

# HEARTLAND

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Building Society

## Disclosure Statement

For the year ended 30 June 2012

# CONTENTS

	Page
General Information	2
Priority of creditors' claims	2
Guarantee arrangements	2
Directors	3
Auditor	4
Conditions of Registration	5
Pending proceedings or arbitration	8
Credit rating	8
Future developments	8
Other material matters	8
Directors' statements	9
Explanatory Foreword	10
Statements of Comprehensive Income	11
Statements of Changes in Equity	12
Statements of Financial Position	13
Statements of Cash Flows	14
Notes to the Financial Statements	15
1 Reporting entity	15
2 Basis of preparation	15
3 Significant accounting policies	16
4 Segmental analysis	21
5 Net interest income / (expense)	22
6 Net operating lease income	22
7 Selling and administration expenses	22
8 Income tax (benefit) / expense	23
9 Imputation credit account	23
10 Reconciliation of profit / (loss) after tax to net cash flows from operating activities	24
11 Cash and cash equivalents	24
12 Investments	24
13 Investment properties	24
14 Finance receivables	25
15 Operating lease vehicles	25
16 Other assets	25
17 Investment in subsidiaries	25
18 Intangible assets and goodwill	26
19 Property, plant and equipment	26
20 Deferred tax	27
21 Borrowings	27
22 Trade and other payables	27
23 Derivative financial instruments	28
24 Share capital	28
25 Special purpose entities	28
26 Related party transactions	29
27 Fair value	30
28 Risk management policies	32
29 Credit risk exposure	35
30 Liquidity risk	47
31 Interest rate risk	51
32 Capital adequacy	52
33 Contingent liabilities and commitments	55
34 Staff share ownership arrangements	56
35 Insurance business, securitisation, funds management, other fiduciary activities	56
36 Business combinations	57
37 Events after the reporting date	58
Historical summary of financial statements	59
Independent auditor's report	60

## GENERAL INFORMATION

This Disclosure Statement is for the year ended 30 June 2012 and has been issued by Heartland Building Society (Heartland or Bank) in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order (No 2) 2012 (Order). The Financial Statements of the Bank for the year ended 30 June 2012 form part of, and should be read in conjunction with, this Disclosure Statement.

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

### Name and address for service

The name of the entity is Heartland Building Society and the address for service is 75 Riccarton Road, Riccarton, Christchurch. The Banking Group consists of the Bank and all of its controlled entities. All controlled entities are incorporated in New Zealand.

### Details of incorporation

Heartland was established in January 2011, as a result of the merger of Canterbury Building Society (CBS Canterbury) (CBS), MARAC Finance Limited (MARAC) and Southern Cross Building Society (SCBS) and is incorporated under the Building Societies Act 1965.

### Ultimate holding company

The ultimate holding company of the Bank is Heartland New Zealand Limited (HNZ), which was listed on the New Zealand Stock Exchange on 25 January 2011. HNZ's address for service is 75 Riccarton Road, Riccarton, Christchurch.

The Bank's intermediate share holders are BSHL No.1 Limited, BSHL No.2 Limited, BSHL No.3 Limited, BSHL No.4 Limited, BSHL No.5 Limited, BSHL No.6 Limited, BSHL No.7 Limited, BSHL No.8 Limited, BSHL No.9 Limited, BSHL No.10 Limited, BSHL No.11 Limited, BSHL No.12 Limited, BSHL No.13 Limited, BSHL No.14 Limited, BSHL No.15 Limited, BSHL No.16 Limited, BSHL No.17 Limited, BSHL No.18 Limited, BSHL No.19 Limited and BSHL No.20 Limited (collectively intermediate parents). HNZ wholly owns the Bank's intermediate parents.

There are no regulations, legislation, or other restrictions of a legally enforceable nature that may materially inhibit the legal ability of HNZ to provide material financial support to the Bank.

### Interests in 5% or more of voting securities of the Bank

At the time this Disclosure Statement was signed, 100% of the voting securities (shares) in the Bank were indirectly owned by HNZ and 99.99% of the voting securities (shares) in the Bank were directly owned by BSHL No. 1 Limited. Disclosed below are persons with shareholdings in HNZ of greater than 5% as at the 12 December 2012:

Name	Percentage held
Harrogate Trustee Limited	9.35%
Accident Compensation Corporation	6.33%
Philip Maurice Carter	5.40%

Other than HNZ, no person has the ability to directly or indirectly appoint 25% or more of the Board of Directors (Board) of the Bank.

## PRIORITY OF CREDITORS' CLAIMS

In the unlikely 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.

## GUARANTEE ARRANGEMENTS

### Guarantee of Bank's obligations

As at the date the Registered Bank's Directors signed this Disclosure Statement, MARAC, VPS Parnell Limited, VPS Properties Limited and PGG Wrightson Finance Limited (PWF), all members of the Banking Group, each guarantee the obligations of the Bank under a Standby Cash Advances Facility Agreement dated 15 December 2010 (as amended from time to time) to Bank of New Zealand and Westpac New Zealand Limited. There is no limit on the amount of the obligations guaranteed. The only material condition applicable to the guarantee is non-performance by the Bank. There are no material legislative or regulatory restrictions in the guarantors' country of incorporation (New Zealand) which would have the effect of subordinating the claims under the guarantee of any of the creditors of the Bank on the assets of the guarantors to other claims on the guarantors in a winding up of that guarantor. The guarantee does not have an expiry date.

MARAC's address for service is Heartland House, 35 Teed Street, Newmarket, Auckland. The net tangible assets of MARAC were \$222.2 million as at 30 June 2012. The address for service of VPS Parnell Limited, VPS Properties Limited and PWF is 75 Riccarton Road, Riccarton, Christchurch and net tangible assets of these entities as at 30 June 2012 are \$0.7m, (\$0.3m) and \$114.4m respectively. Neither MARAC, VPS Parnell Limited, VPS Properties Limited or PWF have a credit rating applicable to their long term senior unsecured obligations.

### Cross Guarantees

The Guaranteeing Group (including the Bank) have entered into an All Obligations Cross Guarantee and Indemnity Deed Poll dated 15 December 2010. The Guaranteeing Group comprises the Bank, MARAC, VPS Parnell Limited, VPS Properties Limited and PWF. Each member of the Guaranteeing Group guarantees all of each other's obligations to Bank of New Zealand and Westpac New Zealand Limited. There is no limit on the amount of the obligations guaranteed. The only material condition applicable to the cross guarantee is non-performance by another member of the Guaranteeing Group. There are no material legislative or regulatory restrictions in the guarantors' country of incorporation (New Zealand) which would have the effect of subordinating the claims under the cross guarantee of any of the creditors of the Bank on the assets of the cross guarantors to other claims on the cross guarantors in a winding up of that cross guarantor. The cross guarantee does not have an expiry date.

## DIRECTORS

All Directors of the Bank reside in New Zealand. Communications to the directors can be sent to Heartland Building Society, 75 Riccarton Road, Riccarton, Christchurch. The Directors of the Bank and their details at the time this Disclosure Statement was signed were:

**Name:** Bruce Robertson Irvine

**Qualifications:** BCom, LLB, FCA, AF Inst D, FNZIM

**Chairman - Board of Directors**

**Occupation:** Company Director

**Type of director:** Independent Non-Executive Director

**External Directorships:**

Arts Management Limited, Avon Pacific Holdings Limited, B R Irvine Limited, Blackbyre Horticulture Limited, Bowdens Mart Limited, Bray Frampton Limited, Britten Motorcycle Company Limited, Cambridge 141 Limited, Canterbury Business Recovery Group Limited, Canterbury Spinners Limited, CCHL (2) Limited, CCHL (4) Limited, CCHL (5) Limited, CCHL (6) Limited, Christchurch City Holdings Limited, Christchurch City Networks Limited, Cockerill and Campbell (2007) Limited, Dogs Breakfast Trading Company Limited, Godfrey Hirst NZ Limited, Hansons Lane International Holdings Limited, Heartland New Zealand Limited, House of Travel ESP Trustee Limited, House of Travel Holdings Limited, Lake Angelus Holdings Limited, Lamanna Bananas (NZ) Limited, Lamanna Limited, Lorne Investments Limited, Mainland Tomatoes Limited, MARAC JV Holdings Limited, Market Fresh Wholesale Limited, Market Gardeners Limited, Market Gardeners Orders (Christchurch) Limited, Market Gardeners Orders Wellington Limited, MG Marketing Limited, MG New Zealand 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.

**Name:** Edward John Harvey

**Qualifications:** BCom, CA

**Type of director:** Independent Non-Executive Director

**Occupation:** Company Director

**External Directorships:**

APN News & Media Limited, APN Media (NZ) Limited, Ballance Agri-Nutrients Limited, Chalmers Properties Limited, DNZ Property Fund Limited, Fiordland Pilot Services Limited, Kathmandu Holdings Limited, New Zealand Opera Limited, Perpetual Property Limited, Pomare Investments Limited, Port Otago Limited.

**Name:** Gary Richard Leech

**Qualifications:** BCom, FCA, AF Inst D, FNZTA

**Type of director:** Independent Non-Executive Director

**Occupation(s):** Company Director and Chartered Accountant in Public Practice

**External Directorships:**

Ashburton Implement Services Limited, Back Track Dairies Limited, Bakker Bulbs Limited, Cariboo New Zealand (2011) Limited, Clock Trustees Limited, Electricity Ashburton Limited, Heartland New Zealand Limited, Hooked Trustee Company Limited, Leech & Partners Trustees (2004) Limited, Leech & Partners Trustees (2007) Limited, Leech & Partners Trustees (2009) Limited, Leech & Partners Trustees (2010) Limited, Leech & Partners Trustees (2011) Limited, Leech & Partners Trustees (2012) Limited, Leech & Partners Limited, Leech & Partners Trustees Limited, Londale Development Limited, Lye Properties Limited, McGoldrick Trustees Limited, Murney Investments Limited, Northbank Irrigation Limited, Potlach Governance Limited, Power Turf New Zealand Limited, Radfield Trustees Limited, Sempiternal Custodians Limited, Sempiternal Trust Company Limited, South Beach Properties Limited, South Pacific Seeds (N.Z.) Limited, South Pacific Seeds Pty Limited, South Pacific Seed Sales (NZ) Limited, TCB Results Limited, Te Mahanga Trustee Company Limited, The New Zealand Sock Company Limited, W. H. Collins & Co. Limited, Webling & Stewart Limited, Windermere Trustees Limited, Woodhams Limited, Woodhams Properties Limited.

**Name:** Graham Russell Kennedy

**Qualifications:** J. P., BCom, FCA, ACIS, ACIM, AF Inst D

**Type of director:** Independent Non-Executive Director

**Occupation:** Company Director

**External Directorships:**

Ashburton Aquatic Park Limited, Ashburton Central Limited, Avon Properties Limited, Avon Properties (2008) Limited, BK&P Trustees Limited, BK Trustees (2005) Limited, BK Trustees (2009) Limited, BK Trustees (2010) Limited, BK Riversdale Trustees Limited, Black Gnat Properties Limited, Black Quill Investments Limited, Bradford Management Limited, Cates Grain & Seed Limited, Clairvoyant Development Limited, Concurrent Properties Limited, Crescent Custodians Limited, Earth & Sky Limited, Germinal Seeds N.Z. Limited, GPGD Limited, Heartland New Zealand Limited, Hornby Consortium Limited, Lake Extension Trust Limited, Norman Spencer Nominees Limited, Penrose Nominees Limited, Shooting Star Properties Limited.

**Name:** Geoffrey Thomas Ricketts

**Qualifications:** LLB (Hons), F Inst D

**Type of director:** Independent Non-Executive Director

**Occupation:** Company Director

**External Directorships:**

Asteron Life Limited, Great Northern Developments Limited, Heartland New Zealand Limited, Janmac Capital Limited, Lion Pty Limited, Lion Nathan Nominees Limited, Macmine Group Limited, Macmine Investments Limited, Maisemore Enterprises Limited, MCF 1 Limited, MCF 2 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, 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 Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Industries Limited, Oceania and Eastern Limited, Oceania and Eastern Overseas Investment Limited, Oceania and Eastern Securities Limited, Oceania Capital Limited, Quartet Equities Limited, Shopping Centres Australasia Property Group Trustee NZ Limited, Suncorp Group Holdings (NZ) Limited, Suncorp Group New Zealand Limited, Suncorp Group Services NZ Limited, The Todd Corporation Limited, Todd Management Services Limited, Vero Insurance New Zealand Limited, Vero Liability Insurance Limited.

**Name:** Christopher Robert Mace

**Qualifications:** CNZM

**Type of director:** Independent Non-Executive Director

**Occupation:** Company Director

**External Directorships:**

Akitu Capital Limited, Akitu Equities Limited, Akitu Investments Limited, Goldburn Resources Limited, Hazardous Investments Limited, Heartland New Zealand Limited, Helicopter Enterprises Limited, J N S Capital Limited, Janik Equities Limited, Janik Group Holdings Limited, Janmac Capital Limited, Mace Capital Limited, Mace Construction Limited, Mace Developments Limited, Mace Enterprises Limited, Mace Investments Limited, Maisemore Enterprises Limited, MARAC Insurance Limited, Martinborough Vineyard Estates Limited, National Institute of Water and Atmospheric Research Limited, NIWA Vessel Management Limited, Nuffield Forestry Limited, O & E Group Services Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Industries Limited, Oceania and Eastern Limited, Oceania and Eastern Overseas Investment Limited, Oceania and Eastern Securities Limited, Oceania Capital 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:** Michelle Anne Smith

**Qualifications:** MCom, CA - NZICA and ICAEW

**Type of director:** Independent Non-Executive Director

**Occupation:** Company Director

**External Directorships:**

Camden Apartments Nominee Company Limited, Medasoty Securities Limited, Medical Assurance Society New Zealand Limited, Medical Funds Management Limited, Medical Insurance Limited, Medical Insurance Society Limited, Medical Life Assurance Society Limited, Medical Pensions Limited, Medical Securities Limited, Michelle A Consulting Limited, Paul Smith Publishing Limited.

**Name:** Jeffrey Kenneth Greenslade

**Qualifications:** LLB

**Type of director:** Non-Independent Executive Director

**Occupation(s):** CEO Heartland Building Society

**External Directorships:**

Brew Greenslade & Company Limited, BSHL No.1 Limited, BSHL No.2 Limited, BSHL No.3 Limited, BSHL No.4 Limited, BSHL No.5 Limited, BSHL No.6 Limited, BSHL No.7 Limited, BSHL No.8 Limited, BSHL No.9 Limited, BSHL No.10 Limited, BSHL No.11 Limited, BSHL No.12 Limited, BSHL No.13 Limited, BSHL No.14 Limited, BSHL No.15 Limited, BSHL No.16 Limited, BSHL No.17 Limited, BSHL No.18 Limited, BSHL No.19 Limited, BSHL No.20 Limited, Greenslade Investments Limited, Heartland Financial Services Limited, Heartland New Zealand Limited, Heartland NZ Trustee Limited, MARAC JV Holdings Limited, MARAC Insurance Limited.

### Conflicts of interest policy

All directors are required to disclose any actual or potential conflict of interest which may exist or is thought to exist upon appointment and are required to keep these disclosures to the Board 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 Building Societies Act 1965 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 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 be given to any other person of like circumstances or means, or could be reasonably likely to influence materially the exercise of the director's duties.

### Audit committee composition

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

Gary Leech (Chairperson)	Independent Non-Executive Director
Bruce Irvine	Independent Non-Executive Director
Graham Kennedy	Independent Non-Executive Director
Christopher Mace	Independent Non-Executive Director

## AUDITOR

KPMG  
KPMG Centre  
18 Viaduct Harbour Avenue  
Auckland

## CONDITIONS OF REGISTRATION

These conditions apply on and after 17 December 2012, except as provided otherwise.

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

1. That the banking group complies with the following requirements:
  - (a) the total capital ratio of the banking group is not less than 12 percent;
  - (b) the tier one capital ratio of the banking group is not less than 12 percent; and
  - (c) the capital of the banking group is not less than \$30 million.

For the purposes of this condition of registration, capital, the total capital ratio and the tier one capital ratio must be calculated in accordance with the Reserve Bank of New Zealand document entitled "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated October 2010.

This condition of registration does not apply after 31 December 2012.

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 tier one and total capital ratios under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated October 2010; and
- (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

This condition of registration does not apply after 31 December 2012.

1B. That—

- (a) the Total capital ratio of the banking group is not less than 12 percent;
- (b) the Tier 1 capital ratio of the banking group is not less than 12 percent;
- (c) the Common Equity Tier 1 capital ratio of the banking group is not less than 10 percent;
- (d) the Total capital of the banking group is not less than \$30 million; and
- (e) the process in Subpart 2H of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated December 2012 is followed for the recognition and repayment of capital.

For the purposes of this condition of registration, capital, the Total capital ratio, the Tier 1 capital ratio, and the Common Equity Tier 1 capital ratio must be calculated in accordance with the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated December 2012.

This condition of registration applies on and after 1 January 2013.

1C. 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 December 2012; and
- (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

This condition of registration applies on and after 1 January 2013.

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.

## CONDITIONS OF REGISTRATION CONTINUED

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 <sup>1</sup>	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 percent 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 December 2012.

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.
6. That the bank complies with the following corporate governance requirements:
- the board of the bank must have at least five directors;
  - the majority of the board members must be non-executive directors;
  - at least half of the board members must be independent directors;
  - an alternate director,—
    - for a non-executive director must be non-executive; and
    - for an independent director must be independent;
  - at least half of the independent directors of the bank must be ordinarily resident in New Zealand;
  - the chairperson of the board of the bank must be independent; and
  - 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,"—

- in relation to a person who is not a director of both Heartland New Zealand Limited and the bank, has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated March 2011; and
- in relation to a person who is a director of both Heartland New Zealand Limited and the bank, means a person who meets the criteria for independence set out in section 10 except for those in paragraph 10(1)(a) and who meets the criteria in section 11 of the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated March 2011 but only if the consolidated total assets of Heartland New Zealand Limited and all of its subsidiaries other than the banking group and the intermediate holding companies of the bank is not greater than 1% of the consolidated total assets of Heartland New Zealand Limited and all of its subsidiaries:

"non-executive" has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated March 2011.

- 6A. That at least two of the independent directors of the bank must not be directors of Heartland New Zealand Limited.

For the purposes of this condition of registration, "independent" has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated March 2011.

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:
- the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
  - 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:
- the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
  - 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:
- the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;
  - the committee must have at least three members;
  - every member of the committee must be a non-executive director of the bank;
  - the majority of the members of the committee must be independent; and
  - 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 meaning as in condition of registration 6.

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

<sup>1</sup> 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

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 per cent at the end of each business day;
- (b) the one-month mismatch ratio of the banking group is not less than zero per cent at the end of each business day; and
- (c) the one-year core funding ratio of the banking group is not less than 75 per cent 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 March 2011 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated December 2011.

12. That the bank has an internal framework for liquidity risk management that is adequate in the bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:

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

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

For the purposes of this condition,—

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

"SPV" means a person—

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

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

14. That—

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

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

15. That Heartland Building Society converts to a company under Part 7A of the Building Societies Act 1965 by 15 February 2013.

In these conditions of registration, —

"banking group" means Heartland Building Society's financial reporting group (as defined in section 2(1) of the Financial Reporting Act 1993):

"generally accepted accounting practice" has the same meaning as in section 2 of the Financial Reporting Act 1993.



## 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 Banking Group or the Bank.

## CREDIT RATING

As at the date of signing this Disclosure Statement, the Bank's credit rating issued by Standard & Poor's (Australia) Pty Limited (S&P) was BBB-stable. This BBB- credit rating was issued on 6 December 2011 and is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars. The following amendments have been made to the credit rating or outlook in the two years up to the date of signing of this disclosure statement:

- on 4 January 2011, S&P issued the BBB- credit rating with outlook stable.
- on 11 August 2011, S&P affirmed the BBB- credit rating and amended the outlook from stable to negative.
- on 6 December 2011, S&P affirmed the BBB- credit rating and amended the outlook from negative to stable.
- on 18 October 2012, S&P affirmed the BBB- credit rating with outlook stable.

The following is a summary of the descriptions of the major ratings categories of each rating agency 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.

Standard & Poor's defines its BBB rating to mean the obligator "has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligator to meet its financial commitments".

## FUTURE DEVELOPMENTS

Heartland intends to approve a scheme of conversion (as permitted under the Building Societies Act 1965) to enable it to become a company having limited liability under the Companies Act 1993.

## OTHER MATERIAL MATTERS

There are no other material matters relating to the business or affairs of the Bank or the Banking Group 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. At the date of registration:
  - (a) the Bank complied with all conditions of the registration;
  - (b) credit exposure 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 17 December 2012 and has been signed by all the Directors.



*Bruce Robertson Irvine (Chair – Board of Directors)*



*Jeffrey Kenneth Greenslade*



*Edward John Harvey*



*Graham Russell Kennedy*



*Gary Richard Leech*



*Christopher Robert Mace*



*Michelle Anne Smith*



*Geoffrey Thomas Ricketts*

## EXPLANATORY FOREWORD

The financial statements presented are those of Heartland Building Society and its subsidiaries (Banking Group or Heartland Group).

On 5 January 2011, the Heartland Group was formed through the business combination of CBS, SCBS and MARAC. On 31 August 2011, the Heartland Group acquired PWF.

From a legal perspective MARAC is a subsidiary the Heartland. Under New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) MARAC was treated as the acquirer of CBS and SCBS. The effect of this is that the financial statements represent a continuation of the MARAC business.

As described in Note 1, the Heartland Group's comparative results for the year ended 30 June 2011 reflect the results of the MARAC Group from 1 July 2010 to 5 January 2011 and the results of the Heartland Group from 6 January 2011 to 30 June 2011. The year ended 30 June 2012 includes the Heartland Group results from 1 July 2011 onwards and the PWF result from 31 August 2011.

## STATEMENTS OF COMPREHENSIVE INCOME

For the year ended 30 June 2012

	NOTE	BANKING GROUP		BANK	
		Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Interest income	5	205,131	161,297	49,674	30,895
Interest expense	5	121,502	99,705	111,971	54,738
<b>Net interest income / (expense)</b>		<b>83,629</b>	<b>61,592</b>	<b>(62,297)</b>	<b>(23,843)</b>
Operating lease income	6	15,064	18,073	-	-
Operating lease expenses	6	9,954	11,130	-	-
<b>Net operating lease income</b>		<b>5,110</b>	<b>6,943</b>	<b>-</b>	<b>-</b>
Lending and credit fee income		1,889	1,327	771	370
Dividends received		-	-	88,482	-
Other income	13	4,330	718	9,033	179
<b>Net operating income / (loss)</b>		<b>94,958</b>	<b>70,580</b>	<b>35,989</b>	<b>(23,294)</b>
Selling and administration expenses	7	64,181	44,826	34,966	9,934
<b>Profit / (loss) before impaired asset expense and income tax</b>		<b>30,777</b>	<b>25,754</b>	<b>1,023</b>	<b>(33,228)</b>
Impaired asset expense	29(c)(ii)	5,642	13,298	3,473	2,074
Decrease in fair value of investment properties	13	3,900	-	-	-
<b>Profit / (loss) before income tax</b>		<b>21,235</b>	<b>12,456</b>	<b>(2,450)</b>	<b>(35,302)</b>
Income tax (benefit) / expense	8	(2,974)	4,712	(30,176)	(10,285)
<b>Profit / (loss) for the year</b>		<b>24,209</b>	<b>7,744</b>	<b>27,726</b>	<b>(25,017)</b>
<b>Other comprehensive income</b>					
Cash flow hedges:					
Effective portion of changes in fair value, net of tax		378	596	-	-
Reserves:					
Net change in available for sale reserve, net of tax		(103)	111	(103)	111
Net change in defined benefit reserve, net of tax		(435)	14	(435)	14
<b>Other comprehensive (loss) / income for the year, net of income tax</b>		<b>(160)</b>	<b>721</b>	<b>(538)</b>	<b>125</b>
<b>Total comprehensive income / (loss) for the year</b>		<b>24,049</b>	<b>8,465</b>	<b>27,188</b>	<b>(24,892)</b>

All comprehensive income for the year is attributable to owners of the Banking Group.

The notes on pages 15 to 58 are an integral part of these financial statements.

## STATEMENTS OF CHANGES IN EQUITY

For the year ended 30 June 2012

	NOTE	Share Capital \$000	Available for sale Reserve \$000	Defined benefit Reserve \$000	Hedging Reserve \$000	Retained Earnings \$000	Total Equity \$000
<b>Jun 2012 - BANKING GROUP</b>							
<b>Balance at 1 July 2011</b>		134,774	111	14	(1,388)	160,330	293,841
<b>Total comprehensive income for the year</b>							
Profit for the year		-	-	-	-	24,209	24,209
Total other comprehensive income		-	(103)	(435)	378	-	(160)
<b>Total comprehensive income for the year</b>		-	<b>(103)</b>	<b>(435)</b>	<b>378</b>	<b>24,209</b>	<b>24,049</b>
<b>Contributions by and distributions to owners</b>							
Issue of share capital	24	55,000	-	-	-	-	55,000
Dividends to equity holders		-	-	-	-	(1,597)	(1,597)
<b>Total transactions with owners</b>		<b>55,000</b>	-	-	-	<b>(1,597)</b>	<b>53,403</b>
<b>Balance at 30 June 2012</b>		<b>189,774</b>	<b>8</b>	<b>(421)</b>	<b>(1,010)</b>	<b>182,942</b>	<b>371,293</b>
<b>Jun 2011 - BANKING GROUP</b>							
<b>Balance at 1 July 2010</b>		55,000	-	-	(1,984)	153,452	206,468
<b>Total comprehensive income for the year</b>							
Profit for the year		-	-	-	-	7,744	7,744
Total other comprehensive income		-	111	14	596	-	721
<b>Total comprehensive income for the year</b>		-	<b>111</b>	<b>14</b>	<b>596</b>	<b>7,744</b>	<b>8,465</b>
<b>Contributions by and distributions to owners</b>							
Issue of share capital		79,774	-	-	-	-	79,774
Dividends to equity holders		-	-	-	-	(866)	(866)
<b>Total transactions with owners</b>		<b>79,774</b>	-	-	-	<b>(866)</b>	<b>78,908</b>
<b>Balance at 30 June 2011</b>		<b>134,774</b>	<b>111</b>	<b>14</b>	<b>(1,388)</b>	<b>160,330</b>	<b>293,841</b>
<b>Jun 2012 - BANK</b>							
<b>Balance at 1 July 2011</b>		284,043	111	14	-	(25,883)	258,285
<b>Total comprehensive income for the year</b>							
Profit for the year		-	-	-	-	27,726	27,726
Total other comprehensive income		-	(103)	(435)	-	-	(538)
<b>Total comprehensive income for the year</b>		-	<b>(103)</b>	<b>(435)</b>	-	<b>27,726</b>	<b>27,188</b>
<b>Contributions by and distributions to owners</b>							
Issue of share capital	24	55,000	-	-	-	-	55,000
Dividends to equity holders		-	-	-	-	(1,597)	(1,597)
<b>Total transactions with owners</b>		<b>55,000</b>	-	-	-	<b>(1,597)</b>	<b>53,403</b>
<b>Balance at 30 June 2012</b>		<b>339,043</b>	<b>8</b>	<b>(421)</b>	-	<b>246</b>	<b>338,876</b>
<b>Jun 2011 - BANK</b>							
<b>Balance at 1 July 2010</b>		-	-	-	-	-	-
<b>Total comprehensive income for the year</b>							
Loss for the year		-	-	-	-	(25,017)	(25,017)
Total other comprehensive income		-	111	14	-	-	125
<b>Total comprehensive income for the year</b>		-	<b>111</b>	<b>14</b>	-	<b>(25,017)</b>	<b>(24,892)</b>
<b>Contributions by and distributions to owners</b>							
Issue of share capital	24	284,043	-	-	-	-	284,043
Dividends to equity holders		-	-	-	-	(866)	(866)
<b>Total transactions with owners</b>		<b>284,043</b>	-	-	-	<b>(866)</b>	<b>283,177</b>
<b>Balance at 30 June 2011</b>		<b>284,043</b>	<b>111</b>	<b>14</b>	-	<b>(25,883)</b>	<b>258,285</b>

The notes on pages 15 to 58 are an integral part of these financial statements.

## STATEMENTS OF FINANCIAL POSITION

As at 30 June 2012

	NOTE	BANKING GROUP		BANK	
		Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Assets</b>					
Cash and cash equivalents	11	89,220	267,034	72,217	245,322
Investments	12	24,327	17,831	24,327	17,831
Due from related parties	26	276	200	1,107,857	740,817
Investment properties	13	55,504	34,499	-	-
Finance receivables	14	2,078,276	1,707,311	547,984	626,518
Operating lease vehicles	15	34,550	32,727	-	-
Current tax assets		5,272	-	6,369	10,708
Other assets	16	15,857	19,499	5,112	7,465
Investment in subsidiaries	17	-	-	302,282	204,269
Intangible assets	18	22,997	21,602	22,213	20,216
Property, plant and equipment	19	10,067	10,079	9,613	9,433
Deferred tax asset	20	8,143	4,703	5,083	371
<b>Total assets</b>		<b>2,344,489</b>	<b>2,115,485</b>	<b>2,103,057</b>	<b>1,882,950</b>
<b>Liabilities</b>					
Borrowings	21	1,939,489	1,787,524	1,750,579	1,613,731
Current tax liabilities		-	2,209	-	-
Due to related parties	26	193	104	770	-
Trade and other payables	22	33,514	31,807	12,832	10,934
<b>Total liabilities</b>		<b>1,973,196</b>	<b>1,821,644</b>	<b>1,764,181</b>	<b>1,624,665</b>
<b>Equity</b>					
Share capital	24	189,774	134,774	339,043	284,043
Retained earnings and reserves		181,519	159,067	(167)	(25,758)
<b>Total equity</b>		<b>371,293</b>	<b>293,841</b>	<b>338,876</b>	<b>258,285</b>
<b>Total equity and liabilities</b>		<b>2,344,489</b>	<b>2,115,485</b>	<b>2,103,057</b>	<b>1,882,950</b>
Total interest earning and discount bearing assets		2,193,238	1,994,344	645,943	891,836
Total interest and discount bearing liabilities		1,940,948	1,787,524	1,750,994	1,613,731

The notes on pages 15 to 58 are an integral part of these financial statements.

## STATEMENTS OF CASH FLOWS

For the year ended 30 June 2012

	NOTE	BANKING GROUP		BANK	
		Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Cash flows from operating activities</b>					
Interest received		197,136	152,011	47,859	29,000
Operating lease income received		13,099	14,367	-	-
Proceeds from sale of operating lease vehicles		7,932	15,384	-	-
Lending, credit fees and other income received		6,219	4,279	9,804	549
Net decrease in finance receivables		-	-	77,596	42,404
<b>Total cash provided from operating activities</b>		<b>224,386</b>	<b>186,041</b>	<b>135,259</b>	<b>71,953</b>
Payments to suppliers and employees		66,940	54,336	29,696	6,448
Interest paid		121,742	91,267	114,713	48,858
Purchase of operating lease vehicles		16,905	18,201	-	-
Net increase in finance receivables		20,547	19,417	-	-
Taxation paid		23	-	-	-
<b>Total cash applied to operating activities</b>		<b>226,157</b>	<b>183,221</b>	<b>144,409</b>	<b>55,306</b>
<b>Net cash flows (applied to) / from operating activities</b>	10	<b>(1,771)</b>	<b>2,820</b>	<b>(9,150)</b>	<b>16,647</b>
<b>Cash flows from investing activities</b>					
Sale of investment property		832	-	-	-
Proceeds from sale of investments		-	3,709	-	3,709
Proceeds from sale of finance receivables to related party		-	39,764	-	-
<b>Total cash provided from investing activities</b>		<b>832</b>	<b>43,473</b>	<b>-</b>	<b>3,709</b>
Purchase of office fit-out, equipment and intangible assets		3,191	1,831	2,886	111
Purchase of investments		6,496	-	6,496	-
Advance to subsidiaries		-	-	-	34,523
Purchase of subsidiary	36	24,898	-	24,898	-
Purchase of investment property		937	21,140	-	-
<b>Total cash applied to investing activities</b>		<b>35,522</b>	<b>22,971</b>	<b>34,280</b>	<b>34,634</b>
<b>Net cash flows (applied to) / from investing activities</b>		<b>(34,690)</b>	<b>20,502</b>	<b>(34,280)</b>	<b>(30,925)</b>
<b>Cash flows from financing activities</b>					
Issue of share capital		55,000	-	55,000	-
<b>Total cash provided from financing activities</b>		<b>55,000</b>	<b>-</b>	<b>55,000</b>	<b>-</b>
Dividends paid		1,597	866	1,597	866
Net decrease in borrowings		256,399	48,954	183,078	17,078
<b>Total cash applied to financing activities</b>		<b>257,996</b>	<b>49,820</b>	<b>184,675</b>	<b>17,944</b>
<b>Net cash flows applied to financing activities</b>		<b>(202,996)</b>	<b>(49,820)</b>	<b>(129,675)</b>	<b>(17,944)</b>
<b>Net decrease in cash held</b>		<b>(239,457)</b>	<b>(26,498)</b>	<b>(173,105)</b>	<b>(32,222)</b>
Opening cash and cash equivalents		267,034	86,406	245,322	-
Cash impact of business combination	36	61,643	207,126	-	277,544
<b>Closing cash and cash equivalents</b>	11	<b>89,220</b>	<b>267,034</b>	<b>72,217</b>	<b>245,322</b>

The notes on pages 15 to 58 are an integral part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

## 1 Reporting entity

The financial statements presented are the consolidated financial statements comprising Heartland Building Society and its subsidiaries (Banking Group or Heartland Group).

On 5 January 2011:

- All of the assets and liabilities of CBS, SCBS (net of the shares held by SCBS in CBS) and CBS Warehouse A Trust (CBS Trust) were amalgamated to form Heartland.
- The borrowings of MARAC were transferred to Heartland.
- The shares in MARAC were transferred to Heartland from MARAC Financial Services Limited to form the Heartland Group.

From a legal perspective MARAC is a subsidiary of Heartland. Under New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) the merger was treated as a reverse acquisition. The business combination was therefore accounted for as if MARAC acquired 72% of Heartland.

As a result the financial statements represent a continuation of the MARAC business. Comparatives for the year ended 30 June 2011 reflect the total comprehensive income of the MARAC Group from 1 July 2010 to 5 January 2011 and the total comprehensive income of the Heartland Group from 6 January 2011 to 30 June 2011. From 1 July 2011 onwards the total comprehensive income reflects the Heartland Group.

The MARAC Group comprises MARAC, Heartland ABCP Trust 1 (ABCP Trust) (previously known as MARAC ABCP Trust 1), MARAC Retirement Bonds Superannuation Fund and Heartland Cash and Term PIE Fund (previously known as MARAC PIE Fund). The Heartland Group wound up MARAC Retirement Bonds Superannuation Fund with effect from 31 October 2010.

On 31 August 2011, Heartland acquired 100% of PGG Wrightson Finance Limited (PWF) from PGG Wrightson Limited (PGW), refer to Note 36 - Business combinations for more information.

The Banking Group includes ABCP Trust and CBS Trust (collectively known as the Trusts). The assets securitised into the Trusts continue to be recognised in the Banking Group's financial statements.

All entities within the Banking Group offer financial services or are special purpose entities. The Banking Group operates and is domiciled in New Zealand. The registered office address is 75 Riccarton Road, Riccarton, Christchurch.

## 2 Basis of preparation

### (a) Statement of compliance

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 1993. 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 (No 2) 2012 (Order). The financial statements also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

The Bank and all entities within the Banking Group are profit-oriented entities. The Bank is a reporting entity and an issuer for the purposes of the Financial Reporting Act 1993 and its financial statements comply with that Act. The financial statements have been prepared in accordance with the requirements of the Building Societies Act 1965 and the Securities Regulations 2009.

### (b) Basis of measurement

The financial statements have been prepared on the basis of historical cost, unless stated otherwise.

### (c) Functional and presentation currency and rounding

These financial statements are presented in New Zealand dollars which is the Banking Group's functional currency. Unless otherwise indicated, amounts are rounded to the nearest thousand.

### (d) Estimates and judgements

The preparation of financial statements requires the use of management judgement, estimates and assumptions that effect reported amounts. Actual results may differ from these judgements. For further information about significant areas of estimation, uncertainty and critical judgements that have the most significant effect on the financial statements, refer to Note 29 - Credit risk exposure.

### (e) Going concern

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

### (f) Comparative information

Certain comparatives have been restated to comply with current year presentation.



# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

## 3 Significant accounting policies

### (a) Consolidation of subsidiaries

Subsidiaries are entities that are controlled by the Banking Group. Investments in subsidiary companies are recorded at cost by the Bank.

The consolidated financial statements are prepared by consolidating the financial statements of the Bank and its subsidiaries. All intercompany transactions, balances and unrealised profits are eliminated on consolidation.

### (b) Special purpose entities

Special purpose 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. The financial statements of special purpose entities are included in the Banking Group's financial statements where the substance of the relationship is that the Bank controls the special purpose entity.

### (c) Interest

Interest income and expense are recognised using the effective interest method in comprehensive income. 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 comprehensive income at the same time as the hedged item or if the hedge relationship is subsequently deemed to be ineffective.

### (d) Operating lease income and expense

Income from operating lease vehicles is apportioned over the term of the operating lease on a straight line basis.

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.

### (e) Lending and credit fee income

Lending and credit fee income that is integral to the effective interest rate of a financial asset or liability is included in the measurement of the effective interest rate. Other lending and credit fee income is recognised as the related services are rendered.

### (f) Dividend income

Dividend income is recognised in comprehensive income on the date that the Bank's right to receive payment is established.

### (g) Tax

#### *Income tax expense*

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

#### *Current tax*

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax 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).

#### *Deferred tax*

Deferred tax is recognised in respect of temporary differences between the financial reporting carrying amount of assets and liabilities and the amounts used for tax purposes.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year(s) when the asset or liability giving rise to them are realised or settled, based on the tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date. The measurement reflects the tax consequences that would follow from the manner in which the Banking Group, at the reporting date, recovers or settles the carrying amount of its assets and liabilities.

Deferred tax assets, including those related to the tax effects of income tax losses and credits available to be carried forward, are recognised only to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences or unused tax losses and credits can be utilised. Deferred tax assets are reviewed each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Current and deferred tax assets and liabilities are offset only to the extent that they relate to income taxes imposed by the same taxation authority and there is a legal right and intention to settle on a net basis and it is allowed under tax law.

### (h) Share capital

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.

### (i) Cash and cash equivalents

Cash and cash equivalents consist of cash and liquid assets used in the day to day cash management of the Banking Group. Cash and cash equivalents are carried at amortised cost in the Statements of Financial Position.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 3 Significant accounting policies (continued)

#### (j) Investments

The Bank and the Banking Group hold investments in local authority stock, public securities and corporate bonds. 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.

#### (k) 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 property is initially recognised at its fair value, with subsequent changes in fair value recognised in comprehensive income.

Fair values are supported by independent valuations or other similar external evidence, adjusted for changes in market conditions and the time since the last valuation.

#### (l) 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.

#### (m) Operating lease vehicles

Operating lease vehicles are stated at cost less accumulated depreciation. 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.

#### (n) Derivative financial instruments

Derivative financial instruments are contracts entered into to reduce the exposure to the volatility of variable rate borrowings (cash flow hedges), or to convert fixed rate borrowings or assets to variable rates (fair value hedges), in order to mitigate the Banking Group's interest rate risk. The financial instruments are subject to the risk that market values may change subsequent to their acquisition; however such changes would be offset by corresponding, but opposite, effects on the variable rate borrowings or fixed rate borrowings or assets being hedged. Derivatives are initially valued at fair value and subsequently remeasured at fair value.

Fair value movements of derivatives that are not designated in a qualifying cash flow hedge relationship, are recognised in comprehensive income. Fair value movements of the effective portion of a qualifying cash flow hedge derivative, are recognised directly in other comprehensive income and held in the hedging reserve in equity. The amount recognised in equity is transferred to comprehensive income in the same year as the hedged cash flow affects comprehensive income, disclosed in the same line as the hedged item. Any ineffective portion of changes in fair value of the derivative is recognised immediately in comprehensive income. Fair value movements of a derivative designated as a fair value hedge are recognised directly in comprehensive income together with the hedged item.

#### (o) Property, plant, equipment and depreciation

Land and buildings are measured at fair value. Fair value is determined on the basis of independent valuations prepared by external valuation experts, based on discounted cash flows or capitalisation of net income.

Any revaluation increase arising on the revaluation of land and buildings is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in comprehensive income, in which case the increase is credited to comprehensive income to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of land and buildings is charged as an expense to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

Depreciation on revalued buildings is charged to comprehensive income. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the asset revaluation reserve, net of any related deferred taxes, is transferred directly to retained earnings.

Other items of 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.

The following annual rates are used in the calculation of depreciation:

Buildings	1.0% - 4.0%
Fixtures and fittings	5.5% - 36.0%
Office equipment and furniture	6.0% - 30.0%
Computer equipment	16.2% - 48.0%
Motor vehicles	21.0% - 25.2%

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

## 3 Significant accounting policies (continued)

### (p) Intangible assets and goodwill

#### **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 and contingent liabilities. When the fair value of the identifiable net assets and contingent liabilities exceeds the cost of an acquisition, the resulting discount is recognised immediately in comprehensive income for the year. Goodwill is tested for impairment at least annually, and is carried at cost less accumulated impairment losses.

#### **Computer software**

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 of three to four years. All other expenditure is expensed immediately as required.

### (q) Financial assets and liabilities

#### **Classification**

Financial assets and liabilities are classified in the following accounting categories:

<b>Financial assets/liabilities</b>	<b>Accounting category</b>
Cash and cash equivalents	Loans and receivables
Investments	Available for sale
Due from related parties	Loans and receivables
Finance receivables	Loans and receivables
Other financial assets	Loans and receivables
Borrowings	Other liabilities at amortised cost
Other financial liabilities	Other liabilities at amortised cost
Derivatives	Held for trading (or qualifying hedges as described in Note 3(n))

#### **Recognition**

The Banking Group initially recognises finance receivables, borrowings and subordinated liabilities on the date that they are originated. All other financial assets and liabilities (including assets and liabilities designated at fair value through comprehensive income) are initially recognised on the trade date at which the Banking Group becomes a party to the contractual provisions of the instrument.

#### **Derecognition**

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 Statements 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 Statements 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.

### (r) Impaired assets and past due assets

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.

The term collectively impaired asset refers to an asset where an event has occurred 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.

Restructured assets are 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. In order to be classified as a restructured asset, following restructuring, the return under the revised terms is expected to be equal to or greater than the Banking Group's average cost of funds, or a loss is not otherwise expected to be incurred.

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.

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 comprehensive income. Any future recoveries of amounts provided for are taken to comprehensive income.

For further information about credit impairment provisioning refer to Note 29 - Credit risk exposure.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 3 Significant accounting policies (continued)

#### (s) 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.

#### (t) Provisions

A provision is recognised if, as a result of a past event, the Banking Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

#### (u) Employee benefits

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.

#### (v) Defined benefit plan

The cost of providing benefits for defined benefit superannuation plans is determined using the Projected Unit Credit Method. Actuarial gains and losses are recognised in full in the year in which they occur by way of a movement in the defined benefit plan reserve, and are presented in the Statements of Changes in Equity.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefit becomes vested. The defined benefit obligation is deducted from the fair value of the defined benefit plan asset to derive the defined benefit plan surplus recognised in trade receivables in the Statements of Financial Position.

#### (w) Borrowings

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

#### (x) Share schemes

The Banking Group provides benefits to staff in the form of share based payments, whereby staff provide services in exchange for shares. Currently in place is a discretionary share scheme and an executive share scheme, refer to Note 34 - Staff share ownership arrangements.

Under both of these schemes HNZ and the previous ultimate parent, Pyne Gould Corporation Limited undertake to transfer a specific number of its shares to various key staff at a specified future date on that staff member achieving certain criteria. The shares are issued at a price agreed by the directors and held in trust until all the conditions are satisfied. The expected benefit is expensed over the years over which any conditions are required to be met.

#### (y) Statements of Cash Flows

The Statements of Cash Flows have been prepared using the direct method modified by the netting of certain cash flows associated with cash and cash equivalents, investments, related party balances, finance receivables and borrowings. Netting of cash flows provides more meaningful disclosure as many of the cash flows are received and paid on behalf of customers and reflect the activities of those customers rather than the Banking Group.

#### (z) Changes in accounting policies

There have been no material changes in accounting policies in the current year.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 3 Significant accounting policies (continued)

#### (aa) 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 2012, 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:

<i>Standard and description</i>	<i>Effective for annual periods beginning on or after:</i>	<i>Expected to be initially applied in year ending:</i>
NZ IAS 12 Income Taxes, which introduces a presumption that an investment property is recovered entirely through sale.	1 January 2012	30 June 2013
NZ IAS 1 Presentation of Financial Statements, which requires an entity to present separately the items of other comprehensive income that would be reclassified to comprehensive income in the future if certain conditions are met.	1 July 2012	30 June 2013
NZ IFRS 10 Consolidated Financial Statements, which introduces a new approach to determining which investees should be consolidated and provides a single model to be applied in the control analysis for all investees.	1 January 2013	30 June 2014
NZ IFRS 13 Fair Value Measurement, which defines fair value, and establishes a framework for measuring fair value including disclosure requirements.	1 January 2013	30 June 2014
NZ IFRS 12 Disclosure of Interests in Other Entities, which contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and/or unconsolidated structured entities.	1 January 2013	30 June 2014
NZ IFRS 9 Financial Instruments, which specifies how an entity should classify and measure financial assets and liabilities.	1 January 2013	30 June 2014
NZ IAS 27 Separate Financial Statements, which carries forward existing accounting and disclosure requirements with minor clarifications.	1 January 2013	30 June 2014
NZ IFRS 7 Financial Instruments: Disclosures, amendment to offsetting financial assets and financial liabilities.	1 January 2013	30 June 2014
NZ IAS 32 Financial Instruments: Presentation, amendment to offsetting financial assets and financial liabilities.	1 January 2014	30 June 2015
NZ IAS 19 Employee Benefits, which requires actuarial gains and losses to be recognised immediately in other comprehensive income and the expected return on plan assets recognised in comprehensive income to be calculated based on the rate used to discount the defined benefit obligation.	1 January 2013	30 June 2014

Initial application of the above standards and interpretations relevant to the Banking Group are not expected to have any material impact on the financial statements of the Banking Group.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 4 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. During the year ended 30 June 2012, the operating segments were restructured to amalgamate Retail and Consumer into one segment. The comparative year has been restated to align with the new operating segments.

All income received is from external sources, except those transactions with related parties, refer to Note 26 - 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 Other.

#### Operating segments

The Banking Group operates predominantly within New Zealand and comprises the following main operating segments:

<b>Retail and Consumer</b>	Providing a comprehensive range of financial services to New Zealand businesses and families, including term, transactional and savings based deposit accounts together with residential mortgage lending, motor vehicle finance and asset finance.
<b>Business</b>	Providing term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized New Zealand businesses.
<b>Rural</b>	Specialist financial services to the farming sector primarily offering livestock, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.
<b>Non-core Property</b>	Funding assets in the non core-property division of MARAC and the Bank.

The Banking Group's operating segments are different than the industry categories detailed in Note 29 - Credit risk exposure. The operating segments are primarily categorised by sales channel, whereas Note 29 - Credit risk exposure categorises exposures based on credit risk concentrations (see Note 29 - Credit risk exposure for further details).

	BANKING GROUP					Total
	Retail & Consumer	Business	Rural	Non-core Property	Other	
	\$000	\$000	\$000	\$000	\$000	\$000
<b>Jun 2012</b>						
Interest income	94,606	49,867	41,391	12,630	6,637	205,131
Interest expense	55,572	28,911	22,340	10,370	4,309	121,502
<b>Net interest income</b>	<b>39,034</b>	<b>20,956</b>	<b>19,051</b>	<b>2,260</b>	<b>2,328</b>	<b>83,629</b>
Net operating lease income	5,097	13	-	-	-	5,110
Net other income	927	57	66	4,104	1,065	6,219
<b>Net operating income</b>	<b>45,058</b>	<b>21,026</b>	<b>19,117</b>	<b>6,364</b>	<b>3,393</b>	<b>94,958</b>
Depreciation and amortisation expense	-	-	-	-	1,830	1,830
Other selling and administration expenses	11,475	5,273	5,837	6,350	33,416	62,351
<b>Selling and administration expenses</b>	<b>11,475</b>	<b>5,273</b>	<b>5,837</b>	<b>6,350</b>	<b>35,246</b>	<b>64,181</b>
<b>Profit / (loss) before impaired asset expense and income tax</b>	<b>33,583</b>	<b>15,753</b>	<b>13,280</b>	<b>14</b>	<b>(31,853)</b>	<b>30,777</b>
Impaired asset expense	1,991	2,445	689	517	-	5,642
Decrease in fair value of investment properties	-	-	-	3,900	-	3,900
<b>Profit / (loss) before income tax</b>	<b>31,592</b>	<b>13,308</b>	<b>12,591</b>	<b>(4,403)</b>	<b>(31,853)</b>	<b>21,235</b>
Income tax benefit	-	-	-	-	(2,974)	(2,974)
<b>Profit / (loss) for the year</b>	<b>31,592</b>	<b>13,308</b>	<b>12,591</b>	<b>(4,403)</b>	<b>(28,879)</b>	<b>24,209</b>
<b>Total assets</b>	<b>989,352</b>	<b>540,228</b>	<b>478,582</b>	<b>160,168</b>	<b>176,159</b>	<b>2,344,489</b>
<b>Total liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,973,196</b>	<b>1,973,196</b>
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>371,293</b>	<b>371,293</b>
<b>Jun 2011</b>						
Interest income	90,280	39,178	4,242	19,805	7,792	161,297
Interest expense	56,972	22,040	2,599	10,637	7,457	99,705
<b>Net interest income</b>	<b>33,308</b>	<b>17,138</b>	<b>1,643</b>	<b>9,168</b>	<b>335</b>	<b>61,592</b>
Net operating lease income	6,823	120	-	-	-	6,943
Net other income	543	21	-	542	939	2,045
<b>Net operating income</b>	<b>40,674</b>	<b>17,279</b>	<b>1,643</b>	<b>9,710</b>	<b>1,274</b>	<b>70,580</b>
Depreciation and amortisation expense	-	-	-	-	1,482	1,482
Other selling and administration expenses	8,996	3,983	1,048	1,986	27,331	43,344
<b>Selling and administration expenses</b>	<b>8,996</b>	<b>3,983</b>	<b>1,048</b>	<b>1,986</b>	<b>28,813</b>	<b>44,826</b>
<b>Profit / (loss) before impaired asset expense and income tax</b>	<b>31,678</b>	<b>13,296</b>	<b>595</b>	<b>7,724</b>	<b>(27,539)</b>	<b>25,754</b>
Impaired asset expense	2,829	7,195	510	2,764	-	13,298
<b>Profit / (loss) before income tax</b>	<b>28,849</b>	<b>6,101</b>	<b>85</b>	<b>4,960</b>	<b>(27,539)</b>	<b>12,456</b>
Income tax expense	-	-	-	-	4,712	4,712
<b>Profit / (loss) for the year</b>	<b>28,849</b>	<b>6,101</b>	<b>85</b>	<b>4,960</b>	<b>(32,251)</b>	<b>7,744</b>
<b>Total assets</b>	<b>1,035,118</b>	<b>476,367</b>	<b>75,961</b>	<b>187,091</b>	<b>340,948</b>	<b>2,115,485</b>
<b>Total liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,821,644</b>	<b>1,821,644</b>
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>293,841</b>	<b>293,841</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 5 Net interest income / (expense)

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Interest income</b>				
Cash and cash equivalents	5,132	6,770	4,690	5,708
Finance receivables	199,526	154,527	42,278	23,900
Derivatives held for risk management:				
- Net interest income on cash flow hedges	473	-	2,706	1,287
<b>Total interest income</b>	<b>205,131</b>	<b>161,297</b>	<b>49,674</b>	<b>30,895</b>
<b>Interest expense</b>				
Retail deposits and debenture stock	100,769	78,327	100,788	48,330
Bank and securitised borrowings	20,733	21,332	11,183	6,408
Derivatives held for risk management:				
- Net interest expense on cash flow hedges	-	46	-	-
<b>Total interest expense</b>	<b>121,502</b>	<b>99,705</b>	<b>111,971</b>	<b>54,738</b>
<b>Net interest income / (expense)</b>	<b>83,629</b>	<b>61,592</b>	<b>(62,297)</b>	<b>(23,843)</b>

Included within the Banking Group's interest income on finance receivables is \$2,674,000 (June 2011: \$5,902,000) on individually impaired assets. Included within the Bank's interest income on finance receivables is \$2,081,000 (June 2011: \$1,540,000) on individually impaired assets.

### 6 Net operating lease income

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Operating lease income</b>				
Lease income	13,065	14,277	-	-
Gain on disposal of lease vehicles	1,999	3,796	-	-
<b>Total operating lease income</b>	<b>15,064</b>	<b>18,073</b>	<b>-</b>	<b>-</b>
<b>Operating lease expense</b>				
Depreciation on lease vehicles	9,149	10,490	-	-
Direct lease costs	805	640	-	-
<b>Total operating lease expenses</b>	<b>9,954</b>	<b>11,130</b>	<b>-</b>	<b>-</b>
<b>Net operating lease income</b>	<b>5,110</b>	<b>6,943</b>	<b>-</b>	<b>-</b>

### 7 Selling and administration expenses

	NOTE	BANKING GROUP		BANK	
		Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Personnel expenses		34,186	21,747	20,580	4,061
Directors' fees		175	-	175	-
Superannuation		475	302	253	30
Audit fees		516	386	489	247
Audit related fees		35	59	32	28
Amortisation - intangible assets	18	1,075	978	178	187
Depreciation - property, plant and equipment	19	755	504	531	186
Operating lease expense as a lessee		1,648	1,277	810	357
Legal and professional fees		5,397	6,632	1,492	1,669
Other operating expenses		19,919	12,941	10,426	3,169
<b>Total selling and administration expenses</b>		<b>64,181</b>	<b>44,826</b>	<b>34,966</b>	<b>9,934</b>

Audit related fees include professional fees in connection with trustee reporting, due diligence, review of prospectus documentation for various Banking Group entities, accounting advice and review work completed.

HNZ has paid some Director's fees on behalf of the Bank.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 8 Income tax (benefit) / expense

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Current income tax expense</b>				
Current year	4,942	2,136	(25,024)	(9,914)
Adjustments for prior year	(3,218)	-	987	-
<b>Deferred tax (benefit) / expense</b>				
Origination and reversal of temporary differences	1,484	2,278	43	(397)
Tax legislation change	(6,182)	298	(6,182)	26
<b>Total income tax (benefit) / expense</b>	<b>(2,974)</b>	<b>4,712</b>	<b>(30,176)</b>	<b>(10,285)</b>
<b>Reconciliation of effective tax rate</b>				
Profit / (loss) before income tax	21,235	12,456	(2,450)	(35,302)
Prima facie tax at 28% (Jun 2011: 30%)	5,946	3,737	(686)	(10,591)
Plus tax effect of items not taxable / deductible	480	677	480	280
Adjustments for prior year	(3,218)	-	987	-
Dividends received	-	-	(24,775)	-
Tax legislation changes	(6,182)	298	(6,182)	26
<b>Total income tax (benefit) / expense</b>	<b>(2,974)</b>	<b>4,712</b>	<b>(30,176)</b>	<b>(10,285)</b>

In May 2010, legislation was passed to reduce the New Zealand corporate tax rate from 30% to 28%, effective for the 2012 income tax year. The tax effect in the prior year of \$298,000 is the impact on the value of deferred tax assets and liabilities as a result of the reduction in the corporate tax rate for the financial year commencing 1 July 2011.

On 29 August 2011, the Taxation (Tax Administration and Remedial Matters) Act 2011 received Royal Assent. This Act contains a retrospective legislative change in relation to mergers of building societies. The result is that the \$6.2 million benefit of future tax deductions which were lost on the merger of MARAC, SCBS and CBS are now available to entities in the Heartland New Zealand Consolidated (Tax) Group, and cash that would otherwise have been required to pay tax will now be available to the Banking Group.

During the year MARAC made a subvention payment to MARAC Financial Services Limited (its former parent) for the use of tax losses to 31 May 2011. The amount paid was less than the tax rate of 30%. As a result the Banking Group recognised a benefit of \$3.4 million included in adjustments for prior year.

### Tax recognised in other comprehensive income

	BANKING GROUP					
	Jun 2012		Net of tax	Jun 2011		Net of tax
Before tax	Tax expense / (benefit)	Before tax		Tax expense	Net of tax	
	\$000	\$000	\$000	\$000	\$000	
Cash flow hedges	476	98	378	851	255	596
Available for sale investments	(147)	(44)	(103)	159	48	111
Defined benefit plan	(463)	(28)	(435)	20	6	14
	<b>(134)</b>	<b>26</b>	<b>(160)</b>	<b>1,030</b>	<b>309</b>	<b>721</b>
	BANK					
Before tax	Jun 2012		Net of tax	Jun 2011		Net of tax
	Tax expense / (benefit)	Before tax		Tax expense	Net of tax	
	\$000	\$000	\$000	\$000	\$000	
Available for sale investments	(147)	44	(103)	159	48	111
Defined benefit plan	(463)	(28)	(435)	20	6	14
	<b>(610)</b>	<b>16</b>	<b>(538)</b>	<b>179</b>	<b>54</b>	<b>125</b>

### 9 Imputation credit account

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Balance at beginning of year	-	33,515	-	-
Imputation credits forfeited on shareholding change	-	(33,507)	-	-
Tax paid net of refunds	23	(8)	-	-
<b>Balance at end of year</b>	<b>23</b>	<b>-</b>	<b>-</b>	<b>-</b>



## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 10 Reconciliation of profit / (loss) after tax to net cash flows from operating activities

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Profit / (loss) for the year</b>	<b>24,209</b>	<b>7,744</b>	<b>27,726</b>	<b>(25,017)</b>
Add / (less) non-cash items:				
Depreciation and amortisation expense	1,830	1,482	709	373
Change in fair value of investment properties	3,900	-	-	-
Impaired asset expense	5,642	13,298	3,473	2,074
Deferred tax (benefit) / expense	(2,978)	2,897	(4,712)	(371)
Derivative financial instruments revaluation	(219)	5,419	(1,250)	5,059
Accruals	529	1,567	446	138
Dividends received	-	-	(88,482)	-
<b>Total non-cash items</b>	<b>8,704</b>	<b>24,663</b>	<b>(89,816)</b>	<b>7,273</b>
Add / (less) movements in working capital items:				
Other assets	2,695	(10,163)	1,715	(890)
Current tax	(6,675)	1,733	(25,347)	(9,866)
Other liabilities	212	(2,174)	1,957	4,188
<b>Total movements in working capital items</b>	<b>(3,768)</b>	<b>(10,604)</b>	<b>(21,675)</b>	<b>(6,568)</b>
<b>Net cash flows from / (applied to) operating activities before movements in finance receivables and operating lease vehicles</b>	<b>29,145</b>	<b>21,803</b>	<b>(83,765)</b>	<b>(24,312)</b>
Movements in operating lease vehicles	(1,823)	10,168	-	-
Movements in finance receivables	(29,093)	(29,151)	74,615	40,959
<b>Net cash flows (applied to) / from operating activities</b>	<b>(1,771)</b>	<b>2,820</b>	<b>(9,150)</b>	<b>16,647</b>

### 11 Cash and cash equivalents

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Cash and cash equivalents	73,641	251,204	61,070	243,955
Cash and cash equivalents - securitised	15,579	15,830	11,147	1,367
<b>Total cash and cash equivalents</b>	<b>89,220</b>	<b>267,034</b>	<b>72,217</b>	<b>245,322</b>

Cash and cash equivalents are short term funds held with New Zealand registered international banks.

### 12 Investments

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Bank deposits	24,327	10,577	24,327	10,577
Public securities and corporate bonds	-	6,256	-	6,256
Local authority stock	-	998	-	998
<b>Total investments</b>	<b>24,327</b>	<b>17,831</b>	<b>24,327</b>	<b>17,831</b>

### 13 Investment properties

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Opening balance	34,499	-	-	-
Acquisitions	23,584	34,499	-	-
Additional capital expenditure	2,153	-	-	-
Sales	(832)	-	-	-
Change in fair value	(3,900)	-	-	-
<b>Closing balance</b>	<b>55,504</b>	<b>34,499</b>	<b>-</b>	<b>-</b>

From 31 December 2010, the Heartland Group (through VPS Properties Limited and VPS Parnell Limited) began acquiring investment properties as a result of enforcement of security over finance receivables. The acquisitions by VPS Properties Limited and VPS Parnell Limited were funded by advances from Heartland and MARAC to those acquiring entities. These advances are covered by the RECL management agreement. Refer to Note 26 - Related party transactions for further detail.

The carrying amount of investment properties at 30 June 2012 is the fair value based on independent valuations and current sale and purchase agreements. Valuations have been obtained from the following independent valuers who hold recognised professional qualifications.

Name of valuer	Date of valuation
Bayleys Valuations Limited	01 Jun 12
Bayleys Valuations Limited	12 Jul 12
Sheldon & Partners Limited	19 Jun 12
Gribble Churchton Taylor Limited	21 Jun 12
Telfer Young (Hawkes Bay) Limited	29 Jun 12

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 13 Investment properties (continued)

During the year ended 30 June 2012, the Banking Group recognised rental income of \$4,094,000 (June 2011: \$542,000) included in other income, direct operating expenses of \$2,975,000 (June 2011: \$198,000) arising from investment property that generated rental income and direct operating expenses of \$107,000 (June 2011: nil) arising from investment property that did not generate rental income.

### 14 Finance receivables

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
<b>Non-securitised</b>				
Gross finance receivables	1,828,201	1,535,183	494,737	615,149
Less allowance for impairment	26,693	37,565	17,404	20,762
<b>Total non-securitised finance receivables</b>	<b>1,801,508</b>	<b>1,497,618</b>	<b>477,333</b>	<b>594,387</b>
<b>Securitized</b>				
Gross finance receivables	277,501	210,425	70,651	32,131
Less allowance for impairment	733	732	-	-
<b>Total securitized finance receivables</b>	<b>276,768</b>	<b>209,693</b>	<b>70,651</b>	<b>32,131</b>
<b>Total finance receivables</b>	<b>2,078,276</b>	<b>1,707,311</b>	<b>547,984</b>	<b>626,518</b>

Refer to Note 36 - Business Combinations for information about the acquisition of finance receivables.

### 15 Operating lease vehicles

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
<b>Cost</b>				
Opening balance	47,230	60,264	-	-
Additions	16,905	11,910	-	-
Disposals	(12,899)	(24,944)	-	-
<b>Closing balance</b>	<b>51,236</b>	<b>47,230</b>	-	-
<b>Accumulated depreciation</b>				
Opening balance	14,503	17,369	-	-
Depreciation charge for the year	9,149	10,490	-	-
Disposals	(6,966)	(13,356)	-	-
<b>Closing balance</b>	<b>16,686</b>	<b>14,503</b>	-	-
Opening net book value	32,727	42,895	-	-
<b>Closing net book value</b>	<b>34,550</b>	<b>32,727</b>	-	-

The future minimum lease payments under non-cancellable operating leases not later than one year is \$11,123,000 (2011: \$10,478,000), within one to five years is \$7,635,000 (2011: \$9,011,000) and over five years is \$7,000 (2011: nil).

### 16 Other assets

	NOTE	BANKING GROUP		BANK	
		Jun 2012	Jun 2011	Jun 2012	Jun 2011
		\$000	\$000	\$000	\$000
Derivative financial assets	23	2,122	3,048	2,122	3,048
Trade receivables		3,261	3,351	890	1,610
GST receivable		-	-	288	-
Prepayments		10,474	13,100	1,812	2,807
<b>Total other assets</b>		<b>15,857</b>	<b>19,499</b>	<b>5,112</b>	<b>7,465</b>

### 17 Investment in subsidiaries

Significant subsidiaries	Nature of business	BANK			
		Jun 2012	Jun 2012	Jun 2011	Jun 2011
		% held	\$000	% held	\$000
MARAC Finance Limited	Financial services	100%	204,269	100%	204,269
PGG Wrightson Finance Limited	Financial services	100%	98,013	0%	-
VPS Parnell Limited	Investment property holding company	100%	-	100%	-
VPS Properties Limited	Investment property holding company	100%	-	100%	-
			<b>302,282</b>		<b>204,269</b>
<b>Other controlled entities</b>					
Heartland Cash and Term PIE Fund	Portfolio investment entity				
CBS Warehouse A Trust Securitisation	Special purpose vehicle holding securitised loans purchased from the Bank				
Heartland ABCP Trust 1	Special purpose vehicle holding securitised loans purchased from MARAC				

All subsidiary companies were incorporated in New Zealand.

On 31 August 2011 Heartland acquired 100% of the shares in PWF, an entity specialising in the provision of financial services to the rural sector, refer to Note 36 - Business Combinations for more details.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 18 Intangible assets and goodwill

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
<b>Computer software - cost</b>				
Opening balance	6,142	3,722	1,144	-
Additions	2,370	1,337	2,075	61
Acquired on amalgamation	-	1,083	-	1,083
Disposals	(1,764)	-	(12)	-
<b>Closing balance</b>	<b>6,748</b>	<b>6,142</b>	<b>3,207</b>	<b>1,144</b>
<b>Computer software - accumulated amortisation</b>				
Opening balance	4,727	2,821	1,115	-
Amortisation charge for the year	1,075	978	178	187
Acquired on amalgamation	-	928	-	928
Disposals	(1,764)	-	(12)	-
<b>Closing balance</b>	<b>4,038</b>	<b>4,727</b>	<b>1,281</b>	<b>1,115</b>
Computer software - opening net book value	1,415	901	29	-
<b>Computer software - closing net book value</b>	<b>2,710</b>	<b>1,415</b>	<b>1,926</b>	<b>29</b>
<b>Goodwill and trademark</b>				
Opening balance	20,187	-	20,187	-
Additions	100	46	100	46
Acquired on amalgamation	-	20,141	-	20,141
<b>Closing balance</b>	<b>20,287</b>	<b>20,187</b>	<b>20,287</b>	<b>20,187</b>
Total intangible assets and goodwill - opening net book value	21,602	901	20,216	-
<b>Total intangible assets and goodwill - closing net book value</b>	<b>22,997</b>	<b>21,602</b>	<b>22,213</b>	<b>20,216</b>

On 5 January 2011, 100% of each of SCBS and CBS amalgamated to form Heartland, refer to Note 36 - Business Combinations. As part of this amalgamation \$20.1 million of goodwill was recognised.

Goodwill of \$20.1 million has not been allocated to individual cash generating units, as the future economic benefit is attributable to all business units. The Banking Group's management and Board continue to monitor goodwill at a group level.

### 19 Property, plant and equipment

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
<b>Cost</b>				
Opening balance	15,191	4,284	10,474	-
Additions	735	448	711	4
Acquired on acquisition	22	-	-	-
Acquired on amalgamation	-	10,470	-	10,470
Disposals	(2,787)	(11)	-	-
<b>Closing balance</b>	<b>13,161</b>	<b>15,191</b>	<b>11,185</b>	<b>10,474</b>
<b>Accumulated depreciation</b>				
Opening balance	5,112	3,764	1,041	-
Depreciation charge for the year	755	504	531	186
Acquired on amalgamation	-	855	-	855
Disposals	(2,773)	(11)	-	-
<b>Closing balance</b>	<b>3,094</b>	<b>5,112</b>	<b>1,572</b>	<b>1,041</b>
Opening net book value	10,079	520	9,433	-
<b>Closing net book value</b>	<b>10,067</b>	<b>10,079</b>	<b>9,613</b>	<b>9,433</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 20 Deferred tax

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Property, plant and equipment	-	67	-	-
Employee entitlements	1,201	584	1,009	1
Finance receivables	7,475	4,984	4,873	280
Trade and other payables	152	145	152	90
Investment properties	1,054	-	-	-
Derivatives held for risk management	392	527	-	-
<b>Tax assets</b>	<b>10,274</b>	<b>6,307</b>	<b>6,034</b>	<b>371</b>
Property, plant and equipment	877	-	928	-
Intangible assets	52	67	23	-
Operating lease vehicles	1,202	1,537	-	-
<b>Tax liabilities</b>	<b>2,131</b>	<b>1,604</b>	<b>951</b>	<b>-</b>
<b>Net tax assets</b>	<b>8,143</b>	<b>4,703</b>	<b>5,083</b>	<b>371</b>

The corporate tax rate changed from 30% to 28% effective 1 July 2011. The tax effect on the temporary differences reported above, that did not reverse prior to this change in tax rate, was a decrease in the Banking Group's deferred tax asset of \$336,000 in June 2011.

All deferred tax movements are included in profit or loss except for those in respect of the available for sale and hedging reserves which are recognised in other comprehensive income.

### 21 Borrowings

#### (a) Concentration of funding by product

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Bank borrowings	50,010	-	50,010	-
Deposits	1,625,120	1,593,247	1,625,569	1,593,731
Securitised borrowings	264,359	194,277	75,000	20,000
<b>Total borrowings</b>	<b>1,939,489</b>	<b>1,787,524</b>	<b>1,750,579</b>	<b>1,613,731</b>

The Banking Group has bank facilities totalling \$650.0 million (June 2011: \$475.0 million).

Bank facilities and deposits (which include NZDX bonds) rank equally and are unsecured. The terms of all deposits issued by the Bank (other than the NZDX bonds) are set out in the appendix to a Supplemental Trust Deed (Accounts) dated 29 October 2010. The terms of the NZDX bonds are set out in the deed poll in schedule 5 of the Master Trust Deed dated 29 October 2010 and a Supplemental Trust Deed (Bonds) dated 29 October 2010.

The Banking Group has securitisation facilities in relation to the Trusts totalling \$450.0 million. On 27 February 2012, the Heartland Group entered into an agreement with its securitisation facility provider to extend the maturity date of ABCP Trust \$300 million securitisation facility to 6 February 2013. On 19 December 2011, Heartland entered into an agreement to increase CBS Trust securitisation facility by \$100 million to \$175 million. \$25m of this increase matured on 1 April 2012. The maturity date of the remaining \$150 million CBS Trust securitisation facility is 22 July 2013.

Investors in ABCP Trust rank equally with each other and are secured over the securitised assets of that trust. Investors in CBS Trust rank equally with each other and are secured over the securitised assets of that trust.

#### (b) Concentration of funding by geographical area

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Auckland	442,727	387,419	379,139	330,550
Wellington	240,758	250,735	114,984	133,327
Rest of North Island	325,091	339,133	325,091	339,133
Canterbury	681,474	615,276	681,926	615,760
Rest of South Island	173,787	134,182	173,787	134,182
Overseas	75,652	60,779	75,652	60,779
<b>Total borrowings</b>	<b>1,939,489</b>	<b>1,787,524</b>	<b>1,750,579</b>	<b>1,613,731</b>

### 22 Trade and other payables

	NOTE	BANKING GROUP		BANK	
		Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
Derivative financial liabilities	23	1,459	2,444	415	1,127
Trade payables		13,432	13,010	8,447	9,104
GST payable		14,028	13,790	-	183
Employee benefits		4,595	2,563	3,970	520
<b>Total trade and other payables</b>		<b>33,514</b>	<b>31,807</b>	<b>12,832</b>	<b>10,934</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 23 Derivative financial instruments

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
Qualifying fair value hedges - non-securitised	2,122	3,048	2,122	3,048
<b>Total derivative financial assets</b>	<b>2,122</b>	<b>3,048</b>	<b>2,122</b>	<b>3,048</b>
Qualifying fair value hedges - non-securitised	297	979	297	979
Qualifying fair value hedges - securitised	118	148	118	148
Qualifying cash flow hedges - securitised	1,044	1,317	-	-
<b>Total derivative financial liabilities</b>	<b>1,459</b>	<b>2,444</b>	<b>415</b>	<b>1,127</b>

Derivatives consist of interest rate swaps held to manage the Banking Group's exposure to interest rate repricing risk on its interest bearing assets and liabilities.

The Banking Group uses interest rate swaps to hedge the interest rate risk arising from its commercial paper issuance and its current and future floating rate bank debt and designates those swaps as qualifying cash flow hedges. The Banking Group uses interest rate swaps to hedge the interest rate risk arising from deposits and fixed rate mortgage loans and designates these swaps as qualifying fair value hedges.

Securitised derivatives are held in the name of the Trusts to hedge the interest rate risk arising in the Trusts.

### 24 Share capital

The share capital reflected in the following note represents the share capital of the Bank. This differs from the share capital reflected in the Banking Group's Statements of Financial Position as a result of the reverse acquisition accounting applied, refer Note 1 - Reporting entity.

	BANK	
	Jun 2012	Jun 2011
	Number of shares 000	Number of shares 000
<b>Issued shares</b>		
Opening balance	297,400	-
Shares issued during the year	55,000	297,400
<b>Closing balance</b>	<b>352,400</b>	<b>297,400</b>

At the opening of business on 5 January 2011, the Bank had on issue 20 fully paid ordinary shares, which were issued at a price of \$10,000 each.

On 5 January 2011, Heartland:

- Issued 214,030,283 fully paid ordinary shares to BSHL No. 1 Limited in exchange for the transfer by BSHL No. 1 Limited of all shares in MARAC.
- Issued 44,241,396 fully paid ordinary shares to CBS as part of the consideration due in exchange for the transfer of engagements from CBS. These shares were then transferred by CBS to BSHL No. 1 Limited.
- Issued 39,128,321 fully paid ordinary shares to SCBS as part of the consideration due in exchange for transfer of engagements from SCBS. These shares were then transferred by SCBS to BSHL No. 1 Limited.

On 31 August 2011, BSHL No. 1 Limited subscribed for 55,000,000 fully paid ordinary shares in the Bank issued at a price of \$1 each.

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

### 25 Special purpose entities

#### *Heartland Cash and Term PIE Fund*

The Banking Group controls the operations of the Heartland Cash and Term PIE Fund, a portfolio investment entity that invests in the Bank's deposits. Investments of Heartland Cash and Term PIE Fund are represented as follows:

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
Deposits	12,347	6,517	12,347	6,517

#### *Heartland ABCP Trust 1 and CBS Warehouse A Trust Securitisation*

The Banking Group has securitised a pool of receivables comprising residential, commercial and motor vehicle loans to the Trusts. The Banking Group substantially retains the credit risks and rewards associated with the securitised assets, and continues to recognise these assets and associated borrowings on the Statements of Financial Position. Despite this presentation in the financial statements, the loans sold to the Trusts are set aside for the benefit of investors in the Trusts and are represented as follows:

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
Cash and cash equivalents - Securitised	15,579	15,830	11,147	1,367
Finance receivables - Securitised	276,768	209,693	70,651	32,131
Borrowings - Securitised	(264,359)	(194,277)	(75,000)	(20,000)

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 26 Related party transactions

The Bank's immediate parent is BSHL No. 1 Limited, which is a wholly owned subsidiary of HNZ. The Bank holds all shares in MARAC and PWF, refer to Note 17 - Investment in subsidiaries.

#### Former related parties

Until 5 January 2011 the immediate parent of MARAC was MARAC Financial Services Limited (MFSL). MFSL's ultimate parent is Pyne Gould Corporation Limited (PGC). On 30 May 2011, PGC distributed directly to PGC shareholders its 72.21% stake in HNZ. As a result from 30 May 2011, PGC and its subsidiaries (including Real Estate Credit Limited) are no longer related parties of the Banking Group, however material transactions in respect of these former related parties are disclosed below.

#### (a) Transactions with former related parties

##### *Real Estate Credit Limited (RECL) Management agreement*

On 5 January 2011, MARAC entered into a management agreement with RECL. The agreement (as previously amended) was further amended on 19 October 2011. Under this arrangement, RECL manages certain non-core real estate loans (not previously sold in September 2009) of MARAC for a 5 year period (ending 5 January 2016), and assumes the risk of loss on those loans for that period. Any payment by RECL to MARAC in respect of that loss is due at the end of the 5 year period (with some limited right on the part of MARAC to earlier payment). The maximum amount payable by RECL in respect of loss (including interest accruing on loss payments until the due date for payment) is limited to \$30 million. The payment obligations of RECL are "limited in recourse" to a pool of security provided by RECL. This pool of security includes an \$11 million 5 year zero coupon bond (issued by Westpac New Zealand Limited which is rated AA- by Standard & Poor's (Australia) Pty Limited), and other assets (initially real estate or real estate loans) with a required minimum security value of (initially) \$19 million. PGC will be obliged to top up the security pool to the extent that the security value of other assets is less than the minimum required.

MARAC paid RECL an upfront fee of \$11 million (which will be amortised over the 5 year period of the arrangement), and will pay an ongoing management fee of \$200,000 per annum for the 5 year period.

The benefit of this management agreement is included in the determination of the charge and the analysis of risk gradings and the classification of individually impaired assets as at 30 June 2012. In September 2011, RECL paid \$1.5 million cash for claims to MARAC. This payment reduced the required minimum security value of other assets to \$17.5 million.

From 31 December 2010, the Banking Group (through VPS Properties Limited and VPS Parnell Limited) began acquiring investment properties as a result of enforcement of security over finance receivables. The acquisitions by VPS Properties Limited and VPS Parnell Limited were funded by advances from the Bank and MARAC to those acquiring entities. These advances are covered by the RECL management agreement.

#### (b) Transactions with related parties

On 5 January 2011, all secured debenture stock issued by MARAC was transferred to become deposits in Heartland. On 31 August 2011, all borrowings issued by PWF were also transferred to become deposits in Heartland, refer to Note 36 - Business Combinations.

Advances have been made by the Bank and MARAC to VPS Parnell Limited and VPS Properties Limited for the purchase of investment properties, refer Note 13 - Investment Properties. VPS Parnell Limited invests in the Bank's deposits.

Shares have been issued to the Bank's immediate parents, refer to Note 24 - Share Capital.

MARAC provided administrative assistance to RECL, MARAC Insurance Limited and Heartland Cash and Term PIE Fund, and received insurance commission from MARAC Insurance Limited.

MARAC Insurance Limited and some key management personnel invested in the Bank's deposits. The investments of Heartland Cash and Term PIE Fund are detailed in Note 25. Key management personnel investments are detailed in Note 26(c).

The Bank charged MARAC and PWF for personnel expenses incurred for centralised management and support services.

All transactions were conducted on normal commercial terms and conditions, except that no interest is charged on intragroup balances.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 26 Related party transactions (continued)

#### (b) Transactions with related parties (continued)

Material related party transactions	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Previous parent and previous ultimate parent</b>				
Interest income - MFSL	-	2,976	-	-
Selling and administration expenses - PGC	-	(2,494)	-	-
<b>Immediate parent</b>				
Due from BSHL No. 1 Limited	200	200	200	200
<b>Ultimate parent</b>				
Due from Heartland New Zealand Limited	76	-	76	-
Due to Heartland New Zealand Limited	193	-	-	-
<b>Subsidiaries</b>				
Other income	-	-	8,739	-
Due from subsidiaries	-	-	1,107,581	740,617
Due to subsidiaries	-	-	770	-
<b>Other related parties</b>				
Lending and credit fee income	368	481	-	-
Other income	328	207	-	-
Interest expense	-	(130)	-	-
Selling and administration expenses	-	(1,000)	-	-
<b>Total transactions with other related parties</b>	<b>696</b>	<b>(442)</b>	<b>-</b>	<b>-</b>
Due to other related parties	-	104	-	-
<b>Total due from related entities</b>	<b>276</b>	<b>200</b>	<b>1,107,857</b>	<b>740,817</b>
<b>Total due to related entities</b>	<b>193</b>	<b>104</b>	<b>770</b>	<b>-</b>

#### (c) Transactions with key management personnel

Key management personnel, being directors of the Bank and those staff reporting directly to the Chief Executive Officer and their immediate relatives, have transacted with the Banking Group during the year as follows:

	BANKING GROUP		BANK	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>Deposit investments by key management personnel:</b>				
Maximum balance	777	409	777	409
Closing balance	468	385	468	385
<b>Loans to key management personnel:</b>				
Closing balance	304	304	304	304
<b>Key management personnel interest expense and compensation is as follows:</b>				
Interest expense	21	20	21	20
Short-term employee benefits	4,570	2,353	4,570	185
Share-based payments	91	287	91	-
<b>Total</b>	<b>4,682</b>	<b>2,660</b>	<b>4,682</b>	<b>205</b>

### 27 Fair value

The following methods and assumptions were used to estimate the fair value of each class of financial asset and liability.

#### Finance receivables

The fair value of the Banking Group's finance receivables is calculated using a valuation technique which assumes current market interest rates for loans of a similar nature and term.

The current market rate used to fair value finance receivables with a fixed interest rate for the Banking Group is 9.06% (June 2011: 9.51%) and for the Bank is 6.60% (June 2011: 7.99%). 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.

#### Investments

Investments in public securities and corporate bonds are classified as being available for sale and are stated at fair value less impairment, with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy).

#### Other financial assets and liabilities

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

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 27 Fair value (continued)

#### Derivative items

The fair value of interest rate contracts is modelled using observable market inputs (Level 2 under the fair value hierarchy).

#### 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.

	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
<b>BANKING GROUP - Jun 2012</b>						
Cash and cash equivalents	-	89,220	-	-	89,220	89,220
Investments	-	-	24,327	-	24,327	24,327
Finance receivables	-	1,801,508	-	-	1,801,508	1,800,616
Finance receivables - securitised	-	276,768	-	-	276,768	281,104
Derivative financial assets	2,122	-	-	-	2,122	2,122
Other financial assets	-	3,537	-	-	3,537	3,537
<b>Total financial assets</b>	<b>2,122</b>	<b>2,171,033</b>	<b>24,327</b>	<b>-</b>	<b>2,197,482</b>	<b>2,200,926</b>
Borrowings	-	-	-	1,675,130	1,675,130	1,681,134
Borrowings - securitised	-	-	-	264,359	264,359	264,359
Derivative financial liabilities	1,459	-	-	-	1,459	1,459
Other financial liabilities	-	-	-	18,220	18,220	18,220
<b>Total financial liabilities</b>	<b>1,459</b>	<b>-</b>	<b>-</b>	<b>1,957,709</b>	<b>1,959,168</b>	<b>1,965,172</b>
<b>BANKING GROUP - Jun 2011</b>						
Cash and cash equivalents	-	267,034	-	-	267,034	267,034
Investments	-	-	17,831	-	17,831	17,831
Finance receivables	-	1,497,618	-	-	1,497,618	1,511,777
Finance receivables - securitised	-	209,693	-	-	209,693	215,743
Derivative financial assets	3,048	-	-	-	3,048	3,048
Other financial assets	-	3,551	-	-	3,551	3,551
<b>Total financial assets</b>	<b>3,048</b>	<b>1,977,896</b>	<b>17,831</b>	<b>-</b>	<b>1,998,775</b>	<b>2,018,984</b>
Borrowings	-	-	-	1,593,247	1,593,247	1,598,815
Borrowings - securitised	-	-	-	194,277	194,277	194,277
Derivative financial liabilities	2,444	-	-	-	2,444	2,444
Other financial liabilities	-	-	-	15,677	15,677	15,677
<b>Total financial liabilities</b>	<b>2,444</b>	<b>-</b>	<b>-</b>	<b>1,803,201</b>	<b>1,805,645</b>	<b>1,811,213</b>
<b>BANK - Jun 2012</b>						
Cash and cash equivalents	-	72,217	-	-	72,217	72,217
Investments	-	-	24,327	-	24,327	24,327
Finance receivables	-	477,333	-	-	477,333	477,453
Finance receivables - securitised	-	70,651	-	-	70,651	70,471
Due from related parties	-	1,107,857	-	-	1,107,857	1,107,857
Derivative financial assets	2,122	-	-	-	2,122	2,122
Other financial assets	-	890	-	-	890	890
<b>Total financial assets</b>	<b>2,122</b>	<b>1,728,948</b>	<b>24,327</b>	<b>-</b>	<b>1,755,397</b>	<b>1,755,337</b>
Borrowings	-	-	-	1,675,579	1,675,579	1,681,134
Borrowings - securitised	-	-	-	75,000	75,000	75,000
Derivative financial liabilities	415	-	-	-	415	415
Other financial liabilities	-	-	-	13,187	13,187	13,187
<b>Total financial liabilities</b>	<b>415</b>	<b>-</b>	<b>-</b>	<b>1,763,766</b>	<b>1,764,181</b>	<b>1,769,736</b>



## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 27 Fair value (continued)

	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
<b>BANK - Jun 2011</b>						
Cash and cash equivalents	-	245,322	-	-	245,322	245,322
Investments	-	-	17,831	-	17,831	17,831
Finance receivables	-	594,387	-	-	594,387	595,189
Finance receivables - securitised	-	32,131	-	-	32,131	32,031
Due from related parties	-	740,817	-	-	740,817	740,817
Derivative financial assets	3,048	-	-	-	3,048	3,048
Other financial assets	-	1,610	-	-	1,610	1,610
<b>Total financial assets</b>	<b>3,048</b>	<b>1,614,267</b>	<b>17,831</b>	<b>-</b>	<b>1,635,146</b>	<b>1,635,848</b>
Borrowings	-	-	-	1,593,731	1,593,731	1,599,389
Borrowings - securitised	-	-	-	20,000	20,000	20,000
Derivative financial liabilities	1,127	-	-	-	1,127	1,127
Other financial liabilities	-	-	-	9,624	9,624	9,624
<b>Total financial liabilities</b>	<b>1,127</b>	<b>-</b>	<b>-</b>	<b>1,623,355</b>	<b>1,624,482</b>	<b>1,630,140</b>

### 28 Risk management policies

The Banking Group is committed to the management of risk. The primary risk categories are credit, liquidity, market (including interest rate) and operational. The Banking Group's risk management strategy is set by the Board. The Banking Group has put in place management structures and information systems to manage risks incorporated in the Banking Group's Risk Management Programme (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 Risk Committee

The Board, through its Risk Committee, is responsible for the overall risk management process and the development of the RMP. The role of the Risk Committee is to assist the Board to formulate its risk appetite, understand the risks the Banking Group faces for each strategic, credit, liquidity, market (including interest rate), regulatory, financial, operational and reputational risk and to ensure that all policy and decisions are made in accordance with the Banking Group's corporate values and guiding principles. The Risk Committee has the following responsibilities:

- To oversee the Banking Group's risk profile and review and approve the Banking Group's Risk Management Framework within the context of the risk-reward strategy determined by the Board at least annually.
- To make recommendations regarding high-level liquidity / capital / funding policies and strategy, including the use of securitisation and special investment vehicles.
- To agree and recommend for Board approval and annual review; a set of risk limits and conditions that apply to the taking of risk, as delegated to the Risk Committee by the Board, that are consistent with the Board's determined risk appetite. This includes the authorities delegated by the Board to the Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Risk Officer (CRO) and any other officers of the Bank to whom the Board or the Committee have delegated authority, and to consider and accept risks beyond management's approval discretion where deemed appropriate.
- To monitor the risk profile, performance, capital levels, exposures against limits and the management and control of the Banking Group's risks.
- To review significant correspondence with the Banking Group's regulators, and receive reports from management on the Banking Group's regulatory relations and report any significant issues to the Board.
- To monitor changes anticipated in the economic and business environment and other factors considered relevant to the Banking Group's risk profile and capital adequacy.
- To review significant risk management issues that are raised in external or internal audits as well as the length of time and action taken to resolve such issues.
- To ensure an appropriate set of applicable corporate governance principles are developed, and reviewed on a regular basis.

The Risk Committee consists of four directors, of which at least three are non-executive directors and two are independent directors. In addition the CEO, CRO and CFO are in attendance at meetings. The Risk Committee meets at least bi-monthly to review identified risk issues, and reports directly to the Board. A member of the Risk Committee sits on the Audit Committee and vice versa.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 28 Risk management policies (continued)

#### **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 and additional services designed to add value and improve the Banking Group's operations. It assists the Banking Group to accomplish 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 granted 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 testing has been implemented to cover all areas of the business. Its focus is on assessment, management and control of risks. The intention is to cycle through various business units and operational areas on a pre-set and agreed cycle relative to assessed risk, looking at the specific internal control issues pertinent to the area, with a requirement to meet or exceed the Standards for the Professional Practice of Internal Auditing of The Institute of Internal Auditors.

Each audit has a separate audit programme tailored to the area of business that is being reviewed. The audit programmes 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 programme.

All internal audit reports are addressed to the manager of the relevant area that is being audited. 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 CFO. A schedule of all outstanding internal control issues is maintained and presented to the Audit Committee to assist the Audit Committee to track the resolution of previously identified issues. Any issues raised that are categorised as high risk are specifically reviewed by internal audit during a follow-up review once the issue is considered closed by management. The follow-up review is performed with a view to formally close out the issue.

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

Charters for the Risk and 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), CFO, CRO, Head of Treasury & Strategy, Treasurer, Head of Retail, Head of Business and Head of Rural. The ALCO has responsibility for overseeing aspects of the Bank's financial position risk management. The purpose of the ALCO is to support the Risk Committee with specific responsibilities for decision making and oversight of risk matters in relation to:

- Financial position structure;
- Non-traded interest rate risk (including the investment of capital);
- Liquidity and funding; and
- Capital management.

The ALCO usually meets monthly, and reports to the Risk Committee.

#### **Specific areas of risk management**

##### **Credit risk**

Credit risk is the risk of loss arising from the non-performance of a counterparty to an instrument or facility. Credit risk arises when funds are extended, committed, invested or otherwise exposed through contractual arrangements, and encompasses both on and off balance sheet instruments. Credit risk is managed to achieve sustainable and superior 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 sound commercial judgement as described in Note 29 - Credit risk exposure.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

## 28 Risk management policies (continued)

### **Market risk**

The Banking Group's market risk arises primarily due to significant 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.

Interest rate risk is the risk that the value of assets or liabilities will change because of changes in interest rates. 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. Market interest rates may change and thus alter the margin between interest-earning assets and interest-bearing liabilities.

The Banking Group's exposure to market risk is governed by a policy approved by the Board as part of the RMP 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 (derivative or synthetic hedging).

### **Liquidity risk**

Liquidity risk is the risk that under certain conditions, cash outflows can exceed cash inflows in a given period. The Banking Group maintains sufficient liquid funds to meet its commitments based on historical and budgeted cash flow forecasts. Management of liquidity risk is achieved by maintaining a prudent level of liquid assets, use of committed and uncommitted wholesale funding facilities, utilisation of securitisation vehicles and management control of the growth of the business.

The Banking Group's liquidity risks are governed by a Board approved liquidity strategy that defines policy, systems and procedures for measuring, assessing, reporting and managing liquidity. This also includes a formal contingency plan for dealing with a liquidity crisis.

### **Operational risk**

Operational risk is the risk arising from day to day operational activities which may result in direct or indirect loss. Operational risk losses occur as the 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, or loss of staff or clients. 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 risk, the Banking Group operates a "three lines of defence" model which outlines principles for the roles, responsibilities and accountabilities for operational risk management:

- The first line of defence is the business line management for 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 Operational Risk function, responsible for the design and ownership of the Operational Risk Policies. It incorporates key processes including risk and control assessment, scenario analysis, loss data collection, new product approval process, key risk indicators, notifiable events process, and the self-certification process.
- The third line of defence is audit. Internal Audit is responsible for assessing compliance with policy frameworks and for providing independent evaluation of the adequacy and effectiveness of the risk and control framework.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

## 29 Credit risk exposure

### Credit risk management framework

Credit risk is the risk of financial loss to the Banking Group caused by the failure of a customer to meet their contractual obligations that arise from the Banking Group's lending activities. Credit risk carries the greatest risk of resulting in a material adjustment to the carrying amounts of the Banking Group's assets within the next financial year.

To manage this risk the Risk Committee, a committee of the Board, has been delegated the task of overseeing a formal credit risk management strategy. The Risk Committee reviews the Banking Group's credit risk exposures to ensure consistency with the Banking Group's credit policies to manage all aspects of credit risk.

### Reviewing and assessing 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.

### Lending standards and processes

The Banking Group has adopted a detailed Credit Policy Framework supported by Lending Standards providing criteria for finance products within each business sector. The combination of the Credit Policy Framework and Lending Standards guides credit assessment, credit risk grading, documentation standards, legal procedures and compliance with regulatory and statutory requirements.

The Risk Committee has authority from the Board for approval of all credit exposures. Lending authority has been individually provided to the Chief Risk Officer, 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. 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 CRO or the Risk Committee.

### Collateral requirements

Although the Banking Group relies primarily on the integrity of borrowers and their ability to make contracted repayments, the Banking Group also requires appropriate collateral for loans. This collateral is usually by way of first charge over the asset financed and usually includes personal guarantees from borrowers and business owners.

Because of the wide nature of the collateral held against loans it is impractical to provide an accurate estimate of their fair value.

### 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 mainly of consumer and retail receivables and usually relates to financing 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. Behavioural loans are risk graded based on arrears status.

The Judgement portfolio consists mainly of business and rural lending and includes non-core property. Judgement loans relate to loans where an ongoing 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. Previously, the risk grading mechanism used a credit risk grade scale of 1 to 7 and classified loans as Transactional or Relationship. During the year, the risk grades have been revised to a more comprehensive 10 point scale model which better represents the Banking Group's risk profile.

In the Judgement portfolio, grade 1 is the strongest risk grade for undoubted risk and grade 9 represents the highest 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.

The Banking Group raises provisions based on historical loss experience for loans risk graded in grades 6 to 8. Loans in grade 9 of the Judgement portfolio are individually assessed for impairment.

### (a) Credit impairment provisioning

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.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

## 29 Credit risk exposure (continued)

### (a) Credit impairment provisioning (continued)

#### Collective provisioning

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.

For Behavioural loans, as arrears drive provision outcomes, the trend in arrears behaviour is an indicator of future provisioning impact. Behavioural loans are classified as either not in arrears, active, arrangement, repossession or recovery. Each arrears classification carries a provision for potential loss based on historical experience for that classification in the same portfolio. Retail mortgages currently carry no provision based on historical loss experience, however a general collective provision is held against this group of loans. The categories are 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.

Judgement loans in grades 6 to 8 ordinarily attract a collective provision based on risk grading overlaid with the strength of security position, except for risk grades 6 which have strong security and accordingly attract no collective provision (typically rural exposures). Other collective provisions are also maintained where considered appropriate against a class of loans or those with common risk characteristics. Judgement loans with a risk grade of 1 to 5 may be past due and not attract a provision if the Banking Group has reviewed the risk position and it is deemed to remain sound. Under such circumstances normally an amended credit risk grade will result.

No provision is 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.

Individual provisioning in regards to property development lending creates the greatest amount of risk resulting in the possibility of a material adjustment to the carrying amounts of the Banking Group's assets within the next year. Estimating the timing and amount of future cash repayments and proceeds from the realisation of collateral are management's most difficult and subjective judgements. Reduced demand in the current environment has meant that value is difficult to determine. Subjective judgements made by management comprise the time taken for new sales being achieved and the amount received, determining the timing and amount of future cash flows.

Because of the wide nature of the collateral held, and the subjective judgements in determining future cash flows on each individually impaired loan, it is impracticable to provide management's assumptions in regards to property receivables as a whole.

#### Bad debts

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 comprehensive income. Any future recoveries of amounts provided for are taken to comprehensive income.

#### Concentration of credit risk

During the year ended 30 June 2012 the Banking Group has amended disclosure in respect of credit risk concentrations to better reflect the risk characteristics of the Banking Group. The Banking Group has the following credit risk concentrations:

#### Corporate

##### Rural

Corporate lending to the farming sector primarily offering livestock, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.

##### Non-core Property

Non core property assets of MARAC and the Bank.

##### Other

All other corporate lending.

#### Residential

A loan 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

All other loans to individuals.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (b) Concentrations of credit risk

##### Verification

In addition to regular internal audit activity in regards to credit standards, the Banking Group employs a comprehensive process of hindsighting loans to ensure that credit policies and the quality of credit processes are maintained.

Disclosures in this credit risk exposure note represent the Banking Group's maximum exposure to credit risk.

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

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
Cash and cash equivalents	89,220	267,034	72,217	245,322
Investments	24,327	17,831	24,327	17,831
Due from related parties	276	200	1,107,857	740,817
Finance receivables	2,078,276	1,707,311	547,984	626,518
Derivative financial assets	2,122	3,048	2,122	3,048
Other financial assets	3,261	3,351	890	1,610
<b>Total on balance sheet credit exposures</b>	<b>2,197,482</b>	<b>1,998,775</b>	<b>1,755,397</b>	<b>1,635,146</b>

The above 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 Statements of Financial Position.

#### (ii) Concentration of credit risk by geographic region

	BANKING GROUP		BANK	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000
Auckland	646,175	685,138	178,996	266,115
Wellington	119,736	224,717	23,141	116,776
Rest of North Island	480,287	400,996	70,517	80,319
Canterbury	583,848	528,180	336,594	404,172
Rest of South Island	363,899	156,193	37,402	25,337
<b>Total financial assets</b>	<b>2,193,945</b>	<b>1,995,224</b>	<b>646,650</b>	<b>892,719</b>
Other financial assets	3,261	3,351	890	1,610
Due from related parties	276	200	1,107,857	740,817
<b>Total on balance sheet credit exposures</b>	<b>2,197,482</b>	<b>1,998,775</b>	<b>1,755,397</b>	<b>1,635,146</b>

#### (iii) Concentration of credit risk by industry sector

	Non-securitised		Securitised		Total	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000	\$000	\$000
<b>BANKING GROUP</b>						
Agriculture	530,226	150,608	999	959	531,225	151,567
Forestry and Fishing	22,676	16,470	13	24	22,689	16,494
Mining	16,227	11,066	46	12	16,273	11,078
Manufacturing	73,280	60,160	515	1,051	73,795	61,211
Electricity, Gas, Water and Waste Services	4,751	3,938	68	111	4,819	4,049
Construction	162,045	195,100	167	624	162,212	195,724
Wholesale Trade	42,407	57,483	94	59	42,501	57,542
Retail Trade	122,150	114,976	495	756	122,645	115,732
Accommodation & Food Services	27,915	19,779	21	19	27,936	19,798
Transport, Postal and Warehousing	98,802	101,871	479	1,365	99,281	103,236
Households	407,027	513,852	272,134	203,613	679,161	717,465
Financial and Insurance Services	128,476	306,412	15,735	15,990	144,211	322,402
Rental, Hiring and Real Estate Services	176,930	125,876	707	23	177,637	125,899
Professional, Scientific and Technical Services	25,621	34,779	281	378	25,902	35,157
Administrative and Support Services	1,600	188	-	-	1,600	188
Public Administration and Safety	607	4,102	1	95	608	4,197
Education and Training	13,604	10,287	172	205	13,776	10,492
Health Care and Social Assistance	2,564	9,591	-	-	2,564	9,591
Arts and Recreation Services	15,630	9,615	210	21	15,840	9,636
Information, Media and Telecommunications	10,547	441	-	-	10,547	441
Other Services	22,017	26,623	243	253	22,260	26,876
<b>Total on balance sheet credit exposures</b>	<b>1,905,102</b>	<b>1,773,217</b>	<b>292,380</b>	<b>225,558</b>	<b>2,197,482</b>	<b>1,998,775</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (b) Concentration of credit risk (continued)

##### (iii) Concentration of credit risk by industry sector (continued)

	Non-securitised		Securitised		Total	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000	\$000	\$000
<b>BANK</b>						
Agriculture	45,291	53,891	-	-	45,291	53,891
Forestry and Fishing	7,187	509	-	-	7,187	509
Mining	249	-	-	-	249	-
Manufacturing	2,166	2,324	-	-	2,166	2,324
Electricity, Gas, Water and Waste Services	137	338	-	-	137	338
Construction	32,873	42,051	-	-	32,873	42,051
Wholesale Trade	2,135	89	-	-	2,135	89
Retail Trade	4,335	3,590	-	-	4,335	3,590
Accommodation & Food Services	16,195	12,878	-	-	16,195	12,878
Transport, Postal and Warehousing	6,957	1,133	-	-	6,957	1,133
Households	256,707	341,391	70,252	31,977	326,959	373,368
Financial and Insurance Services	1,197,254	1,026,699	11,147	1,367	1,208,401	1,028,066
Rental, Hiring and Real Estate Services	79,354	86,412	-	-	79,354	86,412
Professional, Scientific and Technical Services	893	956	-	-	893	956
Administrative and Support Services	137	164	-	-	137	164
Education and Training	157	206	-	-	157	206
Health Care and Social Assistance	2,002	9,576	-	-	2,002	9,576
Arts and Recreation Services	152	10	160	-	312	10
Information, Media and Telecommunications	508	440	-	-	508	440
Other Services	18,908	18,989	241	156	19,149	19,145
<b>Total on balance sheet credit exposures</b>	<b>1,673,597</b>	<b>1,601,646</b>	<b>81,800</b>	<b>33,500</b>	<b>1,755,397</b>	<b>1,635,146</b>

##### (iv) Credit exposure to individual counterparties

At 30 June 2012 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) (June 2011: nil).

The peak aggregate end-of-day credit exposures 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.

##### (v) Credit exposures to connected persons

	BANKING GROUP	
	Jun 2012	Jun 2011
Credit exposures to non-bank connected persons at year end	276	202
Credit exposures to non-bank connected persons at year end (% of total Tier One Capital)	0.08%	0.07%
Peak credit exposures to non-bank connected persons during the quarter	276	490
Peak credit exposures to non-bank connected persons during the quarter (% of total Tier One Capital)	0.08%	0.18%

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 one capital at 30 June 2012.

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 one 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 2012 (June 2011: \$nil).

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

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

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (c) Credit impairment provisioning

##### (i) Provision for impaired assets

	Non-securitised		Securitised		Total	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>BANKING GROUP</b>						
<b>Provision for individually impaired assets</b>						
Opening individual impairment	26,149	17,465	8	366	26,157	17,831
Impairment loss for the year						
- charge for the year	6,920	20,223	1	93	6,921	20,316
- recoveries	227	117	-	-	227	117
- write offs	(14,636)	(19,844)	-	(451)	(14,636)	(20,295)
- assumed on acquisition	1,284	-	-	-	1,284	-
- assumed on amalgamation	-	10,049	-	-	-	10,049
- effect of discounting	(559)	(1,861)	-	-	(559)	(1,861)
<b>Closing individual impairment</b>	<b>19,385</b>	<b>26,149</b>	<b>9</b>	<b>8</b>	<b>19,394</b>	<b>26,157</b>
<b>Provision for collectively impaired assets</b>						
Opening collective impairment	11,416	11,765	724	752	12,140	12,517
Impairment loss for the year						
- (credit) / charge for the year *	(1,897)	(7,548)	618	530	(1,279)	(7,018)
- recoveries	322	264	29	36	351	300
- assumed on amalgamation	-	12,927	-	-	-	12,927
- write offs	(2,533)	(5,992)	(647)	(594)	(3,180)	(6,586)
<b>Closing collective impairment</b>	<b>7,308</b>	<b>11,416</b>	<b>724</b>	<b>724</b>	<b>8,032</b>	<b>12,140</b>
<b>Total provision for impairment</b>	<b>26,693</b>	<b>37,565</b>	<b>733</b>	<b>732</b>	<b>27,426</b>	<b>38,297</b>
<b>BANK</b>						
<b>Provision for individually impaired assets</b>						
Opening individual impairment	17,269	-	-	-	17,269	-
Impairment loss for the year						
- charge for the year	6,148	11,508	-	-	6,148	11,508
- recoveries	32	117	-	-	32	117
- write offs	(6,863)	(4,405)	-	-	(6,863)	(4,405)
- assumed on amalgamation	-	10,049	-	-	-	10,049
<b>Closing individual impairment</b>	<b>16,586</b>	<b>17,269</b>	<b>-</b>	<b>-</b>	<b>16,586</b>	<b>17,269</b>
<b>Provision for collectively impaired assets</b>						
Opening collective impairment	3,493	-	-	-	3,493	-
Impairment loss for the year						
- credit for the year	(2,675)	(9,434)	-	-	(2,675)	(9,434)
- assumed on amalgamation	-	12,927	-	-	-	12,927
<b>Closing collective impairment</b>	<b>818</b>	<b>3,493</b>	<b>-</b>	<b>-</b>	<b>818</b>	<b>3,493</b>
<b>Total provision for impairment</b>	<b>17,404</b>	<b>20,762</b>	<b>-</b>	<b>-</b>	<b>17,404</b>	<b>20,762</b>

\* In determining the charge for the year, the RECL management agreement has been taken into consideration, refer to Note 26 - Related party transactions and Note 13 - Investment properties for more details. In assessing the requirements for provisions, the Banking Group has identified loans for which a loss is expected to be covered by the management agreement of \$28.5 million as at 30 June 2012 (June 2011: \$11.8 million). Claims of \$28.5 million are expected to be made under the RECL Management Agreement in relation to these losses, and to this extent, the RECL Management Agreement would be fully utilised. The agreement covers the MARAC non-core property loans with a net book value of \$94 million as at 30 June 2012 (June 2011: \$121 million).



## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (c) Credit impairment provisioning (continued)

##### (i) Provision for impaired assets (continued)

	Rural \$000	Corporate Property \$000	Other \$000	Residential \$000	All Other \$000	Total \$000
<b>BANKING GROUP - Jun 2012</b>						
<b>Provision for individually impaired assets</b>						
Opening individual impairment	-	20,047	5,945	-	165	26,157
Impairment loss for the year					-	
- charge for the year	709	3,697	1,700	695	120	6,921
- recoveries	35	32	160	-	-	227
- write offs	(1,664)	(6,704)	(6,113)	-	(155)	(14,636)
- assumed on acquisition	1,284	-	-	-	-	1,284
- effect of discounting	-	(155)	(404)	-	-	(559)
<b>Closing individual impairment</b>	<b>364</b>	<b>16,917</b>	<b>1,288</b>	<b>695</b>	<b>130</b>	<b>19,394</b>
<b>Provision for collectively impaired assets</b>						
Opening collective impairment	500	1,595	6,081	2,037	1,927	12,140
Impairment loss for the year						
- charge/(credit) for the year	78	(907)	(419)	(2,011)	1,980	(1,279)
- recoveries	-	-	177	-	174	351
- write offs	-	272	(1,767)	-	(1,685)	(3,180)
<b>Closing collective impairment</b>	<b>578</b>	<b>960</b>	<b>4,072</b>	<b>26</b>	<b>2,396</b>	<b>8,032</b>
<b>Total provision for impairment</b>	<b>942</b>	<b>17,877</b>	<b>5,360</b>	<b>721</b>	<b>2,526</b>	<b>27,426</b>
<b>BANKING GROUP - Jun 2011</b>						
<b>Provision for individually impaired assets</b>						
Opening individual impairment	-	8,712	9,112	-	7	17,831
Impairment loss for the year						
- charge for the year	-	13,182	6,976	-	158	20,316
- recoveries	-	117	-	-	-	117
- write offs	-	(11,404)	(8,891)	-	-	(20,295)
- assumed on amalgamation	-	10,049	-	-	-	10,049
- effect of discounting	-	(609)	(1,252)	-	-	(1,861)
<b>Closing individual impairment</b>	<b>-</b>	<b>20,047</b>	<b>5,945</b>	<b>-</b>	<b>165</b>	<b>26,157</b>
<b>Provision for collectively impaired assets</b>						
Opening collective impairment	-	4,463	3,881	-	4,173	12,517
Impairment loss for the year						
- charge/(credit) for the year	500	(12,260)	3,039	2,037	(334)	(7,018)
- recoveries	-	3	297	-	-	300
- assumed on amalgamation	-	12,649	278	-	-	12,927
- write offs	-	(3,260)	(1,414)	-	(1,912)	(6,586)
<b>Closing collective impairment</b>	<b>500</b>	<b>1,595</b>	<b>6,081</b>	<b>2,037</b>	<b>1,927</b>	<b>12,140</b>
<b>Total provision for impairment</b>	<b>500</b>	<b>21,642</b>	<b>12,026</b>	<b>2,037</b>	<b>2,092</b>	<b>38,297</b>
<b>BANK - Jun 2012</b>						
<b>Provision for individually impaired assets</b>						
Opening individual impairment	-	17,269	-	-	-	17,269
Impairment loss for the year						
- charge for the year	-	5,453	-	695	-	6,148
- recoveries	-	32	-	-	-	32
- write offs	-	(6,863)	-	-	-	(6,863)
<b>Closing individual impairment</b>	<b>-</b>	<b>15,891</b>	<b>-</b>	<b>695</b>	<b>-</b>	<b>16,586</b>
<b>Provision for collectively impaired assets</b>						
Opening collective impairment	500	540	416	2,037	-	3,493
Impairment loss for the year						
- (credit)/charge for the year	(495)	(180)	(23)	(2,011)	34	(2,675)
<b>Closing collective impairment</b>	<b>5</b>	<b>360</b>	<b>393</b>	<b>26</b>	<b>34</b>	<b>818</b>
<b>Total provision for impairment</b>	<b>5</b>	<b>16,251</b>	<b>393</b>	<b>721</b>	<b>34</b>	<b>17,404</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (c) Credit impairment provisioning (continued)

##### (i) Provision for impaired assets (continued)

	Corporate		Residential	All Other	Total
	Rural	Property			
	\$000	\$000	\$000	\$000	\$000
<b>BANK - Jun 2011</b>					
<b>Provision for individually impaired assets</b>					
Opening individual impairment	-	-	-	-	-
Impairment loss for the year					
- charge for the year	-	11,508	-	-	11,508
- recoveries	-	117	-	-	117
- write offs	-	(4,405)	-	-	(4,405)
- assumed on amalgamation	-	10,049	-	-	10,049
<b>Closing individual impairment</b>	-	<b>17,269</b>	-	-	<b>17,269</b>
<b>Provision for collectively impaired assets</b>					
Opening collective impairment	-	-	-	-	-
Impairment loss for the year					
- charge/(credit) for the year	500	(12,109)	138	2,037	(9,434)
- assumed on amalgamation	-	12,649	278	-	12,927
<b>Closing collective impairment</b>	<b>500</b>	<b>540</b>	<b>416</b>	<b>2,037</b>	<b>3,493</b>
<b>Total provision for impairment</b>	<b>500</b>	<b>17,809</b>	<b>416</b>	<b>2,037</b>	<b>20,762</b>

##### (ii) Impaired asset expense

	Non-securitised		Securitised		Total	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000	\$000	\$000
<b>BANKING GROUP</b>						
Individually impaired expense	6,920	20,223	1	93	6,921	20,316
Collectively impaired (recovery)/expense	(1,897)	(7,548)	618	530	(1,279)	(7,018)
<b>Total impaired asset expense</b>	<b>5,023</b>	<b>12,675</b>	<b>619</b>	<b>623</b>	<b>5,642</b>	<b>13,298</b>
<b>BANK</b>						
Individually impaired expense	6,148	11,508	-	-	6,148	11,508
Collectively impaired recovery	(2,675)	(9,434)	-	-	(2,675)	(9,434)
<b>Total impaired asset expense</b>	<b>3,473</b>	<b>2,074</b>	-	-	<b>3,473</b>	<b>2,074</b>

##### (iii) Individually impaired assets

	Non-securitised		Securitised		Total	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000	\$000	\$000
<b>BANKING GROUP</b>						
Opening	68,523	42,102	14	545	68,537	42,647
Additions	40,370	49,434	6	51	40,376	49,485
Deletions	(39,323)	(33,083)	-	(131)	(39,323)	(33,214)
Assumed on acquisition	1,871	-	-	-	1,871	-
Assumed on amalgamation	-	29,914	-	-	-	29,914
Write offs	(14,636)	(19,844)	-	(451)	(14,636)	(20,295)
<b>Closing gross individually impaired assets</b>	<b>56,805</b>	<b>68,523</b>	<b>20</b>	<b>14</b>	<b>56,825</b>	<b>68,537</b>
<b>BANK</b>						
Opening	32,217	-	-	-	32,217	-
Additions	16,514	7,794	-	-	16,514	7,794
Deletions	(4,550)	(1,086)	-	-	(4,550)	(1,086)
Assumed on amalgamation	-	29,914	-	-	-	29,914
Write offs	(6,863)	(4,405)	-	-	(6,863)	(4,405)
<b>Closing gross individually impaired assets</b>	<b>37,318</b>	<b>32,217</b>	-	-	<b>37,318</b>	<b>32,217</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (c) Credit impairment provisioning (continued)

##### (iii) Individually impaired assets (continued)

	Corporate			Residential	All Other	Total
	Rural	Property	Other			
	\$000	\$000	\$000	\$000	\$000	\$000
<b>BANKING GROUP - Jun 2012</b>						
Opening	-	51,853	16,426	-	258	68,537
Additions	625	31,672	5,234	2,661	184	40,376
Deletions	(271)	(25,961)	(12,936)	(31)	(124)	(39,323)
Assumed on acquisition	1,871	-	-	-	-	1,871
Write offs	(1,664)	(6,704)	(6,113)	-	(155)	(14,636)
<b>Closing gross individually impaired assets</b>	<b>561</b>	<b>50,860</b>	<b>2,611</b>	<b>2,630</b>	<b>163</b>	<b>56,825</b>
Less: individual allowance for impairment	364	16,917	1,288	695	130	19,394
<b>Total net impaired assets</b>	<b>197</b>	<b>33,943</b>	<b>1,323</b>	<b>1,935</b>	<b>33</b>	<b>37,431</b>

##### BANKING GROUP - Jun 2011

Opening	-	19,165	23,467	-	15	42,647
Additions	-	39,794	9,433	-	258	49,485
Deletions	-	(25,616)	(7,583)	-	(15)	(33,214)
Assumed on amalgamation	-	29,914	-	-	-	29,914
Write offs	-	(11,404)	(8,891)	-	-	(20,295)
<b>Closing gross individually impaired assets</b>	<b>-</b>	<b>51,853</b>	<b>16,426</b>	<b>-</b>	<b>258</b>	<b>68,537</b>
Less: individual allowance for impairment	-	20,047	5,945	-	165	26,157
<b>Total net impaired assets</b>	<b>-</b>	<b>31,806</b>	<b>10,481</b>	<b>-</b>	<b>93</b>	<b>42,380</b>

##### BANK - Jun 2012

Opening	-	32,217	-	-	-	32,217
Additions	-	13,853	-	2,661	-	16,514
Deletions	-	(4,519)	-	(31)	-	(4,550)
Write offs	-	(6,863)	-	-	-	(6,863)
<b>Closing gross individually impaired assets</b>	<b>-</b>	<b>34,688</b>	<b>-</b>	<b>2,630</b>	<b>-</b>	<b>37,318</b>
Less: individual allowance for impairment	-	15,891	-	695	-	16,586
<b>Total net impaired assets</b>	<b>-</b>	<b>18,797</b>	<b>-</b>	<b>1,935</b>	<b>-</b>	<b>20,732</b>

##### BANK - Jun 2011

Opening	-	-	-	-	-	-
Additions	-	7,794	-	-	-	7,794
Deletions	-	(1,086)	-	-	-	(1,086)
Assumed on amalgamation	-	29,914	-	-	-	29,914
Write offs	-	(4,405)	-	-	-	(4,405)
<b>Closing gross individually impaired assets</b>	<b>-</b>	<b>32,217</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>32,217</b>
Less: individual allowance for impairment	-	17,269	-	-	-	17,269
<b>Total net impaired assets</b>	<b>-</b>	<b>14,948</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>14,948</b>

##### (iv) Restructured assets

	Non-secured		Secured		Total	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000	\$000	\$000
BANKING GROUP - Restructured assets	9,086	3,429	-	-	9,086	3,249

	Corporate			Residential	All Other	Total
	Rural	Property	Other			
	\$000	\$000	\$000	\$000	\$000	\$000
<b>BANKING GROUP - Jun 2012</b>						
Restructured assets	-	5,522	1,127	-	2,437	9,086
<b>BANKING GROUP - Jun 2011</b>						
Restructured assets	-	-	769	-	2,480	3,249

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (c) Credit impairment provisioning (continued)

#### (v) Past due but not impaired

	Non-securitised		Securitised		Total	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011	Jun 2012	Jun 2011
	\$000	\$000	\$000	\$000	\$000	\$000
<b>BANKING GROUP</b>						
Less than 30 days past due	20,258	23,899	3,480	2,678	23,738	26,577
At least 30 and less than 60 days past due	8,699	27,763	1,610	1,614	10,309	29,377
At least 60 but less than 90 days past due	8,342	15,405	517	306	8,859	15,711
At least 90 days past due	50,508	65,739	1,496	1,459	52,004	67,198
<b>Total past due but not impaired</b>	<b>87,807</b>	<b>132,806</b>	<b>7,103</b>	<b>6,057</b>	<b>94,910</b>	<b>138,863</b>

#### BANK

Less than 30 days past due	4,347	9,706	-	-	4,347	9,706
At least 30 and less than 60 days past due	1,572	865	356	224	1,928	1,089
At least 60 but less than 90 days past due	2,615	2,474	-	-	2,615	2,474
At least 90 days past due	407	5,831	-	-	407	5,831
<b>Total past due but not impaired</b>	<b>8,941</b>	<b>18,876</b>	<b>356</b>	<b>224</b>	<b>9,297</b>	<b>19,100</b>

	Corporate		Residential Other	All Other	Total
	Rural	Property			
	\$000	\$000	\$000	\$000	\$000
<b>BANKING GROUP - Jun 2012</b>					
Less than 30 days past due	1,132	365	8,696	1,658	11,887
At least 30 and less than 60 days past due	1,524	139	4,480	722	3,444
At least 60 but less than 90 days past due	2,300	3,455	1,559	251	1,294
At least 90 days past due	2,537	27,167	12,376	15	9,909
<b>Total past due but not impaired</b>	<b>7,493</b>	<b>31,126</b>	<b>27,111</b>	<b>2,646</b>	<b>26,534</b>

#### BANKING GROUP - Jun 2011

Less than 30 days past due	-	9,069	5,255	1,093	11,160
At least 30 and less than 60 days past due	-	18,515	7,592	599	2,671
At least 60 but less than 90 days past due	-	6,331	7,837	501	1,042
At least 90 days past due	-	48,242	14,515	1,068	3,373
<b>Total past due but not impaired</b>	<b>-</b>	<b>82,157</b>	<b>35,199</b>	<b>3,261</b>	<b>18,246</b>

#### BANK - Jun 2012

Less than 30 days past due	-	-	128	1,658	2,561
At least 30 and less than 60 days past due	-	-	1,206	722	-
At least 60 but less than 90 days past due	-	1,890	474	251	-
At least 90 days past due	-	-	392	15	-
<b>Total past due but not impaired</b>	<b>-</b>	<b>1,890</b>	<b>2,200</b>	<b>2,646</b>	<b>2,561</b>

#### BANK - Jun 2011

Less than 30 days past due	-	3,961	-	1,093	4,652
At least 30 and less than 60 days past due	-	83	407	599	-
At least 60 but less than 90 days past due	-	1,973	-	501	-
At least 90 days past due	-	4,763	-	1,068	-
<b>Total past due but not impaired</b>	<b>-</b>	<b>10,780</b>	<b>407</b>	<b>3,261</b>	<b>4,652</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (d) Maximum exposure to credit risk by internal risk grading

	Non-securitised		Securitised		Total	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>BANKING GROUP</b>						
<b>Judgement portfolio</b>						
Grade 1 - Very Strong	1,280	2,985	-	-	1,280	2,985
Grade 2 - Strong	17,090	25,351	-	13	17,090	25,364
Grade 3 - Sound	82,381	95,350	578	-	82,959	95,350
Grade 4 - Adequate *	322,767	186,092	1,010	783	323,777	186,875
Grade 5 - Acceptable	436,570	238,665	5,483	2,899	442,053	241,564
Grade 6 - Monitor	183,756	92,420	58	849	183,814	93,269
Grade 7 - Substandard	50,874	45,410	-	144	50,874	45,554
Grade 8 - Doubtful	13,906	8,772	5	6	13,911	8,778
Grade 9 - At risk of loss	13,471	35,163	-	-	13,471	35,163
<b>Total Judgement portfolio</b>	<b>1,122,095</b>	<b>730,208</b>	<b>7,134</b>	<b>4,694</b>	<b>1,129,229</b>	<b>734,902</b>
<b>Behavioural portfolio</b>						
Not in arrears	658,686	750,476	262,095	199,476	920,781	949,952
Active	6,789	6,387	2,788	2,675	9,577	9,062
Arrangement	8,549	5,952	4,173	2,073	12,722	8,025
Non-performing / Repossession	3,499	3,165	435	563	3,934	3,728
Recovery	1,890	1,430	143	212	2,033	1,642
<b>Total Behavioural portfolio</b>	<b>679,413</b>	<b>767,410</b>	<b>269,634</b>	<b>204,999</b>	<b>949,047</b>	<b>972,409</b>
<b>Total finance receivables</b>	<b>1,801,508</b>	<b>1,497,618</b>	<b>276,768</b>	<b>209,693</b>	<b>2,078,276</b>	<b>1,707,311</b>
Other on balance sheet credit exposures	103,594	275,599	15,612	15,865	119,206	291,464
<b>Total maximum exposure to credit risk</b>	<b>1,905,102</b>	<b>1,773,217</b>	<b>292,380</b>	<b>225,558</b>	<b>2,197,482</b>	<b>1,998,775</b>

\* In determining the Banking Group's risk grading, the following arrangements have been taken into consideration:

The RECL management agreement, refer to Note 26 - Related party transactions and Note 13 - Investment properties for more details. In the risk grading table above, as at 30 June 2012 \$48 million (June 2011: \$51 million) of Judgement loans have been transferred from risk grades below Acceptable to an Adequate risk grade as they are covered by the RECL management agreement. In assessing the requirements for provisions, the Banking Group has identified loans for which a loss is expected to be covered by the management agreement of \$28.5 million as at 30 June 2012 (June 2011: \$11.8 million). Claims of \$28.5 million are expected to be made under the RECL Management Agreement in relation to these losses, and to this extent, the RECL Management Agreement would be fully utilised. The agreement covers the MARAC non-core property loans with a net book value of \$94 million as at 30 June 2012 (June 2011: \$121 million).

PGG Wrightson Finance Limited guaranteed loans, refer to Note 36 - Business Combinations. In the risk grading table above, as at 30 June 2012 \$29 million of Judgement loans have been transferred from risk grades below Acceptable to an Adequate risk grade as they are covered by the Deed of Guarantee and Indemnity with PGG Wrightson Limited. Subsequent to balance date, \$6.7 million of loans covered under this Deed were recovered and PGG Wrightson Limited was released from their guarantee in respect of those loans. At balance date, PGG Wrightson Limited had been put on notice that it will be required to reacquire approximately \$3.5 million of loans covered under this Deed. Subsequent to balance date, Heartland advised PGG Wrightson Limited that it may require it to reacquire approximately a further \$8.3 million of loans covered under this Deed.

	Non-securitised		Securitised		Total	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>BANK</b>						
<b>Judgement portfolio</b>						
Grade 1 - Very Strong	-	485	-	-	-	485
Grade 2 - Strong	9,033	23,681	-	-	9,033	23,681
Grade 3 - Sound	31,286	35,212	578	-	31,864	35,212
Grade 4 - Adequate	50,311	43,675	954	156	51,265	43,831
Grade 5 - Acceptable	67,901	63,910	4,816	2,101	72,717	66,011
Grade 6 - Monitor	34,514	56,278	-	-	34,514	56,278
Grade 7 - Substandard	12,057	20,827	-	-	12,057	20,827
Grade 8 - Doubtful	8,141	7,083	-	-	8,141	7,083
Grade 9 - At risk of loss	10,656	8,975	-	-	10,656	8,975
<b>Total Judgement portfolio</b>	<b>223,899</b>	<b>260,126</b>	<b>6,348</b>	<b>2,257</b>	<b>230,247</b>	<b>262,383</b>
<b>Behavioural portfolio</b>						
Not in arrears	248,425	330,836	63,947	29,650	312,372	360,486
Active	1,987	1,063	-	-	1,987	1,063
Arrangement	690	1,285	356	224	1,046	1,509
Non-performing / Repossession	2,332	1,077	-	-	2,332	1,077
<b>Total Behavioural portfolio</b>	<b>253,434</b>	<b>334,261</b>	<b>64,303</b>	<b>29,874</b>	<b>317,737</b>	<b>364,135</b>
<b>Total finance receivables</b>	<b>477,333</b>	<b>594,387</b>	<b>70,651</b>	<b>32,131</b>	<b>547,984</b>	<b>626,518</b>
Other on balance sheet credit exposures	1,196,264	1,007,259	11,149	1,369	1,207,413	1,008,628
<b>Total maximum exposure to credit risk</b>	<b>1,673,597</b>	<b>1,601,646</b>	<b>81,800</b>	<b>33,500</b>	<b>1,755,397</b>	<b>1,635,146</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (d) Maximum exposure to credit risk by internal risk grading (continued)

	Rural \$000	Corporate Property \$000	Residential Other \$000	All Other \$000	Total \$000	
<b>BANKING GROUP - Jun 2012</b>						
<b>Judgement portfolio</b>						
Grade 1 - Very Strong	1,277	-	-	3	1,280	
Grade 2 - Strong	2,941	-	12,537	443	17,090	
Grade 3 - Sound	15,578	6,018	51,348	5,451	82,959	
Grade 4 - Adequate *	67,231	58,054	140,861	47,159	323,777	
Grade 5 - Acceptable	126,011	22,445	192,300	83,593	442,053	
Grade 6 - Monitor	62,315	564	61,868	57,246	183,814	
Grade 7 - Substandard	22,201	7,379	13,920	6,857	50,874	
Grade 8 - Doubtful	2,956	8,141	1,234	1,580	13,911	
Grade 9 - At risk of loss	-	13,271	170	30	13,471	
<b>Total Judgement portfolio</b>	<b>300,510</b>	<b>115,872</b>	<b>474,238</b>	<b>36,247</b>	<b>1,129,229</b>	
<b>Behavioural portfolio</b>						
Not in arrears	-	-	272,111	283,294	365,376	920,781
Active	-	-	2,127	1,657	5,793	9,577
Arrangement	-	-	3,269	964	8,489	12,722
Non-performing / Repossession	-	-	737	1,950	1,247	3,934
Recovery	-	-	1,738	-	295	2,033
<b>Total Behavioural portfolio</b>	<b>-</b>	<b>-</b>	<b>279,982</b>	<b>287,865</b>	<b>381,200</b>	<b>949,047</b>
<b>Total finance receivables</b>	<b>300,510</b>	<b>115,872</b>	<b>754,220</b>	<b>324,112</b>	<b>583,562</b>	<b>2,078,276</b>
Other on balance sheet credit exposures						119,206
<b>Total maximum exposure to credit risk</b>						<b>2,197,482</b>
<b>BANKING GROUP - Jun 2011</b>						
<b>Judgement portfolio</b>						
Grade 1 - Very Strong	2,985	-	-	-	2,985	
Grade 2 - Strong	-	-	23,425	550	1,389	25,364
Grade 3 - Sound	5,317	19,862	60,370	5,432	4,369	95,350
Grade 4 - Adequate *	11,608	52,802	110,603	4,958	6,904	186,875
Grade 5 - Acceptable	11,936	40,569	151,111	23,654	14,294	241,564
Grade 6 - Monitor	16,884	2,830	60,138	4,067	9,350	93,269
Grade 7 - Substandard	4,014	9,812	25,220	-	6,508	45,554
Grade 8 - Doubtful	-	7,083	1,617	-	78	8,778
Grade 9 - At risk of loss	-	25,607	9,556	-	-	35,163
<b>Total Judgement portfolio</b>	<b>52,744</b>	<b>158,565</b>	<b>442,040</b>	<b>38,661</b>	<b>42,892</b>	<b>734,902</b>
<b>Behavioural portfolio</b>						
Not in arrears	-	-	266,375	326,311	357,266	949,952
Active	-	-	2,055	1,063	5,944	9,062
Arrangement	-	-	2,365	1,102	4,558	8,025
Non-performing / Repossession	-	-	1,050	1,077	1,601	3,728
Recovery	-	-	828	-	814	1,642
<b>Total Behavioural portfolio</b>	<b>-</b>	<b>-</b>	<b>272,673</b>	<b>329,553</b>	<b>370,183</b>	<b>972,409</b>
<b>Total finance receivables</b>	<b>52,744</b>	<b>158,565</b>	<b>714,713</b>	<b>368,214</b>	<b>413,075</b>	<b>1,707,311</b>
Other on balance sheet credit exposures						291,464
<b>Total maximum exposure to credit risk</b>						<b>1,998,775</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 29 Credit risk exposure (continued)

#### (d) Maximum exposure to credit risk by internal risk grading (continued)

	Rural \$000	Corporate Property \$000	Residential Other \$000	All Other \$000	Total \$000	
<b>BANK - Jun 2012</b>						
<b>Judgement portfolio</b>						
Grade 2 - Strong	-	-	7,864	1,169	-	9,033
Grade 3 - Sound	3,717	-	21,135	4,565	2,447	31,864
Grade 4 - Adequate	2,570	-	36,589	10,472	1,634	51,265
Grade 5 - Acceptable	8,953	1,481	34,708	17,704	9,871	72,717
Grade 6 - Monitor	16,267	627	9,235	1,820	6,565	34,514
Grade 7 - Substandard	2,096	7,379	399	517	1,666	12,057
Grade 8 - Doubtful	-	8,141	-	-	-	8,141
Grade 9 - At risk of loss	-	10,656	-	-	-	10,656
<b>Total Judgement portfolio</b>	<b>33,603</b>	<b>28,284</b>	<b>109,930</b>	<b>36,247</b>	<b>22,183</b>	<b>230,247</b>
<b>Behavioural portfolio</b>						
Current	-	-	22,480	283,294	6,598	312,372
Active	-	-	23	1,657	307	1,987
Arrangement	-	-	82	964	-	1,046
Non-performing / Repossession	-	-	382	1,950	-	2,332
<b>Total Behavioural portfolio</b>	<b>-</b>	<b>-</b>	<b>22,967</b>	<b>287,865</b>	<b>6,905</b>	<b>317,737</b>
<b>Total finance receivables</b>	<b>33,603</b>	<b>28,284</b>	<b>132,897</b>	<b>324,112</b>	<b>29,088</b>	<b>547,984</b>
Other on balance sheet credit exposures						1,207,413
<b>Total maximum exposure to credit risk</b>						<b>1,755,397</b>

#### BANK - Jun 2011

<b>Judgement portfolio</b>						
Grade 1 - Very Strong	485	-	-	-	-	485
Grade 2 - Strong	-	-	21,905	550	1,226	23,681
Grade 3 - Sound	3,103	-	23,467	5,432	3,210	35,212
Grade 4 - Adequate	2,437	1,498	34,171	4,958	767	43,831
Grade 5 - Acceptable	4,502	7,088	23,641	23,654	7,126	66,011
Grade 6 - Monitor	16,342	1,553	25,973	4,067	8,343	56,278
Grade 7 - Substandard	4,014	9,812	1,355	-	5,646	20,827
Grade 8 - Doubtful	-	7,083	-	-	-	7,083
Grade 9 - At risk of loss	-	8,975	-	-	-	8,975
<b>Total maximum exposure to credit risk</b>	<b>30,883</b>	<b>36,009</b>	<b>130,512</b>	<b>38,661</b>	<b>26,318</b>	<b>262,383</b>
<b>Behavioural portfolio</b>						
Not in arrears	-	-	26,291	326,311	7,884	360,486
Active	-	-	-	1,063	-	1,063
Arrangement	-	-	407	1,102	-	1,509
Non-performing / Repossession	-	-	-	1,077	-	1,077
<b>Total Behavioural portfolio</b>	<b>-</b>	<b>-</b>	<b>26,698</b>	<b>329,553</b>	<b>7,884</b>	<b>364,135</b>
<b>Total finance receivables</b>	<b>30,883</b>	<b>36,009</b>	<b>157,210</b>	<b>368,214</b>	<b>34,202</b>	<b>626,518</b>
Other on balance sheet credit exposures						1,008,628
<b>Total maximum exposure to credit risk</b>						<b>1,635,146</b>

#### (e) 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 2012, the Banking Group did not have any assets under administration (30 June 2011: nil).

#### (f) Commitments to extend credit

	Non-securitized		Securitized		Total	
	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000	Jun 2012 \$000	Jun 2011 \$000
<b>BANKING GROUP</b>						
Undrawn facilities available to customers	125,492	74,099	-	49	125,492	74,148
Conditional commitments to fund at future dates	38,796	19,199	-	-	38,796	19,199
<b>BANK</b>						
Undrawn facilities available to customers	13,182	23,530	-	49	13,182	23,579
Conditional commitments to fund at future dates	16,029	-	-	-	16,029	-

As at 30 June 2012 there are no undrawn lending commitments to counterparties for whom drawn balances are classified as individually impaired (30 June 2011: nil).

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 30 Liquidity risk

Liquidity risk is the risk that the Banking Group may encounter difficulty in raising funds at short notice to meet its commitments and arises from any mismatch of the maturity of financial assets and liabilities. Responsibility for liquidity management is delegated to the Asset and Liability Committee (ALCO), with the Risk Committee providing oversight.

The Banking Group manages liquidity and funding risk by:

- weekly liquidity reporting and scenario analysis to quantify the Banking Group's current and forecast position.
- maintaining a diverse and stable funding base.
- retaining borrowing facilities committed to the Banking Group by registered banks.
- holding a portfolio of liquid assets.
- ensuring the liquidity management framework is compliant with local regulatory requirements.

The following tables show the cash flows on the Banking Group's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. In the following tables, total financial assets do not include unrecognised loan commitments and total financial liabilities do not include undrawn committed bank facilities.

The tables include estimates as to the average interest rate applicable for each asset or liability class during the contractual term.

#### Contractual liquidity profile of financial assets and liabilities

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
<b>BANKING GROUP - Jun 2012</b>							
<b>Financial assets</b>							
Cash and cash equivalents	89,220	-	-	-	-	-	89,220
Investments	-	498	498	996	25,314	-	27,306
Finance receivables	-	572,857	336,063	342,005	509,685	638,107	2,398,717
Finance receivables - securitised	-	53,568	54,157	86,874	83,887	112,015	390,501
Derivative financial assets	2,122	-	-	-	-	-	2,122
Other financial assets	-	3,537	-	-	-	-	3,537
<b>Total financial assets</b>	<b>91,342</b>	<b>630,460</b>	<b>390,718</b>	<b>429,875</b>	<b>618,886</b>	<b>750,122</b>	<b>2,911,403</b>
<b>Financial liabilities</b>							
Borrowings	237,036	760,301	419,224	272,619	49,549	-	1,738,729
Borrowings - securitised	-	4,578	192,072	75,157	-	-	271,807
Derivative financial liabilities	1,459	-	-	-	-	-	1,459
Other financial liabilities	-	18,220	-	-	-	-	18,220
<b>Total financial liabilities</b>	<b>238,495</b>	<b>783,099</b>	<b>611,296</b>	<b>347,776</b>	<b>49,549</b>	<b>-</b>	<b>2,030,215</b>
<b>Net financial (liabilities)/assets</b>	<b>(147,153)</b>	<b>(152,639)</b>	<b>(220,578)</b>	<b>82,099</b>	<b>569,337</b>	<b>750,122</b>	<b>881,188</b>
Unrecognised loan commitments	125,492	-	-	-	-	-	125,492
Undrawn committed bank facilities	335,000	-	-	-	-	-	335,000

The undrawn committed bank facilities totalling \$335.0 million are available to be drawn down on demand. To the extent drawn, \$50.0 million is contractually repayable in 0-6 months' time, \$110.0 million is contractually repayable in 6-12 months' time and \$175.0 million is contractually repayable in 1-2 years' time upon facility expiry.

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
<b>BANKING GROUP - Jun 2011</b>							
<b>Financial assets</b>							
Cash and cash equivalents	77,773	189,679	-	-	-	-	267,452
Investments	-	7,036	1,327	621	10,556	1,038	20,578
Finance receivables	-	433,361	215,885	335,376	517,824	767,084	2,269,530
Finance receivables - securitised	-	49,601	44,479	72,866	64,606	49,456	281,008
Derivative financial assets	3,048	-	-	-	-	-	3,048
Other financial assets	-	3,551	-	-	-	-	3,551
<b>Total financial assets</b>	<b>80,821</b>	<b>683,228</b>	<b>261,691</b>	<b>408,863</b>	<b>592,986</b>	<b>817,578</b>	<b>2,845,167</b>
<b>Financial liabilities</b>							
Borrowings	166,262	948,688	319,267	79,118	135,550	1,990	1,650,875
Borrowings - securitised	-	3,632	174,847	682	20,056	-	199,217
Derivative financial liabilities	2,444	-	-	-	-	-	2,444
Other financial liabilities	-	15,677	-	-	-	-	15,677
<b>Total financial liabilities</b>	<b>168,706</b>	<b>967,997</b>	<b>494,114</b>	<b>79,800</b>	<b>155,606</b>	<b>1,990</b>	<b>1,868,213</b>
<b>Net financial (liabilities)/assets</b>	<b>(87,885)</b>	<b>(284,769)</b>	<b>(232,423)</b>	<b>329,063</b>	<b>437,380</b>	<b>815,588</b>	<b>976,954</b>
Unrecognised loan commitments	74,148	-	-	-	-	-	74,148
Undrawn committed bank facilities	280,000	-	-	-	-	-	280,000



## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 30 Liquidity risk (continued)

#### Contractual liquidity profile of financial assets and liabilities (continued)

##### BANKING GROUP - Jun 2011

The undrawn committed bank facilities totalling \$280.0 million were available to be drawn down on demand. To the extent drawn, \$25.0 million was contractually repayable in 6-12 months' time, \$155.0 million was contractually repayable in 1-2 years' time and \$100.0 million was contractually repayable in 2-5 years' time upon the facilities expiring.

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
<b>BANK - Jun 2012</b>							
<b>Financial assets</b>							
Cash and cash equivalents	72,217	-	-	-	-	-	72,217
Investments	-	498	498	996	25,314	-	27,306
Due from related parties	1,107,857	-	-	-	-	-	1,107,857
Finance receivables	-	74,611	43,354	54,322	150,575	575,835	898,697
Finance receivables - securitised	-	3,224	3,878	6,682	23,540	112,015	149,339
Derivative financial assets	2,122	-	-	-	-	-	2,122
Other financial assets	-	890	-	-	-	-	890
<b>Total financial assets</b>	<b>1,182,196</b>	<b>79,223</b>	<b>47,730</b>	<b>62,000</b>	<b>199,429</b>	<b>687,850</b>	<b>2,258,428</b>
<b>Financial liabilities</b>							
Borrowings	237,036	760,301	419,224	272,619	49,549	-	1,738,729
Borrowings - securitised	-	1,312	1,291	75,157	-	-	77,760
Derivative financial liabilities	415	-	-	-	-	-	415
Other financial liabilities	-	13,187	-	-	-	-	13,187
<b>Total financial liabilities</b>	<b>237,451</b>	<b>774,800</b>	<b>420,515</b>	<b>347,776</b>	<b>49,549</b>	<b>-</b>	<b>1,830,091</b>
<b>Net financial assets/(liabilities)</b>	<b>944,745</b>	<b>(695,577)</b>	<b>(372,785)</b>	<b>(285,776)</b>	<b>149,880</b>	<b>687,850</b>	<b>428,337</b>
Unrecognised loan commitments	13,182	-	-	-	-	-	13,182
Undrawn committed bank facilities	225,000	-	-	-	-	-	225,000

The undrawn committed bank facilities totalling \$225.0 million were available to be drawn down on demand. To the extent drawn, \$50.0 million was contractually repayable in 0-6 months' time and \$175.0 million was contractually repayable in 1-2 years' time upon facility expiry.

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
<b>BANK - Jun 2011</b>							
<b>Financial assets</b>							
Cash and cash equivalents	56,449	189,679	-	-	-	-	246,128
Investments	-	7,036	1,327	621	10,556	1,038	20,578
Due from related parties	740,817	-	-	-	-	-	740,817
Finance receivables	-	115,948	56,410	103,095	165,490	764,633	1,205,576
Finance receivables - securitised	-	2,624	1,771	3,713	11,439	49,456	69,003
Derivative financial assets	3,048	-	-	-	-	-	3,048
Other financial assets	-	1,610	-	-	-	-	1,610
<b>Total financial assets</b>	<b>800,314</b>	<b>316,897</b>	<b>59,508</b>	<b>107,429</b>	<b>187,485</b>	<b>815,127</b>	<b>2,286,760</b>
<b>Financial liabilities</b>							
Borrowings	166,262	948,688	319,267	79,118	135,550	1,990	1,650,875
Borrowings - securitised	-	341	341	682	20,056	-	21,420
Derivative financial liabilities	1,127	-	-	-	-	-	1,127
Other financial liabilities	-	9,624	-	-	-	-	9,624
<b>Total financial liabilities</b>	<b>167,389</b>	<b>958,653</b>	<b>319,608</b>	<b>79,800</b>	<b>155,606</b>	<b>1,990</b>	<b>1,683,046</b>
<b>Net financial assets/(liabilities)</b>	<b>632,925</b>	<b>(641,756)</b>	<b>(260,100)</b>	<b>27,629</b>	<b>31,879</b>	<b>813,137</b>	<b>603,714</b>
Unrecognised loan commitments	23,579	-	-	-	-	-	23,579
Undrawn committed bank facilities	255,000	-	-	-	-	-	255,000

The undrawn committed bank facilities totalling \$255.0 million are available to be drawn down on demand. To the extent drawn, \$155.0 million is contractually repayable in 1-2 years' time and \$100.0 million is contractually repayable in 2-5 years' time upon the facilities expiring.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 30 Liquidity risk (continued)

#### Expected maturity profile of financial assets and liabilities

The tables following show management's expected maturities of existing financial assets and financial liabilities.

Expected maturities of financial assets are based on management's best estimate having regard to current market conditions and past experience. The expected maturities of securitised borrowings are based on the expected maturities of securitised receivables and historical deposit and debenture reinvestment levels have been applied to other borrowings. Other financial liabilities reflect contractual maturities.

The tables does not reflect a forward looking view of how the Banking Group expects actual financial assets and liabilities to perform in the future, as it does not include new lending and borrowing.

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
<b>BANKING GROUP - Jun 2012</b>							
<b>Financial assets</b>							
Cash and cash equivalents	89,220	-	-	-	-	-	89,220
Investments	-	498	498	996	25,314	-	27,306
Finance receivables	-	579,947	386,570	372,340	666,179	56,459	2,061,495
Finance receivables - securitised	-	67,976	60,171	82,716	115,136	-	325,999
Derivative financial asset	2,122	-	-	-	-	-	2,122
Other financial assets	-	3,537	-	-	-	-	3,537
<b>Total financial assets</b>	<b>91,342</b>	<b>651,958</b>	<b>447,239</b>	<b>456,052</b>	<b>806,629</b>	<b>56,459</b>	<b>2,509,679</b>
<b>Financial liabilities</b>							
Borrowings	2,370	267,212	226,095	456,293	546,244	359,443	1,857,657
Borrowings - securitised	-	4,578	4,503	9,082	27,269	265,746	311,178
Derivative financial liabilities	1,459	-	-	-	-	-	1,459
Other financial liabilities	-	18,220	-	-	-	-	18,220
<b>Total financial liabilities</b>	<b>3,829</b>	<b>290,010</b>	<b>230,598</b>	<b>465,375</b>	<b>573,513</b>	<b>625,189</b>	<b>2,188,514</b>
<b>Net financial assets/(liabilities)</b>	<b>87,513</b>	<b>361,948</b>	<b>216,641</b>	<b>(9,323)</b>	<b>233,116</b>	<b>(568,730)</b>	<b>321,165</b>
Unrecognised loan commitments	125,492	-	-	-	-	-	125,492
Undrawn committed bank facilities	335,000	-	-	-	-	-	335,000

	On Demand \$000	0-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2-5 Years \$000	5+ Years \$000	Total \$000
<b>BANKING GROUP - Jun 2011</b>							
<b>Financial assets</b>							
Cash and cash equivalents	77,773	189,679	-	-	-	-	267,452
Investments	-	7,036	1,327	621	10,556	1,038	20,578
Finance receivables	-	396,687	303,218	383,950	716,916	-	1,800,771
Finance receivables - securitised	-	62,667	49,735	69,475	70,192	-	252,069
Derivative financial assets	3,048	-	-	-	-	-	3,048
Other financial assets	-	3,551	-	-	-	-	3,551
<b>Total financial assets</b>	<b>80,821</b>	<b>659,620</b>	<b>354,280</b>	<b>454,046</b>	<b>797,664</b>	<b>1,038</b>	<b>2,347,469</b>
<b>Financial liabilities</b>							
Borrowings	-	267,635	195,399	307,165	505,886	515,471	1,791,556
Borrowings - securitised	-	3,632	174,847	682	20,056	-	199,217
Derivative financial liabilities	2,444	-	-	-	-	-	2,444
Other financial liabilities	-	15,677	-	-	-	-	15,677
<b>Total financial liabilities</b>	<b>2,444</b>	<b>286,944</b>	<b>370,246</b>	<b>307,847</b>	<b>525,942</b>	<b>515,471</b>	<b>2,008,894</b>
<b>Net financial assets/(liabilities)</b>	<b>78,377</b>	<b>372,676</b>	<b>(15,966)</b>	<b>146,199</b>	<b>271,722</b>	<b>(514,433)</b>	<b>338,575</b>
Unrecognised loan commitments	74,148	-	-	-	-	-	74,148
Undrawn committed bank facilities	280,000	-	-	-	-	-	280,000

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 30 Liquidity risk (continued)

#### Expected maturity 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
<b>BANK - Jun 2012</b>							
<b>Financial assets</b>							
Cash and cash equivalents	72,217	-	-	-	-	-	72,217
Investments	-	498	498	996	25,314	-	27,306
Due from related parties	1,107,857	-	-	-	-	-	1,107,857
Finance receivables	-	74,611	43,354	54,322	384,789	123	557,199
Finance receivables - securitised	-	3,224	3,878	6,682	71,053	-	84,837
Derivative financial assets	2,122	-	-	-	-	-	2,122
Other financial assets	-	890	-	-	-	-	890
<b>Total financial assets</b>	<b>1,182,196</b>	<b>79,223</b>	<b>47,730</b>	<b>62,000</b>	<b>481,156</b>	<b>123</b>	<b>1,852,428</b>
<b>Financial liabilities</b>							
Borrowings	2,370	267,212	226,095	456,293	546,244	359,443	1,857,657
Borrowings - securitised	-	1,312	1,291	2,603	7,815	75,214	88,235
Derivative financial liabilities	415	-	-	-	-	-	415
Other financial liabilities	-	13,187	-	-	-	-	13,187
<b>Total financial liabilities</b>	<b>2,785</b>	<b>281,711</b>	<b>227,386</b>	<b>458,896</b>	<b>554,059</b>	<b>434,657</b>	<b>1,959,494</b>
<b>Net financial assets/(liabilities)</b>	<b>1,179,411</b>	<b>(202,488)</b>	<b>(179,656)</b>	<b>(396,896)</b>	<b>(72,903)</b>	<b>(434,534)</b>	<b>(107,066)</b>
Unrecognised loan commitments	13,182	-	-	-	-	-	13,182
Undrawn committed bank facilities	225,000	-	-	-	-	-	225,000
<b>BANK - Jun 2011</b>							
<b>Financial assets</b>							
Cash and cash equivalents	56,449	189,679	-	-	-	-	246,128
Investments	-	7,036	1,327	621	10,556	1,038	20,578
Due from related parties	740,817	-	-	-	-	-	740,817
Finance receivables	-	115,948	56,410	103,095	441,869	-	717,322
Finance receivables - securitised	-	2,624	1,771	3,713	31,196	-	39,304
Derivative financial assets	3,048	-	-	-	-	-	3,048
Other financial assets	-	1,610	-	-	-	-	1,610
<b>Total financial assets</b>	<b>800,314</b>	<b>316,897</b>	<b>59,508</b>	<b>107,429</b>	<b>483,621</b>	<b>1,038</b>	<b>1,768,807</b>
<b>Financial liabilities</b>							
Borrowings	-	267,635	195,399	307,165	505,886	515,471	1,791,556
Borrowings - securitised	-	341	341	682	20,056	-	21,420
Derivative financial liabilities	1,127	-	-	-	-	-	1,127
Other financial liabilities	-	9,624	-	-	-	-	9,624
<b>Total financial liabilities</b>	<b>1,127</b>	<b>277,600</b>	<b>195,740</b>	<b>307,847</b>	<b>525,942</b>	<b>515,471</b>	<b>1,823,727</b>
<b>Net financial assets/(liabilities)</b>	<b>799,187</b>	<b>39,297</b>	<b>(136,232)</b>	<b>(200,418)</b>	<b>(42,321)</b>	<b>(514,433)</b>	<b>(54,920)</b>
Unrecognised loan commitments	23,579	-	-	-	-	-	23,579
Undrawn committed bank facilities	255,000	-	-	-	-	-	255,000

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 31 Interest rate risk

Interest rate risk is the risk that market interest rates will change and impact on the Banking Group's financial results by affecting the margin between interest earning assets and interest bearing liabilities. The Banking Group monitors market interest rates on a daily basis and regularly reviews interest rate exposure. Interest rate risk is mitigated by management's frequent monitoring of the interest rate repricing profiles of borrowings and finance receivables, and where appropriate, the establishment of derivative instruments.

#### 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	4-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2+ Years \$000	Non-interest bearing	Total \$000
<b>BANKING GROUP - Jun 2012</b>							
<b>Financial assets</b>							
Cash and cash equivalents	89,220	-	-	-	-	-	89,220
Investments	22,149	-	-	-	2,178	-	24,327
Due from related parties	-	-	-	-	-	276	276
Finance receivables	1,248,945	98,677	153,534	172,003	127,642	707	1,801,508
Finance receivables - securitised	89,285	30,031	49,895	69,868	37,689	-	276,768
Other financial assets	2,122	-	-	-	-	3,261	5,383
<b>Total financial assets</b>	<b>1,451,721</b>	<b>128,708</b>	<b>203,429</b>	<b>241,871</b>	<b>167,509</b>	<b>4,244</b>	<b>2,197,482</b>
<b>Financial liabilities</b>							
Borrowings	669,815	308,897	396,086	259,956	40,376	-	1,675,130
Borrowings - securitised	75,105	189,254	-	-	-	-	264,359
Other financial liabilities	1,459	-	-	-	-	18,220	19,679
<b>Total financial liabilities</b>	<b>746,379</b>	<b>498,151</b>	<b>396,086</b>	<b>259,956</b>	<b>40,376</b>	<b>18,220</b>	<b>1,959,168</b>
Effect of derivatives held for risk management	218,387	42,690	(43,869)	(175,718)	(41,490)	-	-
<b>Net financial assets/(liabilities)</b>	<b>923,729</b>	<b>(326,753)</b>	<b>(236,526)</b>	<b>(193,803)</b>	<b>85,643</b>	<b>(13,976)</b>	<b>238,314</b>

#### BANKING GROUP - Jun 2011

<b>Financial assets</b>							
Cash and cash equivalents	267,034	-	-	-	-	-	267,034
Investments	5,120	1,675	987	-	10,049	-	17,831
Finance receivables	809,883	98,591	180,315	229,841	178,108	880	1,497,618
Finance receivables - securitised	41,030	25,552	38,366	59,700	45,045	-	209,693
Other financial assets	3,048	-	-	-	-	3,551	6,599
<b>Total financial assets</b>	<b>1,126,115</b>	<b>125,818</b>	<b>219,668</b>	<b>289,541</b>	<b>233,202</b>	<b>4,431</b>	<b>1,998,775</b>
<b>Financial liabilities</b>							
Borrowings	650,449	451,096	299,036	61,623	131,043	-	1,593,247
Borrowings - securitised	194,277	-	-	-	-	-	194,277
Other financial liabilities	-	-	-	-	-	18,121	18,121
<b>Total financial liabilities</b>	<b>844,726</b>	<b>451,096</b>	<b>299,036</b>	<b>61,623</b>	<b>131,043</b>	<b>18,121</b>	<b>1,805,645</b>
Effect of derivatives held for risk management	192,007	(41,023)	(77,519)	(90,435)	16,970	-	-
<b>Net financial assets/(liabilities)</b>	<b>473,396</b>	<b>(366,301)</b>	<b>(156,887)</b>	<b>137,483</b>	<b>119,129</b>	<b>(13,690)</b>	<b>193,130</b>

#### BANK - Jun 2012

<b>Financial assets</b>							
Cash and cash equivalents	72,217	-	-	-	-	-	72,217
Investments	22,149	-	-	-	2,178	-	24,327
Due from related parties	-	-	-	-	-	1,107,857	1,107,857
Finance receivables	416,923	17,785	16,423	22,632	2,863	707	477,333
Finance receivables - securitised	58,205	2,450	2,545	6,397	1,054	-	70,651
Other financial assets	2,122	-	-	-	-	890	3,012
<b>Total financial assets</b>	<b>571,616</b>	<b>20,235</b>	<b>18,968</b>	<b>29,029</b>	<b>6,095</b>	<b>1,109,454</b>	<b>1,755,397</b>
<b>Financial liabilities</b>							
Borrowings	669,815	308,897	396,086	259,956	40,825	-	1,675,579
Borrowings - securitised	75,000	-	-	-	-	-	75,000
Other financial liabilities	415	-	-	-	-	13,187	13,602
<b>Total financial liabilities</b>	<b>745,230</b>	<b>308,897</b>	<b>396,086</b>	<b>259,956</b>	<b>40,825</b>	<b>13,187</b>	<b>1,764,181</b>
Effect of derivatives held for risk management	36,735	30,067	(4,389)	(61,453)	(960)	-	-
<b>Net financial assets/(liabilities)</b>	<b>(136,879)</b>	<b>(258,595)</b>	<b>(381,507)</b>	<b>(292,380)</b>	<b>(35,690)</b>	<b>1,096,267</b>	<b>(8,784)</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 31 Interest rate risk (continued)

#### Contractual repricing analysis (continued)

	0-3 Months \$000	4-6 Months \$000	6-12 Months \$000	1-2 Years \$000	2+ Years \$000	Non-interest bearing \$000	Total \$000
<b>BANK - Jun 2011</b>							
<b>Financial assets</b>							
Cash and cash equivalents	245,322	-	-	-	-	-	245,322
Investments	5,120	1,675	987	-	10,049	-	17,831
Due from related parties	-	-	-	-	-	740,817	740,817
Finance receivables	429,442	31,205	52,292	69,620	10,945	880	594,384
Finance receivables - securitised	20,640	6,103	2,724	1,989	675	-	32,131
Other financial assets	3,048	-	-	-	-	1,610	4,658
<b>Total financial assets</b>	<b>703,572</b>	<b>38,983</b>	<b>56,003</b>	<b>71,609</b>	<b>21,669</b>	<b>743,307</b>	<b>1,635,143</b>
<b>Financial liabilities</b>							
Borrowings	650,933	451,096	299,036	61,623	131,043	-	1,593,731
Borrowings - securitised	20,000	-	-	-	-	-	20,000
Other financial liabilities	-	-	-	-	-	10,751	10,751
<b>Total financial liabilities</b>	<b>670,933</b>	<b>451,096</b>	<b>299,036</b>	<b>61,623</b>	<b>131,043</b>	<b>10,751</b>	<b>1,624,482</b>
Effect of derivatives held for risk management	49,367	(21,333)	(37,429)	(33,315)	42,710	-	-
<b>Net financial assets</b>	<b>82,006</b>	<b>(433,446)</b>	<b>(280,462)</b>	<b>(23,329)</b>	<b>(66,664)</b>	<b>732,556</b>	<b>10,661</b>

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

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 comprehensive income in terms of a fair value change from movements in market interest rates. Furthermore there is no material cash flow impact on the Statements of Cash Flows from a 100 basis point change in interest rates.

### 32 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. These requirements define what is acceptable as capital and provide for methods of measuring the risks incurred by the Banking Group.

The Banking Group must comply with RBNZ minimum capital adequacy ratios as determined in its Conditions of Registration which require capital adequacy ratios to be calculated under the Basel II framework in accordance with the Capital Adequacy Framework (Standardised Approach) BS2A. Basel II consists of three pillars. Pillar One covers the capital requirements for credit, operational, and market (including interest rate) risks. Pillar Two covers all other material risks not already included in Pillar One and the requirement for an internal capital adequacy process; and Pillar Three relates to market disclosure.

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 for the year ended 30 June 2012.

#### Internal Capital Adequacy Assessment Process ('ICAAP')

The Banking Group has an ICAAP which complies with the requirements set out in BS12 and is in accordance with its Conditions of Registration. The Board has overall responsibility for ensuring the Banking Group has adequate overall capital in relation to its risk profile and establishes minimum internal capital levels and limits above the regulatory minimum.

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 32(i) for further details.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 32 Capital adequacy (continued)

#### (a) Bank Capital Summary

	BANKING GROUP
	Jun 2012
	\$000
<b>Tier One Capital</b>	
Issued and fully paid up ordinary share capital	189,774
Perpetual fully paid up non-cumulative preference shares	-
Revenue and similar reserves	160,330
Current year's audited retained earnings	22,612
Tier One minority interests	-
Less deductions from Tier One Capital	
Intangible assets	(22,997)
Net future tax benefits	(8,143)
<b>Total Tier One Capital</b>	<b>341,576</b>
<b>Tier Two Capital</b>	
Upper Tier Two Capital	-
Lower Tier Two Capital	-
<b>Total Tier Two Capital</b>	<b>-</b>
<b>Total Tier One and Tier Two Capital</b>	<b>341,576</b>
<i>Less deductions from capital</i>	-
<b>Total Capital</b>	<b>341,576</b>

#### Capital structure

##### Ordinary shares

In accordance with BS2A, ordinary share capital is classified as Tier One Capital. The ordinary shares have no par value. Each ordinary share of Heartland 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

The accumulated comprehensive income that has been retained in the Banking Group.

#### (b) Credit risk

	BANKING GROUP			
	Total exposure	Risk weighting	Risk weighted exposure	Minimum Pillar One capital requirement
Jun 2012	\$000	%	\$000	\$000
<b>On balance sheet exposures</b>				
Cash	387	0%	-	-
Bank deposits	24,327	20%	4,865	389
Banks	88,833	20%	17,767	1,421
Zero coupon bond (see Note 26(a))	9,026	20%	1,805	144
Residential mortgages not past due - Welcome home loans < 90% loan to value ratio (LVR)	13,253	35%	4,639	371
Residential mortgages not past due - Welcome home loans > 90% LVR	63,140	50%	31,570	2,526
Residential mortgages not past due < 80% LVR	233,699	35%	81,795	6,544
Residential mortgages not past due 80 < 90% LVR	10,146	50%	5,073	406
Residential mortgages not past due 90 < 100% LVR	1,735	75%	1,301	104
Residential mortgages not past due 100%+ LVR	3,256	100%	3,256	260
Past due residential mortgages	2,071	100%	2,071	166
Other past due assets - provision 20%+	13,420	100%	13,420	1,074
Other past due assets - provision < 20%	71,769	150%	107,654	8,612
Corporates and other assets	1,778,287	100%	1,778,287	142,263
Non risk weighted assets	31,140	n/a	-	-
<b>Total on balance sheet exposures</b>	<b>2,344,489</b>		<b>2,053,503</b>	<b>164,280</b>

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 32 Capital adequacy (continued)

#### (b) Credit risk (continued)

	BANKING GROUP					
	Total exposure	Credit conversion Factor	Credit equivalent amount	Average risk weight	Risk weighted exposure	Minimum Pillar One capital requirement
	\$000	\$000	\$000	%	\$000	\$000
<b>Off balance sheet exposures</b>						
Direct credit substitute	5,318	100%	5,318	100%	5,318	425
Performance-related contingency	8,086	50%	4,043	100%	4,043	323
Other commitments where original maturity is more than one year	117,922	50%	58,961	100%	58,961	4,717
Other commitments where original maturity is less than or equal to one year	7,570	20%	1,514	100%	1,514	121
<b>Market related contracts: *</b>						
Interest rate contracts	261,197	n/a	1,167	20%	233	19
<b>Total off balance sheet exposures</b>	<b>400,093</b>		<b>71,003</b>		<b>70,069</b>	<b>5,605</b>
<b>Total credit risk (on and off balance sheet)</b>	<b>2,744,582</b>				<b>2,123,572</b>	<b>169,885</b>

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

#### (c) Residential mortgages by loan-to-valuation ratio (LVR)

	BANKING GROUP	
	Jun 2012	Jun 2011
	\$000	\$000
<b>LVR range</b>		
Does not exceed 80%	235,684	279,274
Exceeds 80% and not 90%	21,862	12,931
Exceeds 90%	69,754	82,620
<b>Total on balance sheet exposures</b>	<b>327,300</b>	<b>374,825</b>
Off balance sheet exposures	8,423	8,996
<b>Total residential mortgages</b>	<b>335,723</b>	<b>383,821</b>

At 30 June 2012, of the balance of "Exceeds 90% residential mortgages" above, \$63.1 million (Jun 2011: \$75.4 million) relates to Welcome Home loans, whose credit risk is mitigated by the Crown.

#### (d) Reconciliation of mortgage related amounts

	BANKING GROUP	
	Jun 2012	Jun 2011
	\$000	\$000
Loans and advances - loans with residential mortgages (see Note 29(d))	324,112	368,214
Plus: Residential mortgages classified as Property in Note 29(d)	3,188	6,611
<b>On-balance sheet residential mortgage exposures subject to the standardised approach</b>	<b>327,300</b>	<b>374,825</b>
Off balance sheet mortgage exposures subject to the standardised approach	8,423	8,996
<b>Total residential exposures subject to the standardised approach</b>	<b>335,723</b>	<b>383,821</b>

#### (e) Credit risk mitigation

As at 30 June 2012 the Banking Group has \$76.4 million (June 2011: \$79.2 million) of Welcome Home Loans, whose credit risk is mitigated by the Crown. Other than this the Banking Group does not have any exposures covered by eligible collateral, guarantees and credit derivatives.

The Banking Group has entered into arrangements to mitigate a risk of loss. This includes a management agreement with RECL in respect of certain non-core real estate loans (see Note 26 - Related party transactions) and a Deed of Guarantee and Indemnity in relation to the Recourse Loans (see Note 36 - Business combinations) acquired in PWF.

#### (f) Operational Risk

Operational risk capital requirement	BANKING GROUP	
	Implied risk weighted exposure	Total operational risk capital requirement
	\$000	\$000
Operational risk	172,355	13,788

Operational risk has been calculated based on the previous 12 quarters of the Banking Group. As the Bank commenced operations on 5 January 2011, quarterly data prior to merger has been calculated as a combination of CBS, SCBS and MARAC.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 32 Capital adequacy (continued)

#### (g) Market risk

		BANKING GROUP	
		Implied risk weighted exposure	Aggregate capital charge
		\$000	\$000
Market risk end-period capital charge	Interest rate risk only	53,094	4,248
Market risk peak end-of-day capital charge	Interest rate risk only	62,870	5,030

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.

#### (h) Total capital requirements

		BANKING GROUP		
		Total exposure	Risk weighted exposure or implied risk weighted exposure	Capital requirement
		\$000	\$000	\$000
Total credit risk		2,744,582	2,123,572	169,885
Operational risk		n/a	172,355	13,788
Market risk		n/a	53,094	4,248
<b>Total</b>		<b>n/a</b>	<b>2,349,021</b>	<b>187,921</b>

#### Basel II Capital Ratios

		BANKING GROUP	
		Jun 2012	Jun 2011
		%	%
<b>Regulatory capital ratios</b>			
Tier One Capital expressed as a percentage of total risk weighted exposures		14.54%	14.12%
Minimum Tier One Capital as per Conditions of Registration		12.00%	12.00%
Total Capital expressed as a percentage of total risk weighted exposures		14.54%	14.12%
Minimum Total Capital as per Conditions of Registration		12.00%	12.00%
<b>Solo capital adequacy *</b>			
Tier One Capital expressed as a percentage of total risk weighted exposures		16.26%	15.54%
Minimum Tier One Capital as per Conditions of Registration		12.00%	12.00%
Total Capital expressed as a percentage of total risk weighted exposures		16.26%	15.54%
Minimum Total Capital as per Conditions of Registration		12.00%	12.00%

\* 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 and CBS Trust.

#### (i) Other material risks

The ICAAP has identified the capital required to be held against other material risks (being concentration risk, strategic / business risk, reputational risk, regulatory risk and model risk). The Board has determined that the regulatory minimum capital of 12% as per the Conditions of Registration is sufficient to cover these other material risks. As a result, there is no additional internal capital allocation for other material risks.

### 33 Contingent liabilities and commitments

		BANKING GROUP		BANK	
		Jun 2012	Jun 2011	Jun 2012	Jun 2011
		\$000	\$000	\$000	\$000
Letters of credit, guarantee commitments and performance bonds		13,404	6,968	-	-
<b>Total contingent liabilities</b>		<b>13,404</b>	<b>6,968</b>	<b>-</b>	<b>-</b>

The Banking Group also has contingent commitments to fund at future dates as set out in Note 29(f) - Credit risk exposure.



## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 34 Staff share ownership arrangements

#### **Discretionary share scheme**

At 1 July 2010, the trustees of the PGC discretionary share scheme held 60,009 shares in PGC on behalf of certain senior MARAC staff. The trustees participated in the PGC dividend reinvestment plan in December 2010, resulting in an allotment of a further 2,160 shares. A total of 9,661 PGC shares were transferred to staff during the year ended 30 June 2011. In May 2011 38,436 PGC shares were exchanged for 14,072 HNZ shares. A total of 14,072 PGC shares and 14,072 HNZ shares were transferred to staff in the year ended 30 June 2012. At 30 June 2012 the trustees held no shares in PGC or HNZ for these senior staff members.

In August 2011, the Heartland New Zealand Limited Employee Share Plan (Employee Share Plan) was established. At 30 June 2012 the terms and conditions of the Employee Share Plan have yet to be determined by the Board.

#### **Executive share scheme**

In January 2011, the PGC executive share plan was established, resulting in an allotment of 803,999 PGC shares to certain senior MARAC staff. A total of 402,000 PGC shares were transferred to executives during the year ended June 2011. In May 2011 294,263 PGC shares were cancelled in exchange for 107,736 HNZ shares. A total of 107,736 PGC shares and 107,736 HNZ shares were transferred to executives during the year ended 30 June 2012. At 30 June 2012 the trustees held no shares in PGC or HNZ for these executives.

The total expense recognised during the year in relation to these share schemes was \$115,346 (June 2011: \$464,072).

Additionally, in January 2011 certain key executives of the Banking Group who were previously employed by PGC also participated in the PGC Executive Share scheme, resulting in an allotment of 3,574,999 PGC shares. A total of 1,787,500 PGC shares were transferred to executives during the year ended 30 June 2011. In May 2011 1,308,449 PGC shares were cancelled in exchange for 479,050 HNZ shares. A total of 479,050 PGC shares and 479,050 HNZ shares were transferred to executives during the year ended 30 June 2012. At 30 June 2012 the trustees held no shares in PGC or HNZ for these executives. No expense is recognised in relation to these shares as the cost was borne by PGC.

### 35 Insurance business, securitisation, funds management, other fiduciary activities

#### **Insurance business**

The Banking Group does not conduct any insurance business.

#### **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 wholly owned subsidiary of MARAC JV Holdings Limited of which HNZ holds a 50% joint venture interest with the New Zealand Automobile Association. During the year ended 30 June 2012, there have been no material changes in the Banking Group's marketing and distribution of insurance products.

#### **Securitisation**

As at 30 June 2012, the Banking Group had securitised assets amounting to \$276.8 million (30 June 2011: \$209.7 million). These assets have been sold to CBS Trust (a special purpose vehicle established for the purpose of purchasing residential mortgages from the Banking Group and funded through a warehouse loan facility provided by Westpac) and 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 a Westpac liquidity facility). Note 25 - Special purpose entities provides further information on the securitised assets. The Banking Group receives fees for various services provided to the securitisation vehicles on an arm's length basis, including servicing fees. These fees are recognised as earned. All securitisation vehicles form part of the Banking Group.

#### **Funds management and other fiduciary activities**

The Banking Group, through MARAC, controls, manages and administers the Heartland Cash and Term PIE Fund and its products (Heartland Call PIE and Heartland Term Deposit PIE). Note 25 - Special Purpose Entities has further details. The Heartland Cash and Term PIE Fund deals with MARAC in the normal course of business, in MARAC's capacity as manager 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 28 - Risk Management Policies.

#### **Provision of financial services and asset purchases**

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

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

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 35 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 ended 30 June 2012 (30 June 2011: \$nil).

The Banking Group provided funding to ABCP Trust and CBS Trust, which are members 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 2012	Jun 2011
Peak end-of-day aggregate amount of funding provided (\$000's)	57,571	53,061
Peak end-of-day aggregate amount of funding provided as a percentage of the Banking Group's Tier One Capital as at the end of the year	16.9%	19.6%

	CBS TRUST		ABCP TRUST	
	Jun 2012	Jun 2011	Jun 2012	Jun 2011
Peak end-of-day aggregate amount of funding provided (\$000's)	37,377	35,607	22,787	21,712
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	45.7%	106.3%	10.8%	11.3%

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 One Capital (as the case required) as at the end of the year.

### 36 Business combinations

#### (a) Heartland merger

On 5 January 2011, Heartland acquired the assets and engagements of SCBS and CBS and all of the shares in MARAC. As part of this process:

- MARAC Financial Services Limited exchanged its shareholding in MARAC and its investment in MARAC JV Holdings Limited for shares in HNZ. The agreed consideration of \$206,769,000 converted to the issue of 3.94 fully paid shares in HNZ in exchange for each MARAC share.
- Heartland, a wholly owned subsidiary of HNZ, acquired all of the assets and engagements of SCBS and CBS for the total agreed consideration of \$79,574,000.
- Heartland acquired all of the shares in MARAC through HNZ transferring its shareholding in MARAC to Heartland (through its subsidiaries as intermediate holders).

#### Fair value of consideration transferred at acquisition date

	HEARTLAND GROUP
	05-Jan-11
	\$000
Shares issued, at fair value	79,574
<b>Consideration transferred</b>	<b>79,574</b>

#### Identifiable assets acquired and liabilities assumed

	Fair value
	05-Jan-11
	\$000
<b>Assets</b>	
Cash and cash equivalents	207,126
Investments	21,540
Finance receivables	669,689
Other assets	12,075
Intangible assets	155
<b>Total assets</b>	<b>910,585</b>
<b>Liabilities</b>	
Borrowings	841,335
Other liabilities	9,817
Contingent liabilities	-
<b>Total liabilities</b>	<b>851,152</b>
<b>Total net identifiable assets</b>	<b>59,433</b>
Total consideration transferred	79,574
Fair value of identifiable net assets	59,433
<b>Goodwill</b>	<b>20,141</b>

Goodwill on acquisition of \$20.1 million has arisen due to expected benefits of the newly formed financial services group. The Bank has the benefits of scale and scope and is expected to be value enhancing for all shareholders and offers a better outcome than could be expected as standalone entities.

Goodwill of \$20.1 million has not been allocated to individual cash generating units, as the future economic benefit is attributable to all business units. The Banking Group's management and board continue to monitor goodwill at a total level.

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2012

### 36 Business combinations (continued)

#### (b) Purchase of PGG Wrightson Finance Limited

On 31 August 2011, Heartland acquired 100% of PWF from PGW. PWF offers a wide range of financial services, specialising in the rural sector.

The purchase price was \$98.0 million being an amount equal to the net tangible assets of PWF, adjusted to take account of certain agreed items. In consideration:

- PGW retained certain loans, most of which were impaired (excluded loans). PWF transferred these excluded loans to a special purpose vehicle (SPV) established by PGW. This resulted in a debt being owed by the SPV back to PWF of \$73.1 million.
- Heartland paid PGW cash of \$24.9 million.

Contemporaneously, HNZ issued \$10.0 million of shares to PGW.

On 31 August 2011 immediately prior to settlement \$52.7 million of loans not previously recorded in the accounts of PWF that were subject to a risk sharing agreement between PWF and ASB Bank and were purchased by PWF for cash. Of these loans \$37.3 million form part of the finance receivables purchased by Heartland and \$15.4 million were excluded loans transferred to the SPV.

#### *Fair value of consideration transferred at acquisition date*

	<b>HEARTLAND GROUP</b>
	<b>31-Aug-11</b>
	<b>\$000</b>
Excluded loans and deferred tax	73,115
Cash paid	24,898
<b>Consideration transferred</b>	<b>98,013</b>

#### *Identifiable assets acquired and liabilities assumed*

	<b>Fair value</b>
	<b>31-Aug-11</b>
	<b>\$000</b>
<b>Assets</b>	
Cash and cash equivalents	61,643
Finance receivables *	371,627
Other assets	1,346
<b>Total assets</b>	<b>434,616</b>
<b>Liabilities</b>	
Due to related parties **	335,703
Other liabilities	900
Contingent liabilities	-
<b>Total liabilities</b>	<b>336,603</b>
<b>Total net identifiable assets</b>	<b>98,013</b>
Total consideration transferred	98,013
Fair value of identifiable net assets	98,013
<b>Goodwill</b>	<b>-</b>

\* Prior to the final settlement on 31 August 2011 the Heartland Group purchased a \$29 million loan from PWF for cash, bringing the total receivables acquired to \$401 million.

\*\* Due to related parties consists of PWF's borrowings acquired of \$408.8 million which were transferred to become deposits in Heartland on 31 August 2011, offset by \$73.1 million excluded loans and deferred tax.

As part of the acquisition, Heartland and PGW entered into a Deed of Guarantee and Indemnity in relation to the Recourse Loans, with book value on acquisition of \$30.6 million. This arrangement provides Heartland with a guarantee from PGW in relation to the future payment of principal and interest on the Recourse Loans for a prescribed period of three years. As at 30 June 2012, total recourse loans of \$28.9 million are included in the Banking Group's finance receivables.

#### *Transactions separate from the acquisition*

The Heartland Group incurred acquisition-related costs of \$0.8 million in the year to 30 June 2011 and \$0.2 million in the year ended 30 June 2012, relating to external legal fees and due diligence costs. These costs are included in selling and administration expenses.

### 37 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

	BANKING GROUP					
	For the year ended	Audited 30 Jun 12	Audited 30 Jun 11	Audited 30 Jun 10	Audited 30 Jun 09	Audited 30 Jun 08
		\$000	\$000	\$000	\$000	\$000
Interest income		205,131	161,297	148,337	168,933	173,438
Interest expense		121,502	99,705	89,271	109,318	108,637
<b>Net interest income</b>		<b>83,629</b>	<b>61,592</b>	<b>59,066</b>	<b>59,615</b>	<b>64,801</b>
Other net income		11,329	8,988	10,015	6,004	5,389
<b>Total operating income before other gains</b>		<b>94,958</b>	<b>70,580</b>	<b>69,081</b>	<b>65,619</b>	<b>70,190</b>
Employee benefits		34,661	22,049	13,049	13,377	14,411
Other operating expenses		29,520	22,777	11,976	11,671	11,404
<b>Profit before impairment and tax</b>		<b>30,777</b>	<b>25,754</b>	<b>44,056</b>	<b>40,571</b>	<b>44,375</b>
Impaired asset expense		5,642	13,298	23,765	13,318	5,726
Decrease in fair value of investment properties		3,900	-	-	-	-
<b>Net profit before tax</b>		<b>21,235</b>	<b>12,456</b>	<b>20,291</b>	<b>27,253</b>	<b>38,649</b>
Income tax (benefit) / expense		(2,974)	4,712	5,992	8,199	12,785
<b>Net profit after tax attributable to owners of the entity</b>		<b>24,209</b>	<b>7,744</b>	<b>14,299</b>	<b>19,054</b>	<b>25,864</b>
<b>Other comprehensive income/(loss) for the period net of tax</b>						
Effective portion of changes in fair value of cash flow hedges, net of		378	596	4,208	(4,427)	(1,765)
Net change in available-for-sale reserve, net of tax		(103)	111	-	-	-
Net change in defined benefit reserve, net of income tax		(435)	14	-	-	-
<b>Total comprehensive income for the year, net of tax</b>		<b>24,049</b>	<b>8,465</b>	<b>18,507</b>	<b>14,627</b>	<b>24,099</b>
Dividends paid to equity holders		1,597	866	-	13,000	5,000

### Statements of Financial Position

	BANKING GROUP					
	As at	Audited 30 Jun 12	Audited 30 Jun 11	Audited 30 Jun 10	Audited 30 Jun 09	Audited 30 Jun 08
		\$000	\$000	\$000	\$000	\$000
Total assets		2,344,489	2,115,485	1,294,556	1,412,795	1,352,264
Individually impaired assets		56,825	68,537	42,647	23,465	20,407
Total liabilities		1,973,196	1,821,644	1,088,088	1,259,834	1,212,275
Total equity		371,293	293,841	206,468	152,961	139,989

From a legal perspective MARAC is a subsidiary of Heartland. Under New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) the merger was treated as a reverse acquisition. The business combination was therefore accounted for as if MARAC acquired 72% of Heartland. The effect of this treatment is that these financial statements represent a continuation of the business of MARAC. See Note 1 - Reporting entity for further information.

The information for the periods from 30 June 2008 to 30 June 2010 has been taken from the audited financial statements of MARAC. Where accounting classifications have changed or where changes in accounting policy are adopted retrospectively, comparatives have been revised and may differ from results previously reported.



## Independent auditor's report

### To the shareholders of Heartland Building Society

#### Report on the disclosure statement (excluding supplementary information relating to capital adequacy)

We have audited the accompanying disclosure statement and supplementary information (excluding the supplementary information relating to capital adequacy disclosed in note 32) of Heartland Building Society ("the bank") and its related entities ("the banking group") on pages 11 to 59. The disclosure statement comprises the statements of financial position as at 30 June 2012, 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 bank and banking group. The supplementary information comprises the information that is required to be disclosed under the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order (No 2) 2012 (the "Order").

#### Directors' responsibility for the disclosure statement

The directors are responsible for the preparation of the disclosure statement, which includes financial statements prepared in accordance with Clause 24 of the Order, generally accepted accounting practice in New Zealand, and International Financial Reporting Standards, and that gives a true and fair view 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 disclosure statement that is free from material misstatement whether due to fraud or error.

In addition, 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 (excluding the supplementary information relating to capital adequacy disclosed in note 32), disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order and presented to us by the directors. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the disclosure statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the disclosure statement. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the disclosure statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the bank and banking group's preparation of the disclosure statement that gives a true and fair view of 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 bank and 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 disclosure statement.

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

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

### **Opinion**

In our opinion the disclosure statement of Heartland Building Society and its related entities (“the bank” and “banking group”) on pages 11 to 59 (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 13, 14, 15 and 17 of the Order):

- complies with generally accepted accounting practice in New Zealand;
- complies with International Financial Reporting Standards; and
- gives a true and fair view of the financial position as at 30 June 2012 and of their financial performance and cash flows for the year ended on that date.

### **Opinion on supplementary information (excluding supplementary information relating to capital adequacy)**

In our opinion, the supplementary information that is required to be disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order, and is included within notes 28, 29, 30, 31, 32 and 35 of the disclosure statement:

- 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 bank and banking group; and
- presents fairly, in all material respects, the matters to which it relates, in accordance with those Schedules.

### **Report on other legal and regulatory requirements (excluding supplementary information relating to capital adequacy)**

In accordance with the requirements of sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993, and 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 bank and banking group, as far as appears from our examination of those records.



## **Report on supplementary information relating to capital adequacy**

We have reviewed the capital adequacy information, as disclosed in note 32 of the disclosure statement for the year ended 30 June 2012.

### **Directors' responsibility for the capital adequacy information**

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.

### **Auditor's responsibility**

Our responsibility is to express an opinion on the supplementary information relating to capital adequacy based on our review. We conducted our review in accordance with the Review Engagement Standards issued by the New Zealand Institute of Chartered Accountants.

We are responsible for reviewing the disclosures in order to state whether, on the basis of the procedures described below, anything has come to our attention that would cause us to believe that the supplementary information is not, in all material respects:

- prepared in accordance with the bank'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.

### **Opinion**

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 32 of the disclosure statement, is not, in all material respects, in accordance with:

- the bank's conditions of registration; and
- Schedule 9 of the Order.

*KPMG*

17 December 2012

Auckland