with related parties		
MARAC Insurance Limited		
Interest expense	-	(31)
Lending and credit fee income	-	625
Other income	-	500
Total transactions with related parties	**-**	**1,094**
Due to related parties		
MARAC Insurance Limited	-	2,448
Total due to related parties	**-**	**2,448**

Transactions with key management personnel

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

	Jun 2016 $000	Jun 2015 $000
Transactions with key management personnel		
Interest income	104	68
Interest expense	(460)	(573)
Key management personnel compensation:		
Short-term employee benefits	(5,064)	(6,690)
Share-based payment expense	(848)	(2,693)
Total transactions with key management personnel	**(6,268)**	**(9,888)**
Due (to) / from key management personnel		
Finance receivables	1,428	1,391
Borrowings - deposits	(26,526)	(14,386)
Total due (to) / from key management personnel	**(25,098)**	**(12,995)**

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 of the end of the reporting period during which the change has occurred.

(a) Financial instruments measured at fair value

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

Investments

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

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

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

Finance receivables

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

Derivative items

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

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

	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Jun 2016				
Assets				
Investments	229,144	-	7,291	236,435
Finance receivables	-	21,884	-	21,884
Derivative assets held for risk management	-	148	-	148
Total	**229,144**	**22,032**	**7,291**	**258,467**
Liabilities				
Derivative liabilities held for risk management	-	5,866	-	5,866
Total	**-**	**5,866**	**-**	**5,866**
Jun 2015				
Assets				
Investments	311,815	10,804	6,719	329,338
Finance receivables	-	25,021	-	25,021
Derivative assets held for risk management	-	59	-	59
Total	**311,815**	**35,884**	**6,719**	**354,418**
Liabilities				
Derivative liabilities held for risk management	-	6,407	-	6,407
Total	**-**	**6,407**	**-**	**6,407**

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 8.65% (2015: 8.95%). 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 is 3.29% (2015: 4.32%).

Other financial assets and financial liabilities

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

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

	Level 1	Level 2	Level 3	Total Fair Value	Total Carrying Value
	$000	$000	$000	$000	$000
Jun 2016					
Assets					
Cash and cash equivalents	84,154	-	-	84,154	84,154
Finance receivables	-	-	2,792,936	2,792,936	2,796,222
Finance receivables - securitised	-	-	297,371	297,371	295,851
Other financial assets	-	-	5,452	5,452	5,452
Total financial assets	**84,154**	**-**	**3,095,759**	**3,179,913**	**3,181,679**
Liabilities					
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**
Jun 2015					
Assets					
Cash and cash equivalents	37,012	-	-	37,012	37,012
Finance receivables	-	-	2,582,776	2,582,776	2,584,456
Finance receivables - securitised	-	-	279,491	279,491	277,614
Other financial assets	-	-	5,546	5,546	5,546
Total financial assets	**37,012**	**-**	**2,867,813**	**2,904,825**	**2,904,628**
Liabilities					
Borrowings	-	2,576,425	-	2,576,425	2,566,615
Borrowings - securitised	-	258,630	-	258,630	258,630
Other financial liabilities	-	2,448	20,594	23,042	23,042
Total financial liabilities	**-**	**2,837,503**	**20,594**	**2,858,097**	**2,848,287**

16 Fair value (continued)

(c) Classification of financial instruments

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

	Held for trading	Loans and receivables	Available for sale	Financial liabilities at amortised cost	Total Carrying Value	Total Fair Value
	$000	$000	$000	$000	$000	$000
Jun 2016						
Cash and cash equivalents	-	84,154	-	-	84,154	84,154
Investments	7,291	-	229,144	-	236,435	236,435
Finance receivables	-	2,818,106	-	-	2,818,106	2,814,820
Finance receivables - securitised	-	295,851	-	-	295,851	297,371
Derivative financial assets	148	-	-	-	148	148
Other financial assets	-	5,452	-	-	5,452	5,452
Total financial assets	**7,439**	**3,203,563**	**229,144**	**-**	**3,440,146**	**3,438,380**
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**
Jun 2015						
Cash and cash equivalents	-	37,012	-	-	37,012	37,012
Investments	6,719	-	322,619	-	329,338	329,338
Finance receivables	-	2,584,456	-	-	2,584,456	2,582,776
Finance receivables - securitised	-	277,614	-	-	277,614	279,491
Derivative financial assets	59	-	-	-	59	59
Other financial assets	-	5,546	-	-	5,546	5,546
Total financial assets	**6,778**	**2,904,628**	**322,619**	**-**	**3,234,025**	**3,234,222**
Borrowings	-	-	-	2,566,615	2,566,615	2,576,425
Borrowings - securitised	-	-	-	258,630	258,630	258,630
Derivative financial liabilities	6,407	-	-	-	6,407	6,407
Other financial liabilities	-	-	-	23,042	23,042	23,042
Total financial liabilities	**6,407**	**-**	**-**	**2,848,287**	**2,854,694**	**2,864,504**

Risk Management

17 Risk management policies

The banking group is committed to the management of risk and operates an Enterprise Risk Management Program (RMP) across four primary risk domains; credit, liquidity, market (including interest rate), and operational & compliance. The banking group's risk management strategy is set by the board of directors (Board). The banking group has put in place management structures and information systems to manage risks incorporated in the RMP. The banking group has separate monitoring tasks where feasible and subjects all risk processes to hindsight and internal audit, and accounting systems 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 the overall risk management process and 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 responsibilities:

- To advise the Board on the formulation of the Board's Statement of Risk Appetite 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 internal audit 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 or exceed 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 direct reporting lines, and accountability to the Audit Committee of the bank and administratively to the CRO. A schedule of all outstanding internal control issues is maintained and presented to the Audit Committee to assist the Audit Committee to track the resolution of previously identified issues. Any issues raised that are categorised as high risk are specifically reviewed by internal audit during a follow-up review once the issue is considered closed by management. The follow-up review is performed with a view to formally close out the issue.

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

17 Risk management policies (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), Head of Banking, CFO, CRO and Treasurer. The ALCO has responsibility for overseeing aspects of the banking group's financial position risk management. The ALCO usually meet monthly, and reports to the BRC. The purpose of the ALCO is to support the BRC with specific responsibilities for 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), Head of Banking, CFO, CRO, Chief Strategy Advisor, 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 groups risk appetite. The purpose of ERC is to support the BRC with specific responsibilities for 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 as a breach of laws or banking regulations. Examples include failure to comply with policy and legislation, human error, natural disasters, fraud and other malicious acts. 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 Heartland 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.

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 exposure

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 do so. 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 BRC oversees the formal credit risk management strategy. The BRC reviews the Banking Group's credit risk exposures on a quarterly 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 banking group has adopted a detailed Credit Risk Framework which contains further detail and appetite regarding the above credit risk management strategies. 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.

Home equity loans and negative equity risk

Home equity release 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 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 home equity operations are similarly aligned. The policy is managed and reviewed by Credit 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 above are based on net carrying amounts as reported in the Statement of Financial Position.

	Jun 2016 $000	Jun 2015 $000
Cash and cash equivalents	84,154	37,012
Investments	236,435	329,338
Finance receivables	3,113,957	2,862,070
Derivative financial assets	148	59
Other financial assets	5,452	5,546
Total on balance sheet credit exposures	**3,440,146**	**3,234,025**

18 Credit risk exposure (continued)

(b) Concentration of credit risk by geographic region

	Jun 2016 $000	Jun 2015 $000
Auckland	847,182	830,027
Wellington	188,962	206,818
Rest of North Island	888,085	788,904
Canterbury	505,455	494,848
Rest of South Island	488,301	424,828
Australia:		
Queensland	113,912	117,867
New South Wales	189,868	182,032
Victoria	90,326	83,213
Western Australia	18,120	17,396
South Australia	16,860	18,169
Rest of Australia	10,387	11,048
Rest of the world [1]	103,934	75,318
	3,461,392	**3,250,468**
Collective provision	(16,259)	(10,201)
Less acquisition fair value adjustment for present value of future losses	(4,987)	(6,242)
Total on balance sheet credit exposures	**3,440,146**	**3,234,025**

[1] These overseas assets are not Finance Receivables, they are Investments. These assets represent NZD-denominated investments in AA+ and higher rated securities issued by offshore supranational agencies ("Kauri Bonds").

(c) Concentration of credit risk by industry sector

	Jun 2016 $000	Jun 2015 $000
Agriculture	628,202	537,286
Forestry and Fishing	52,478	35,126
Mining	14,912	14,105
Manufacturing	88,412	93,779
Finance & Insurance	339,646	377,318
Wholesale trade	36,040	82,665
Retail trade	260,510	193,862
Households	1,498,261	1,397,003
Property and Business services	405,469	396,939
Transport and storage	26,715	20,068
Other Services	110,747	102,317
	3,461,392	**3,250,468**
Collective provision	(16,259)	(10,201)
Less acquisition fair value adjustment for present value of future losses	(4,987)	(6,242)
Total on balance sheet credit exposures	**3,440,146**	**3,234,025**

18 Credit risk exposure (continued)

(d) Commitments to extend credit

	Jun 2016 $000	Jun 2015 $000
Undrawn facilities available to customers	147,903	116,217
Conditional commitments to fund at future dates	114,855	108,037

As at 30 June 2016 there are no undrawn lending commitments to counterparties for whom drawn balances are classified as individually impaired (2015: nil).

(e) Credit exposures to connected persons

	Jun 2016
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 2016.

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 2016.

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

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

(f) Credit exposure to individual counterparties

At 30 June 2016 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) (2015: 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:

Corporate

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.

Property Property asset lending including non-core property.

Other All other lending that does not fall into another category.

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 Consumer lending to individuals.

(a) Finance receivables by credit risk concentration

	NOTE	Corporate Rural $000	Corporate Property $000	Corporate Other $000	Residential $000	All Other $000	Total $000
Jun 2016							
Neither at least 90 days past due nor impaired		654,353	266	935,859	854,183	636,432	3,081,093
At least 90 days past due	19(b)	4,293	-	12,632	588	4,454	21,967
Individually impaired	19(c)	22,667	3,561	7,536	-	-	33,764
Restructured assets		56	-	766	-	2,459	3,281
Fair value adjustment for present value of future losses	11	-	-	-	(4,987)	-	(4,987)
Provision for impairment	19(e)	(4,464)	(1,649)	(8,416)	(3,046)	(3,586)	(21,161)
Total net finance receivables		**676,905**	**2,178**	**948,377**	**846,738**	**639,759**	**3,113,957**
Jun 2015							
Neither at least 90 days past due nor impaired		553,739	-	884,942	837,063	553,502	2,829,246
At least 90 days past due	19(b)	17,904	286	13,384	655	2,746	34,975
Individually impaired	19(c)	1,562	6,854	16,982	224	-	25,622
Restructured assets		43	-	1,024	-	2,814	3,881
Fair value adjustment for present value of future losses	11	-	-	-	(6,242)	-	(6,242)
Provision for impairment	19(e)	(2,173)	(4,614)	(14,368)	(1,763)	(2,494)	(25,412)
Total net finance receivables		**571,075**	**2,526**	**901,964**	**829,937**	**556,568**	**2,862,070**

(b) Past due but not impaired

	Corporate Rural $000	Corporate Property $000	Corporate Other $000	Residential $000	All Other $000	Total $000
Jun 2016						
Less than 30 days past due	10,822	-	20,512	1,522	20,194	53,050
At least 30 and less than 60 days past due	4,837	-	5,855	719	5,287	16,698
At least 60 but less than 90 days past due	3,051	-	3,124	-	2,394	8,569
At least 90 days past due	4,293	-	12,632	588	4,454	21,967
Total past due but not impaired	**23,003**	**-**	**42,123**	**2,829**	**32,329**	**100,284**
Jun 2015						
Less than 30 days past due	7,338	-	9,185	2,877	14,700	34,100
At least 30 and less than 60 days past due	3,752	-	3,434	491	3,984	11,661
At least 60 but less than 90 days past due	416	-	4,099	532	1,789	6,836
At least 90 days past due	17,904	286	13,384	655	2,746	34,975
Total past due but not impaired	**29,410**	**286**	**30,102**	**4,555**	**23,219**	**87,572**

19 Asset quality (continued)

(c) Individually impaired assets

	Rural	Corporate Property	Other	Residential	All Other	Total
	$000	$000	$000	$000	$000	$000
Jun 2016						
Opening	1,562	6,854	16,982	224	-	25,622
Additions	23,135	350	11,431	-		34,916
Deletions	(1,420)	(1,115)	(12,005)	(224)	-	(14,764)
Write offs	(610)	(2,528)	(8,872)	-	-	(12,010)
Closing gross individually impaired assets	**22,667**	**3,561**	**7,536**	**-**	**-**	**33,764**
Less: provision for individually impaired assets	869	524	3,509	-	-	4,902
Total net impaired assets	**21,798**	**3,037**	**4,027**	**-**	**-**	**28,862**
Jun 2015						
Opening	2,818	17,090	7,709	-	-	27,617
Additions	1,072	700	32,707	227	-	34,706
Deletions	(1,651)	(10,375)	(23,117)	(3)	-	(35,146)
Write offs	(677)	(561)	(317)	-	-	(1,555)
Closing gross individually impaired assets	**1,562**	**6,854**	**16,982**	**224**	**-**	**25,622**
Less: provision for individually impaired assets	817	3,258	11,136	-	-	15,211
Total net impaired assets	**745**	**3,596**	**5,846**	**224**	**-**	**10,411**

(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 Judgement.

The Behavioural portfolio consists of consumer, retail and home equity release 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 Judgement 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 home equity release 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 Judgement portfolio consists mainly of Business and Rural lending. Judgement loans relate to loans where an on-going and detailed working relationship with the customer has been developed.

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

In the Judgement 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. Grades 2 to 8 represent ascending steps in management's assessment of risk of exposures. The banking group typically finances new loans in risk grades 2 to 5 of the Judgement portfolio.

19 Asset quality (continued)

(d) Credit risk grading (continued)

	Rural	Corporate Property	Other	Residential	All Other	Total
	$000	$000	$000	$000	$000	$000
Jun 2016						
Judgement portfolio						
Grade 1 - Very Strong	936	-	-	-	-	936
Grade 2 - Strong	5,553	-	20,593	13,897	-	40,043
Grade 3 - Sound	16,523	-	75,078	1,132	-	92,733
Grade 4 - Adequate	90,431	-	178,616	2,098	-	271,145
Grade 5 - Acceptable	405,299	-	295,342	1,712	-	702,353
Grade 6 - Monitor	79,468	266	46,168	-	-	125,902
Grade 7 - Substandard	414	-	20,020	-	-	20,434
Grade 8 - Doubtful	11,495	3,037	2,372	-	-	16,904
Grade 9 - At risk of loss	10,223	-	1,965	-	-	12,188
Total Judgement portfolio	**620,342**	**3,303**	**640,154**	**18,839**	**-**	**1,282,638**
Behavioural portfolio						
Not in arrears	58,419	-	301,797	833,201	604,652	1,798,069
Active	817	-	5,875	1,522	17,681	25,895
Arrangement	607	-	3,092	1,209	10,015	14,923
Non-performing / Repossession	230	-	1,194	-	5,083	6,507
Recovery	85	-	1,172	-	5,914	7,171
Total Behavioural portfolio	**60,158**	**-**	**313,130**	**835,932**	**643,345**	**1,852,565**
Provision for collectively impaired assets	(3,595)	(1,125)	(4,907)	(3,046)	(3,586)	(16,259)
Fair value adjustment for present value of future losses	-	-	-	(4,987)	-	(4,987)
Total finance receivables	**676,905**	**2,178**	**948,377**	**846,738**	**639,759**	**3,113,957**
Jun 2015						
Judgement portfolio						
Grade 1 - Very Strong	533	-	-	-	-	533
Grade 2 - Strong	8,019	-	30,113	2,480	-	40,612
Grade 3 - Sound	17,363	-	52,022	463	-	69,848
Grade 4 - Adequate	101,029	-	160,527	3,791	-	265,347
Grade 5 - Acceptable	343,645	-	259,241	5,315	-	608,201
Grade 6 - Monitor	49,276	286	50,162	125	-	99,849
Grade 7 - Substandard	3,484	-	11,453	-	-	14,937
Grade 8 - Doubtful	761	3,596	157	-	-	4,514
Grade 9 - At risk of loss	-	-	7,082	-	-	7,082
Total Judgement portfolio	**524,110**	**3,882**	**570,757**	**12,174**	**-**	**1,110,923**
Behavioural portfolio						
Not in arrears	47,208	-	324,995	821,357	530,204	1,723,764
Active	415	-	4,526	2,721	13,535	21,197
Arrangement	443	-	2,776	1,690	10,946	15,855
Non-performing / Repossession	201	-	1,266	-	1,620	3,087
Recovery	54	-	876	-	2,757	3,687
Total Behavioural portfolio	**48,321**	**-**	**334,439**	**825,768**	**559,062**	**1,767,590**
Provision for collectively impaired assets	(1,356)	(1,356)	(3,232)	(1,763)	(2,494)	(10,201)
Fair value adjustment for present value of future losses	-	-	-	(6,242)	-	(6,242)
Total finance receivables	**571,075**	**2,526**	**901,964**	**829,937**	**556,568**	**2,862,070**

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 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 home equity release 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)

(e) Provision for impairment (continued)

	Rural	Corporate Property	Other	Residential	All Other	Total
	$000	$000	$000	$000	$000	$000
Jun 2016						
Provision for individually impaired assets						
Opening provision for individually impaired assets	817	3,258	11,136	-	-	15,211
Impairment loss for the year						
- charge / (credit) for the year	662	(206)	607	-	-	1,063
- recoveries	-	-	638	-	-	638
- write offs	(610)	(2,528)	(8,872)	-	-	(12,010)
Closing provision for individually impaired assets	**869**	**524**	**3,509**	**-**	**-**	**4,902**
Provision for collectively impaired assets						
Opening provision for collectively impaired assets	1,356	1,356	3,232	1,763	2,494	10,201
Impairment loss for the year						
- charge / (credit) for the year	2,258	(233)	3,630	1,301	5,482	12,438
- recoveries	-	2	193	70	8	273
- write offs	(19)	-	(2,148)	(88)	(4,398)	(6,653)
Closing provision for collectively impaired assets	**3,595**	**1,125**	**4,907**	**3,046**	**3,586**	**16,259**
Total provision for impairment	**4,464**	**1,649**	**8,416**	**3,046**	**3,586**	**21,161**
Jun 2015						
Provision for individually impaired assets						
Opening provision for individually impaired assets	1,531	3,739	4,092	-	-	9,362
Impairment loss for the year						
- (credit) / charge for the year	(35)	349	6,892	-	-	7,206
- recoveries	-	-	669	-	-	669
- write offs	(677)	(561)	(317)	-	-	(1,555)
- effect of discounting	(2)	(269)	(200)	-	-	(471)
Closing provision for individually impaired assets	**817**	**3,258**	**11,136**	**-**	**-**	**15,211**
Provision for collectively impaired assets						
Opening provision for collectively impaired assets	583	2,005	3,183	57	1,171	6,999
Impairment loss for the year						
- charge / (credit) for the year	775	(691)	537	1,706	2,572	4,899
- recoveries	-	42	168	-	3	213
- write offs	(2)	-	(656)	-	(1,252)	(1,910)
Closing provision for collectively impaired assets	**1,356**	**1,356**	**3,232**	**1,763**	**2,494**	**10,201**
Total provision for impairment	**2,173**	**4,614**	**14,368**	**1,763**	**2,494**	**25,412**

(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 2016, the banking group had assets under administration of $3,017,000 (2015: $2,476,000).

20 Liquidity risk

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

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

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

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

	Jun 2016 $000	Jun 2015 $000
Cash and cash equivalents	84,154	37,012
Investments	229,144	322,619
Undrawn committed bank facilities	66,000	90,000
Total liquidity	**379,298**	**449,631**

Contractual liquidity profile of financial assets and liabilities

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

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

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

	On Demand $000	0-6 Months $000	6-12 Months $000	1-2 Years $000	2-5 Years $000	5+ Years $000	Total $000
Jun 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	-	634,053	393,951	512,900	850,623	2,894,979	5,286,506
Finance receivables - securitised	-	92,427	72,671	97,377	70,280	-	332,755
Derivative financial assets	-	148	-	-	-	-	148
Other financial assets	-	5,452	-	-	-	-	5,452
Total financial assets	**84,154**	**743,389**	**484,820**	**698,208**	**1,056,514**	**2,902,270**	**5,969,355**
Financial liabilities							
Borrowings	718,587	860,437	552,208	208,556	465,204	-	2,804,992
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**	**892,944**	**837,444**	**208,556**	**465,204**	**-**	**3,122,735**
Net financial (liabilities) / assets	**(634,433)**	**(149,555)**	**(352,624)**	**489,652**	**591,310**	**2,902,270**	**2,846,620**
Unrecognised loan commitments	147,903	-	-	-	-	-	147,903
Undrawn committed bank facilities	66,000	-	-	-	-	-	66,000

20 Liquidity risk (continued)

Contractual liquidity profile of financial assets and liabilities (continued)

	On Demand $000	0-6 Months $000	6-12 Months $000	1-2 Years $000	2-5 Years $000	5+ Years $000	Total $000
Jun 2015							
Financial assets							
Cash and cash equivalents	37,012	-	-	-	-	-	37,012
Investments	-	27,039	47,376	35,801	237,409	19,852	367,477
Finance receivables	-	544,745	334,438	501,222	841,869	3,291,828	5,514,102
Finance receivables - securitised	-	87,168	68,824	92,675	66,949	-	315,616
Derivative financial assets	-	59	-	-	-	-	59
Other financial assets	-	5,546	-	-	-	-	5,546
Total financial assets	**37,012**	**664,557**	**450,638**	**629,698**	**1,146,227**	**3,311,680**	**6,239,812**
Financial liabilities							
Borrowings	746,637	731,784	435,145	150,732	649,509	-	2,713,807
Borrowings - securitised	-	5,215	260,964	-	-	-	266,179
Derivative financial liabilities	-	6,407	-	-	-	-	6,407
Other financial liabilities	1,695	20,594	267	522	-	-	23,078
Total financial liabilities	**748,332**	**764,000**	**696,376**	**151,254**	**649,509**	**-**	**3,009,471**
Net financial (liabilities) / assets	**(711,320)**	**(99,443)**	**(245,738)**	**478,444**	**496,718**	**3,311,680**	**3,230,341**
Unrecognised loan commitments	116,217	-	-	-	-	-	116,217
Undrawn committed bank facilities	90,000	-	-	-	-	-	90,000

Undrawn committed bank facilities of $66.0 million (2015: $90.0 million) were available to be drawn down on demand. To the extent drawn, $66.0 million is contractually repayable in 6-12 months' time upon facility expiry.

21 Interest rate risk

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

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

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

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

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

21 Interest rate risk (continued)

Contractual repricing analysis

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

	0-3 Months $000	3-6 Months $000	6-12 Months $000	1-2 Years $000	2+ Years $000	Non-interest bearing $000	Total $000
Jun 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	2,102,720	92,566	156,153	230,743	235,730	194	2,818,106
Finance receivables - securitised	42,858	37,003	63,728	87,089	65,173	-	295,851
Other financial assets	148	-	-	-	-	5,452	5,600
Total financial assets	**2,284,095**	**131,027**	**231,775**	**367,729**	**412,491**	**13,029**	**3,440,146**
Financial liabilities							
Borrowings	1,562,772	380,170	529,796	183,094	59,726	-	2,715,558
Borrowings - securitised	284,429	-	-	-	-	-	284,429
Other financial liabilities	5,866	-	-	-	-	21,995	27,861
Total financial liabilities	**1,853,067**	**380,170**	**529,796**	**183,094**	**59,726**	**21,995**	**3,027,848**
Effect of derivatives held for risk management	235,387	(28,241)	(54,756)	(81,230)	(71,160)	-	-
Net financial assets / (liabilities)	**666,415**	**(277,384)**	**(352,777)**	**103,405**	**281,605**	**(8,966)**	**412,298**
Jun 2015							
Financial assets							
Cash and cash equivalents	36,928	-	-	-	-	84	37,012
Investments	137,742	1,938	25,797	14,410	142,732	6,719	329,338
Finance receivables	1,962,329	87,889	149,239	204,142	180,427	430	2,584,456
Finance receivables - securitised	40,193	35,548	60,778	83,434	57,661	-	277,614
Other financial assets	59	-	-	-	-	5,546	5,605
Total financial assets	**2,177,251**	**125,375**	**235,814**	**301,986**	**380,820**	**12,779**	**3,234,025**
Financial liabilities							
Borrowings	1,529,593	375,635	411,061	119,351	130,975	-	2,566,615
Borrowings - securitised	258,630	-	-	-	-	-	258,630
Other financial liabilities	8,102	-	250	503	-	20,594	29,449
Total financial liabilities	**1,796,325**	**375,635**	**411,311**	**119,854**	**130,975**	**20,594**	**2,854,694**
Effect of derivatives held for risk management	250,699	(25,355)	(46,365)	(88,039)	(90,940)	-	-
Net financial assets / (liabilities)	**631,625**	**(275,615)**	**(221,862)**	**94,093**	**158,905**	**(7,815)**	**379,331**

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

	Jun 2016 $000	Jun 2015 $000
Finance	852,433	790,137
Other	2,147,554	2,035,108
Total borrowings	**2,999,987**	**2,825,245**

(b) Concentration of funding by geographical area

	Jun 2016 $000	Jun 2015 $000
Auckland	849,276	441,921
Wellington	155,248	384,344
Rest of North Island	520,764	472,167
Canterbury	800,893	772,689
Rest of South Island	206,748	206,563
Overseas [1]	467,058	547,561
Total borrowings	**2,999,987**	**2,825,245**

[1] Included in Overseas funding is the CBA bank facility totalling $379 million (2015: $466 million), refer to Note 13 - Borrowings for more information.

Other Disclosures

23 Significant subsidiaries and interests in joint arrangements

Significant subsidiaries / Joint arrangements	Country of incorporation and place of business	Nature of business	Proportion of ownership interest and voting power held Jun 2016	Jun 2015
VPS Properties Limited	New Zealand	Investment property holding company	100%	100%
New Sentinel Limited (NSL) [2]	New Zealand	Financial services	n/a	100%
Australian Seniors Finance Pty Limited (ASF)	Australia	Financial services	100%	100%
MARAC Insurance Limited [3]	New Zealand	Insurance services	100%	50%

[2] On 30 April 2016, NSL was amalgamated with the bank.

[3] On 17 July 2015, the bank acquired the remaining 50% of MARAC Insurance Limited for $2.3 million. A loss on acquisition of $339k was recognised during the year ended 30 June 2015. MARAC Insurance Limited was previously a joint arrangement accounted for using the equity method.

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*

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

	Jun 2016 $000	Jun 2015 $000
Deposits	80,527	45,110

24 Structured entities (continued)

(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 as it is the residual beneficiary and subordinated debt holder of the Trust. Despite the bank being the residual beneficiary, the loans sold to ABCP Trust are set aside for the benefit of investors in ABCP Trust and bank depositors will have no recourse to these assets. ABCP Trust's material assets and liabilities are represented as follows:

	NOTE	Jun 2016 $000	Jun 2015 $000
Cash and cash equivalents - securitised		15,208	5,553
Finance receivables - securitised	11	295,851	277,614
Borrowings - securitised	13	(284,429)	(258,630)
Derivative financial asset - securitised	15(a)	-	59
Derivative financial liabilities - securitised		(2,833)	(1,995)

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

SW Trust and ASF Trust form part of ASF's home equity release business. They 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 balances of SW Trust and ASF Trust are represented as follows:

	Jun 2016 $000	Jun 2015 $000
Cash and cash equivalents	2,503	1,207
Finance receivables - Home equity release loans	434,688	424,445
Borrowings - CBA	(379,299)	(372,333)
Derivative financial liabilities	(2,083)	(3,608)

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 has been allotted under three tranches (referred to as the 2013, 2014 and 2015 tranches). Under the LTI Plan participants are 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 market price is the volume weighted average price (VWAP) of the bank's ordinary shares on the NZX Main Board (Heartland Shares) for the 20 business days immediately before (but excluding) the exercise date for those options. The reference price will be 5% over the VWAP of Heartland shares for the 20 business days immediately following, but not excluding, the reference date. The reference dates of the 2013, 2014 and 2015 tranches are 26 August 2013, 25 August 2014 and 18 August 2015 respectively.

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 2012, 1 July 2013 and 1 July 2014 for the 2013, 2014 and 2015 plans respectively. Participants in the 2013, 2014 and 2015 tranches will be able to exercise their options between September 2015 to 1 July 2017, September 2016 to 1 July 2018 and September 2017 to 1 July 2019 respectively.

2015 Special Grant (LTI SG)

Participants of the LTI SG will be able to exercise the options in the period beginning on the date the market price of Heartland shares is equal to $1.50 and ending on 1 July 2017. Market price is 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 are subject to the participants continued employment with the banking group for the service period of 3 years which begins on 1 July 2014. Following exercise a lock up period until 1 July 2020 will apply during which participants are restricted from disposing of shares.

The reference price is the amount (if any) by which the market price of Heartland shares at the time of exercise exceeds $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 are exercised. However, for the purpose of calculating the settlement amount, the market price of Heartland shares is capped at $1.50 and any increase above this amount shall be disregarded.

25 Staff share ownership arrangements (continued)

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 as consideration for the grant of shares under the SES. Under the SES, selected Senior Executives 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.

	SES Number of Shares	LTI SG Number of options	LTI Plan Number of options
1 July 2014	**-**	**-**	**5,004,975**
Granted	-	5,208,403	8,954,082
Exercised	-	-	-
Forfeited	-	-	(507,342)
30 June 2015	**-**	**5,208,403**	**13,451,715**
Granted [1]	-	-	9,246,957
Committed but not granted [1]	-	-	2,026,121
Exercised [2]	-	-	(540,414)
Modified to SES [3]	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 options granted during the period under the LTI Plan is $1.90 million. This fair value was derived using the Black-Scholes model. The key inputs used in the model are:
- Volatility 20.5% (calculated based on the historical movement in Heartland's shares)
- Risk free rate 2.669% p.a.
- Estimated option life 3.9 years
- Expiry date 30 June 2019
- Share price at issue $1.15

2 Weighted average share price on exercise was $1.24.

3 The fair value of shares issued during the period under the SES is $2.39 million, which was based on the a quoted price on the NZX Main Board including transaction costs.

(b) Effect of share-based payment transactions

	Jun 2016 $000	Jun 2015 $000
Award of shares	132	48
SES	1,406	-
LTI SG	163	36
LTI Plan	187	1,407
Total expense recognised	**1,888**	**1,491**

As at 30 June 2016, $1.51 million of share scheme awards remain unvested and not expensed (30 June 2015: $0.93 million). This expense will be recognised over the vesting period of the awards.

In the prior year the banking group had a cash settled share scheme. The banking group recognised an expense of $1.56m in respect of this.

(c) Number of options outstanding at 30 June 2016

	Options Outstanding	Remaining life (years)
LTI SG	1,302,101	1
LTI Plan - 2013 tranche	4,376,584	1
LTI Plan - 2014 tranche	5,535,712	2
LTI Plan - 2015 tranche	7,542,783	3
	18,757,180	

26 Capital adequacy

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

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

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

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

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

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

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

The capital adequacy tables set out on the following pages summarise the composition of regulatory capital and the capital adequacy ratios for the banking group as at 30 June 2016.

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.

26 Capital adequacy (continued)

(a) Capital

	Jun 2016 $000
Tier 1 Capital	
CET1 capital	
Paid-up ordinary shares issued by the banking group plus related share premium	421,377
Retained earnings (net of appropriations)	78,811
Accumulated other comprehensive income and other disclosed reserves	(31)
Less deductions from CET1 capital	
Intangible assets	(57,755)
Deferred tax assets	(7,068)
Hedging reserve	2,260
Defined benefit superannuation fund assets	(469)
Total CET1 capital	**437,125**
Additional Tier 1 Capital	
Nil	-
Total Tier 1 Capital	**437,125**
Tier 2 Capital	
Subordinated bond	1,455
Foreign currency translation reserve	(1,816)
Total Tier 2 Capital	**(361)**
Total Capital	**436,764**

(b) Capital structure

Ordinary shares

In accordance with BS2A, ordinary share capital is classified as Common Equity Tier 1 Capital and is not subject to phase-out from eligibility as capital under the Reserve Bank of New Zealand's Basel III transitional arrangements. 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.

Reserves

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.

Hedging reserve — The hedging reserve comprises the fair value gains and losses associated with the effective portion of designated cash flow hedging instruments.

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.

Retained earnings

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

Subordinated bond

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.

If the Reserve Bank or a Statutory Manager requires the bank to write down the Principal Amount and/or the interest on the Subordinated Bonds, the Bonds will be written down and could 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 these Bonds.

26 Capital adequacy (continued)

(c) Credit risk

(i) On balance sheet exposures

	Total exposure	Risk weighting	Risk weighted exposure	Minimum Pillar One capital require-ment
	$000	%	$000	$000
Jun 2016				
Cash and gold bullion	92	0%	-	-
Multilateral development banks	38,766	0%	-	-
Multilateral development banks	53,110	20%	10,622	850
Public sector entities	38,828	20%	7,766	621
Banks	138,827	20%	27,765	2,221
Banks	35,145	50%	17,573	1,406
Corporates	1,024	20%	205	16
Corporates	7,000	50%	3,500	280
Corporates	506	100%	506	40
Welcome Home Loans - loan to value ratio (LVR) <= 90%[1]	5,492	35%	1,922	154
Welcome Home Loans - LVR > 90%[1]	1,916	50%	958	77
Welcome Home Loans - LVR > 100%[1]	205	100%	205	16
Residential mortgages < 80% LVR	822,695	35%	287,943	23,035
Residential mortgages 80 < 90% LVR	8,460	50%	4,230	338
Residential mortgages 90 < 100% LVR	2,635	75%	1,976	158
Residential mortgages 100%+ LVR	4,604	100%	4,604	368
Past due residential mortgages	731	100%	731	58
Other past due assets - provision > 20%	5,771	100%	5,771	462
Other past due assets - provision < 20%	45,037	150%	67,556	5,404
Non property investment mortgage loan < 80% LVR	17,101	35%	5,985	479
Non property investment mortgage loan 80 < 90% LVR	2,716	50%	1,358	109
Non property investment mortgage loan 90 < 100% LVR	469	75%	352	28
Non property investment mortgage loan > 100% LVR	8,771	100%	8,771	702
Property Investment Mortgage Loan < 80% LVR	6,446	40%	2,578	206
Property Investment Mortgage Loan 80 < 90% LVR	345	70%	242	19
Property Investment Mortgage Loan 90 < 100% LVR	896	90%	806	64
Property Investment Mortgage Loan < 100% LVR	1,789	100%	1,789	143
All other equity holdings	7,291	400%	29,164	2,333
Other assets	2,227,481	100%	2,227,481	178,198
Not risk weighted assets	63,032	0%	-	-
Total on balance sheet exposures	**3,547,181**		**2,722,359**	**217,785**

(ii) Off balance sheet exposures

	Total exposure	Credit conversion Factor	Credit equivalent amount	Average risk weight	Risk weighted exposure	Minimum Pillar One capital require-ment[1]
	$000	$000	$000	%	$000	$000
Jun 2016						
Direct credit substitute	5,058	100%	5,058	100%	5,058	405
Performance-related contingency	7,815	50%	3,908	100%	3,908	313
Other commitments where original maturity is more than one year	134,805	50%	67,403	100%	67,403	5,392
Other commitments where original maturity is less than or equal to one year	127,953	20%	25,591	100%	25,591	2,047
Market related contracts [2]						
Interest rate contracts	16,750	n/a	-	20%	-	-
Interest rate contracts	249,101	0.5%	1,246	20%	249	20
Total off balance sheet exposures	**541,482**		**103,206**		**102,209**	**8,177**

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

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

26 Capital adequacy (continued)

(d) Additional mortgage information - LVR range

	On balance sheet exposures	Off balance sheet exposures [1]	Total exposures
	$000	$000	$000
Jun 2016			
Does not exceed 80%	825,729	1,781	827,510
Exceeds 80% and not 90%	11,084	-	11,084
Exceeds 90%	10,091	17	10,108
Total exposures	**846,904**	**1,798**	**848,702**

At 30 June 2016, $2.1 million relating to Welcome Home loans, whose credit risk is mitigated by the Crown is included in "Exceeds 90% residential mortgages".

(e) Reconciliation of mortgage related amounts

	Jun 2016
	$000
Loans and advances - loans with residential mortgages	846,904
On balance sheet residential mortgage exposures subject to the standardised approach	**846,904**
Off balance sheet mortgage exposures subject to the standardised approach	1,798
Total residential exposures subject to the standardised approach	**848,702**

(f) Credit risk mitigation

As at 30 June 2016 the banking group had $7.6 million of Welcome Home Loans, whose credit risk was mitigated by the Crown. Other than this the banking group does not have any exposures covered by eligible collateral, guarantees and credit derivatives.

(g) Operational Risk

	Implied risk weighted exposure	Aggregate capital charge
	$000	$000
Operational risk	185,039	14,803

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

(h) Market risk

		Implied risk weighted exposure	Aggregate capital charge
		$000	$000
Market risk end-of-period capital charge	Interest rate risk only	100,880	8,070
Market risk peak end-of-day capital charge	Interest rate risk only	105,360	8,429
Market risk end-of-period capital charge	Foreign currency risk only	59,016	4,721
Market risk peak end-of-day capital charge	Foreign currency risk only	59,016	4,721

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.

[1] Off balance sheet exposures means unutilised limits.

26 Capital adequacy (continued)

(i) Total capital requirements

	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement per BS2A
	$000	$000	$000
Total credit risk and equity			
On balance sheet	3,547,181	2,722,359	217,785
Off balance sheet	541,482	102,209	8,177
Operational risk	n/a	185,039	14,803
Market risk	n/a	159,896	12,791
Total	**n/a**	**3,169,503**	**253,556**

(j) Capital ratios

	Jun 2016	Jun 2015[1]
	%	%
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.79%	12.79%
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	13.79%	12.79%
Minimum Tier 1 Capital as per Conditions of Registration	6.00%	6.00%
Total Capital expressed as a percentage of total risk weighted exposures	13.78%	12.86%
Minimum Total Capital as per Conditions of Registration	8.00%	8.00%
Buffer ratio		
Buffer ratio	5.78%	4.86%
Buffer ratio requirement	2.50%	2.50%

(k) Solo capital adequacy

	Jun 2016	Jun 2015[1]
	%	%
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	15.78%	14.45%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	15.78%	14.45%
Total Capital expressed as a percentage of total risk weighted exposures	15.77%	14.53%

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 2016, the banking group has made an internal capital allocation of $85.83 million to cover these risks (2015: 68.7m)[1].

[1] The capital ratios as at 30 June 2015 are the ratios previously disclosed for the registered bank at that date, Former Heartland Bank.

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

Insurance business

The banking group conducts insurance business through its subsidiary MARAC Insurance.

The banking group's aggregate amount of insurance business comprises the total consolidated assets of MARAC Insurance of $8.80 million, which is 0.25% of the total consolidated assets of the banking group.

The banking group's objective is to minimize 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 underwritten by MARAC Insurance Limited, a subsidiary of the banking group. During the year ended 30 June 2016, there have been no material changes in the banking group's marketing and distribution of insurance products.

Securitisation

As at 30 June 2016, the banking group had securitised assets amounting to $296 million (2015: $278 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.

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.

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.

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

Peak aggregate funding to entities

The banking group did not provide any funding to entities conducting funds management and other fiduciary activities, or insurance product or marketing and distribution activities described in this note, during the year (2015: $nil).

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

	TOTAL TRUSTS	
	Jun 2016	**Jun 2015**
Peak end-of-day aggregate amount of funding provided ($000's)	85,525	30,613
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	19.6%	9.0%

	Seniors Warehouse Trust		ASF Settlement Trust		ABCP TRUST	
	Jun 2016	**Jun 2015**	**Jun 2016**	**Jun 2015**	**Jun 2016**	**Jun 2015**
Peak end-of-day aggregate amount of funding provided ($000's)	52,507	n/a	4,157	n/a	28,861	30,613
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	12.2%	n/a	66.5%	n/a	10.7%	10.5%

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

28 Contingent liabilities and commitments

	Jun 2016	Jun 2015
	$000	**$000**
Letters of credit, guarantee commitments and performance bonds	12,873	14,844
Total contingent liabilities	**12,873**	**14,844**
Undrawn facilities available to customers	147,903	116,217
Conditional commitments to fund at future dates	114,855	108,037
Total commitments	**262,758**	**224,254**

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 2015 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 2016, 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.	1 January 2018	30 June 2019
NZ IFRS 9 Financial Instruments (2013), which provides a principles-based approach to hedge accounting and aligns hedge accounting more closely with risk management.	1 January 2018	30 June 2019
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 full impacts of NZ IFRS 9 and NZ IFRS 16 are yet to be assessed.

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

For the year ended	Audited 30 Jun 16 $000	Audited 30 Jun 15 $000	Audited 30 Jun 14 $000	Audited 30 Jun 13 $000	Audited 30 Jun 12 $000
Interest income	265,475	260,468	210,297	206,349	205,148
Interest expense	118,815	126,041	101,221	110,895	121,502
Net interest income	**146,660**	**134,427**	**109,076**	**95,454**	**83,646**
Other net income	10,901	10,280	13,079	11,433	11,238
Total operating income before other gains	**157,561**	**144,707**	**122,155**	**106,887**	**94,884**
Employee benefits	39,799	40,401	35,765	33,861	34,661
Other operating expenses	30,073	28,002	28,974	36,486	30,886
Profit before impairment and tax	**87,689**	**76,304**	**57,416**	**36,540**	**29,337**
Impaired asset expense	13,501	12,105	5,895	22,527	5,642
Decrease in fair value of investment properties	-	-	1,203	5,101	3,900
Net profit before tax	**74,188**	**64,199**	**50,318**	**8,912**	**19,795**
Share of joint arrangement profit	-	137	486	504	534
Profit before income tax	**74,188**	**64,336**	**50,804**	**9,416**	**20,329**
Income tax expense / (benefit)	20,024	16,173	14,765	2,504	(3,277)
Net profit after tax attributable to owners of the entity	**54,164**	**48,163**	**36,039**	**6,912**	**23,606**
Other comprehensive income for the year net of tax					
Effective portion of changes in fair value of cash flow hedges, net of tax	(708)	(2,709)	1,111	1,056	378
Net change in available-for-sale reserve, net of tax	(208)	898	(12)	276	(103)
Movement in foreign currency translation reserve, net of income tax	(4,047)	2,136	95	-	-
Net change in defined benefit reserve, net of income tax	(93)	50	3	462	(435)
Total comprehensive income for the year, net of tax	**49,108**	**48,538**	**37,236**	**8,706**	**23,446**
Dividends paid to equity holders	37,690	30,188	19,930	13,591	-

Statements of Financial Position

As at	Audited 30 Jun 16 $000	Audited 30 Jun 15 $000	Audited 30 Jun 14 $000	Audited 30 Jun 13 $000	Audited 30 Jun 12 $000
Total assets	3,547,181	3,359,259	3,016,888	2,504,627	2,348,089
Individually impaired assets	33,764	25,622	27,617	69,301	56,825
Total liabilities	3,048,840	2,879,134	2,564,266	2,134,085	1,973,291
Total equity	498,341	480,125	452,622	370,542	374,798

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 bank and banking group disclosure statement

We have audited the accompanying financial statements and supplementary information (excluding supplementary information relating to Capital Adequacy) of Heartland Bank Limited (“the bank”) and its related entities (“the banking group”) on pages 12 to 53 of the disclosure statement. The financial statements comprise the statement of financial position as at 30 June 2016, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information of the banking group. The supplementary information comprises the information that is required to be disclosed in accordance with Schedules 2, 4, 7, 9, 13, 14, 15 and 17 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the “Order”).

This report is made solely to the shareholders. Our audit work has been undertaken so that we might state to the shareholders of the bank 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 audit work, this report or any of the opinions we have formed.

Directors' responsibility for the disclosure statement

The directors are responsible for the preparation of the disclosure statement, including financial statements prepared in accordance with Clause 24 of the Order and generally accepted accounting practice in New Zealand, that is a fair presentation of the matters to which they relate. The directors are also responsible for such internal controls as they determine are necessary to enable the preparation of the banking group financial statements that are free from material misstatement whether due to fraud or error.

The directors are responsible for the preparation and fair presentation of supplementary information, in accordance with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order.

Auditor’s responsibility

Our responsibility is to express an opinion on the disclosure statement, including the financial statements prepared in accordance with Clause 24 of the Order and the supplementary information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order. We conducted our audit in accordance with International Standards on Auditing (New Zealand) (“ISAs (NZ)”). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the banking group financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the banking group’s financial statements (excluding the supplementary information relating to Capital Adequacy). The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the banking group’s financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the banking group’s preparation of the banking group’s financial statements that present fairly the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the banking group’s internal controls.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on financial statements

In our opinion, the financial statements on pages 12 to 53 (excluding the supplementary information relating to Capital Adequacy):

- complies with generally accepted accounting practice in New Zealand;
- complies with the International Financial Reporting Standards; and
- give a true and fair view of the financial position of the banking group as at 30 June 2016 and of the financial performance and cash flows of the banking group for the year ended on that date.

Opinion on supplementary information (excluding supplementary information relating to Capital Adequacy)

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 Order:

- 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;
- is in accordance with the books and records of the banking group in all material respects; and
- fairly states the matters to which it relates in accordance with those Schedules.

Review report on the supplementary information relating to Capital Adequacy

We have reviewed the supplementary information relating to Capital Adequacy, as disclosed in note 26 to the disclosure statement for the year ended 30 June 2016.

Directors' responsibility 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 disclosure statement.

Auditor's responsibility

Our responsibility is to express an opinion on the Capital Adequacy information based on our review. We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* issued by the New Zealand External Reporting Board. 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 is limited primarily to enquiries of bank and banking group personnel and analytical review procedures applied to the financial data, and thus provides less assurance than an audit. We have not performed an audit in respect of the Capital Adequacy disclosures, and accordingly, we do not express an audit opinion on these disclosures.

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.

Review opinion on the supplementary information relating to Capital Adequacy

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 disclosure statement, is not, 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.

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.

Independence

Our firm has provided other services to the banking group in relation to other assurance services, general accounting services and advisory services. 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. There are, however, certain restrictions on dealings which the partners and employees of our firm can have with 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.

KPMG

16 August 2016
Auckland