Financial Statements

HEARTLAND
GROUP

FOR THE 12 MONTHS ENDED 30 JUNE 2020

CONTENTS

Financial Statements

GENERAL INFORMATION

These financial statements are issued by Heartland Group Holdings Limited (**HGH**) and its subsidiaries (the **Group**) for the year ended 30 June 2020.

Name and address for service

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

Details of incorporation

HGH was incorporated in New Zealand under the Companies Act 1993 on 19 July 2018.

AUDITOR

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland

OTHER MATERIAL MATTERS

There are no material matters relating to the business or affairs of the Group that are not contained elsewhere in these consolidated financial statements which would, if disclosed in these consolidated financial statements, materially affect the decision of a person to subscribe for debt or equity instruments of which the Group is the issuer.

DIRECTORS

All Directors of HGH reside in New Zealand with the exception of Ellen Comerford who resides in Australia. Communications to the Directors can be sent to Heartland Group Holdings Limited, 35 Teed Street, Newmarket, Auckland. At the time of the signing of these consolidated financial statements the Directors of HGH and their details were:

Name: Geoffrey Thomas Ricketts CNZM
Chairman - Board of Directors
Type of Director: Independent Non-Executive Director
Qualifications: LLB (Hons), LLD *(honoris causa),* CFInstD
Occupation: Company Director
External Directorships:

Janmac Capital Limited, Maisemore Enterprises Limited, MCF2 Message4U Limited, MCF 2 Nexus Limited, MCF 7 Limited, MCF 8 Limited, MCF 9 Limited, MCF 10 Limited, MCF2 (Fund 1) Limited, MCF2A General Partner Limited, MCF2 GP Limited, MCF3 GP Limited, MCF3B General Partner Limited, MCF3A General Partner Limited, MCF2 FFF-GK Limited, MCF3 Cook Limited, MCF3 TEG Limited, MCF3 Squiz Limited, MC Medical Properties Limited, Mercury Capital No.1 Fund Limited, Mercury Capital No. 1 Trustee Limited, Mercury Medical Holdings 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 Limited, Oceania and Eastern Securities Limited, Oceania North Limited, Oceania Securities Limited, Quartet Equities Limited, The Centre for Independent Studies Limited.

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

Auscred Limited, Hollard Holdings Australia Pty Limited, The Hollard Insurance Group Pty Limited, Comerford Gohl Holdings Pty Limited.

Name: Sir Christopher Robert Mace KNZM
Type of Director: Independent Non-Executive Director
Qualifications: CMInstD
Occupation: Company Director
External Directorships:

Akitu Equities Limited, Akitu Capital Limited, Akitu Group Company No 1 Limited, Akitu Group Company No 2 Limited, Akitu Group Company No 3 Limited, Akitu Health Services Limited, Akitu Investments Limited, Akitu Investments No 2 Limited, Goldburn Resources Limited, Helicopter Enterprises Limited, Janik Equities Limited, Janmac Capital Limited, J N S Capital Limited, Mace Capital Limited, Mace Construction Limited, Mace Developments Limited, Mace Enterprises Limited, Mace Investments Limited, Maisemore Enterprises Limited, Nuffield Forestry Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, O & E Group Services Limited, Paroa Bay Station Limited, PPT Trustee (NZ) Limited, Quartet Equities Limited, Ryburn Lagoon Trust Limited, St. Just Enterprises Limited, Te Puia Tapapa GP Limited, The Aotearoa Circle.

Name: Gregory Raymond Tomlinson
Type of Director: Non-Independent Non-Executive Director
Qualifications: AME
Occupation: Company Director
External Directorships:

Alta Cable Holdings Limited, Argenta Limited, Chippies Vineyard Limited, Forte Health Group Limited, Forte Health Limited, Impact Capital Limited, Indevin Group Limited, Little Ngakuta Trust Company Limited, Mountbatten Trustee Limited, Nearco Stud Limited, Oceania Healthcare Limited, Pelorus Finance Limited, St Leonards Limited, The Icehouse Limited, Tomlinson Group NZ Limited, Tomlinson Holdings Limited, Tomlinson Group Investments Limited, Tomlinson Ventures Limited.

Name: Jeffrey Kenneth Greenslade
Type of Director: Non-Independent Executive Director
Qualifications: LLB
Occupation: Chief Executive Officer of HGH

External Directorships:
Henley Family Investments Limited.

DIRECTORS' STATEMENTS

The consolidated financial statements are dated 17 September 2020 and have been signed by all the Directors.

G T Ricketts (Chair)

E F Comerford

J K Greenslade

Sir C R Mace

G R Tomlinson

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2020

$000's	Note	June 2020	June 2019
Interest income	3	346,802	330,041
Interest expense	3	130,129	135,734
Net interest income		**216,673**	**194,307**
Operating lease income	4	5,946	6,337
Operating lease expense	4	4,063	3,670
Net operating lease income		**1,883**	**2,667**
Lending and credit fee income		10,811	6,642
Other income	5	3,882	2,435
Net operating income		**233,249**	**206,051**
Operating expenses	6	106,794	85,798
Profit before impaired asset expense and income tax		**126,455**	**120,253**
Fair value gain on investment		2,097	1,936
Impaired asset expense	8	29,419	20,676
Profit before income tax		**99,133**	**101,513**
Income tax expense	9	27,161	27,896
Profit for the year		**71,972**	**73,617**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss, net of income tax:			
Effective portion of change in fair value of derivative financial instruments		(2,179)	(4,762)
Movement in fair value reserve		766	2,968
Movement in foreign currency translation reserve		114	(5,281)
Items that will not be reclassified to profit or loss, net of income tax:			
Movement in defined benefit reserve		-	(86)
Other comprehensive (loss) for the year, net of income tax		**(1,299)**	**(7,161)**
Total comprehensive income for the year		**70,673**	**66,456**
Earnings per share			
Basic earnings per share	10	12c	13c
Diluted earnings per share	10	12c	13c

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

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2020

		June 2020				June 2019			
$000's	**Note**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**
Balance at beginning of year		**558,970**	**(4,297)**	**120,995**	**675,668**	**542,315**	**4,585**	**117,260**	**664,160**
NZ IFRS 9 adjustment		-	-	-	-	-	-	(19,283)	(19,283)
NZ IFRS 16 adjustment	1	-	-	(751)	(751)	-	-	-	-
Restated balance at beginning of year		**558,970**	**(4,297)**	**120,244**	**674,917**	**542,315**	**4,585**	**97,977**	**644,877**
Total comprehensive income for the year									
Profit for the year		-	-	71,972	71,972	-	-	73,617	73,617
Other comprehensive (loss), net of income tax		-	(1,299)	-	(1,299)	-	(7,161)	-	(7,161)
Total comprehensive income for the year		**-**	**(1,299)**	**71,972**	**70,673**	**-**	**(7,161)**	**73,617**	**66,456**
Contributions by and distributions to owners									
Dividends paid	16	-	-	(62,993)	(62,993)	-	-	(50,599)	(50,599)
Dividend reinvestment plan	16	16,895	-	-	16,895	14,333	-	-	14,333
Issue of share capital		-	-	-	-	-	-	-	-
Transaction costs associated with capital raising		(28)	-	-	(28)	(18)	-	-	(18)
Share based payments		-	516	-	516	-	619	-	619
Shares vested		420	(420)	-	-	2,340	(2,340)	-	-
Total transactions with owners		**17,287**	**96**	**(62,993)**	**(45,610)**	**16,655**	**(1,721)**	**(50,599)**	**(35,665)**
Balance at the end of the year		**576,257**	**(5,500)**	**129,223**	**699,980**	**558,970**	**(4,297)**	**120,995**	**675,668**

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2020

$000's	Note	June 2020	June 2019
Assets			
Cash and cash equivalents		147,179	74,496
Investments	11	413,340	354,928
Investment properties		11,132	11,132
Derivative financial instruments	12	17,246	14,491
Finance receivables	13	3,045,195	3,031,128
Finance receivables - reverse mortgages	13	1,538,585	1,318,677
Operating lease vehicles	14	17,603	15,516
Right of use assets	18	18,362	-
Other assets	18	19,558	27,208
Intangible assets	18	72,813	71,924
Deferred tax asset	9	17,123	9,531
Total assets		**5,318,136**	**4,929,031**
Liabilities			
Deposits	15	3,264,192	3,153,681
Other borrowings	15	1,267,931	1,057,568
Tax liabilities		12,303	7,532
Derivative financial instruments	12	17,012	11,147
Lease liabilities	18	20,456	-
Trade and other payables	18	36,262	23,435
Total liabilities		**4,618,156**	**4,253,363**
Equity			
Share capital	16	576,257	558,970
Retained earnings and reserves		123,723	116,698
Total equity		**699,980**	**675,668**
Total equity and liabilities		**5,318,136**	**4,929,031**

Total interest earning and discount bearing assets		5,114,348	4,757,615
Total interest and discount bearing liabilities		4,518,174	4,199,564

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2020

$000's	Note	June 2020	June 2019
Cash flows from operating activities			
Interest received		258,665	249,193
Operating lease income received		5,934	5,392
Lending, credit fees and other income received		16,037	7,284
Operating inflows		**280,636**	**261,869**
Interest paid		117,313	143,252
Payments to suppliers and employees		82,874	87,528
Taxation paid		24,619	25,895
Operating outflows		**224,806**	**256,675**
Net cash flows from operating activities before changes in operating assets and liabilities		**55,830**	**5,194**
Proceeds from sale of operating lease vehicles		4,969	4,959
Purchase of operating lease vehicles		(9,938)	(5,496)
Net movement in finance receivables		(171,617)	(329,378)
Net movement in deposits		110,993	270,232
Net cash flows (applied to) operating activities		**(9,763)**	**(54,489)**
Cash flows from investing activities			
Sale of property, plant and equipment and intangible assets		118	-
Total cash provided from investing activities		**118**	**-**
Purchase of property, plant and equipment and intangible assets		6,739	4,514
Net increase in investments		55,549	11,226
Total cash applied to investing activities		**62,288**	**15,740**
Net cash flows (applied to) investing activities		**(62,170)**	**(15,740)**
Cash flows from financing activities			
Net increase / (decrease) in wholesale funding		85,795	(14,580)
Proceeds from issue of Unsubordinated Notes		106,952	177,247
Total cash provided from financing activities		**192,747**	**162,667**
Dividends paid	16	46,098	36,266
Repayments of subordinated notes		-	26,206
Payment of lease liabilities		2,005	-
Transaction costs associated with capital raising		28	18
Total cash applied to financing activities		**48,131**	**62,490**
Net cash flows from financing activities		**144,616**	**100,177**
Net increase in cash held		**72,683**	**29,948**
Opening cash and cash equivalents		74,496	44,548
Closing cash and cash equivalents		**147,179**	**74,496**

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2020

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

$000's	Note	June 2020	June 2019
Profit for the year		**71,972**	**73,617**
Add / (less) non-cash items:			
Depreciation and amortisation expense		9,161	5,760
Depreciation on lease vehicles	14	3,634	3,363
Capitalised net interest income and fee income		(77,429)	(81,325)
Impaired asset expense	8	29,419	20,676
Investment fair value movement		(2,097)	(1,936)
Other non-cash items		2,488	1,750
Total non-cash items		**(34,824)**	**(51,712)**
Add / (less) movements in operating assets and liabilities:			
Finance receivables		(171,617)	(329,378)
Operating lease vehicles		(4,969)	(537)
Other assets		9,528	(5,599)
Current tax		4,771	(3,927)
Derivative financial instruments		931	(8,231)
Deferred tax		(7,592)	(4,212)
Deposits		110,993	270,232
Other liabilities		11,044	5,258
Total movements in operating assets and liabilities		**(46,911)**	**(76,394)**
Net cash flows applied to operating activities		**(9,763)**	**(54,489)**

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2020

1 Financial statements preparation

Reporting entity

The financial statements presented are the consolidated financial statements comprising Heartland Group Holdings Limited (**HGH**) and its subsidiaries (the **Group**). Refer Note 25 – Significant subsidiaries for further details.

As at 30 June 2020, HGH is a company incorporated in New Zealand under the Companies Act 1993 and a Financial Market Conduct (**FMC**) reporting entity for the purposes of the Financial Markets Conduct Act 2013.

Basis of preparation

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**) and the NZX Main Board Listing Rules and the ASX Listing Rules. 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. The financial statements also comply with International Financial Reporting Standards (**IFRS**) as issued by the International Accounting Standards Board.

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

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

The accounting policies adopted have been applied consistently throughout the periods presented in these financial statements.

Certain comparative balances have been reclassified to align with the presentation used in the current financial year. These reclassifications have no impact on the overall financial performance or financial position for the comparative year.

Basis of measurement

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

Principles of consolidation

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

Assets and liabilities in a transactional currency that is not the New Zealand dollar, are translated at the exchange rates ruling at balance date. Revenue and expense items are translated at the spot rate at the transaction date. Exchange differences are taken to the consolidated statement of comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2020

1 Financial statements preparation (continued)

Changes in accounting standards

Impact of adopting NZ IFRS 16 Leases

The Group has adopted NZ IFRS 16 retrospectively from 1 July 2019, but has not restated comparatives for the 2019 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 July 2019.

The Group leases office space, car parks, equipment and cars. Rental contracts are typically made for fixed periods but may have extension options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions.

Until 30 June 2019, leases of property, plant and equipment were classified as either finance or operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss.

From 1 July 2019, leases are recognised as a right-of-use asset and a corresponding lease liability at the date at which the leased asset is available for use by the Group. The right-of-use assets are initially measured at cost, comprising the amount of the initial measurement of the lease liability, any lease payments made at or before the commencement date less any lease incentives received, any initial direct costs and restoration costs. The right-of-use asset is depreciated over the shorter of the asset's estimated useful life and the lease term on a straight-line basis. The estimated useful life of right-of-use assets are determined on the same basis as those of property, plant and equipment.

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option. Extension options are only included in the lease term if the lease is reasonably certain to be extended.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less.

On adoption of NZ IFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of NZ IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the Group's incremental borrowing rate as at 1 July 2019. The weighted average Group's incremental borrowing rate applied to the lease liabilities on 1 July 2019 was 2.9%.

The Group elected not to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, for contracts entered into before the transition date, the Group relied on its assessment made applying NZ IAS 17 and NZ IFRIC 4 Determining whether an Arrangement contains a Lease.

$000's	
Operating lease commitments as at 30 June 2019	**12,497**
Discounted using the Group's incremental borrowing rate on initial application	(1,060)
Adjustments relating to changes in the index or rate effective variable payments	316
Lease liability recognised as at 1 July 2019	**11,753**
Of which are:	
Current lease liabilities	1,947
Non-current lease liabilities	9,806
Total lease liabilities	**11,753**

1 Financial statements preparation (continued)

The associated right-of-use assets which are predominantly property leases were measured on a retrospective basis as if the new rules had always been applied. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets at the date of initial application.

The change in accounting policy affected the following items in the consolidated statement of financial position as at 1 July 2019.

- Right-of-use assets: increased by $10.7 million
- Deferred tax assets: increased by $0.3 million
- Lease liabilities: increased by $11.8 million

The net impact on retained earnings on 1 July 2019 was a decrease of $0.8 million.

The adoption of NZ IFRS 16 has no material impact to the Group's leasing business where the Group acts as the lessor.

There have been no other changes to accounting policies or new or amended standards that are issued and effective that are expected to have a material impact on the Group.

Accounting standards issued but not yet effective

NZ IFRS 17 Insurance Contracts was issued in July 2017 and is applicable to general and life insurance contracts. NZ IFRS 17 will replace NZ IFRS 4 Insurance Contracts. In March 2020, the effective date of NZ IFRS 17 was deferred by one year. As such it is expected that the standard will be effective for the Group's reporting for the financial year ending 30 June 2024, including 30 June 2023 comparatives.

The Group conducts insurance business through its subsidiary MARAC Insurance Limited (**MIL**). MIL has entered into a distribution agreement with DPL Insurance Limited (**DPL**) to distribute DPL's insurance products through its network and has stopped writing insurance policies in February 2020. The Group will assess the impact arising from NZ IFRS 17 in conjunction with this new arrangement.

Other amendments to existing standards that are not yet effective are not expected to have a material impact on the Group.

Estimates and judgements

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

- Provisions for impairment - The effect of credit risk is quantified based on the Group's best estimate of future cash repayments and proceeds from any security held or by reference to risk profile groupings, historical loss data and forward-looking information. Refer to Note 8 - Impaired asset expense, and Note 13 - Finance receivables for further details.
- Fair value of reverse mortgages - Fair value is quantified by the transaction price and the Group's subsequent best estimate of the risk profile of the reverse mortgage portfolio. Refer to Note 20 - Fair value for further details.
- Goodwill - Determining the fair value of assets and liabilities of acquired businesses requires the Group to exercise judgement. The carrying value of goodwill is tested annually for impairment, refer to Note 18 - Other balance sheet items.

1 Financial statements preparation (continued)

Assumptions made at each reporting date (e.g. the calculation of the provision for impairment and fair value adjustments) are based on best estimates as at that date. Although the Group has internal controls in place to ensure that estimates can be reliably measured, actual amounts may differ from these estimates. The estimates and judgements used in the preparation of the Group's financial statements are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity. Revisions to accounting estimates are recognised in the reporting period in which the estimates are revised and in any future periods affected.

COVID-19 Pandemic - Impact on Estimates and Judgements

On 11 March 2020, COVID-19 was declared a pandemic by the World Health Organisation. The domestic economy has been significantly disrupted by measures put in place to limit the impact of the spread of COVID-19 among the community, and also by the downstream effects of the deterioration that COVID-19 has caused in the global economy. Countermeasures implemented by Government (including the Government's support and fiscal programmes) and the Reserve Bank of New Zealand have assisted to mitigate the impact of those measures – however, the unprecedented nature of the current environment and the number of variables which impact on that environment means that significant uncertainty around future economic conditions remains.

The Group has responded to the pandemic by working with its customers to understand their needs and provide them with the financial support that best meets their requirements. To date, that support has included participating in industry wide measures (such as the mortgage deferrals programme and the provision of liquidity under the Business Finance Guarantee Scheme (**BFGS**) program), and implementing other measures such as temporary payment reduction or payment deferral arrangements for both business and consumer customers. The Group has also developed a product, Heartland Extend, which provides customers with flexible payment options.

The accounting judgement that is most impacted by the pandemic relates to expected credit losses (**ECL**) on finance receivables at amortised cost. The Group's accounting policy for the recognition and measurement of the allowance for ECL is described in Note 8 Impaired asset expense. The Group measures the allowance for ECL using an expected credit loss impairment model in compliance with NZ IFRS 9 Financial Instruments.

The impact of the pandemic has also been considered where there is significant use of forward-looking estimates and judgement, primarily when identifying impairment indicators for goodwill and intangible assets and calculating the recoverable amount.

The impact of the COVID-19 pandemic on each of these estimates and judgements is discussed further in the following notes to the consolidated financial statements:

- Note 8 - Impaired asset expense
- Note 13 - Finance receivables
- Note 18 - Other balance sheet items - Goodwill
- Note 20 - Fair value

1 Financial statements preparation (continued)

Financial assets and liabilities

Financial Assets

Financial assets are classified based on:

- The business model within which the assets are managed; and
- Whether the contractual cash flows of the instrument represent solely payment of principal and interest (**SPPI**).

The Group determines the business model at the level that reflects how groups of financial assets are managed. When assessing the business model, the Group considers factors including how performance and risks are managed, evaluated and reported and the frequency and volume of, and reason for sales in previous periods.

Financial assets are classified into the following measurement categories:

Financial Assets	**Measurement Category**	**Note**
Bank bonds and floating rate notes	Fair value through other comprehensive income (**FVOCI**)	11
Public sector securities and corporate bonds	FVOCI	11
Local authority stock	FVOCI	11
Equity investments	Fair value through profit or loss (**FVTPL**)	11
Finance receivables – reverse mortgages	FVTPL	13
Finance receivables	Amortised cost	13

Financial assets measured at amortised cost
Financial assets are measured at amortised cost if they are held within a business model whose objective is achieved through holding the financial asset to collect contractual cash flows which represent SPPI on the principal balance.

Financial assets at amortised cost are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

Financial assets measured at FVOCI
Financial assets are measured at FVOCI if they are held within a business model whose objective is achieved both through collecting contractual cash flows which represent SPPI on the principal balance or selling the financial asset.

Financial assets at FVOCI are measured at fair value with unrealised gains and losses recognised in other comprehensive income except for interest income, impairment charges and foreign exchange gains and losses, which are recognised in profit or loss.

1 Financial statements preparation (continued)

Financial assets measured at FVTPL
Financial assets are measured at FVTPL if:

- They are held within a business model whose objective is achieved through selling or repurchasing the financial asset in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or
- They are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

Financial assets at FVTPL are measured at fair value with subsequent changes in fair value recognised in profit or loss.

Financial Liabilities

Financial liabilities are classified into the following measurement categories:

- Those to be measured at amortised cost;
- Those to be measured at FVTPL.

Financial liabilities measured at amortised cost
Financial liabilities are measured at amortised cost if they are not held for trading or designated at FVTPL.

Financial liabilities measured at amortised cost are accounted for using the effective interest rate method.

Financial liabilities measured at FVTPL
Financial liabilities are measured at FVTPL if:

- They are held for trading whose principal objective is achieved through selling or repurchasing the financial liability in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or
- They are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

Financial liabilities at FVTPL are measured at fair value with subsequent changes in fair value recognised in profit or loss.

Further details of the accounting policy for each category of financial asset or financial liability mentioned above is set out in the note for the relevant item.

The Group’s policies for determining the fair value of financial assets and financial liabilities are set out in Note 20 - Fair value.

Recognition

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2020

1 Financial statements preparation (continued)

Derecognition

The 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 Group is recognised as a separate asset.

The Group enters into transactions whereby it transfers assets recognised on its consolidated statement of financial position, but retains either all risks or 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 consolidated statement of financial position. Transfers of assets with the retention of all or substantially all risks and rewards include, for example, securitised assets and repurchase transactions.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, the exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, with the difference in the respective carrying amounts recognised in profit or loss.

Offsetting financial instruments

The Group offsets financial assets and financial liabilities and reports the net balance in the balance sheet where there is currently a legally enforceable right to set off and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Performance

2 Segmental analysis

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

Operating segments

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

Motor	Motor vehicle finance.
Reverse mortgages	Reverse mortgage lending within New Zealand.
Other personal	A comprehensive range of financial services - including term, transactional and personal loans to individuals.
Business	Term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized businesses.
Rural	Specialist financial services to the farming sector primarily offering livestock finance, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.
Australia	Reverse mortgage lending and other financial services within Australia.

Certain operating expenses, such as premises, IT and support centre costs are not allocated to operating segments and are included in Other. Liabilities are managed centrally and therefore are not allocated across the operating segments.

The Group's operating segments are different from the industry categories detailed in Note 22 - Credit risk exposure. The operating segments are primarily categorised by sales channel, whereas Note 22 - Credit risk exposure categorises exposures based on credit risk concentrations.

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Australia	Other	Total
June 2020								
Net interest income	56,957	20,118	18,365	57,950	29,674	30,127	3,482	216,673
Net other income	3,622	3,430	3,055	3,465	1,028	4,214	(2,238)	16,576
Net operating income	**60,579**	**23,548**	**21,420**	**61,415**	**30,702**	**34,341**	**1,244**	**233,249**
Operating expenses	3,248	4,804	6,776	11,283	2,648	11,680	66,355	106,794
Profit / (loss) before impaired asset expense and income tax	**57,331**	**18,744**	**14,644**	**50,132**	**28,054**	**22,661**	**(65,111)**	**126,455**
Fair value gain on investment	-	-	-	-	-	-	2,097	2,097
Impaired asset expense/(benefit)	10,160	-	11,119	10,110	(1,970)	-	-	29,419
Profit / (loss) before income tax from continuing operations	**47,171**	**18,744**	**3,525**	**40,022**	**30,024**	**22,661**	**(63,014)**	**99,133**
Income tax expense	-	-	-	-	-	-	27,161	27,161
Profit / (loss) for the year	**47,171**	**18,744**	**3,525**	**40,022**	**30,024**	**22,661**	**(90,175)**	**71,972**
Total assets	1,125,295	559,934	214,759	1,126,632	604,938	979,496	707,082	**5,318,136**
Total liabilities								**4,618,156**

2 Segmental analysis (continued)

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Australia	Other	Total
June 2019								
Net interest income	54,695	20,674	14,564	52,857	30,393	22,265	(1,141)	194,307
Net other income	2,578	224	4,344	2,989	1,288	477	(156)	11,744
Net operating income	**57,273**	**20,898**	**18,908**	**55,846**	**31,681**	**22,742**	**(1,297)**	**206,051**
Operating expenses	2,750	2,279	5,602	9,156	3,263	5,122	57,626	85,798
Profit / (loss) before impaired asset expense and income tax	**54,523**	**18,619**	**13,306**	**46,690**	**28,418**	**17,620**	**(58,923)**	**120,253**
Fair value gain on investment	-	-	-	-	-	-	1,936	1,936
Impaired asset expense/(benefit)	5,277	-	8,429	7,102	(132)	-	-	20,676
Profit / (loss) before income tax from continuing operations	**49,246**	**18,619**	**4,877**	**39,588**	**28,550**	**17,620**	**(56,987)**	**101,513**
Income tax expense	-	-	-	-	-	-	27,896	27,896
Profit / (loss) for the year	**49,246**	**18,619**	**4,877**	**39,588**	**28,550**	**17,620**	**(84,883)**	**73,617**
Total assets	1,089,769	510,299	220,500	1,096,773	650,751	808,733	552,206	**4,929,031**
Total liabilities								**4,253,363**

3 Net interest income

Policy

Interest income and expense on financial instruments is measured using the effective interest rate method that discounts the financial instruments' future cash flows to their present value and allocates the interest income or expense over the life of the financial instrument. The effective interest rate is established on initial recognition of the financial assets or liabilities and is not subsequently revised. For financial instruments at amortised cost, the calculation of the effective interest rate includes all yield related fees and commissions paid or received that are an integral part of the underlying financial instrument.

$000's	June 2020	June 2019
Interest income		
Cash and cash equivalents	499	717
Investments	8,496	9,733
Finance receivables	250,606	239,624
Finance receivables - reverse mortgages	87,201	79,967
Total interest income	**346,802**	**330,041**
Interest expense		
Retail deposits	90,739	96,476
Other borrowings	35,888	37,415
Net interest expense on derivative financial instruments	3,502	1,843
Total interest expense	**130,129**	**135,734**
Net interest income	**216,673**	**194,307**

4 Net operating lease income

Policy

As a lessor, the Group retains substantially all the risks and rewards of ownership of an asset are classified as operating leases. Rental income and expense from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term. Profits on the sale of operating lease assets are included as part of operating lease income. Current year depreciation and losses on the sale of operating lease assets are included as part of operating lease expenses. The leased assets are depreciated over their useful lives on a basis consistent with similar assets.

$000's	June 2020	June 2019
Operating lease income		
Lease income	5,194	5,518
Gain on disposal of lease assets	752	819
Total operating lease income	**5,946**	**6,337**
Operating lease expense		
Depreciation on lease assets	3,634	3,363
Direct lease costs	429	307
Total operating lease expense	**4,063**	**3,670**
Net operating lease income	**1,883**	**2,667**

5 Other income

Policy

Rental income from investment property

Rental income from investment properties is recognised on a straight-line basis over the term of the relevant lease.

Insurance income

Insurance premium income and commission expense are recognised in profit or loss from the date of attachment of the risk over the period of the insurance contract. Claim expense is recognised in the profit or loss on an accrual basis once our liability to the policyholder has been confirmed under the terms of the contract.

$000's	June 2020	June 2019
Rental income from investment properties	1,125	731
Insurance income	1,610	2,537
Gain on sale of investments	-	173
Other income/(loss)	774	(408)
FX gain/(loss)	373	(598)
Total other income	**3,882**	**2,435**

6 Operating expenses

Policy

Operating expenses are recognised as the underlying service is rendered or over a period in which an asset is consumed or a liability is incurred.

$000's	June 2020	June 2019
Personnel expenses	54,511	47,222
Directors' fees	1,059	1,099
Superannuation	1,069	1,081
Depreciation - property, plant and equipment	2,380	1,867
Operating lease expense as a lessee	-	1,807
Legal and professional fees	3,615	3,129
Advertising and public relations	6,729	3,354
Depreciation - right of use asset	2,324	-
Technology services	6,372	5,721
Telecommunications, stationary and postage	1,886	1,883
Customer acquisition costs	7,419	1,227
Amortisation of intangible assets	4,456	3,893
Other operating expenses[1]	14,974	13,515
Total operating expenses	**106,794**	**85,798**

[1]Other operating expenses include compensation of auditor which is disclosed in Note 7.

7 Compensation of auditor

$000's	June 2020	June 2019
Audit and review of the financial statements[1]	774	614
Other assurance services paid to auditor[2]	133	52
Total compensation of auditor	**907**	**666**

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

[2] Other assurance services paid to the auditor comprise regulatory assurance services, agreed upon procedures engagements and supervisor reporting.

8 Impaired asset expense

Policy

Impairment of finance receivables

At each reporting date, the Group applies a three stage approach to measuring ECL to finance receivables not carried at fair value. The ECL model assesses whether there has been a significant increase in credit risk since initial recognition.

The ECL model is a forward looking model where impairment allowances are recognised before losses are actually incurred. On initial recognition, an impairment allowance is required, based on events that are possible in the next 12 months.

Assets may migrate through the following stages based on their change in credit quality:

Stage 1 - 12 months ECL (past due 30 days or less)

Where there has been no evidence of increased credit risk since initial recognition, and are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

Stage 2 - Lifetime ECL not credit impaired (greater than 30 but less than 90 days past due)

Where there has been a significant increase in credit risk.

Stage 3 - Lifetime ECL credit impaired (90 days past due or more)

Objective evidence of impairment, so are considered to be in default or otherwise credit impaired.

In determining whether credit risk has increased all available information relevant to the assessment of economic conditions at the reporting date are taken into consideration. To do this the Group considers its historical loss experience and adjusts this for current observable data. In addition to this the Group uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. Future economic conditions consider macroeconomic factors such as unemployment, interest rate, gross domestic product, and inflation, and requires an evaluation of both the current and forecast direction of the economic cycle. The methodology and assumptions including any forecasts of future economic conditions are reviewed regularly as incorporating forward-looking information increases the level of judgement as to how changes in these macroeconomic factors will affect the ECL.

The calculation of expected credit loss is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

$000's	June 2020	June 2019
Non-securitised		
Individually impaired asset expense	3,385	1,311
Collectively impaired asset expense	25,637	19,024
Total non-securitised impaired asset expense	**29,022**	**20,335**
Securitised		
Collectively impaired asset expense	397	341
Total securitised impaired asset expense	**397**	**341**
Total		
Individually impaired asset expense	3,385	1,311
Collectively impaired asset expense	26,034	19,365
Total impaired asset expense	**29,419**	**20,676**

8 Impaired asset expense (continued)

The Group has followed industry and regulatory guidance when assessing individual customers, or portfolios of assets, to determine if a significant increase in credit risk (**SICR**) has occurred. The industry guidance provides that any payment deferral or similar allowance provided to customers as a result of the impact of COVID-19 would not automatically result in a SICR. Accordingly, customers who received assistance through the pandemic as a result of a payment reduction, deferral arrangement, or through the Heartland Extend product, have not been assessed as being subject to a SICR.

However, as a result (and when considered in conjunction with the measures put in place to limit the impact of the spread of COVID-19 among the community), the traditional indicators of increased credit risk may not provide an accurate measure of the credit quality of the Group's assets.

The Group's models for estimating expected credit losses for each of its portfolios are based on the historic credit experience of those portfolios. The models assume that economic conditions (such as GDP growth, unemployment rates, and house price index forecasts) remain static over time. If the Group forecasts that economic conditions will not remain static in the foreseeable future, the Group applies judgment to determine whether the modelled output should be subject to an economic overlay. This follows analysis of historic data and performance which has established no clear correlation between key economic indicators and the credit performance of the Group's unique portfolios, meaning the approach is an inherently judgmental exercise.

In the current scenario, the pandemic has caused a deterioration in economic conditions. The Group has therefore applied judgement to estimate whether the modelled output should be subject to an economic overlay. In exercising that judgement, it was assumed that the Group's "base case" economic forecast would prevail. That base case forecast scenario is for:

- A steep initial adverse movement (at close to -20%) in gross domestic product to 30 June 2020 but with a relatively quick, full recovery by June 2022;
- Unemployment to peak at 8.2% (June 2021) and then to largely recover over the following 2.5 years; but
- House prices falling 6.6% to March 2021, with a full recovery to June 2021.

That base case also assumes:

- There are no further significant periods of lockdown in or across any part of NZ as at the date of approval of the Group's financial statements for the year ended 30 June 2020.
- Heartland Extend, through providing customers with time (with economic conditions improving over time) would be successful in supporting the Group's consumer and business customers who need that assistance.
- The recently amended BFGS would be successful in supporting the Group's business customers who need that assistance.
- Second hand car prices would remain stable.
- The price for exported primary produce would not materially fall.

Using those assumptions, and taking Management's experience and deep understanding of the Group's customers (following the customer contact programmes implemented by the Group during, and after, COVID-19), the Group recognised that there is downside risk (including in the event that any of the underlying assumptions transpire to be incorrect) and, as a result, the Group's expected credit losses could be understated.

It is stressed that there is considerable uncertainty in these judgements. As noted by the New Zealand Treasury:

"The magnitude and duration of the downturn and the subsequent pace of the recovery depends on many unknown factors, including the course of the virus, how long activity restrictions are in place, how quickly the global economy will recover, how behaviours and production might change, and how successful government policies will be in supporting households and firms."

8 Impaired asset expense (continued)

To reflect that inherent risk, the Group employed three methodologies to ascertain a range of potential expected credit losses on each of its portfolios:

1. First, the Group has calculated a “Stage 2” lifetime expected loss provision as applied to the most affected parts of its portfolio.

   This methodology neutralises the concern that the Group’s assistance measures (when considered in conjunction with the measures put in place to limit the impact of the spread of COVID-19 among the community), may have masked traditional indicators of increased credit risk, by demonstrating how much provisions would increase by if all customers receiving assistance were treated as posing increased credit risk for the Group.
2. Secondly, the Group used the loss rates experienced on its Motor portfolio during the Global Financial Crisis of 2008, applied them to its current Motor portfolio, and extrapolated the proportionate increase in provisions to its other affected portfolios.
3. Lastly, the Group engaged a consultant to analyse historic correlations between certain industry default levels and macroeconomic indicators. This correlation was then applied to the Group’s base case forecast scenario economic outlook, to determine the degree to which (based on that historic correlation, and the base case forecast scenario) the Group’s customers may be likely to default in the base case forecast scenario economic overlay. That increased chance of default was then used to calculate an increase in provisions in affected portfolios.

Each of those methodologies have limitations. However, they did provide the Group with a range of “downside” potential credit losses for each portfolio. Across the three methodologies and portfolios, the range of possible outcomes was between $4.1 million and $11.8 million. Judgement was applied (taking into account the ranges provided by those methodologies, and all other relevant factors) in order to calculate an economic overlay across each affected portfolio. As a result a pre-tax overlay of $9.6 million was applied as outlined in Note 13 - Finance receivables.

9 Taxation

Policy

Income tax

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

Current tax

Current tax is the expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to the tax payable or receivable 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 provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. As required by NZ IAS 12 Income Taxes, a deferred tax asset is recognised only to the extent that it is probable that a future taxable profit will be available to realise the asset.

Goods and services tax (GST)

Revenues, expenses and assets are recognised net of GST. As the 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 an expense or, if relevant, as part of the cost of acquisition of an asset.

9 Taxation (continued)

Income tax expense

$000's	June 2020	June 2019
Income tax recognised in profit or loss		
Current tax		
Current year	30,868	25,181
Adjustments for prior year	1,834	(1,989)
Tax other rates	335	277
Deferred tax		
Current year	(3,568)	3,306
Adjustments for prior year	(2,289)	1,067
Tax other rates	(19)	54
Total income tax expense recognised in profit or loss	**27,161**	**27,896**
Income tax recognised in other comprehensive income		
Current tax		
Derivatives at fair value reserve	768	(82)
Fair value movements of cash flow hedge	(1,477)	-
Deferred tax		
Defined benefit plan	-	(34)
Fair value movements of cash flow hedges	-	(238)
Total income tax expense recognised in other comprehensive income	**(709)**	**(354)**

$000's	June 2020	June 2019
Profit before income tax	**99,133**	**101,513**
Reconciliation of effective tax rate		
Tax at New Zealand income tax rate of 28%	27,757	28,424
Higher tax rate for overseas jurisdiction	316	331
Adjusted tax effect of items not taxable/deductible	(457)	63
Adjustments for prior year	(455)	(922)
Total income tax expense	**27,161**	**27,896**

9 Taxation (continued)

Deferred tax assets comprise the following temporary differences:

$000's	**June 2020**	**June 2019**
Employee expenses	1,942	1,286
Share based payment	692	-
Provision for impairment	17,739	14,574
Investment properties	-	4
Intangibles and property, plant and equipment	(4,576)	(4,182)
Deferred acquisition costs	(936)	(1,321)
Operating lease vehicles	731	(800)
Other temporary differences	1,531	(30)
Total deferred tax assets	**17,123**	**9,531**
Opening balance of deferred tax assets	**9,531**	**5,319**
Movement recognised in profit or loss	7,336	(4,537)
Movement recognised in other comprehensive income	-	(272)
Transfer on demerger	-	777
Movement recognised in retained earnings	256	8,244
Closing balance of deferred tax assets	**17,123**	**9,531**

Imputation credit account

$000's	**June 2020**	**June 2019**
Imputation credit account	5,676	9,116

10 Earnings per share

	June 2020			**June 2019**		
	Earnings Per Share Cents	**Net Profit After Tax $000's**	**Weighted Average No. of Shares 000's**	**Earnings Per Share Cents**	**Net Profit After Tax $000's**	**Weighted Average No. of Shares 000's**
Basic earnings	12	71,972	576,929	13	73,617	563,364
Diluted earnings	12	71,972	576,929	13	73,617	563,364

Financial Position

11 Investments

Policy
Investments are classified into one of the following categories:

Fair value through profit or loss
Investments under this category include equity investments and are measured at fair value plus transaction costs. Changes in fair value of these investments are recognised in profit or loss in the period in which they occur.

Fair value through other comprehensive income
Investments under this category include bank bonds, floating rate notes, local authority stock, public securities and corporate bonds. These are initially measured at fair value, including transaction costs, and subsequently carried at fair value. Changes in fair value of these investments are recognised in other comprehensive income and presented within the fair value reserve.

Amortised cost
Investments under this category include bank deposits and are measured using effective interest rate method. They are held to collect contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

$000's	June 2020	June 2019
Bank deposits, bank bonds and floating rate notes	366,289	246,724
Public sector securities and corporate bonds	30,716	82,370
Local authority stock	-	13,399
Equity investments	16,335	12,435
Total investments	**413,340**	**354,928**

Refer to Note 20 - Fair value for details of the split between investments measured at fair value through profit or loss, fair value through other comprehensive income and amortised cost.

12 Derivative financial instruments

Policy
Derivative financial instruments are contracts whose value is derived from changes in one or more underlying financial instruments or indices. They include forward contracts, swaps, options and combinations of these instruments.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently measured at their fair value at each reporting date. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. Fair values include adjustment for counterparty credit risk. The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. A hedge instrument is a designated derivative, the changes in fair values or cash flows of which are expected to offset changes in the fair value of cash flows of the designated hedged item.

A hedged item is an asset, liability, firm commitment or highly probable forecast transaction that exposes the Group to risk of changes in fair value or cash flows, and that is designated as being hedged. The Group applies fair value hedge accounting to hedge movements in the value of fixed interest rate assets and liabilities subject to interest rate risk. The Group applies cash flow hedge accounting to hedge the variability in highly probable forecast future cash flows attributable to interest rate risk on variable rate assets and liabilities.

12 Derivative financial instruments (continued)

Fair value hedge accounting

The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments or counterparty must be a third party external to the Group.

The Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value of hedged items.

Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify for fair value hedge accounting are recorded in the consolidated statement of comprehensive income together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to carrying amount of a hedged item is amortised to the consolidated statement of comprehensive income on an effective yield basis over the remaining period to maturity of the hedged item. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the consolidated statement of comprehensive income.

Cash flow hedge accounting

The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments or counterparty must be a third party external to the Group.

The Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

A fair value gain or loss associated with the effective portion of a derivative designated as a cash flow hedge is recognised initially in the hedging reserve. The ineffective portion of a fair value gain or loss is recognised immediately in the consolidated statement of comprehensive income.

When a hedging derivative expires or is sold, the hedge no longer meets the criteria for hedge accounting, or the Group elects to revoke the hedge designation, the cumulative gain or loss on the hedging derivative remains in the cash flow hedging reserve until the forecast transaction occurs and affects income, at which point it is transferred to the corresponding income or expense line. If a forecast transaction is no longer expected to occur, the cumulative gain or loss on the hedging derivative previously reported in the cash flow hedging reserve is immediately transferred to the consolidated statement of comprehensive income.

12 Derivative financial instruments (continued)

$000's	June 2020 Notional Principal	June 2020 Fair Value Assets	June 2020 Fair Value Liabilities	June 2019 Notional Principal	June 2019 Fair Value Assets	June 2019 Fair Value Liabilities
Held for risk management						
Interest rate related contracts						
Swaps	1,140,422	17,238	16,938	1,958,083	13,048	11,005
Foreign currency related contracts						
Forwards	237,900	8	74	222,769	315	142
Options	-	-	-	177,255	1,128	-
Total derivative financial instruments	**1,378,322**	**17,246**	**17,012**	**2,358,107**	**14,491**	**11,147**

13 Finance receivables

(a) Finance receivables held at amortised cost

Policy

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.

Fees and direct costs relating to loan origination, financing and loan commitments are deferred and amortised to interest income over the life of the loan using the effective interest rate method. Lending fees not directly related to the origination of a loan are recognised over the period of service.

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 Group.

Individually impaired assets are those loans for which the 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.

In determining whether credit risk has increased all available information relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date are taken into consideration.

The calculation of expected credit loss is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

13 Finance receivables (continued)

$000's	June 2020	June 2019
Non-securitised		
Neither at least 90 days past due nor impaired - at amortised cost	2,945,858	3,018,741
At least 90 days past due - at amortised cost	58,876	44,466
Individually impaired - at amortised cost	24,667	26,412
Gross finance receivables	**3,029,401**	**3,089,619**
Less provision for impairment	(62,272)	(58,491)
Total non-securitised finance receivables	**2,967,129**	**3,031,128**
Securitised		
Neither at least 90 days past due nor impaired - at amortised cost	78,059	-
At least 90 days past due - at amortised cost	404	-
Individually impaired - at amortised cost	-	-
Gross finance receivables	**78,463**	**-**
Less provision for impairment	(397)	-
Total securitised finance receivables	**78,066**	**-**
Total		
Neither at least 90 days past due nor impaired - at amortised cost	3,023,917	3,018,741
At least 90 days past due - at amortised cost	59,280	44,466
Individually impaired - at amortised cost	24,667	26,412
Gross finance receivables	**3,107,864**	**3,089,619**
Less provision for impairment	(62,669)	(58,491)
Total finance receivables	**3,045,195**	**3,031,128**

The impact of COVID-19 on use of judgements and estimates is discussed in Note 8 - Impaired asset expense.

13 Finance receivables (continued)

Movement in provision

The following table details the movement from the opening balance to the closing balance of the provision for impairment losses by class.

$000's	12 - Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2020					
Non-securitised					
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Changes in loss allowance					
Transfer between stages	(1,190)	(294)	(109)	1,593	-
New and increased provision (net of collective provision releases)	2,901	2,090	25,047	1,792	31,830
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**1,711**	**1,796**	**22,130**	**3,385**	**29,022**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,705)	(5,947)	(28,090)
Effect of changes in foreign exchange rate	27	4	10	-	41
Impairment allowance as at 30 June 2020	**32,160**	**2,143**	**22,668**	**5,301**	**62,272**
Securitised					
Impairment allowance as at 30 June 2019	**-**	**-**	**-**	**-**	**-**
Changes in loss allowance					
Transfer between stages	(19)	11	8	-	-
New and increased provision (net of collective provision releases)	279	12	106	-	397
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**260**	**23**	**114**	**-**	**397**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Impairment allowance as at 30 June 2020	**260**	**23**	**114**	**-**	**397**
Total					
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Changes in loss allowance					
Transfer between stages	(1,209)	(283)	(101)	1,593	-
New and increased provision (net of collective provision releases)	3,180	2,102	25,153	1,792	32,227
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**1,971**	**1,819**	**22,244**	**3,385**	**29,419**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,705)	(5,947)	(28,090)
Effect of changes in foreign exchange rate	27	4	10	-	41
Impairment allowance as at 30 June 2020	**32,420**	**2,166**	**22,782**	**5,301**	**62,669**

13 Finance receivables (continued)

$000's	12 - Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2019					
Non-securitised					
Impairment allowance as at 30 June 2018	**31,784**	**1,365**	**14,945**	**8,897**	**56,991**
Changes in loss allowance					
Transfer between stages	(2,462)	(238)	52	2,648	-
New and increased provision (net of collective provision releases)	1,151	656	19,151	1,311	22,269
Recovery of amounts written off	-	-	(828)	-	(828)
Credit impairment charge	**(1,311)**	**418**	**18,375**	**3,959**	**21,441**
Recovery of amounts previously written off	-	-	829	-	829
Write offs	-	-	(15,722)	(4,993)	(20,715)
Effect of changes in foreign exchange rate	(51)	(2)	(2)	-	(55)
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Securitised					
Impairment allowance as at 30 June 2018	**400**	**20**	**345**	**-**	**765**
Changes in loss allowance					
Transfer between stages	(8)	(7)	15	-	-
New and increased provision (net of collective provision releases)	(392)	(13)	(360)	-	(765)
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**(400)**	**(20)**	**(345)**	**-**	**(765)**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Impairment allowance as at 30 June 2019	-	-	-	-	-
Total					
Impairment allowance as at 30 June 2018	**32,184**	**1,385**	**15,290**	**8,897**	**57,756**
Changes in loss allowance					
Transfer between stages	(2,470)	(245)	67	2,648	-
New and increased provision (net of collective provision releases)	759	643	18,791	1,311	21,504
Recovery of amounts written off	-	-	(828)	-	(828)
Credit impairment charge	**(1,711)**	**398**	**18,030**	**3,959**	**20,676**
Recovery of amounts previously written off	-	-	829	-	829
Write offs	-	-	(15,722)	(4,993)	(20,715)
Effect of changes in foreign exchange rate	(51)	(2)	(2)	-	(55)
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**

13 Finance receivables (continued)

Impact of COVID-19 on allowance for ECL

The following table represents a summary of amounts included in the credit impairment charge with respect to the Group's allowance for ECL:

$000's	June 2020
Collectively impaired asset expense (excluding COVID-19 adjustments)	16,434
COVID-19 adjustments	9,600
Total collectively impaired asset expense	**26,034**
Individually impaired asset expense	3,385
Total impaired asset expense	**29,419**

Impact of changes in gross finance receivables held at amortised cost on allowance for ECL

$000's	12 - month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2020					
Gross finance receivables as at 1 July 2019	2,799,282	206,882	57,043	26,412	3,089,619
Transfer between stages	(61,191)	12,570	41,245	7,376	-
Additions	1,497,073	87,843	23,610	-	1,608,526
Deletions	(1,402,340)	(118,572)	(37,334)	(3,174)	(1,561,420)
Write offs	(6,616)	(5,463)	(10,835)	(5,947)	(28,861)
Gross finance receivables as at 30 June 2020	**2,826,208**	**183,260**	**73,729**	**24,667**	**3,107,864**

(b) Finance receivables held at fair value

Policy

Finance receivables – reverse mortgages are initially recognised, and subsequently measured, at fair value through profit or loss.

$000's	June 2020	June 2019
Finance receivables - reverse mortgages	1,538,585	1,318,677
Total finance receivables - reverse mortgages	1,538,585	1,318,677

Note 20 (a) - Financial instruments measured at fair value discloses further information regarding the Group’s valuation policy.

Note 22 - Credit risk exposure discloses further information regarding how reverse mortgages operate.

Credit risk adjustments on financial assets designated at fair value through Profit or loss

There were no credit risk adjustments on individual financial assets.

14 Operating lease vehicles

Policy

Operating lease vehicles are stated at cost less accumulated depreciation.

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

$000's	**June 2020**	**June 2019**
Cost		
Opening balance	21,623	24,703
Additions	9,938	5,495
Disposals	(7,463)	(8,575)
Closing balance	**24,098**	**21,623**
Accumulated depreciation		
Opening balance	6,107	7,179
Depreciation charge for the year	3,634	3,363
Disposals	(3,246)	(4,435)
Closing balance	**6,495**	**6,107**
Opening net book value	15,516	17,524
Closing net book value	**17,603**	**15,516**

The future minimum lease payments receivable under operating leases not later than one year is $3.487 million (2019: $3.952 million), within one to five years is $2.053 million (2019: $3.137 million) and over five years is nil (2019: nil).

15 Borrowings

Policy

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

$000's	**June 2020**	**June 2019**
Deposits	3,264,192	3,153,681
Total borrowings related to deposits	**3,264,192**	**3,153,681**
Unsubordinated Notes	448,228	337,680
Bank borrowings	-	25,002
Certificate of deposit	-	34,836
Securitised borrowings	819,703	660,050
Total other borrowings	**1,267,931**	**1,057,568**

Deposits and unsubordinated notes rank equally and are unsecured.

15 Borrowings (continued)

The Group has the following unsubordinated notes on issue at balance sheet date:

Principal	Valuation	Note	Issue Date	Maturity Date	Frequency of Interest Repayment
$125 million	Amortised cost	20(b)	12 April 2019	12 April 2024	Half yearly
$150 million	Amortised cost	20(b)	21 September 2017	21 September 2022	Half yearly
AU $45 million	Amortised cost	20(b)	8 March 2019	8 March 2021	Quarterly
AU $100 million	Amortised cost	20(b)	13 November 2019	13 May 2022	Quarterly

At 30 June 2020 the Group had the following securitised borrowings outstanding:

- Heartland Auto Receivables Warehouse Trust 2018 - 1 securitisation facility $300 million, drawn $66 million (2019: $150 million, undrawn). Securitised borrowings held by investors are secured over the assets of the Heartland Auto Receivables Warehouse Trust 2018-1. The facility has a maturity date of 29 August 2021.

- Senior Warehouse Trust securitisation facility AU $600 million, drawn AU $544 million (2019: AU $650 million, drawn AU $631 million). The bank facility is secured over the assets of ASF Settlement Trust and Seniors Warehouse Trust. The facility has a maturity date of 30 September 2022.

- Senior Warehouse Trust No. 2 securitisation facility AU $250 million, drawn AU $160 million (2019: nil). The bank facility is secured over the assets of Seniors Warehouse Trust No. 2 and has a maturity date of 1 July 2022.

16 Share capital and dividends

Policy

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 effect.

000's	June 2020 Number of Shares	June 2019 Number of Shares
Issued shares		
Opening balance	569,338	560,588
Shares issued during the year	817	-
Dividend reinvestment plan	10,824	9,191
Cancelled shares	-	(441)
Closing balance	**580,979**	**569,338**

Under dividend reinvestment plans, 7,313,501 new shares were issued at $1.5444 per share on 6 September 2019 and 3,511,020 at $1.5948 on 11 March 2020 (2019: 5,282,619 new shares were issued at $1.6250 per share on 21 September 2018 and 3,907,858 at $1.4709 per share on 1 April 2019). Other shares issued during the period relate to staff share schemes.

Dividends paid

	June 2020			June 2019		
	Date Declared	Cents Per Share	$000's	Date Declared	Cents Per Share	$000's
Final dividend	15 August 2019	6.5	37,007	15 August 2018	5.5	30,808
Interim dividend	18 February 2020	4.5	25,986	19 February 2019	3.5	19,791
Total dividends paid			**62,993**			**50,599**

17 Other reserves

$000's	Employee Benefits Reserve	Foreign Currency Translation Reserve (FCTR)	Fair Value Reserve	Defined Benefit Reserve	Cash Flow Hedge Reserve	Total
June 2020						
Balance as at 1 July 2019	838	(4,021)	4,558	171	(5,843)	(4,297)
Other comprehensive income, net of income tax	-	114	766	-	(2,179)	(1,299)
Share based payments	516	-	-	-	-	516
Shares vested	(420)	-	-	-	-	(420)
Balance as at 30 June 2020	**934**	**(3,907)**	**5,324**	**171**	**(8,022)**	**(5,500)**
June 2019						-
Balance as at 1 July 2018	2,559	1,260	1,590	257	(1,081)	4,585
Other comprehensive income, net of income tax	-	(5,281)	2,968	(86)	(4,762)	(7,161)
Share based payments	619	-	-	-	-	619
Shares vested	(2,340)	-	-	-	-	(2,340)
Balance as at 30 June 2019	**838**	**(4,021)**	**4,558**	**171**	**(5,843)**	**(4,297)**

18 Other balance sheet items

Policy

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

$000's	June 2020	June 2019
Other assets		
Trade receivables	1,952	6,269
GST receivable	985	3,840
Prepayments	4,857	5,649
Property, plant and equipment	10,153	10,216
Other receivables	1,611	1,234
Total other assets	**19,558**	**27,208**

18 Other balance sheet items (continued)

Policy

Intangible assets

Intangible assets with finite useful lives

Software acquired or internally developed by the Group is stated at cost less accumulated amortisation and any accumulated impairment losses. 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 the assets' estimated useful lives. The expected useful life of the software has been determined to be ten years.

Goodwill

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

$000's	**June 2020**	**June 2019**
Computer software		
Cost	42,534	37,210
Accumulated amortisation	14,864	10,429
Net carrying value of computer software	**27,670**	**26,781**
Goodwill		
Cost	45,143	45,143
Net carrying value of goodwill	**45,143**	**45,143**
Total intangible assets	**72,813**	**71,924**

Goodwill was tested for impairment on 30 June 2020. In assessing impairment, an internal valuation model was developed to indicate the value of the business i.e. the recoverable amount. This value was compared to the net assets of the Group.

The recoverable amount was determined on a value in use basis using a five-year discounted cash flow methodology based on financial budget and forecasts. Key assumptions used in the model included a discount rate of 10% and a terminal growth rate of 2% which reflect both past experience and external sources of information.

The deterioration in economic conditions as a result of the COVID-19, and the consequential impact on the Group were also considered for any indicators of impairment. These included:

- Comparing cashflows and other key financial metrics against budget;
- Material decreases in mid-term and/or long-term growth rates as compared to previous estimates;
- Any material changes in business model or strategy;
- Comparing the Group's market capitalisation against its net assets;
- Changes in market interest rates or other market rates of return;
- Fluctuations in the foreign exchange rates or commodity prices that impact the entity's cash flows; and
- Any deferral of investment projects.

There was no indication of impairment and no impairment losses have been recognised against the carrying amount of goodwill for the year ended 30 June 2020 (30 June 2019: nil).

18 Other balance sheet items (continued)

For the purposes of impairment testing, goodwill is allocated to cash generating units (**CGU**'s). A CGU is the smallest identifiable group of assets that generate independent cash inflows. The Group has assessed that goodwill should be allocated to the following smallest identifiable CGUs:

- Heartland Australia Holdings Pty Limited: $15.3 million (2019: $15.3 million).
- Heartland Bank Limited (**HBL**): $29.8 million (2019: $29.8 million).

Policy

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 the entitlements and discounting back to present value. Obligations to defined contribution superannuation schemes are recognised as an expense when the contribution is paid.

$000's	June 2020	June 2019
Trade and other payables		
Trade payables	20,657	8,815
Insurance liability	6,094	7,469
Employee benefits	8,223	5,595
Other tax payables	1,288	1,556
Total trade and other payables	**36,262**	**23,435**

Policy

Leases

The Group leases office space, car parks, equipment and cars. Rental contracts are typically made for fixed periods but may have extension options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions.

In determining the lease term, all facts and circumstances that create an economic incentive to exercise an extension option are considered. Extension options are only included in the lease term if the lease is reasonably certain to be extended.

Lease liabilities are measured at the present value of the remaining lease payments and discounted using the Group's incremental borrowing rate (**IBR**). Lease liabilities are measured using the effective interest method. Carrying amounts are remeasured only upon reassessments and lease modifications.

Right of use assets are depreciated at the shorter of lease term or the Group's depreciation policy for that asset class.

$000's	June 2020	June 2019
Right of use assets		
Balance at 1 July 2019	10,728	-
Depreciation charge for the year, included within depreciation expense in the income statement	(2,324)	-
Additions to right of use assets	9,958	-
Total right of use assets	**18,362**	**-**
Lease liability		
Current	2,222	-
Non-current	18,234	-
Total lease liability	**20,456**	**-**
Interest expense relating to lease liability	**570**	**-**

19 Related party transactions and balances

Policy

A person or entity is a related party under the following circumstances:

a) A person or a close member of that person's family if that person:
   i) has control or joint control over HGH;
   ii) has significant influence over HGH; or
   iii) is a member of the key management personnel of HGH.

b) An entity is related to HGH if any of the following conditions applies:
   i) The entity and HGH are members of the same group;
   ii) One entity is an associate or joint venture of the other entity;
   iii) Both entities are joint ventures of the same third party;
   iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity;
   v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to HGH;
   vi) The entity is controlled, or jointly controlled by a person identified in (a); and
   vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

(a) Transactions with key management personnel

Key management personnel (**KMP**), are those who, directly or indirectly, have authority and responsibility for planning, directing and controlling the activities of the Group. This includes all executive staff, Directors and their close family members.

KMP receive personal banking and financial investment services from the Group in the ordinary course of business. The terms and conditions, for example interest rates and collateral, and the risks to the Group are comparable to transactions with other employees and did not involve more than the normal risk of repayment or present other unfavourable features.

All other transactions with KMPs and their related entities are made on terms equivalent to those that prevail in arm's length transactions.

$000's	**June 2020**	**June 2019**
Transactions with key management personnel		
Interest income	18	-
Interest expense	(47)	(76)
Key management personnel compensation		
Short-term employee benefits	(8,814)	(4,839)
Share-based payment expense	(828)	(703)
Total transactions with key management personnel	**(9,671)**	**(5,618)**
Due (to) / from key management personnel		
Lending	239	-
Borrowings - deposits	(1,646)	(3,019)
Total due (to) key management personnel	**(1,407)**	**(3,019)**

19 Related party transactions and balances (continued)

(b) Transactions with related parties

HGH is the ultimate parent company of the Group.

Entities within the Group have regular transactions between each other on agreed terms. The transactions include the provision of administrative services, tax transactions, and customer operations and call centre. Banking facilities are provided by Heartland Bank Limited to other Heartland Group entities on normal commercial terms as with other customers. There is no lending from subsidiaries within the Group to HGH.

Related party transactions between the Group eliminate on consolidation. Related party transactions outside of the Group are as follows:

$000's	June 2020	June 2019
Southern Cross Building Society Staff Superannuation (SCBS)		
Interest expense	33	43
Management fees from SCBS	10	10
ASF Custodians Pty Limited		
Audit fees	7	-
Heartland Trust (HT)		
Dividend paid	712	583

Heartland Trust held 6,475,976 shares in HGH (2019: 6,475,976 shares).

The Trustees of Heartland Trust and certain employees of the Group provided their time and skills to the oversight and operation of HT at no charge.

(c) Other balances with related parties

$000's	June 2020	June 2019
Southern Cross Building Society Staff Superannuation		
Retail deposits	1,934	2,070

20 Fair value

Policy

Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

On initial recognition, the transaction price generally represents the fair value of the financial instrument, unless there is observable information from an active market that provides a more appropriate fair value.

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

The Group measures fair values using the following fair value hierarchy, which reflects the observability of the inputs used in measuring fair value:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

20 Fair value (continued)

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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

(a) Financial instruments measured at fair value

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

Investments

Investments in public sector securities and corporate bonds are classified as being available for sale and are stated at FVOCI, with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using observable market inputs (Level 2 under the fair value hierarchy). Refer to Note 11 - Investments for more details.

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

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

Finance receivables - reverse mortgages

Reverse mortgage loans are classified at fair value through profit or loss. On initial recognition the Group considers the transaction price to represent the fair value of the loan.

For subsequent measurement the Group has considered if the fair value can be determined by reference to a relevant active market or observable inputs, but has concluded relevant support is not currently available. In the absence of such market evidence the Group has used valuation techniques (income approach) including actuarial assessments to consider the fair value.

When the Group enters into a reverse mortgage loan the Group has set expectations regarding the loan’s current and future risk profile and expectation of performance. This expectation references a wide range of assumptions including:

- Mortality and move to care;
- Voluntary exits;
- House price changes;
- No negative equity guarantee; and
- Interest rate margin.

20 Fair value (continued)

At balance date the Group does not consider any of the above expectations to have moved outside of the original expectation range. Therefore the Group has continued to estimate the fair value of the portfolio at transaction price. There has been no fair value movement recognised in profit or loss during the period. Given the nature of the loan terms and tenor, the fair value as recorded is regarded as not being highly sensitive to the above assumptions, particularly to house prices and interest rates, that would impact the fair value at balance date. While noting the significant uncertainty around future economic conditions, based on current judgment there is no evidence that COVID-19 will have a long-term adverse impact on market conditions, particularly regarding the key elements of house prices or interest rates, that would materially influence the fair value of the reverse mortgage portfolio at balance date.

The Group will continue to reassess the existence of a relevant active market and movements in expectations on an on-going basis.

Derivative financial instruments

Interest rate and foreign currency related contracts are recognised in the financial statements at fair value. Fair values are determined from observable market prices as at the reporting date, discounted cash flow models or option pricing models as appropriate. (Level 2 under the fair value hierarchy).

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

$000's	Level 1	Level 2	Level 3	Total
June 2020				
Assets				
Investments	295,300	94,354	16,335	405,989
Derivative financial instruments	-	17,246	-	17,246
Finance receivables - reverse mortgages	-	-	1,538,585	1,538,585
Total financial assets measured at fair value	**295,300**	**111,600**	**1,554,920**	**1,961,820**
Liabilities				
Derivative financial instruments	-	17,012	-	17,012
Total financial liabilities measured at fair value	**-**	**17,012**	**-**	**17,012**
June 2019				
Assets				
Investments	255,875	79,047	12,435	347,357
Derivative financial instruments	-	14,491	-	14,491
Finance receivables - reverse mortgages	-	-	1,318,677	1,318,677
Total financial assets measured at fair value	**255,875**	**93,538**	**1,331,112**	**1,680,525**
Liabilities				
Derivative financial instruments	-	11,147	-	11,147
Total financial liabilities measured at fair value	**-**	**11,147**	**-**	**11,147**

20 Fair value (continued)

The movement in Level 3 assets measured at fair value are below:

$000's	Finance Receivables - Reverse Mortgage	Investments	Total
June 2020			
As at 1 July 2019	1,318,677	12,435	1,331,112
New loans	290,488	-	290,488
Repayments	(182,653)	-	(182,653)
Capitalised Interest and fees	91,288	-	91,288
Additions	-	1,803	1,803
Other	20,785	2,097	22,882
As at 30 June 2020	**1,538,585**	**16,335**	**1,554,920**

$000's	Finance Receivables - Reverse Mortgage	Investments	Total
June 2019			
As at 1 July 2018	1,129,956	9,694	1,139,650
Adjustment for NZ IFRS 9	2,882	-	2,882
New loans	233,095	-	233,095
Repayments	(104,644)	-	(104,644)
Capitalised Interest and fees	80,999	-	80,999
Additions	-	2,741	2,741
Other	(23,611)	-	(23,611)
As at 30 June 2019	**1,318,677**	**12,435**	**1,331,112**

(b) Financial instruments not measured at fair value

The following assets and liabilities of the Group are not measured at fair value in the consolidated statement of financial position.

Cash and cash equivalents

Cash and cash equivalents are measured at amortised cost and their carrying value is considered equivalent to their fair value due to their short term nature.

Finance receivables

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

The current weighted average lending rate used to fair value finance receivables with a fixed interest rate was 8.06% (2019: 8.88%). 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.

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 Group for the debt of similar maturities. The average current market rate used to fair value borrowings is 2.24% (2019: 2.59%).

20 Fair value (continued)

Other financial assets and financial liabilities

Financial instruments such as short-term trade receivables and payables are considered equivalent to their carrying value due to their short term nature.

The following table sets out financial instruments not measured at fair value, compares their carrying value against their fair value and analyses them by level in the fair value hierarchy.

$000's	June 2020 Fair Value Hierarchy	June 2020 Total Fair Value	June 2020 Total Carrying Value	June 2019 Fair Value Hierarchy	June 2019 Total Fair Value	June 2019 Total Carrying Value
Assets						
Cash and cash equivalents	Level 1	147,179	147,179	Level 1	74,496	74,496
Investments[1]	Level 2	7,375	7,351	Level 2	7,432	7,571
Finance receivables	Level 2	3,092,150	3,045,195	Level 2	3,017,327	3,031,128
Other financial assets	Level 3	3,563	3,563	Level 3	7,503	7,503
Total financial assets		**3,250,267**	**3,203,288**		**3,106,758**	**3,120,698**
Liabilities						
Retail deposits	Level 2	3,278,483	3,264,192	Level 2	3,160,426	3,153,681
Other borrowings	Level 2	448,626	448,228	Level 2	397,643	397,643
Borrowings - securitised	Level 2	819,305	819,703	Level 2	659,925	659,925
Other financial liabilities	Level 3	26,751	26,751	Level 3	16,284	16,284
Total financial liabilities		**4,573,165**	**4,558,874**		**4,234,278**	**4,227,533**

[1]Included within investments are bank deposits which are held to support the Group's contractual cash flows. Such investments are measured at amortised cost.

(c) Classification of financial instruments

The following table summarises the categories of financial instruments and the carrying value and fair value of all financial instruments of the Group:

$000's	FVOCI	FVTPL	Amortised Cost	Total Carrying Value	Total Fair Value
June 2020					
Cash and cash equivalents	-	-	147,179	147,179	147,179
Investments	389,654	16,335	7,351	413,340	413,364
Finance receivables	-	-	3,045,195	3,045,195	3,092,150
Finance receivables - reverse mortgages	-	1,538,585	-	1,538,585	1,538,585
Derivative financial instruments	32	17,213	-	17,246	17,246
Other financial assets	-	-	3,563	3,563	3,563
Total financial assets	**389,686**	**1,572,133**	**3,203,288**	**5,165,108**	**5,212,087**
Retail deposits	-	-	3,264,192	3,264,192	3,278,483
Other borrowings	-	-	1,267,931	1,267,931	1,267,931
Derivative financial instruments	15,408	1,604	-	17,012	17,012
Other financial liabilities	-	-	26,751	26,751	26,751
Total financial liabilities	**15,408**	**1,604**	**4,558,874**	**4,575,886**	**4,590,177**

20 Fair value (continued)

$000's	FVOCI	FVTPL	Amortised Cost	Total Carrying Value	Total Fair Value
June 2019					
Cash and cash equivalents	-	-	74,496	74,496	74,496
Investments	334,922	12,435	7,571	354,928	354,789
Finance receivables	-	-	3,031,128	3,031,128	3,017,327
Finance receivables - reverse mortgages	-	1,318,677	-	1,318,677	1,318,677
Derivative financial instruments	2,825	11,666	-	14,491	14,491
Other financial assets	-	-	7,503	7,503	7,503
Total financial assets	**337,747**	**1,342,778**	**3,120,698**	**4,801,223**	**4,787,283**
Retail deposits	-	-	3,153,681	3,153,681	3,160,426
Other borrowings	-	-	1,057,568	1,057,568	1,057,568
Derivative financial instruments	9,893	1,254	-	11,147	11,147
Other financial liabilities	-	-	16,284	16,284	16,284
Total financial liabilities	**9,893**	**1,254**	**4,227,533**	**4,238,680**	**4,245,425**

Risk Management

21 Enterprise risk management program

The board of directors (the **Board**) sets and monitors the Group’s risk appetite across the primary risk domains of credit, capital, liquidity, market (including interest rate), operational and compliance and general business risk. Management are, in turn, responsible for ensuring appropriate structures, policies, procedures and information systems are in place to actively manage these risk domains, as outlined within the Enterprise Risk Management Framework (**ERMF**). Collectively, these processes are known as the Group's Enterprise Risk Management Program (**RMP**).

Role of the Board and the Board Risk Committee

The Board, through its Board Risk Committee (**BRC**) is responsible for oversight and governance of the development of the RMP. The role of the BRC is to assist the Board to formulate its risk appetite, and to monitor the effectiveness of the RMP. The BRC has the following specific responsibilities:

- To advise the Board on the formulation of the Board's Risk Appetite Statement at least annually.
- To review any reports, policies, standards, other risk documents or matters, or minutes which have been prepared by or in respect of the HGH's Board, Risk Committee, or Executive Risk Committee as it may see fit, and to advise the Board in relation thereto.
- To advise and make recommendations to the Board as to the key parameters for ICAAP, delegated authorities, risk appetite and stress testing for its subsidiary, Heartland Bank Limited.

The BRC consists of three non-executive directors. All three members of the BRC sit on the Audit Committee. In addition, the directors who are not members of the BRC are entitled to attend meetings and to receive copies of the BRC papers.

Audit Committee

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 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 both the BRC and Audit Committee ensure suitable cross representation to allow effective communication pertaining to identified issues with oversight by the Board.

Internal Audit

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

21 Enterprise risk management program (continued)

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

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

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

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

The Head of Internal Audit has a direct reporting line to the Chairman of the Audit Committee whilst administratively reporting to the Chief Legal & Bank Risk Officer. Internal audit has accountability to the Audit Committee of the Group. 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.

Asset and Liability Committee (ALCO)

The ALCO comprises the CEO HGH, CEO HBL, GCRO, CFO, Chief Legal & Bank Risk Officer, Treasurer, Head of Retail, Financial Controller HBL and Chief Distribution Officer. The ALCO generally meets monthly, and provides reports to the BRC. ALCO's specific responsibilities include decision making and oversight of risk matters in relation to:

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

21 Enterprise risk management program (continued)

Operational and compliance risk

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

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational and compliance risk, the Group operates a “three lines of defence” model which outlines principles, responsibilities and accountabilities for operational and compliance risk management:

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

Market risk

Market risk is the possibility of experiencing losses or gains due to factors affecting the overall performance of financial markets in which the Group is exposed. The primary market risk exposures for the Group are interest rate risk and foreign exchange risk. The risk being that market interest rates or foreign exchange rates will change and adversely impact on the Group’s earnings due to either adverse moves in foreign exchange market rates or in the case of interest rate risks mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates.

Interest rate risk

Interest rate risk refers to exposure of an entity’s earnings and / or capital because of a mismatch between the interest rate exposures of its assets and liabilities. Interest rate risk for the Group arises from the provision of non-traded retail banking products and services and from traded wholesale transactions entered into to reduce aggregate interest rate risk (known as hedges). This risk arises from four key sources:

- Mismatches between the repricing dates of interest bearing assets and liabilities (yield curve and repricing risk);
- Banking products repricing differently to changes in wholesale market rates (basis risk);
- Loan prepayment or deposit early withdrawal behaviour from customers that deviates from the expected or contractually agreed behaviour (optionality risk); and
- The effect of internal or market forces on a bank’s net interest margin where, for example, in a low rate environment any fall in rates will further decrease interest income earned on the assets whereas funding cost cannot be reduced as it is already at the minimum level (margin compression risk).

Refer Note 24 - Interest rate risk for further details regarding interest rate risk.

21 Enterprise risk management program (continued)

Foreign exchange risk

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

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

Counterparty Credit Risk

The Group has on-going credit exposure associated with:

- Cash and cash equivalents;
- Finance receivables;
- Holding of investment securities; and
- Payments owed to the Group from risk management instruments.

Counterparty credit risk is managed against limits set in the Market Risk Policy including credit exposure on derivative contracts, bilateral set-off arrangements, cash and cash equivalents and investment securities.

22 Credit risk exposure

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

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

To manage this risk, HBL's Executive Risk Committee (**ERC**) oversees the formal credit risk management strategy. The ERC reviews the Group's credit risk exposures typically on a monthly basis. The credit risk management strategies aim to ensure that:

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

The BRC also oversees the Group's credit risk exposures to monitor overall risk metrics having regard to risk appetite set by the Board.

22 Credit risk exposure (continued)

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

The Group employs a process of hindsighting loans to ensure that credit policies and the quality of credit processes are maintained.

Impact of COVID-19 has been considered by the Group as outlined in Note 8 - Impaired asset expense.

Reverse mortgage loans and negative equity risk

Reverse mortgage loans are a form of mortgage lending designed for the needs of people over 60 years. These loans differ to conventional mortgages in that they typically are not repaid until the borrower ceases to reside in the property. Further, interest is not required to be paid, it is capitalised into the loan balance and is repayable on termination of the loan. As such, there are no incoming cash flows and therefore no default risk to manage during the term of the loan. Negative equity risk arises from the promise by the Group that the maximum repayment amount is limited to the net sale proceeds of the borrowers' property.

The Group’s exposure to negative equity risk is managed by the Credit Risk Oversight Policy in conjunction with associated lending standards specific for this product. In addition to usual criteria regarding the type, and location, of security property that the Group will accept for reverse mortgage lending, a key aspect of the Group's policy is that a borrower’s age on origination of the reverse mortgage loan will dictate the loan-to-value ratio of the reserve mortgage on origination. Both New Zealand and Australia reverse mortgage operations are similarly aligned. The policy is managed and reviewed periodically to ensure appropriate consistency across locations.

Business Finance Guarantee Scheme

HBL, along with other registered banks in New Zealand, has entered into a Deed of Indemnity with the New Zealand Government to implement the New Zealand Governments Business Finance Guarantee Scheme. The purpose of the scheme is to provide short term credit to eligible small and medium size businesses, who have been impacted by economic effects of COVID 19. The scheme allows banks to lend to a maximum of $500,000 for a maximum of three years. The New Zealand Government will guarantee 80% of any loss incurred (credit risk) with HBL holding the remaining 20%. As at 30 June 2020 the Group had a total exposure of $6.5 million to its customers under the scheme.

Maximum exposure to credit risk at the relevant reporting dates

The following table represents the maximum credit risk exposure, without taking account of any collateral held. The exposures set out below are based on net carrying amounts as reported in the consolidated statement of financial position.

$000's	June 2020	June 2019
Cash and cash equivalents	147,179	74,496
Investments	397,005	342,493
Finance receivables	3,045,195	3,031,128
Finance receivables - reverse mortgages	1,538,585	1,318,677
Derivative financial assets	17,246	14,491
Other financial assets	3,563	7,503
Total on balance sheet credit exposures	**5,148,773**	**4,788,788**

22 Credit risk exposure (continued)

Concentration of credit risk by geographic region

$000's	June 2020	June 2019
New Zealand	3,855,199	3,686,867
Australia	1,060,894	906,261
Rest of the world [1]	295,349	254,151
	5,211,442	**4,847,279**
Provision for impairment	(62,669)	(58,491)
Total on balance sheet credit exposures	**5,148,773**	**4,788,788**

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

Concentration of credit risk by industry sector

The Australian and New Zealand Standard Industrial Classification (**ANZSIC**) codes have been used as the basis for categorising customer industry sectors.

$000's	June 2020	June 2019
Agriculture	625,141	689,089
Forestry and fishing	145,045	132,545
Mining	12,993	13,695
Manufacturing	75,659	70,740
Finance and insurance	596,772	430,532
Wholesale trade	39,540	40,869
Retail trade and accommodation	232,664	237,342
Households	2,603,760	2,428,705
Other business services	163,801	170,013
Construction	197,174	186,843
Rental, hiring and real estate services	142,467	148,502
Transport and storage	257,634	237,451
Other	118,792	60,953
	5,211,442	**4,847,279**
Provision for impairment	(62,669)	(58,491)
Total on balance sheet credit exposures	**5,148,773**	**4,788,788**

Commitments to extend credit

$000's	June 2020	June 2019
Undrawn facilities available to customers	248,868	177,316
Conditional commitments to fund at future dates	58,045	14,286

As at 30 June 2020 there was no undrawn lending commitments available to counterparties for whom drawn balances were classified as individually impaired (2019: nil).

22 Credit risk exposure (continued)

Credit risk grading

The Group's finance receivables are monitored either by account behaviour (**Behavioural portfolio**) or a regular assessment of their credit risk grade based on an objective review of defined risk characteristics (**Judgemental portfolio**).

Finance receivables - reverse mortgages have no arrears characteristics and are assessed on origination against a pre-determined criteria.

The Judgemental portfolio consists mainly of business and rural lending where an on-going and detailed working relationship with the customer has been developed while the Behavioural portfolio consists of consumer, retail and smaller business receivables.

Judgemental loans are individually risk graded based on loan status, financial information, security and debt servicing ability. Exposures in the Judgemental portfolio are credit risk graded by an internal risk grading mechanism where grade 1 is the strongest risk. Grade 8 and grade 9 are the weakest risk grades where a loss is probable. Behavioural loans are managed based on their arrears status.

Upon adoption of NZ IFRS 9 all loans past due but not impaired have been categorised into three impairments stages (see Note 8) which are in most cases based on arrears status. If a Judgemental loan is risk graded 6 or above it will be classified as stage 2 as a minimum and carry a provision based on lifetime expected credit losses.

$000's	12 Months ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specifically Provided	Fair Value	Total
June 2020						
Judgemental portfolio						
Grade 1 - Very Strong	28	-	-	-	-	28
Grade 2 - Strong	9,323	-	-	-	-	9,323
Grade 3 - Sound	65,084	-	189	-	-	65,273
Grade 4 - Adequate	509,154	5,117	4,238	-	-	518,509
Grade 5 - Acceptable	817,190	4,613	1,938	-	-	823,741
Grade 6 - Monitor	-	112,586	2,558	-	-	115,144
Grade 7 - Substandard	-	27,289	17,652	-	-	44,941
Grade 8 - Doubtful	-	-	-	16,025	-	16,025
Grade 9 - At risk of loss	-	-	-	8,642	-	8,642
Total judgemental portfolio	1,400,779	149,605	26,575	24,667	-	1,601,626
Total behavioural portfolio	1,425,429	33,655	47,154	-	1,538,585	3,044,823
Gross finance receivables	**2,826,208**	**183,260**	**73,729**	**24,667**	**1,538,585**	**4,646,449**
Provision for impairment	(32,420)	(2,166)	(22,782)	(5,301)	-	(62,669)
Total finance receivables	**2,793,788**	**181,094**	**50,947**	**19,366**	**1,538,585**	**4,583,780**

22 Credit risk exposure (continued)

$000's	12 Months ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specifically Provided	Fair Value	Total
June 2019						
Judgemental portfolio						
Grade 1 - Very Strong	7	-	-	-	-	7
Grade 2 - Strong	8,685	-	-	-	-	8,685
Grade 3 - Sound	86,109	-	71	-	-	86,180
Grade 4 - Adequate	478,682	3,707	5,478	-	-	487,867
Grade 5 - Acceptable	851,873	4,835	4,854	-	-	861,562
Grade 6 - Monitor	-	142,122	5,031	-	-	147,153
Grade 7 - Substandard	-	22,913	3,450	-	-	26,363
Grade 8 - Doubtful	-	-	-	15,391	-	15,391
Grade 9 - At risk of loss	-	-	-	11,021	-	11,021
Total Judgemental portfolio	1,425,356	173,577	18,884	26,412	-	1,644,229
Total Behavioural portfolio	1,373,926	33,305	38,159	-	1,318,677	2,764,067
Gross finance receivables	**2,799,282**	**206,882**	**57,043**	**26,412**	**1,318,677**	**4,408,296**
Provision for impairment	(30,422)	(1,781)	(18,425)	(7,863)	-	(58,491)
Total finance receivables	**2,768,860**	**205,101**	**38,618**	**18,549**	**1,318,677**	**4,349,805**

23 Liquidity risk

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

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

The Group's exposure to liquidity risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of the 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 Group in terms of a mix of assets and liabilities given its expectations of future cash flows, liquidity constraints and capital adequacy. The Group employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies.

RBNZ facilities

In March 2020, HBL was onboarded by the RBNZ as an approved counterparty and executed a 2011 Global Master Repo Agreement providing an additional source for intra-day liquidity for the Group if required.

On 16 March 2020, as a result of COVID-19, the RBNZ announced that it would provide term funding through a Term Auction Facility to give banks the ability to access term funding using repurchase agreements with qualifying collateral for a term of up to twelve months. From 26 May 2020, the RBNZ also made available, for a period of 6 months, a Term Lending Facility to offer loans for a fixed term of three years at the Official Cash Rate, with access to the funds linked to HBL'S lending under the BFGS. The Group had not utilised either of these facilities as at 30 June 2020.

The Group holds the following liquid assets and committed funding sources for the purpose of managing liquidity risk:

$000's	**June 2020**	**June 2019**
Cash and cash equivalents	147,179	74,496
Investments	397,005	342,493
Undrawn committed bank facilities	390,762	219,631
Total liquidity	**934,946**	**636,620**

23 Liquidity risk (continued)

Contractual liquidity profile of liabilities

The following tables present the Group's liabilities by relevant maturity groupings based upon contractual maturity date. The amounts disclosed in the tables represent undiscounted future principal and interest cash flows. As a result, the amounts in the tables below may differ to the amounts reported on the consolidated statement of financial position.

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

$000's	On Demand	0-6 Months	6-12 Months	1-2 Years	2-5 Years	5+ Years	Total
June 2020							
Financial liabilities							
Retail deposits	813,140	1,418,656	833,440	162,221	86,615	-	3,314,072
Other borrowings	-	13,517	61,038	196,835	1,039,462	-	1,310,852
Lease liabilities	-	1,400	1,415	5,730	7,634	7,085	23,264
Derivative financial liabilities	-	5,722	4,665	5,297	1,354	-	17,038
Other financial liabilities	-	26,751	-	-	-	-	26,751
Total financial liabilities	**813,140**	**1,466,046**	**900,558**	**370,083**	**1,135,065**	**7,085**	**4,691,977**
Undrawn facilities available to customers	248,868	-	-	-	-	-	248,868
Undrawn committed bank facilities	390,762	-	-	-	-	-	390,762
June 2019							
Financial liabilities							
Retail deposits	895,290	1,415,994	605,804	224,545	73,034	1,680	3,216,347
Other borrowings	-	75,198	15,032	81,915	977,044	-	1,149,189
Derivative financial liabilities	-	4,751	7,769	10,552	5,741	-	28,813
Other financial liabilities	-	16,284	-	-	-	-	16,284
Total financial liabilities	**895,290**	**1,512,227**	**628,605**	**317,012**	**1,055,819**	**1,680**	**4,410,633**
Undrawn facilities available to customers	102,285	-	-	-	-	-	102,285
Undrawn committed bank facilities	219,631	-	-	-	-	-	219,631

24 Interest rate risk

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

The Group's exposure to market risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ALCO must conform to this. The objective of the ALCO is to derive the most appropriate strategy for the 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 Group measures sensitivity to interest rate changes by assessing the change in the fair value of the position to a +/- 1 basis point shock to the curve (that is multiplied by 100), with basis point sensitivity limits set according to the Risk Appetite Statement and Market Risk Policy. The Group also manages interest rate risk by:

- Monitoring maturity profiles and seeking to match the re-pricing of assets and liabilities;
- Monitoring interest rates daily and regularly (at least monthly) reviewing interest rate exposures; and
- Entering into derivatives to hedge against movements in interest rates.

Contractual repricing analysis

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

$000's	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2+ Years	Non-Interest Bearing	Total
June 2020							
Financial assets							
Cash and cash equivalents	147,172	-	-	-	-	7	147,179
Investments	43,863	18,425	52,708	59,296	222,713	16,335	413,340
Finance receivables	1,522,837	198,446	352,076	557,569	400,658	13,609	3,045,195
Finance receivables - reverse mortgages	1,538,585	-	-	-	-	-	1,538,585
Derivative financial assets	-	-	-	-	-	17,246	17,246
Other financial assets	-	-	-	-	-	3,563	3,563
Total financial assets	**3,252,457**	**216,871**	**404,784**	**616,865**	**623,371**	**50,760**	**5,165,108**
Financial liabilities							
Retail deposits	1,616,521	585,482	815,366	155,219	77,655	13,949	3,264,192
Other borrowings	976,638	970	-	-	290,323	-	1,267,931
Derivative financial liabilities	-	-	-	-	-	17,012	17,012
Lease liabilities	-	-	-	-	-	20,456	20,456
Other financial liabilities	-	-	-	-	-	26,751	26,751
Total financial liabilities	**2,593,159**	**586,452**	**815,366**	**155,219**	**367,978**	**78,168**	**4,596,342**
Effect of derivatives held for risk management	557,955	(51,349)	(239,137)	(237,212)	(30,257)	-	-
Net financial assets / (liabilities)	**1,217,253**	**(420,930)**	**(649,719)**	**224,434**	**225,136**	**(27,408)**	**568,766**

24 Interest rate risk (continued)

$000's	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2+ Years	Non-Interest Bearing	Total
June 2019							
Financial assets							
Cash and cash equivalents	74,490	-	-	-	-	6	74,496
Investments	24,097	15,368	91,248	62,048	149,732	12,435	354,928
Finance receivables	1,553,748	206,801	337,236	537,300	386,870	9,173	3,031,128
Finance receivables - reverse mortgages	1,318,677	-	-	-	-	-	1,318,677
Derivative financial assets	-	-	-	-	-	14,491	14,491
Other financial assets	-	-	-	-	-	7,503	7,503
Total financial assets	**2,971,012**	**222,169**	**428,484**	**599,348**	**536,602**	**43,608**	**4,801,223**
Financial liabilities							
Retail deposits	1,614,124	519,676	729,734	212,575	65,887	11,685	3,153,681
Other borrowings	772,134	-	-	-	285,434	-	1,057,568
Derivative financial liabilities	-	-	-	-	-	11,147	11,147
Other financial liabilities	-	-	-	-	-	16,284	16,284
Total financial liabilities	**2,386,258**	**519,676**	**729,734**	**212,575**	**351,321**	**39,116**	**4,238,680**
Effect of derivatives held for risk management	(36,789)	162,749	38,975	(313,184)	148,249	-	-
Net financial assets / (liabilities)	**547,965**	**(134,758)**	**(262,275)**	**73,589**	**333,530**	**4,492**	**562,543**

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

Other Disclosures

25 Significant subsidiaries

Significant Subsidiaries	Country of Incorporation and Place of Business	Nature of Business	Proportion of ownership and voting power held June 2020	June 2019
Heartland Bank Limited	New Zealand	Bank	100%	100%
VPS Properties Limited	New Zealand	Investment property holding company	100%	100%
MARAC Insurance Limited	New Zealand	Insurance services	100%	100%
Heartland Australia Holdings Pty Limited	Australia	Financial services	100%	100%
Heartland Australia Group Pty Limited	Australia	Financial services	100%	100%
Australian Seniors Finance Pty Limited	Australia	Management services	100%	100%

26 Structured entities

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

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

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

$000's	June 2020	June 2019
Deposits	166,676	146,094

(b) Seniors Warehouse Trust, Seniors Warehouse Trust No.2 (together the SW Trusts) and ASF Settlement Trust (ASF Trust)

SW Trusts and ASF Trust (collectively the Trusts) form part of ASF's reverse mortgage business and were set up by ASF as asset holding entities. The Trustee for the Trusts is ASF Custodians Pty Limited and the Trust Manager is ASF. The reverse mortgage loans held by the Trusts are set aside for the benefit of the investors in the Trusts. The balances of SW Trusts and ASF Trust are represented as follows:

$000's	June 2020	June 2019
Cash and cash equivalents	26,491	6,112
Finance receivables - reverse mortgages	929,179	756,454
Other borrowings	(783,373)	(659,925)

26 Structured entities (continued)

(c) Heartland Auto Receivables Warehouse Trust 2018-1 (Auto Warehouse)

The Auto Warehouse securitises motor loan receivables as a source of funding.

The Group continues to recognise the securitised assets and associated borrowings in the consolidated statement of financial position as the Group remains exposed to and has the ability to affect variable returns from those assets and liabilities. Although the Group recognises those interests in Auto Warehouse, the loans sold to Auto Warehouse are set aside for the benefit of investors in Auto Warehouse and other depositors and lenders to the Group have no recourse to those assets.

$000's	June 2020	June 2019
Cash and cash equivalents	5,493	555
Finance receivables	78,066	-
Other borrowings	(79,012)	(559)

27 Staff share ownership arrangements

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

(a) Share-based compensation plan details

Heartland performance rights plan (PR plan)

The PR plan was established to enhance the alignment of participants' interests with those of the Group's shareholders. Under the PR plan participants are issued performance rights which will entitle them to receive shares in the Group. As at June 2020, there were 3 tranches being 2017, 2018 and 2022. The 2017 and 2018 tranche rules have been aligned to the PR Plan 2022, and therefore they all have the same terms and conditions applying regarding participants, awarding of PR, measurement date and vesting as outlined below:

PR Plan 2022 Tranche (PR plan 2022)

The number of performance rights offered is determined by the participant's long-term incentive (**LTI**) value over the volume weighted average price (**VWAP**) of the Group's ordinary shares on the NZX Main Board for the 20 business days immediately before (and excluding) the issue date. The issue date is 14 September 2019. Performance rights do not entitle participants to dividends or voting rights.

The performance rights are issued subject to the participants' continued employment with the Group until the measurement date and the Group achieving its financial measures, strategic objectives and culture and conduct objectives, over the period commencing 1 July 2019 and ending on 30 June 2022. The targets are dynamic and may be adjusted by the Board from time to time in order to account for unanticipated capital changes during the performance period. The measurement date is the business days following the date on which the Group announces its full year results for the financial year ended 2022.

Performance rights will vest on the measurement date to the extent these criteria have been met, but subject to caps and also to retesting on a later measurement date if the criteria are not met on the initial measurement date.

27 Staff share ownership arrangements (continued)

	PR Plan Number of Rights	SES[1] Number of Shares
1 July 2019	**3,121,340**	**-**
Granted	(816,858)	-
Issued	1,230,740	-
Forfeited	(318,295)	-
30 June 2020	**3,216,927**	**-**
1 July 2018	**3,180,298**	**1,858,676**
Granted	-	(1,858,676)
Issued	293,759	-
Forfeited	(352,717)	-
30 June 2019	**3,121,340**	**-**

[1]Senior Executive Scheme (**SES**) was established in June 2016 and terminated in June 2019.

(b) Effect of share-based payment transactions

$000's	**June 2020**	**June 2019**
Award of Shares		
SES	-	327
PR Plan	516	341
Total expense recognised	**516**	**668**

As at 30 June 2020, $1.9 million of the share scheme awards remain unvested and not expensed (2019: $0.59 million). This expense will be recognised over the vesting period of the awards.

(c) Number of rights outstanding at 30 June 2020

	June 2020		**June 2019**	
000's	**Rights Outstanding**	**Remaining Years**	**Rights Outstanding**	**Remaining Years**
PR plan - 2016	-	-	823	-
PR Plan - 2017	2,039	2	2,039	2
PR Plan - 2018	259	2	259	2
PR Plan - 2022	919	2	-	-
Total	**3,217**		**3,121**	

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

Insurance business

The Group conducts insurance business through its subsidiary MIL.

The Group's aggregate amount of insurance business comprises the total consolidated assets of MIL of $10.9 million (2019: $12.9 million), which represents 0.2% of the total consolidated assets of the Group.

During the current year the Group has undertaken a strategic review of its insurance business in line with its core banking business. The Group has entered into a distribution agreement with DPL to distribute DPL's insurance products through its network and has stopped writing insurance policies in February 2020. The Group will gradually exit from the insurance business as the existing written policies expire over time.

Securitisation, funds management and other fiduciary activities

Changes to the Group’s involvement in securitisation activities are set out in Note 26. There have been no material changes to the Group’s involvement in funds management and other fiduciary activities during the year.

29 Concentrations of funding

(a) Concentrations of funding by industry

The Australian and New Zealand Standard Industrial Classification (**ANZSIC**) codes have been used as the basis for categorising customer industry sectors:

$000's	June 2020	June 2019
Agriculture	109,268	68,559
Forestry and fishing	14,901	25,360
Mining	35	61
Manufacturing	6,976	11,233
Finance and insurance	1,431,320	1,149,034
Wholesale trade	10,855	11,520
Retail trade and accommodation	20,423	19,730
Households	2,263,668	2,340,764
Rental, hiring and real estate services	41,348	30,110
Construction	19,702	15,338
Other business services	63,697	57,360
Transport and storage	4,552	4,416
Other	97,150	140,084
	4,083,895	3,873,569
Unsubordinated notes	448,228	337,680
Total borrowings	**4,532,123**	**4,211,249**

(b) Concentration of funding by geographical area

$000's	June 2020	June 2019
New Zealand	3,470,744	3,404,163
Rest of the world	1,061,379	807,086
Total borrowings	**4,532,123**	**4,211,249**

30 Contingent liabilities and commitments

The Group in the ordinary course of business will be subject to claims and proceedings against it whereby the validity of the claim will only be confirmed by uncertain future events. In such circumstances the contingent liabilities are possible obligations, or present obligations if known, where the transfer of economic benefit is uncertain or cannot be reliable measured. Contingent Liabilities are not recognised, but are disclosed, unless they are remote. Where some loss is probable, provisions have been made on a case by case basis.

Contingent liabilities and credit related commitments arising in respect of the Group's operations were:

$000's	**June 2020**	**June 2019**
Letters of credit, guarantee commitments and performance bonds	6,515	6,757
Total contingent liabilities	**6,515**	**6,757**
Undrawn facilities available to customers	248,868	177,316
Conditional commitments to fund at future dates	58,045	14,286
Total commitments	**306,913**	**191,602**

31 Events after the reporting date

COVID-19 pandemic update

Following the confirmation of further community spread of COVID-19 with unknown origin, the Government announced on 12 August 2020 that New Zealand's COVID-19 Alert Levels will change, with the Auckland region (Wellsford to Pukekohe) moving to Alert Level 3 and the rest of New Zealand moving to Alert Level 2. Following that, the Auckland region moved to Alert Level 2 from 31 August 2020. This did not have any impact on Group's estimates and judgements (refer to Note 1 - Financial statements preparation).

Dividend

The Group declared a fully imputed dividend of 2.5 cents per share on 17 September 2020, to be paid to share holders on 9 October 2020.

Funding facility

On 15 September 2020, the Group announced that a funding facility of AU$142 million had been secured for its Australian reverse mortgages portfolio.

There were no other events subsequent to the reporting period which would materially affect the consolidated financial statements.

Independent Auditor's Report

To the shareholders of Heartland Group Holdings Limited

Report on the audit of the consolidated financial statements

Opinion

We have audited the accompanying consolidated financial statements which comprise:

- the consolidated statement of financial position as at 30 June 2020;
- the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended; and
- notes, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements of Heartland Group Holdings Limited and its subsidiaries (the "Group") on pages 6 to 62:

i. present fairly in all material respects the Group's financial position as at 30 June 2020 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

Basis for opinion

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

We are independent of the Group in accordance with Professional and Ethical Standard 1 International Code of Ethics for Assurance Practitioners (Including International Independence Standards) (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) ("IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our responsibilities under ISAs (NZ) are further described in the auditor's responsibilities for the audit of the consolidated financial statements section of our report.

Our firm has also provided other services to the Group in relation to the review of the Group's consolidated interim financial statements, regulatory assurance services, agreed upon procedure engagements and supervisor reporting. Subject to certain restrictions, partners and employees of our firm may also deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. These matters have not impaired our independence as auditor of the Group. The firm has no other relationship with, or interest in, the Group.

Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the consolidated financial statements as a whole. The materiality for the consolidated financial statements as a whole was set at $5,470,000 determined with reference to a benchmark of the Group's normalised profit before tax. We chose the benchmark because, in our view, this is a key measure of the Group's performance.

We agreed with the Audit Committee that we would report to them, misstatements identified during our audit above $270,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

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

Key changes in the assessment of audit risks

Covid-19

The Covid-19 pandemic has created significant additional risks across a number of areas of the business, particularly the assessment of the provision for impairment of finance receivables. All forward looking assumptions are inherently more uncertain during these unprecedented times. While the key audit matter "Provision for impairment of finance receivables", detailed below, is unchanged from last year, the underlying audit risk has increased which impacted the extent and nature of audit evidence that we had to gather.

The key audit matter	How the matter was addressed in our audit
Provision for impairment of finance receivables Refer to notes 1 and 13 to the consolidated financial statements.	
The provision for impairment of finance receivables is a key audit matter due to the financial significance and the inherent complexity of the Group's expected credit loss ("ECL") models. Significant judgement and estimates are required to incorporate forward-looking information to reflect future economic conditions, including the potential economic impact of the Covid-19 pandemic and other assumptions such as defining a significant increase in credit risk ("SICR"). The collective provision is estimated through the ECL model which uses historical data, adjusted for forward looking information and the assigned risk grade or arrears status. Additionally, management apply judgement in the determination of provision overlays to adjust for future market conditions. The level of judgement involved in determining the provision for collectively impaired assets requires us to challenge the appropriateness of management's assumptions. The provision for individually impaired assets is based on the application of management judgement regarding expected future cashflows, which are inherently uncertain.	Together with KPMG credit risk specialists we assessed the Group's collective and individual provisions. Our procedures, amongst others, included: — Assessing the Group's governance and oversight, including the continuous reassessment of overall provisioning; — Assessing the Group's significant accounting policies and ECL modelling methodology against the requirements of the standards and underlying accounting records; — Testing key controls including the arrears calculations, customer loan ratings, annual loan reviews, credit risk reviews and data reconciliations between the ECL models and source systems; — Assessing the model output against actual losses incurred by the Group; — Challenging the key assumptions, including forward looking economic assumptions, against external information including benchmarking management's estimates to a range of different market forecasts; — Evaluating individual credit assessments for a sample of 'rural' and other 'corporate' loans on management's credit watchlist. This included inspection of the latest correspondence with the borrower, assessment of the provision estimates prepared by credit risk officers, and consideration of the resolution strategy. We challenged assumptions and assessed collateral values by comparing them to valuations performed by independent valuers; and — Assessing the disclosures in the consolidated financial statements against the requirements of NZ IFRS. From the procedures performed we consider the Group appropriately identified and considered the uncertainties in the provision estimates.

The key audit matter	How the matter was addressed in our audit
Valuation of finance receivables – reverse mortgages Refer to notes 13(b) and 20 to the consolidated financial statements.	
The Group's reverse mortgage portfolio is held at fair value. The fair value calculation is based on the application of management judgement. In assessing the fair value, the Group continuously considers evidence of a relevant active market. In the absence of such a market, in the current period, the Group considered changes since loan origination and expected future cashflows. The inherent uncertainties include estimated exits, interest rates and security property values.	Our procedures over the fair value loan portfolios, amongst others, included: — Testing key controls over the accuracy of data impacting the fair value assessment; — Assessing evidence of a relevant active market or observable inputs; and — Challenging the key assumptions used by the Group in determining the portfolio's fair value. The estimates and assumptions used to determine the valuation of finance receivables are reasonable, with no evidence of management bias or influence identified from our procedures.
Operation of IT systems and controls	
The Group is reliant on complex IT systems for the processing and recording of significant volumes of transactions and other core banking activity. For significant financial statement balances, such as finance receivables and deposits, where relevant, our audit involves an assessment of the design of the Group's internal control environment. There are some areas of the audit where we seek to test and place reliance on IT systems, automated controls and reporting. The effective operation of these controls is dependent upon the Group's general IT control environment, which incorporates controls relevant to IT system changes and development, IT operations, developer and user access.	Our audit procedures, amongst others, included: — Gaining an understanding of business processes, key controls and IT systems relevant to significant financial statement balances, including technology services provided by a third party; — Assessing the effectiveness of the IT control environment, including core banking IT systems, key automated controls and reporting; and — Evaluating general IT controls relevant to IT system changes and development, IT operations, developer and user access. Where we noted design or operating effectiveness matters relating to IT system or application controls relevant to our audit, we performed alternative audit procedures. We also identified and tested mitigating controls in order to respond to the impact on our overall audit approach. We did not identify any material issues or exceptions from those additional procedures.

Other information

The Directors, on behalf of the Group, are responsible for the other information included in the entity's Annual Report. Other information may include the Annual Review and information included in the Financial Report. Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

The Annual Report is expected to be made available to us after the date of this Independent Auditor's Report. Our responsibility is to read the Annual Report when it becomes available and consider whether the other information it contains is materially inconsistent with the consolidated financial statements, or our knowledge obtained in the audit, or otherwise appear misstated. If so, we are required to report such matters to the Directors.

Use of this independent auditor’s report

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

Responsibilities of the Directors for the consolidated financial statements

The Directors, on behalf of the Group, are responsible for:

- the preparation and fair presentation of the consolidated financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;
- implementing necessary internal control to enable the preparation of consolidated financial statements that are fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

Auditor’s responsibilities for the audit of the consolidated financial statements

Our objective is:

- to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- to issue an independent auditor’s report that includes our opinion.

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

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

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

http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

This description forms part of our independent auditor’s report.

The engagement partner on the audit resulting in this independent auditor's report is Graeme Edwards.

For and on behalf of

KPMG

KPMG
Auckland

17 September 2020