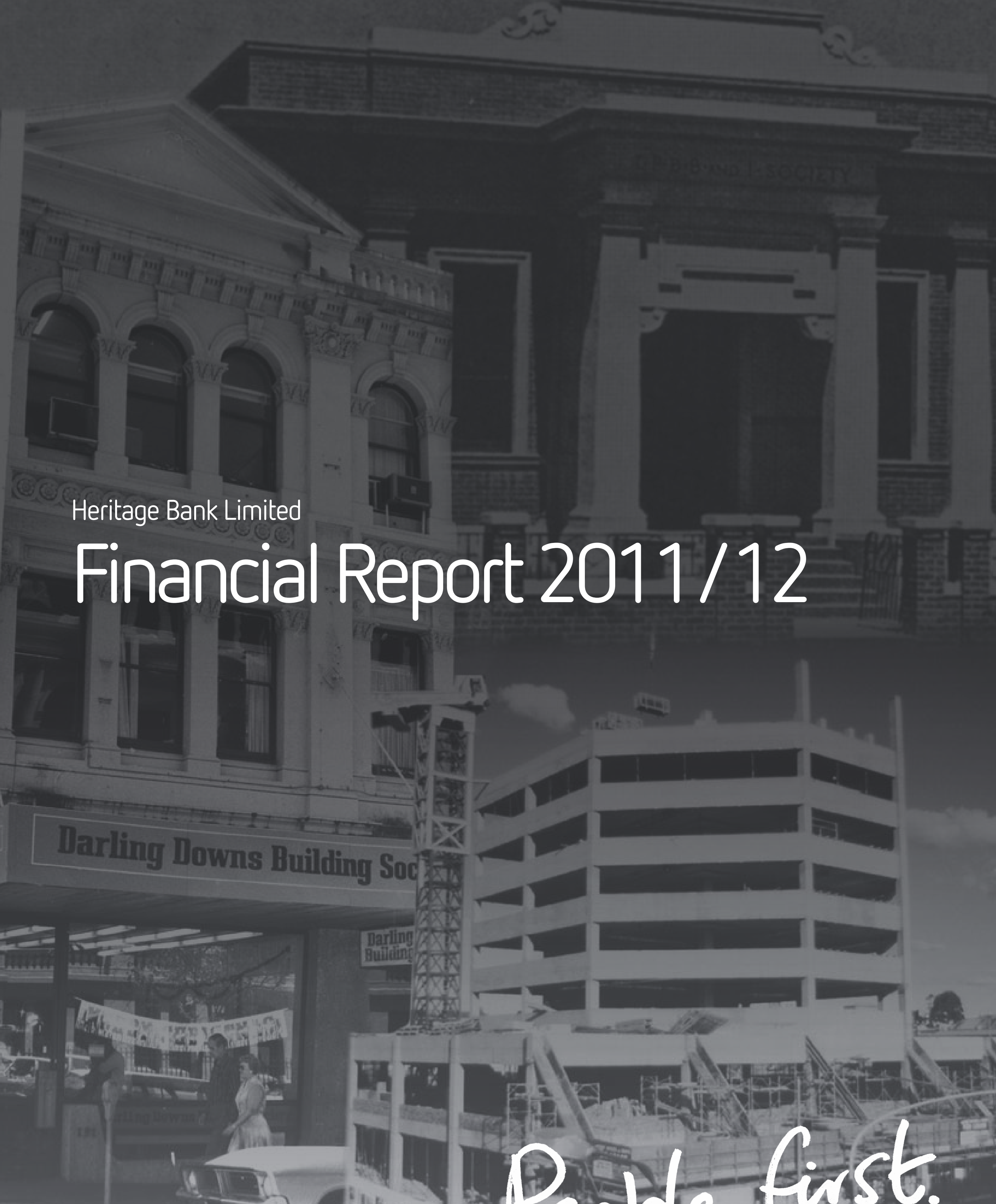
Heritage Bank Limited

Financial Report 2011/12



People first.

Heritage Bank

Heritage Bank Limited
(formerly Heritage Building Society Limited)
ABN 32 087 652 024. AFSL 240984. Australian Credit Licence 240984.

Financial Report for the year ended 30 June 2012

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Auditors
Ernst & Young

Registered Office
Heritage Bank Limited
6th Floor 400 Ruthven Street
Toowoomba Qld 4350 Australia

Postal Address
P.O. Box 190
Toowoomba Qld 4350 Australia

Contact Details
Telephone (07) 4690 9000
International 61 7 4690 9000
Internet www.heritage.com.au
Contact Centre 13 14 22
Heritage Access Line 13 14 72

Directors' Report

Your directors submit their report of the consolidated entity (the "Group"), being Heritage Bank Limited ("Heritage" - formerly Heritage Building Society Limited) and its controlled entities, for the year ended 30 June 2012.

DIRECTORS

The name and details of the directors of the Group in office during the financial year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

NAME AND QUALIFICATIONS

Mr Brian R. Carter AM, LLB, HonDUniv, FAICD
Chairman (retired effective 21 June 2012)

Mr Carter is a retired Solicitor and Toowoomba businessman. He served as a Director of Darling Downs Building Society from 1975-81 and was Deputy Chairman in 1980-81. He had been a Director of Heritage since the merger in 1981. He was Deputy Chairman in 1981-82 and had been Chairman of Directors since 1982. Mr Carter was an ex officio member of, and had involvement with, all Board Committees. Mr Carter has also been Chairman of the Council of the Queensland Institute of Medical Research (1997-98) and Chairman of the Board of St. Vincent's Hospital Toowoomba (1990-96) as well as various other organisations. Mr Carter was appointed a Member in the General Division of the Order of Australia "For service to business and commerce through the building society industry, and to the community through health care and medical research organisations". He was awarded the Centenary of Federation Medal for distinguished service to the community. Mr Carter was awarded an honorary doctorate at the University of Southern Queensland for his strong advocacy of the university and his significant contribution to the community through his voluntary, charitable and sporting contributions. Mr Carter retired as both the Chairman and as a Director on 21 June 2012.

Mr Kerry J. Betros BBus, FCPA, MAICD
Deputy Chairman (Chairman effective 21 June 2012)

Mr Betros is Managing Director of Betros Bros Holdings Pty Limited and associated companies, Darling Downs-based wholesalers and retailers, established in 1938. He graduated from DDIAE (now USQ) with a Bachelor of Business majoring in management and accounting. He has previously served on various other boards and organisations and was awarded the Centenary of Federation Medal for distinguished service to the community. Mr Betros has been a director of Heritage since 1991. He was the inaugural Chairman of Heritage's Finance Committee, has been the Chairman of the Internal Audit Committee and has served on a number of other committees. He became the Chairman of Directors on 21 June 2012.

Dr Dennis P. Campbell PhD, MBA, FCHSE, CHE, FAIM
(Deputy Chairman effective 21 June 2012)

Dr Campbell was previously a Chief Executive Officer in both the public and private health sectors. He held the position of CEO at St Vincent's Hospital Toowoomba for ten years. He also served as a Corporate Director with Legal Aid Queensland for ten years. He serves as a member of numerous Boards and Advisory Committees, representing both public and private health sectors, has legal and health qualifications and is involved in organisational health consulting. Dr Campbell joined the Heritage Board in 2000, is a member of the Insurance and Constitution Review Committees and became Chairman of the Finance Committee on 19 July 2012. Dr Campbell became Chairman of Permanent LMI Pty Limited on 1 January 2010. He also serves as a trustee of the Queensland Museum Foundation, is Chairperson of the Management Advisory Committee of the Cobb & Co Museum, Toowoomba and is Deputy Chairman of the Darling Downs Hospital and Health Board. In 2007, he was awarded an Australia Day Medallion for his services to the Australian College of Health Service Executives. In 2008, he was awarded the Gold Medal for Leadership and Achievement in Health Services Management recognising his contribution and professional achievements in shaping health care policy at the institutional, state and national levels. Dr Campbell was appointed Deputy Chairman of Directors on 21 June 2012.

Mrs Vivienne A. Quinn MAHRI, MRCSA, FAICD

Mrs Quinn is the Managing Director of Quinn & Associates Pty Limited, a Brisbane-based staff recruitment consultancy that operates throughout Australia. She has had 30 years in staff recruitment and has a depth of marketing experience. She is also a partner in a primary production / tourism business on the Southern Downs. Mrs Quinn has served on various Federal and State Government Boards and on the State Councils of human resource industry bodies. She has served on the Heritage Board since 1995, is a member of the Audit and Compliance Committee and is Chairman of the Superannuation Policy Committee.

Professor Peter Swannell AM,
BSc, PhD, HonDUniv, FIEAust, CPEng(Ret)

Emeritus Professor Swannell was the Vice-Chancellor and President of the University of Southern Queensland from November 1996 until September 2003, having joined the University as Foundation Professor and Dean of the Faculty of Engineering and Surveying in 1990. This appointment followed an academic career spanning over 25 years in the United Kingdom and Australia. He has served as a Chairman and member of a number of Boards and Committees and is currently the Chairman of Empire Theatres Pty Limited (since 1999). Professor Swannell joined the Heritage Board in 2003 and was Chairman of the Insurance Committee and a member of the Finance Committee until 30 June 2011. He is currently a member of the Audit and Compliance Committee and has been a director of Permanent LMI Pty Limited since 1 July 2011. He was appointed as a Member in the General Division of the Order of Australia, "For services to higher education, particularly through the advancement of distance education and on-line learning opportunities, to engineering and as researcher and teacher, and to the community". He was also awarded the Centenary of Federation Medal for services to education, particularly as Vice Chancellor of the University of Southern Queensland.

Ms Susan M. Campbell
FCPA, FFin, MAICD, BCom, GradDip(SIA), MBA

Ms Campbell was appointed as a Director in 2005 and brings with her a range of finance skills from the banking and financial services sector. She is managing director of ARGYLL, a specialist financial services consulting firm, and is Heritage's first interstate director. Ms Campbell is chairman of the newly created Risk Management Committee and is a member of the Finance Committee. Susan is active with the Institute of Chartered Accountants Australia and the Australian Financial Markets Association and works with many organisations in Australia and Asia developing their treasury and risk management skills. Her previous work has included working with global banks in Melbourne and London, corporate treasuries, and as a senior lecturer at RMIT University.

Mr Brendan P. Baulch BCom, LLB, CA

Mr Baulch is a Chartered Accountant based in Toowoomba. He began his career with PriceWaterhouse in their corporate tax division in Melbourne, after which he spent a total of eight years in London, gaining international accounting experience in a range of business sectors including telecommunications (Cable & Wireless plc), investment banking (Société Générale) and insurance (Lloyd's of London). He is currently the principal of Baulch & Associates, a Toowoomba-based accounting practice providing taxation, audit and management accounting services. Mr Baulch is a registered tax agent and a registered company auditor. He was appointed as Director in 2007, has been a member of the Audit and Compliance Committee and was appointed Chairman of the Audit and Compliance Committee on 1 July 2011.

Mr Stephen Davis CRV, AAPI, MAICD

Mr Davis is a licensed valuer, auctioneer and real estate agent and has since 1989 been the Managing Director of David W Swan & Associates Pty Limited. He is also the Managing Director of Australian Strata Titles Services Pty Limited trading as Toowoomba Body Corporate Management. Mr Davis has been involved in community organisations and is currently the Deputy Chairman and Treasurer of the Toowoomba Hospice Association. Mr Davis was appointed to the Heritage Board on 1 July 2011 and is a member of the Superannuation Policy Committee.

Mr David W. Thorpe BEc (Hons), FCPA, GAICD

Mr Thorpe is a financial services executive based in Brisbane. Mr Thorpe was Chief Executive Officer of the Queensland Association of Permanent Building Societies for more than 20 years and Associate Director of the Australian Finance Conference. He also worked in executive positions in private and public companies as well as the Commonwealth and Queensland Governments. Mr Thorpe was appointed to the Heritage Board on 18 April 2012 to fill the vacancy created when Mr Brian Carter retired in June.

COMPANY SECRETARIES

Mr T. William Armagnacq BCom, FCA, FAICD
Company Secretary / Assistant Chief Executive Officer

Mr Armagnacq has been a Secretary of Heritage since May 2003. From January 1998 to April 2003 he was company secretary of a number of companies which are part of the Ergon Energy Corporation Limited Group. From July 1989 to December 1997, Mr Armagnacq was a partner of Chartered Accountants, KPMG. He has also been a director of a number of companies and is currently a director of Permanent LMI Pty Limited.

Mr David Janetzki LLB (Hons), BEcon, AMusA
General Counsel / Assistant Company Secretary

Mr Janetzki is Heritage's General Counsel and was appointed as a Secretary in October 2007. He has worked as inhouse counsel for the Manpower Group in London and as a lawyer for Corrs Chambers Westgarth. He lectures at the University of Southern Queensland in banking, finance, insurance and business law subjects and serves as a trustee of the Empire Theatres Foundation.

Directors' Report (continued)

DIRECTORS' MEETINGS

The number of meetings of directors (including meetings of committees of directors) held during the financial year and the number of meetings attended by each director were as follows:

	Board		Finance		Audit and Compliance		Remuneration and Appointments		Insurance	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Mr Carter AM *	13	13	12	12	7	6	1	1	1	-
Mr Betros	13	13	12	12	-	-	1	1	-	-
Dr Campbell	13	13	12	12	-	-	-	-	1	1
Mrs Quinn	13	13	-	-	7	7	1	1	-	-
Prof Swannell AM	13	13	-	-	-	-	-	-	1	1
Ms Campbell	13	13	12	12	-	-	-	-	-	-
Mr Baulch	13	13	-	-	7	7	-	-	-	-
Mr Davis	13	13	-	-	7	7	-	-	-	-
Mr Thorpe	5	4	-	-	-	-	-	-	-	-

The meetings held during the year indicate the number of meetings held during the period the individual was a director or committee member.

The Constitution Review Committee did not meet during the financial year. The Superannuation Policy Committee is not a Board Committee, however Mrs Quinn and Professor Swannell were employer representatives during the financial year. The Board approved the creation of a Risk Management Committee on 19 July 2012, committee members include Ms Campbell, Dr Campbell, Mr Baulch and Mr Betros (as an ex officio member).

* Mr Carter was an ex officio member, not an appointed member, of the Audit and Compliance, Finance and Insurance Committees. He attended only those meetings involving significant issues to Heritage.

PRINCIPAL ACTIVITIES

Heritage Bank Limited is a mutual bank that is incorporated and domiciled in Australia. The principal activity of the Group during the year was the provision of financial products and services to customers. There has been no significant change in the nature of these activities during the year.

The Group employed 704 full time equivalent employees as at 30 June 2012 (2011 – 692 employees).

REVIEW AND RESULT OF OPERATIONS

The operating profit of the Group for the financial year after income tax was $31.272 million (2011 - $32.056 million). This represents a 2.4% decrease compared to the previous year and is a solid result despite the subdued operating environment.

Heritage changed its name from Heritage Building Society Limited to Heritage Bank Limited effective 1 December 2011.

The Group reported a 2.2% increase in total consolidated assets to a total of $8.221 billion (2011 - $8.045 billion).

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

There was no significant change in the state of affairs of the Group during the year ended 30 June 2012 not otherwise listed in the report or the financial statements.

SIGNIFICANT EVENTS AFTER THE BALANCE DATE

There are no significant events since the end of the financial year which will affect the operating results or state of affairs of the Group in subsequent years.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

A statement on the likely developments in the operations of the Group, and the expected results of these operations has not been included in the report because, in the opinion of the Directors, it could prejudice the interest of the economic entity.

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

During the financial year, the Group paid premiums in respect of insurance contracts which insure each person who is or has been a director or executive officer of the Group against certain liabilities arising in the course of their activities to the Group.

The directors have not included details of the nature of the liabilities covered, or the amount of the premium paid, as such disclosure is prohibited under the terms of the contract.

REMUNERATION REPORT (AUDITED)

This Remuneration Report for the year ended 30 June 2012 outlines the remuneration arrangements of the Group in accordance with section 300A of the *Corporations Act 2001*. The information provided in the Remuneration Report has been audited as required by section 308(3C) of the *Corporations Act 2001*.

Introduction

The Remuneration Report provides members with information relating to the Group's remuneration policies and practices and outlines remuneration arrangements for the Group's "key management personnel". This Remuneration Report forms part of the Directors' Report.

"Key management personnel" are defined as "those persons having authority and responsibility for planning, directing and controlling the major activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity".

Governance and Risk Management

The Remuneration and Appointments Committee is appointed and authorised by Heritage's Board to assist the Board in fulfilling its regulatory obligations.

Accordingly, the Remuneration and Appointments Committee exercises the authority and power delegated to it by the Board.

The Remuneration and Appointments Committee's role is to report to the Board and review, oversee and provide appropriate advice and recommendations on matters relating to:

- Remuneration policies (including incentive payments);
- Appointment and remuneration of the CEO; and
- Senior executive appointments and senior executive remuneration in conjunction with the CEO.

Key responsibilities include, among others:

- Conduct regular reviews of, and make recommendations to the Board on the remuneration policy and related policies; and
- Make annual recommendations to the Board on the remuneration of the CEO and senior executives, other persons whose activities may in the opinion of the Remuneration and Appointments Committee affect the financial soundness of Heritage and any other person specified by APRA.

In exercising its responsibilities, the Remuneration and Appointments Committee assesses the appropriateness of the nature and amount of remuneration of non-executive directors and senior executives on an annual basis with the overarching objective of ensuring maximum member benefit from the retention of a high quality and high performing Board and senior executive group.

All members of the Remuneration and Appointments Committee are non-executive directors. Members of the Remuneration and Appointments Committee during the period to 30 June 2012 have been Mr Kerry Betros and Mrs Vivienne Quinn. Mr Brian Carter served as Chairman of the Remuneration and Appointments Committee until his retirement as director and Chairman of Heritage on 21 June 2012.

Directors' Report (continued)

REMUNERATION REPORT (AUDITED) (continued)

Key Management Personnel

Directors	Position
Brian Carter	Chairman (Non-executive) (retired effective 21 June 2012)
Kerry Betros	Deputy Chairman (Non-executive) (Chairman effective 21 June 2012)
Dennis Campbell	Director (Non-executive) (Deputy Chairman effective 21 June 2012)
Vivienne Quinn	Director (Non-executive)
Peter Swannell	Director (Non-executive)
Susan Campbell	Director (Non-executive)
Brendan Baulch	Director (Non-executive)
Stephen Davis	Director (Non-executive) (Appointed 1 July 2011)
David Thorpe	Director (Non-executive) (Appointed 18 April 2012)

Senior Executives	Position	Contract Duration	Notice Period (Executive to Heritage)
John Minz	Chief Executive Officer	3 years	–
Bill Armagnacq	Company Secretary/Assistant Chief Executive Officer	3 years	3 months
Jane Calder	General Manager, Marketing	3 years	3 months
Peter Cavanagh	Chief Strategy Officer (up to 6 December 2011) General Manager, Strategy (from 7 December 2011)	3 years	3 months
Peter Cleary	Chief Financial Officer	3 years	3 months
Paul Francis	General Manager, Retail Services	No fixed term	1 month
Bob Hogarth	General Manager, Human Resources	No fixed term	1 month
Dunstin Lynch	General Manager, Technology	3 years	3 months
John Williams	Chief Operating Officer	3 years	3 months
Paul Williams	Treasurer (up to 6 December 2011) Chief Treasury and Business Strategy Officer (from 7 December 2011)	3 years	3 months

No termination payments are made by Heritage in the event key management personnel contracts are terminated. Notice and any statutory payments or entitlements are paid as appropriate.

Apart from the retirement of Mr Carter effective 21 June 2012 and the appointments of Mr Davis (1 July 2011) and Mr Thorpe (18 April 2012) there have been no changes to those persons defined as "key management personnel" between 1 July 2011 and the date of this Remuneration Report.

REMUNERATION REPORT (AUDITED) (continued)

Non-Executive Directors' Remuneration

Background

Directors' remuneration is reviewed annually by the Remuneration and Appointments Committee. Based on the review undertaken by the Remuneration and Appointments Committee, the Board may make recommendations to members at the Annual General Meeting taking into account an individual's responsibilities, performance, qualifications, experience, industry standards, Heritage's profitability and fees paid by comparable institutions. Much of this information is derived from independent remuneration sources.

Recommendations also take into account the need to attract and retain appropriately qualified and experienced non-executive directors.

Directors' fees are set by members at the Annual General Meeting in the aggregate and the individual allocation is determined and approved by the Board.

Directors' Fees

The non-executive directors' aggregate fee amount as set by members at the Annual General Meeting on 19 October 2011 was $980,000 plus a pro-rata amount in the event an additional director was appointed. Mr Thorpe was appointed on 18 April 2012. The individual allocation is provided in the table on page 9. This amount does not include superannuation, retirement allowances or any other entitlements.

Directors are entitled to payment of superannuation contributions at the rate of 9% of fees paid, payment of directors' liability and personal accident insurance and related fringe benefits tax. Under Heritage's Constitution, directors are entitled to a lump sum retiring allowance calculated as one-fourth of the aggregate amount of directors' fees which the director has received or has become entitled to receive. With the consent of the Board all or part of the retiring allowance to which a director has or will become entitled may be paid to a superannuation fund of which the director is a member.

No part of non-executive director remuneration is based on the financial performance of Heritage or the performance of the director and is not otherwise at risk.

Non-executive directors do not participate in Heritage incentive schemes. Heritage does not have share capital and non-executive directors do not receive any shares, award rights, share options, securities or any other benefit howsoever arising.

Directors may maintain loan and credit facilities from Heritage at normal member rates of interest and therefore no additional remuneration is obtained by way of a benefit.

Directors' fees are not payable to senior executives for serving as directors or company secretaries on any subsidiary, associated or joint venture companies or industry organisations in which Heritage has an interest or membership.

Other Directors' Fees

Mr Kerry Betros received additional remuneration and superannuation contributions as Chairman of HBS Custodian Pty Limited. HBS Custodian Pty Limited is wholly owned by Heritage Bank Limited and had been the Manager of Heritage's securitisation activities up to 31 December 2011. Application has recently been made to ASIC to de-register the company and revoke its Australian Financial Services Licence.

Dr Campbell and Professor Swannell received fees and associated superannuation as directors of Permanent LMI Pty Limited, which is a joint venture arrangement between Heritage Bank Limited and QBE Lenders' Mortgage Insurance Limited. Dr Campbell is also the Chairman of Permanent LMI Pty Limited. Permanent LMI Pty Limited is licensed as an insurer to undertake lender's mortgage insurance and only insures loans written by Heritage.

Senior Executives' Remuneration

Background

A key objective of Heritage's remuneration philosophy is to enable Heritage to attract, motivate and retain high performing senior executives.

Remuneration, including any performance based component, is designed to appropriately reward senior executives (and all employees) to encourage behaviour that supports Heritage's long-term financial soundness and risk management framework. In this regard, Heritage's Human Resources department has a set of policies and procedures in connection with remuneration including incentives, commissions and other benefits.

For senior executives, any performance-based component of remuneration is designed to align remuneration with prudent risk-taking and incorporate adjustments to reflect:

- the outcomes of business activities;
- the risks related to the business activities taking account, where relevant, of the cost of the associated capital; and
- the time necessary for the outcomes of those business activities to be reliably measured.

Directors' Report (continued)

REMUNERATION REPORT (AUDITED) (continued)

Senior Executives' Remuneration (continued)

Background (continued)

The Board may adjust performance-based components of senior executive remuneration downwards, to zero if appropriate, if such adjustments are necessary to:

- protect the financial soundness of Heritage; or
- respond to significant unexpected or unintended consequences that were not foreseen by the Remuneration and Appointments Committee.

Senior Executive Remuneration

Senior executive remuneration is currently a mix of fixed salary and short term (yearly) incentive payments.

Fixed Remuneration

Senior executives are paid a competitive fixed component of remuneration that reflects their core performance requirements and the expectations associated with their particular position. The fixed component of remuneration includes matters such as salary, superannuation, motor vehicle novated leases and leave entitlements. Senior executive base salary is reviewed annually taking into account the individual executive's position, external market trends and personal performance.

Short Term Incentive Benefits

No senior executive is provided with a yearly incentive payment on the basis of Heritage's financial performance.

However, Heritage provides an opportunity for senior executives to be paid a yearly incentive dependent on the individual's performance throughout the year and the duties and responsibilities undertaken. Any incentive payments are made on the basis of specified, quantifiable results, which may include the completion of a particular business project or the introduction of a new system which improves Heritage's ability to provide products and services to its members.

The opportunity for senior executives to be granted a yearly incentive payment is designed to support Heritage's overall remuneration policy by focussing senior executives on achieving yearly personal performance goals which contribute to sustainable Heritage growth and member value.

Linking short-term incentive payments to individual performance ensures that senior executives establish a *People first* culture that continually supports Heritage's long-term financial soundness.

Long Term Incentive Benefits

Heritage does not offer any long-term incentive benefits to senior executives. Heritage does not have share capital and senior executives do not receive any shares, award rights, share options, securities or any other long-term benefits howsoever arising.

Senior Executive Performance

Heritage's senior executive employment contracts are either a fixed term or open-ended in nature. The terms and conditions of such employment contracts are commensurable with the banking and finance industry in which Heritage operates.

Senior executives complete an annual performance review with the CEO at which time their performance and remuneration will be discussed. The CEO completes an annual performance review with the Chairman of the Board.

In the case of the CEO, any decisions in respect of remuneration are made on the recommendation of the Remuneration and Appointments Committee and approved by the Board. In the case of senior executives, any decisions in respect of remuneration are made on the recommendation of the CEO and approved by the Remuneration and Appointments Committee and the Board.

Remuneration Table

This section provides the remuneration details for non-executive directors and executives.

		Short Term Benefits			Long Term Benefits		
		Fees	Other Group Company Fees	Non-Cash Benefits	Superannuation Contributions	Retiring Allowance	Total
		$ ' 000	$ ' 000	$ ' 000	$ ' 000	$ ' 000	$ ' 000
Non - Executive Directors							
Mr B.R. Carter AM	**2012**	**243**	**-**	**2**	**22**	**61**	**328**
Chairman retired effective 21 June 2012	2011	239	-	3	22	59	323
Mr K.J. Betros	**2012**	**191**	**3**	**2**	**17**	**48**	**261**
Deputy Chairman from 1 July 2011 Chairman effective 21 June 2012	2011	140	13	3	14	35	205
Dr D.P. Campbell	**2012**	**87**	**-**	**2**	**8**	**22**	**119**
Deputy Chairman effective 21 June 2012	2011	82	-	3	7	21	113
Mr G.G. Kidd	**2012**	**-**	**-**	**-**	**-**	**-**	**-**
Deputy Chairman retired effective 30 June 2011	2011	148	-	3	13	37	201
Mrs V.A. Quinn	**2012**	**86**	**-**	**2**	**8**	**21**	**117**
Director	2011	82	-	3	7	21	113
Professor P. Swannell AM	**2012**	**86**	**-**	**2**	**8**	**21**	**117**
Director	2011	82	-	3	7	21	113
Ms S.M. Campbell	**2012**	**86**	**-**	**2**	**8**	**21**	**117**
Director	2011	82	-	3	7	21	113
Mr B.P. Baulch	**2012**	**112**	**-**	**2**	**10**	**28**	**152**
Director	2011	82	-	3	7	21	113
Mr S. Davis	**2012**	**86**	**-**	**2**	**8**	**21**	**117**
Director	2011	-	-	-	-	-	-
Mr D.W. Thorpe	**2012**	**17**	**-**	**-**	**2**	**4**	**23**
Director	2011	-	-	-	-	-	-
Total for 2012		**994**	**3**	**16**	**91**	**247**	**1,351**
Total for 2011		940	13	22	84	236	1,294

Non-executive directors do not participate in Heritage incentive schemes.

		Short Term Benefits			Long Term Benefits		
		Salary	Incentive	Non-Cash Benefits	Superannuation Contributions	Long Service Leave Entitlements	Total
		$ ' 000	$ ' 000	$ ' 000	$ ' 000	$ ' 000	$ ' 000
Executives							
John Minz	**2012**	**559**	**55**	**24**	**99**	**21**	**758**
Chief Executive Officer	2011	520	50	23	99	25	717
Bill Armagnacq	**2012**	**247**	**35**	**22**	**50**	**7**	**361**
Company Secretary / Assistant CEO	2011	234	28	22	50	5	339
Jane Calder	**2012**	**231**	**35**	**15**	**29**	**5**	**315**
General Manager, Marketing	2011	206	28	7	32	4	277
Peter Cavanagh	**2012**	**250**	**27**	**14**	**26**	**5**	**322**
Chief Strategy Officer	2011	242	27	15	25	5	314
Peter Cleary	**2012**	**272**	**35**	**6**	**50**	**8**	**371**
Chief Financial Officer	2011	266	36	-	48	7	357
Paul Francis	**2012**	**272**	**40**	**19**	**49**	**9**	**389**
General Manager, Retail Services	2011	260	38	15	50	3	366
Bob Hogarth	**2012**	**190**	**35**	**17**	**53**	**8**	**303**
General Manager, Human Resources	2011	172	34	19	49	6	280
Dunstin Lynch	**2012**	**187**	**30**	**27**	**33**	**5**	**282**
General Manager, Technology	2011	169	35	18	36	18	276
John Williams	**2012**	**240**	**38**	**20**	**52**	**6**	**356**
Chief Operating Officer	2011	225	38	12	39	22	336
Paul Williams	**2012**	**311**	**40**	**-**	**38**	**13**	**402**
Chief Treasury & Business Strategy Officer	2011	276	38	-	39	6	359
Total for 2012		**2,759**	**370**	**164**	**479**	**87**	**3,859**
Total for 2011		2,570	352	131	467	101	3,621

Directors' Report (continued)

AUDITOR'S INDEPENDENCE DECLARATION

In relation to the Auditor's Independence, the Directors have sought and received a report that there has been no breaches of the Auditor Independence requirement of the *Corporations Act 2001*. The report is shown on page 71.

ROUNDING

The amounts contained in this report and the financial report have been rounded to the nearest $1,000 (where rounding is applicable) under the option available to the company under ASIC Class Order 98/0100. The company is an entity to which the Class Order applies.

Signed in accordance with a resolution of the directors:

TOOWOOMBA
23 August 2012

KERRY J. BETROS
Chairman

DENNIS P. CAMPBELL
Deputy Chairman

Income Statement

INCOME STATEMENT

For the year ended 30 June 2012

	Note	CONSOLIDATED		PARENT	
		2012 $'000	2011 $'000	2012 $'000	2011 $'000
Interest revenue	3 (a)	503,065	508,229	522,131	527,695
Interest expense	4 (a)	(382,263)	(392,447)	(414,625)	(429,357)
Net interest income		120,802	115,782	107,506	98,338
Other income	3 (b)	35,504	32,011	47,326	47,843
Total income		156,306	147,793	154,832	146,181
Impairment losses on loans and receivables	4 (b)	(2,092)	(2,040)	(2,092)	(2,040)
Marketing expense		(7,237)	(6,199)	(7,237)	(6,199)
Occupancy expense		(10,133)	(9,374)	(10,133)	(9,374)
Employee benefits expense	4 (c)	(57,299)	(53,034)	(57,299)	(53,034)
Administrative expense		(23,179)	(19,942)	(21,705)	(18,330)
Other expense	4 (d)	(12,594)	(14,335)	(12,594)	(14,335)
Share of net profit of associates	3 (c)	585	1,017	585	1,017
Profit before tax		44,357	43,886	44,357	43,886
Income tax expense	5 (a)	(13,085)	(11,830)	(13,085)	(11,830)
Profit after tax		31,272	32,056	31,272	32,056

The accompanying notes form part of these financial statements

Statement of Comprehensive Income

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2012

	Note	CONSOLIDATED		PARENT	
		2012 $'000	2011 $'000	2012 $'000	2011 $'000
Profit after tax		**31,272**	32,056	**31,272**	32,056
Other comprehensive income					
Actuarial gain / (loss) on defined benefit plan		**(1,802)**	(535)	**(1,802)**	(535)
Gain / (loss) on cash flow hedge taken to members' funds		**(7,270)**	7,187	**1,165**	(2,388)
Net gain on sale of Visa shares reclassified to the Income Statement		**(2,464)**	-	**(2,464)**	-
Gain / (loss) on revaluation of available for sale financial investments		**2,741**	(287)	**2,741**	(287)
Income tax gain / (expense) on items of other comprehensive income	5 (b)	**2,098**	(2,136)	**(433)**	737
Other comprehensive income / (loss) for the year, net of tax		**(6,697)**	4,229	**(793)**	(2,473)
Total comprehensive income / (loss) for the year, net of tax		**24,575**	36,285	**30,479**	29,583

The accompanying notes form part of these financial statements

Statement of Financial Position

STATEMENT OF FINANCIAL POSITION

As at 30 June 2012

	Note	CONSOLIDATED		PARENT	
		2012 $'000	2011 $'000	2012 $'000	2011 $'000
Assets					
Cash and cash equivalents	7	133,081	40,649	123,769	37,919
Receivables due from other financial institutions	8	277,809	398,956	229,559	361,556
Other receivables	9	48,959	57,096	48,593	56,635
Loans and receivables	10	6,637,957	6,486,295	6,637,957	6,486,295
Held to maturity financial assets	12	1,079,857	1,020,973	1,079,857	1,020,973
Investments accounted for using the equity method	13	3,948	4,111	3,948	4,111
Available for sale financial investments	14	4,299	5,421	4,299	5,421
Derivatives		3,180	1,101	16,280	8,587
Other investments	16	-	-	327,335	285,620
Property, plant and equipment	17	20,593	21,029	20,593	21,029
Other assets	18	1,509	1,341	1,509	1,341
Intangibles	19	1,049	1,408	1,049	1,408
Deferred tax assets	5 (d)	8,841	6,468	7,458	6,468
Total Assets		8,221,082	8,044,848	8,502,206	8,297,363
Liabilities					
Deposits and borrowings	20	7,585,481	7,400,553	5,863,993	5,332,716
Accounts payable and other liabilities	21	220,507	214,504	2,242,087	2,573,554
Derivatives		35,810	43,528	6,097	1,136
Current tax liabilities		2,471	4,075	2,471	4,075
Deferred tax liabilities	5 (e)	3,732	2,834	5,987	3,942
Provisions	22	10,041	9,288	10,041	9,288
Retirement benefit liability	23 (b)	2,424	849	2,424	849
Subordinated debt	24	64,020	97,196	64,020	97,196
Total Liabilities		7,924,486	7,772,827	8,197,120	8,022,756
Net Assets		296,596	272,021	305,086	274,607
Members' Funds					
Retained profits		292,411	262,941	292,411	262,941
Reserves	25	4,185	9,080	12,675	11,666
Total Members' Funds		296,596	272,021	305,086	274,607

The accompanying notes form part of these financial statements

Statement of Changes in Equity

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2012

	CONSOLIDATED				
	Retained profits	Asset revaluation reserve	Cash flow hedge reserve	Available for sale asset reserve	Total
	$'000	$'000	$'000	$'000	$'000
Balance 1 July 2011	**262,941**	**5,714**	**1,860**	**1,506**	**272,021**
Profit for the year	**31,272**	**-**	**-**	**-**	**31,272**
Other comprehensive income	**(1,802)**	**-**	**(5,089)**	**194**	**(6,697)**
Total as at 30 June 2012	**292,411**	**5,714**	**(3,229)**	**1,700**	**296,596**
Balance 1 July 2010	231,420	5,714	(3,105)	1,707	235,736
Profit for the year	32,056	-	-	-	32,056
Other comprehensive income	(535)	-	4,965	(201)	4,229
Total as at 30 June 2011	262,941	5,714	1,860	1,506	272,021

	PARENT				
	Retained profits	Asset revaluation reserve	Cash flow hedge reserve	Available for sale asset reserve	Total
	$'000	$'000	$'000	$'000	$'000
Balance 1 July 2011	**262,941**	**5,714**	**4,446**	**1,506**	**274,607**
Profit for the year	**31,272**	**-**	**-**	**-**	**31,272**
Other comprehensive income	**(1,802)**	**-**	**815**	**194**	**(793)**
Total as at 30 June 2012	**292,411**	**5,714**	**5,261**	**1,700**	**305,086**
Balance 1 July 2010	231,420	5,714	6,183	1,707	245,024
Profit for the year	32,056	-	-	-	32,056
Other comprehensive income	(535)	-	(1,737)	(201)	(2,473)
Total as at 30 June 2011	262,941	5,714	4,446	1,506	274,607

The accompanying notes form part of these financial statements

Cash Flow Statement

CASH FLOW STATEMENT

For the year ended 30 June 2012

	Note	CONSOLIDATED		PARENT	
		2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
Cash flows from operating activities					
Interest received		**512,433**	516,724	**396,286**	364,693
Dividend received		**789**	2,768	**789**	2,768
Borrowing costs and interest paid		**(381,370)**	(394,429)	**(275,472)**	(260,929)
Other non-interest income received		**33,740**	33,294	**45,538**	49,213
Payments to suppliers and employees		**(106,562)**	(92,542)	**(104,887)**	(92,118)
Income tax paid		**(14,065)**	(15,189)	**(14,065)**	(15,189)
Net cash flows from operating activities	26 (a)	**44,965**	50,626	**48,189**	48,438
Cash flows from investing activities					
(Increase) / decrease in investment securities and receivables due from other financial institutions		**50,844**	(217,000)	**61,694**	(223,199)
(Increase) / decrease in loans, receivables and other receivables		**(128,254)**	(308,102)	**(587,624)**	(759,262)
Proceeds from the wind up of shares in joint venture		**-**	13	**-**	13
Proceeds from sale of property, plant and equipment		**233**	292	**233**	292
Acquisition of property, plant and equipment		**(5,866)**	(5,632)	**(5,866)**	(5,632)
Net cash flows used in investing activities		**(83,043)**	(530,429)	**(531,563)**	(987,788)
Cash flows from financing activities					
Increase in deposits and other borrowings		**165,510**	438,921	**524,243**	521,989
Payments for redemption of subordinated debt		**(35,000)**	-	**(35,000)**	-
Proceeds from securitisation of loans		**-**	-	**79,981**	374,788
Net cash flows from financing activities		**130,510**	438,921	**569,224**	896,777
Net (decrease) / increase in cash held		**92,432**	(40,882)	**85,850**	(42,573)
Cash - beginning of the year		**40,649**	81,531	**37,919**	80,492
Cash - end of the year	26 (b)	**133,081**	40,649	**123,769**	37,919

The accompanying notes form part of these financial statements

Notes to the Financial Statements

1. CORPORATE INFORMATION

The consolidated financial report of Heritage Bank Limited and the Special Purpose Vehicles (SPVs) for the year ended 30 June 2012 was authorised for issue in accordance with a resolution of the directors on 23 August 2012.

The parent entity, Heritage Bank Limited ("Heritage") is a mutual bank that is incorporated and domiciled in Australia. The nature of operations and principal activities of the Group are described in Note 32.

The SPVs are made up of ten trust vehicles that have been established for the purpose of securitising Heritage's loans (refer Note 29(e) for further details). The SPVs have been consolidated as Heritage is exposed to the majority of the residual risk of the trusts and also has the rights to obtain the majority of the benefits of the trusts.

Derecognition of Financial Assets and Financial Liabilities

The Group derecognises a financial asset or financial liability or part thereof where an entity has transferred substantially all the risks and rewards of that asset or liability. The SPVs assets and liabilities qualify for derecognition in full or in part.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of accounting

The financial report is a general purpose financial report, which has been prepared in accordance with the requirements of the *Corporations Act 2001* including applicable Australian Accounting Standards.

The financial report has also been prepared on a historical cost basis, except for derivative financial instruments and available for sale investments, which have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in the fair values attributable to the risks that are being hedged.

The financial report is presented in Australian dollars and all values are rounded to the nearest thousand dollar ($'000) unless otherwise stated under the option available to the Group under ASIC Class Order 98/0100.

Heritage Bank Limited is a for-profit entity.

(b) Statement of compliance

The financial report complies with Australian Accounting Standards as issued by the Australian Accounting Standards Board and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

The following Australian Accounting Standards and Amendments to Australian Accounting Standards have been identified as those which may impact the Group in the period of initial application. Management is in the process of assessing the impact of these new standards. The standards are available for early adoption at 30 June 2012, but have not been applied in preparing this financial report.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Statement of compliance (continued)

Reference	Title	Nature of change to accounting policy	Application date of standard	Application date for Group
AASB 2011-9	*Amendments to Australian Accounting Standards - Presentation of Other Comprehensive Income*	Group items on the basis that they might be reclassified subsequently to profit or loss.	1 July 2012	1 July 2012
AASB 10	*Consolidated Financial Statements ** *	AASB 10 establishes a new control model that applies to all entities which broadens the situations when an entity is considered to be controlled by another entity.	1 January 2013	1 July 2013
AASB 11	*Joint Arrangements ** *	AASB 11 uses the principle of control established in AASB 10, it also removes the option to account for jointly controlled entities using proportionate consolidation.	1 January 2013	1 July 2013
AASB 12	*Disclosure of Interests in Other Entities*	AASB 12 includes all disclosures relating to an entity's interests in subsidiaries, joint arrangements, associates and structured entities.	1 January 2013	1 July 2013
AASB 13	*Fair Value Measurement*	AASB 13 establishes a single source of guidance for determining the fair value of assets and liabilities.	1 January 2013	1 July 2013
AASB 119	*Employee Benefits*	Requires the liabilities arising from defined benefit fund plans to be recognised in full in other comprehensive income.	1 January 2013	1 July 2013
AASB 1053	*Application of Tiers of Australian Accounting Standards*	The standard establishes a differential financial reporting framework consisting of two Tiers of reporting requirements.	1 July 2013	1 July 2013
AASB 9	*Financial Instruments*	Improve and simplify the approach for classification and measurement of financial assets.	1 January 2015	1 July 2015

** The impact of these standards is being assessed for the investment in Permanent LMI Pty Limited, (refer note 13) which is currently being accounted for using the equity method. If it is determined that the entity is controlled by Heritage it will be required to be consolidated, if it is determined not to be controlled by Heritage it will continue to be accounted for using the equity method.

Notes to the Financial Statements (continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Statement of compliance (continued)

The following amendments are not applicable to the Group and therefore have no impact.

Reference	Title
AASB 2010-8	*Amendments to Australian Accounting Standards - Deferred Tax: Recovery of Underlying Assets*
AASB 2011-3	*Amendments to Australian Accounting Standards - Orderly Adoption of Changes to the ABS GFS Manual*
AASB 2011-4	*Amendments to Australian Accounting Standards to remove individual KMP disclosure requirements for disclosing entities that are not companies*
AASB 2012-2	*Amendments to Australian Accounting Standards - Disclosures - Offsetting Financial Assets and Financial Liabilities*
AASB 2012-3	*Offsetting Financial Assets and Financial Liabilities*
AASB 2012-4	*Amendments to Australian Accounting Standards - Government Loans*
AASB 2012-5	*AASB 1 and AASB 101 amendments*

(c) Basis of consolidation

The consolidated financial statements include those of Heritage and the Special Purpose Vehicles (SPVs) relating to the securitisation of Heritage's loans, referred to as the "Group". The SPVs underlying assets, liabilities, revenues, expenses and cash flows are reported in the Group's Statement of Financial Position, Income Statement, Statement of Comprehensive Income, Statement of Changes in Equity and Cash Flow Statement (refer to Note 29 (e)). Where entities have been acquired during the year, their operating results have been included from the date of acquisition. All inter-company transactions and balances have been eliminated including any unrealised profit.

(d) Significant accounting judgements, estimates and assumptions

(i) Significant accounting judgements and estimates

In the process of applying the Group's accounting policies, management has made judgements, apart from those involving estimations, which have had an impact on the amounts recognised in the financial statements. The carrying amounts of certain assets and liabilities are often determined based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

Loan provisioning

The Group determines whether loans are impaired on an ongoing basis. This requires an estimation of the value of the future cash flows. The Group's policy for calculation of loan loss allowance is disclosed in Note 10 and Note 11. Refer to Note 2 (h).

Building impairment

The carrying value of the building is reviewed for impairment at each reporting date (refer to Note 2 (k) for further details).

Superannuation defined benefit plan

Various actuarial assumptions are required when determining the Group's superannuation obligations. The Group's policy on the superannuation defined benefit plan is disclosed in Note 23.

Investments

Where the fair value of investments cannot be derived from active markets they are determined by other valuation techniques and judgements including consideration of liquidity where applicable.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Revenue recognition

(i) Interest income

Revenue is recognised as interest accrues using the effective interest method. This is a method of calculating the amortised cost of a financial asset and allocating the interest income over the relevant period using the effective interest rate. This is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset.

Payments made to brokers for the introduction of mortgage loan borrowers to Heritage are expensed over three years from the date of payment to match the cost of acquiring the loan to the income derived from it. In line with the effective interest rate method mortgage commission is reclassified to interest revenue.

Set up costs incurred for securitisation are carried forward and amortised over the period of probable future economic benefits, approximately four years. In line with the effective interest rate method securitisation establishment costs are reclassified to interest revenue.

(ii) Dividend income

Revenue is recognised when the Group's right to receive the payment is established.

(iii) Fees and commissions

Fees and commissions that form an integral part of interest are classified as part of interest revenue. Revenue is recognised as interest accrues using the effective interest method.

(f) Cash and cash equivalents

Cash in the Statement of Financial Position and Cash Flow Statement comprises of cash at bank and on hand.

(g) Derivative financial instruments and hedging

The Group uses derivative financial instruments such as interest rate, basis and cross currency swaps to hedge its risks associated with interest rate and currency fluctuations. These instruments are initially recognised at cost on the date on which a derivative contract is entered into and are subsequently remeasured to fair value. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Any gains or losses arising from changes in the fair value of derivatives, except for those that qualify as effective cash flow hedges, are taken directly to net profit or loss for the year.

The fair value of swap contracts is determined by reference to market values for similar instruments.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Hedges that meet the strict criteria for hedge accounting are accounted for as follows:

(i) Fair value hedges

Fair value hedges are hedges of the Group's exposure to changes in the fair value of a recognised asset or liability. For fair value hedges, the carrying amount of the hedged item is adjusted for gains and losses attributable to the risk being hedged. The derivative is remeasured to fair value and gains and losses from both are taken to the Income Statement.

Notes to the Financial Statements (continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Derivative financial instruments and hedging (continued)

(ii) Cash flow hedges

Cash flow hedges are hedges of the Group's exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability. The effective portion of the gain or loss on the hedging instrument is recognised directly in equity, while the ineffective portion is recognised in the Income Statement.

Amounts taken to equity are transferred to the Income Statement when the hedged transaction affects the Income Statement, such as when hedged income or expenses are recognised.

Refer to Note 2 (l) for further detail.

(h) Loan provisioning

Loan impairment will only be recognised when objective evidence is available that a loss event has occurred and as a consequence it is not likely that all amounts owed will be received. Outlined below are the relevant accounting policies.

Specific provision

A specific provision is raised for losses that may be incurred for individual loans that are known to be impaired by assessing the recoverability against the security value.

Collective provision

Loans that are not known to be impaired are grouped together according to their risk characteristics and are then assessed for impairment. Based on historical loss data and current available information for assets with similar risk characteristics, the appropriate collective provision is raised. From the analysis performed, the provision has been consistent with the historical level of bad debts experienced in those portfolios.

Impairment losses

Impairment losses are written off in the year in which they are recognised. If a provision for impairment has been recognised in relation to the loan, write-offs are made against the provision. If no provision for impairment has previously been recognised, write-offs for impairment losses are recognised as expenses in the Income Statement.

(i) Income tax

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, effects neither the accounting profit nor taxable profit or loss; or

- when the taxable temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, and the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, to the extent that it is probable that taxable profit will be available against the deductible temporary differences, except:

- when the deferred income tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or

- when the deductible temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, in which case a deferred tax asset is only recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which temporary differences can be utilised.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Income tax (continued)

Tax effect accounting is applied using the balance sheet method whereby deferred income tax is provided on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on the tax rates that have been enacted at the balance sheet date.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

(j) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the Statement of Financial Position are shown inclusive of GST.

(k) Property, plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses.

Land and buildings are measured at cost less accumulated depreciation on buildings. An impairment loss is recognised for the amount by which the asset's carrying value exceeds its recoverable amount.

Depreciation is calculated on a straight-line basis over the estimated useful life of the assets as follows:

Building - 40 years
Leasehold improvements - the lease term
Plant and equipment - 3 to 8 years

(i) Impairment

The carrying values of property, plant and equipment are reviewed for impairment at each reporting date, with recoverable amounts being estimated when events or changes in circumstance indicate the carrying value may be impaired.

An impairment loss exists when the carrying value of an asset or cash-generating units exceeds its estimated recoverable amount. The asset or cash-generating unit is then written down to its recoverable amount.

(l) Classification of financial assets and financial instruments

(i) Financial instruments (derivatives)

Those derivatives that the Group does not apply hedge accounting to are classified as 'held for trading' financial assets. These are measured at fair value, with fair value changes charged to the Income Statement. Those derivatives where the Group is applying hedge accounting are designated and qualify as either cash flow hedges or fair value hedges. The various derivatives entered into are as follows:

(a) Cash flow hedge of variable rate liabilities

The Group's policy is to enter into pay fixed / receive floating swaps with approved external counterparties to mitigate against variability in cash flows of a portfolio of floating rate liabilities.

Notes to the Financial Statements (continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(l) Classification of financial assets and financial instruments (continued)

(b) Cash flow hedge of variable rate assets

The Group's policy is to enter into pay floating / receive fixed swaps to counteract against variability in cash flows of a portfolio of floating rate assets.

(c) Cash flow hedge of Euro denominated notes

The Group's policy is to enter into a cross currency swap to effectively convert the floating Euro denominated debt to floating Australian dollar debt.

(d) Fair value hedge

The Group has entered into a pay floating / receive fixed swap with approved external counterparties to mitigate against changes in the fair value of term subordinated debt due to movement in interest rates.

The Group has entered into a pay fixed / receive floating swap with approved external counterparties to mitigate against changes in the fair value of a fixed rate asset bond due to movement in interest rates.

(ii) Financial assets

Financial assets are classified into one of the following categories:

Loans and receivables

These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These assets are carried at amortised cost using the effective interest method.

Held to maturity financial assets

These are non-derivative financial assets with fixed or determinable payments and fixed maturity and where the Group has the intention and ability to hold to maturity. These assets are measured at amortised cost using the effective interest method less any impairment.

Available for sale financial investments

These are those non-derivative financial assets that are not classified in any of the above categories. After initial measurement, available for sale financial investments are subsequently measured at fair value or cost where the fair value is unable to be measured reliably. Unrealised gains and losses are recognised directly in the Statement of Changes in Equity in the available for sale asset reserve.

Impairment - loans and receivables

Refer Note 2(h) for details.

Impairment of financial assets other than loans and receivables

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of assets is impaired. A financial asset is deemed to be impaired if there is objective evidence of impairment as a result of an event that has occured after initial recognition of the asset and that event has had an impact on the estimated future cash flows of the financial asset.

Impairment - financial assets carried at amortised cost

For financial assets carried at amortised cost, the Group assesses individually whether objective evidence of impairment exists or collectively for financial assets that are not individually significant or have no individual impairment. If there is objective evidence that an impairment loss has been incurred the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows.

Impairment - Available for sale financial investments

The Group assesses whether there is objective evidence of impairment based on there being a significant or prolonged decline in fair value.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Employee benefits

Provision has been made for the liability to pay annual leave for all employees at the remuneration rates which are expected to be paid when the liability is settled. Provision for the liability to pay long service leave is made for all employees from their date of commencement at discounted expected future values in accordance with AASB 119 *Employee Benefits*.

In accordance with AASB 119 the net position of the defined benefit plan is recognised in the Statement of Financial Position. Any gains or losses with the exception of the actuarial gain or loss, arising from changes in the net position between reporting periods is recognised through the profit and loss account. Actuarial gains or losses are recognised directly through retained earnings and disclosed in Other Comprehensive Income.

(n) Provision for directors' retiring allowance

Provision has been made for all directors in accordance with Rule 69.5 of the Constitution of Heritage. The retiring allowance is calculated as one-fourth of the aggregate amount of directors' fees which have been approved at the annual general meeting. All or part of this retiring allowance can be paid to a complying superannuation fund.

(o) Make good provision and asset

A provision is made for the anticipated costs of restoring leased premises at the end of the leased term that reflects the present obligation to restore the premises. The estimate of the costs has been calculated by reviewing current and historical defit costs and calculating an average cost per square metre. A cost per branch has been calculated depending on its size. A provision and asset has then been recorded to reflect the cost at the end of each lease term. The asset is amortised over the lease term. Both the asset and liability is reassessed at the end of each financial year to account for new, amended and expired leases.

(p) Intangible assets

Intangible assets include the value of computer software which are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and impairment losses. Amortisation is calculated on the straight line basis over three years.

(q) Subordinated debt

Subordinated debt includes debt listed with Australian Securities Exchange and other unlisted debt. The listed debt is initially recognised at fair value net of direct issue costs. Changes in the fair value are recognised in the Income Statement. The unlisted debt is measured at amortised cost using the effective interest rate method.

(r) Leasing

The determination of whether an arrangement is a lease, or it contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Leases which do not transfer to Heritage substantially all the risks and benefits incidental to ownership of the leased items are operating leases. Operating lease payments are recognised as an expense in the Income Statement on a straight line basis over the lease term.

(s) Accounting for associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee. The results, assets and liabilities of associates are incorporated using the equity method of accounting.

Notes to the Financial Statements (continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(t) Guarantees

Guarantees are issued to third parties by Heritage in favour of bodies such as councils or electricity supply boards, relative to work or construction to be carried out by those clients.

The member is required to lodge funds as a term deposit equal to the guarantee amount. This deposit is then held as security. For business customers, residential or commercial mortgages are held as security.

Heritage charges a fee equal to 1% of the guarantee amount annually.

3. INCOME

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
(a) Interest revenue				
Deposits and investment securities	**67,187**	58,976	**64,235**	57,272
Loans and receivables	**441,919**	458,747	**446,776**	464,033
Interest rate swaps	**1,971**	722	**19,132**	16,606
Gain on fair value hedges	**1,870**	-	**1,870**	-
Gain on derivatives held at fair value	**209**	-	**209**	-
Add: Loan application direct revenue	**1,973**	2,120	**1,973**	2,120
Less: Commission and agent direct costs	**(11,164)**	(11,668)	**(11,164)**	(11,668)
Less: Securitisation establishment costs	**(900)**	(668)	**(900)**	(668)
Total interest revenue	**503,065**	508,229	**522,131**	527,695
(b) Other income				
Fees and commissions	**30,603**	29,543	**42,425**	45,375
Dividends - other corporations	**41**	22	**41**	22
Income from property	**428**	419	**428**	419
Impairment losses on loans recovered	**516**	191	**516**	191
Realised gain on sale of Visa shares transferred from Other Comprehensive Income	**2,464**	-	**2,464**	-
Other revenue	**1,452**	1,836	**1,452**	1,836
Total other income	**35,504**	32,011	**47,326**	47,843
(c) Share of net profit of associate using the equity method	**585**	1,017	**585**	1,017

4. EXPENSES

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
(a) Interest expense				
Deposits	263,780	243,052	267,864	247,741
Subordinated debt including fair value adjustment	8,392	8,138	8,392	8,138
Interest bearing notes	106,865	139,297	-	-
Interest rate swaps	2,713	1,705	2,713	1,723
Loss on fair value hedges	254	255	254	255
Loss on derivatives held at fair value	259	-	259	-
Inter entity interest expense	-	-	135,143	171,500
Total interest expense	382,263	392,447	414,625	429,357
(b) Impairment losses on loans and receivables	2,092	2,040	2,092	2,040
(c) Employee benefits expense				
Salaries, wages and allowances	43,196	40,353	43,196	40,353
Net defined benefit fund expense	348	309	348	309
Contribution to accumulation fund	4,009	3,794	4,009	3,794
Other employee costs	9,746	8,578	9,746	8,578
Total employee benefits expense	57,299	53,034	57,299	53,034
(d) Other expense				
Depreciation				
Plant and equipment	4,435	4,719	4,435	4,719
Buildings	584	835	584	835
	5,019	5,554	5,019	5,554
Amortisation	872	994	872	994
Communication	4,118	5,107	4,118	5,107
Fees and commissions	2,515	2,538	2,515	2,538
Net loss on disposal of property, plant and equipment	70	142	70	142
	7,575	8,781	7,575	8,781
Total other expense	12,594	14,335	12,594	14,335

Notes to the Financial Statements (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
5. INCOME TAX				
(a) Income tax expense				
The major components of income tax expense are:				
Income statement				
Current income tax				
Current income tax charge	**12,491**	14,362	**12,491**	14,362
Under / (over) provision of previous year	**(28)**	(101)	**(28)**	(101)
Deferred income tax				
Deferred income tax relating to temporary differences	**622**	(2,431)	**622**	(2,431)
Income tax expense	**13,085**	11,830	**13,085**	11,830
(b) Other comprehensive income				
Cash flow hedges	**2,181**	(2,222)	**(350)**	651
Available for sale asset reserve	**(83)**	86	**(83)**	86
Income tax gain / (expense) on items of other comprehensive income	**2,098**	(2,136)	**(433)**	737
(c) Reconciliation of income tax expense to prima facie tax payable				
Profit from ordinary activities before tax	**44,357**	43,886	**44,357**	43,886
Tax at the tax rate of 30%	**13,307**	13,166	**13,307**	13,166
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:				
Depreciation of buildings	**32**	32	**32**	32
Dividend credits from share of associate	**(225)**	(824)	**(225)**	(824)
Defined benefit fund	**(68)**	(441)	**(68)**	(441)
Other items (net)	**67**	(2)	**67**	(2)
Under / (over) provision of the previous year - non deductible expense	**(28)**	(101)	**(28)**	(101)
Income tax expense	**13,085**	11,830	**13,085**	11,830

5. INCOME TAX (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
(d) Analysis of deferred tax assets				
Employee benefits	**2,614**	2,389	**2,614**	2,389
Provision for impairment	**1,498**	1,354	**1,498**	1,354
Other	**3,346**	2,725	**3,346**	2,725
Total	**7,458**	6,468	**7,458**	6,468
Amounts recognised directly in equity:				
Cash flow hedges	**1,383**	-	**-**	-
Total deferred tax assets	**8,841**	6,468	**7,458**	6,468
(e) Analysis of deferred tax liabilities				
Loan costs	**62**	475	**62**	475
Fixed assets	**1,193**	(170)	**1,193**	(170)
Investment in associate	**651**	700	**651**	700
Other	**1,097**	386	**1,097**	386
Total	**3,003**	1,391	**3,003**	1,391
Amounts recognised directly in equity:				
Cash flow hedges	**-**	797	**2,255**	1,905
Available for sale asset reserve	**729**	646	**729**	646
Total deferred tax liabilities	**3,732**	2,834	**5,987**	3,942

Notes to the Financial Statements (continued)

6. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled.

	CONSOLIDATED		
As at 30 June 2012	Less than 12 months $'000	Over 12 months $'000	Total $'000
Assets			
Cash and cash equivalents	133,081	-	133,081
Receivables due from other financial institutions	277,809	-	277,809
Other receivables	48,959	-	48,959
Loans and receivables	563,425	6,074,532	6,637,957
Held to maturity financial assets	800,704	279,153	1,079,857
Investments accounted for using the equity method	-	3,948	3,948
Available for sale financial investments	4,299	-	4,299
Derivatives	-	3,180	3,180
Property, plant and equipment	-	20,593	20,593
Other assets	1,407	102	1,509
Intangibles	-	1,049	1,049
Deferred tax assets	-	8,841	8,841
Total Assets	1,829,684	6,391,398	8,221,082
Liabilities			
Deposits and borrowings	5,543,351	2,042,130	7,585,481
Accounts payable and other liabilities	220,507	-	220,507
Derivatives	1,000	34,810	35,810
Current tax liabilities	2,471	-	2,471
Deferred tax liabilities	-	3,732	3,732
Provisions	4,364	5,677	10,041
Retirement benefit liability	-	2,424	2,424
Subordinated debt	1,002	63,018	64,020
Total Liabilities	5,772,695	2,151,791	7,924,486
Net Assets	(3,943,011)	4,239,607	296,596

6. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

	CONSOLIDATED		
As at 30 June 2011	Less than 12 months $'000	Over 12 months $'000	Total $'000
Assets			
Cash and cash equivalents	40,649	-	40,649
Receivables due from other financial institutions	398,956	-	398,956
Other receivables	57,096	-	57,096
Loans and receivables	556,613	5,929,682	6,486,295
Held to maturity financial assets	849,005	171,968	1,020,973
Investments accounted for using the equity method	-	4,111	4,111
Available for sale financial investments	-	5,421	5,421
Derivatives	-	1,101	1,101
Property, plant and equipment	-	21,029	21,029
Other assets	1,161	180	1,341
Intangibles	-	1,408	1,408
Deferred tax assets	-	6,468	6,468
Total Assets	1,903,480	6,141,368	8,044,848
Liabilities			
Deposits and borrowings	4,747,904	2,652,649	7,400,553
Accounts payable and other liabilities	214,504	-	214,504
Derivatives	17,246	26,282	43,528
Current tax liabilities	4,075	-	4,075
Deferred tax liabilities	-	2,834	2,834
Provisions	4,029	5,259	9,288
Retirement benefit liability	-	849	849
Subordinated debt	1,149	96,047	97,196
Total Liabilities	4,988,907	2,783,920	7,772,827
Net Assets	(3,085,427)	3,357,448	272,021

Notes to the Financial Statements (continued)

6. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

	PARENT		
As at 30 June 2012	Less than 12 months $'000	Over 12 months $'000	Total $'000
Assets			
Cash and cash equivalents	123,769	-	123,769
Receivables due from other financial institutions	229,559	-	229,559
Other receivables	48,593	-	48,593
Loans and receivables	563,425	6,074,532	6,637,957
Held to maturity financial assets	800,704	279,153	1,079,857
Investments accounted for using the equity method	-	3,948	3,948
Available for sale financial investments	4,299	-	4,299
Derivatives	-	16,280	16,280
Other investments	-	327,335	327,335
Property, plant and equipment	-	20,593	20,593
Other assets	1,407	102	1,509
Intangibles	-	1,049	1,049
Deferred tax assets	-	7,458	7,458
Total Assets	1,771,756	6,730,450	8,502,206
Liabilities			
Deposits and borrowings	5,153,858	710,135	5,863,993
Accounts payable and other liabilities	624,703	1,617,384	2,242,087
Derivatives	1,000	5,097	6,097
Current tax liabilities	2,471	-	2,471
Deferred tax liabilities	-	5,987	5,987
Provisions	4,364	5,677	10,041
Retirement benefit liability	-	2,424	2,424
Subordinated debt	1,002	63,018	64,020
Total Liabilities	5,787,398	2,409,722	8,197,120
Net Assets	(4,015,642)	4,320,728	305,086

6. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

	PARENT		
	Less than 12 months	Over 12 months	Total
As at 30 June 2011	$'000	$'000	$'000
Assets			
Cash and cash equivalents	37,919	-	37,919
Receivables due from other financial institutions	361,556	-	361,556
Other receivables	56,635	-	56,635
Loans and receivables	556,613	5,929,682	6,486,295
Held to maturity financial assets	849,005	171,968	1,020,973
Investments accounted for using the equity method	-	4,111	4,111
Available for sale financial investments	-	5,421	5,421
Derivatives	83	8,504	8,587
Other investments	-	285,620	285,620
Property, plant and equipment	-	21,029	21,029
Other assets	1,161	180	1,341
Intangibles	-	1,408	1,408
Deferred tax assets	-	6,468	6,468
Total Assets	1,862,972	6,434,391	8,297,363
Liabilities			
Deposits and borrowings	4,624,928	707,788	5,332,716
Accounts payable and other liabilities	356,293	2,217,261	2,573,554
Derivatives	-	1,136	1,136
Current tax liabilities	4,075	-	4,075
Deferred tax liabilities	-	3,942	3,942
Provisions	4,029	5,259	9,288
Retirement benefit liability	-	849	849
Subordinated debt	1,149	96,047	97,196
Total Liabilities	4,990,474	3,032,282	8,022,756
Net Assets	(3,127,502)	3,402,109	274,607

Notes to the Financial Statements (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000

7. CASH AND CASH EQUIVALENTS

Cash at bank and on hand	**133,081**	40,649	**123,769**	37,919

These are interest and non-interest bearing.

8. RECEIVABLES DUE FROM OTHER FINANCIAL INSTITUTIONS

Interest earning deposits (b)	**253,437**	375,207	**205,187**	337,807
Deposits with other authorised deposit-taking institutions (c)	**24,372**	23,749	**24,372**	23,749
	277,809	398,956	**229,559**	361,556

(a) Impairment losses

No impairment losses have been recognised during the year on the receivables due from other financial institutions (2011 - nil).

(b) Interest earning deposits

The weighted average effective interest rate for the interest earning deposits is 3.84% (2011 - 5.20%).

(c) Deposits with other authorised deposit-taking institutions

The deposits with other authorised deposit-taking institutions do not have a specified maturity date. They are carried at amortised cost.

9. OTHER RECEIVABLES

Interest receivable	**7,263**	8,831	**7,018**	8,516
Securitisation deposits	**33,621**	45,645	**33,621**	45,645
Other	**8,075**	2,620	**7,954**	2,474
	48,959	57,096	**48,593**	56,635

No impairment losses have been recognised during the year for other receivables (2011 - nil).

10. LOANS AND RECEIVABLES

	NOTE	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Credit cards		76,055	77,495	76,055	77,495
Term loans		4,536,277	4,057,879	4,536,277	4,057,879
Securitised loans		2,021,730	2,348,296	2,021,730	2,348,296
Other		387	443	387	443
Related parties (a)	29	2,096	1,808	2,096	1,808
		6,636,545	6,485,921	6,636,545	6,485,921
Provision for impairment (c)		(4,993)	(4,515)	(4,993)	(4,515)
Add: Securitisation establishment costs		2,354	998	2,354	998
Add: Commission and agent direct costs		4,051	3,891	4,051	3,891
Net loans and advances		6,637,957	6,486,295	6,637,957	6,486,295

(a) Aggregate amounts receivable from related parties

	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Key management personnel	2,096	1,808	2,096	1,808
Provision for impairment	-	-	-	-
	2,096	1,808	2,096	1,808

(b) Concentration of risk

The loan portfolio of the Group does not include any loan or groups of related loans which represent 10% or more of capital.

Notes to the Financial Statements (continued)

10. LOANS AND RECEIVABLES (continued)

(c) Provision for impairment	Credit Cards $'000	Term Loans $'000	Other $'000	Total $'000
Consolidated 2012				
Specific provision				
Opening balance	528	800	211	1,539
Impairment losses provided for / (reversed) during the year	(17)	13	(60)	(64)
Closing balance	511	813	151	1,475
Collective provision				
Opening balance	1,371	1,393	212	2,976
Impairment losses provided for / (reversed) during the year	103	367	72	542
Writeback of provision to members funds	-	-	-	-
Closing balance	1,474	1,760	284	3,518
Total provision for impairment	1,985	2,573	435	4,993
Charges to operating profit before tax for impairment losses on loans and receivables comprises:				
Specific provision	(17)	13	(60)	(64)
Collective provision	103	367	72	542
Impairment losses recognised directly	1,065	551	(2)	1,614
	1,151	931	10	2,092
Consolidated 2011				
Specific provision				
Opening balance	290	539	176	1,005
Impairment losses provided for / (reversed) during the year	238	261	35	534
Closing balance	528	800	211	1,539
Collective provision				
Opening balance	1,201	1,490	286	2,977
Impairment losses provided for / (reversed) during the year	170	(97)	(74)	(1)
Writeback of provision to members funds	-	-	-	-
Closing balance	1,371	1,393	212	2,976
Total provision for impairment	1,899	2,193	423	4,515
Charges to operating profit before tax for impairment losses on loans and receivables comprises:				
Specific provision	238	261	35	534
Collective provision	170	(97)	(74)	(1)
Impairment losses recognised directly	1,169	307	31	1,507
	1,577	471	(8)	2,040

10. LOANS AND RECEIVABLES (continued)

(c) Provision for impairment (continued)

	Credit Cards $'000	Term Loans $'000	Other $'000	Total $'000
Parent				
2012				
Specific provision				
Opening balance	528	800	211	1,539
Impairment losses provided for / (reversed) during the year	(17)	13	(60)	(64)
Closing balance	511	813	151	1,475
Collective provision				
Opening balance	1,371	1,393	212	2,976
Impairment losses provided for / (reversed) during the year	103	367	72	542
Writeback of provision to members funds	–	–	–	–
Closing balance	1,474	1,760	284	3,518
Total provision for impairment	1,985	2,573	435	4,993
Charges to operating profit before tax for impairment losses on loans and receivables comprises:				
Specific provision	(17)	13	(60)	(64)
Collective provision	103	367	72	542
Impairment losses recognised directly	1,065	551	(2)	1,614
	1,151	931	10	2,092
Parent				
2011				
Specific provision				
Opening balance	290	539	176	1,005
Impairment losses provided for / (reversed) during the year	238	261	35	534
Closing balance	528	800	211	1,539
Collective provision				
Opening balance	1,201	1,490	286	2,977
Impairment losses provided for / (reversed) during the year	170	(97)	(74)	(1)
Writeback of provision to members funds	-	-	-	-
Closing balance	1,371	1,393	212	2,976
Total provision for impairment	1,899	2,193	423	4,515
Charges to operating profit before tax for impairment losses on loans and receivables comprises:				
Specific provision	238	261	35	534
Collective provision	170	(97)	(74)	(1)
Impairment losses recognised directly	1,169	307	31	1,507
	1,577	471	(8)	2,040

There is no provision for any securitised loans.

The collective provision for impairment has been calculated by placing loans into pools with similar risk characteristics and collectively assessing for impairment.

Notes to the Financial Statements (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
11. IMPAIRMENT OF LOANS AND RECEIVABLES				
The policy covering impaired loans and receivables is set out in Note 2.				
Total impaired assets				
Gross loans no longer accruing interest	**4,634**	5,229	**4,634**	5,229
Less individually assessed provisions for impairment	**(1,475)**	(1,539)	**(1,475)**	(1,539)
Total net impaired assets	**3,159**	3,690	**3,159**	3,690
Restructured loans				
Balance	**-**	372	**-**	372
	-	372	**-**	372
Assets acquired through enforcement of security				
Balance	**-**	-	**-**	-
	-	-	**-**	-
Interest revenue foregone on past due / impaired and restructured loans	**390**	323	**390**	323
Net fair value of assets acquired through the enforcement of security through the financial year	**-**	-	**-**	-
12. HELD TO MATURITY FINANCIAL ASSETS				
Bank debt securities including fair value adjustment	**771,107**	627,958	**771,107**	627,958
Government securities	**248,853**	341,019	**248,853**	341,019
Asset backed debt securities	**59,897**	51,996	**59,897**	51,996
	1,079,857	1,020,973	**1,079,857**	1,020,973

(a) Impairment losses

No impairment losses have been recognised during the year on held to maturity financial assets (2011 - nil).

13. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Investment in associate	**3,948**	4,111	**3,948**	4,111
Interest in associate	OWNERSHIP INTEREST HELD BY HERITAGE			
Balance date 31 December	**49.9%**	49.9%	**49.9%**	49.9%
Share of associate's balance sheet:				
Current assets	**7,262**	8,184	**7,262**	8,184
Non-current assets	**1,518**	1,693	**1,518**	1,693
	8,780	9,877	**8,780**	9,877
Current liabilities	**1,502**	1,616	**1,502**	1,616
Non-current liabilities	**2,582**	2,902	**2,582**	2,902
	4,084	4,518	**4,084**	4,518
Net assets	**4,696**	5,359	**4,696**	5,359
Share of associate's profit or loss:				
Revenue	**2,204**	3,739	**2,204**	3,739
Profit / (loss) before income tax	**836**	1,453	**836**	1,453
Income tax expense	**(251)**	(436)	**(251)**	(436)
Profit / (loss) after income tax	**585**	1,017	**585**	1,017

Investment in associate:

During the year, the Group has received dividend payments of $0.749 million (2011 - $2.746 million).

Other than the dividend payment no significant event or transaction has occurred between the date of Permanent LMI Pty Ltd financial statements as at 31 December 2011 and that of the Group that would require adjustment to the Group's financial statements.

Notes to the Financial Statements (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
14. AVAILABLE FOR SALE FINANCIAL INVESTMENTS				
Investments				
Visa shares (a)	**3,821**	4,943	**3,821**	4,943
Unlisted shares (b)	**257**	257	**257**	257
Other (c)	**221**	221	**221**	221
	4,299	5,421	**4,299**	5,421

(a) Visa shares

On 27 June 2012 the Group sold 31,503 Visa shares resulting in a realised gain of $2.464 million that was transferred from Other Comprehensive Income to the Income Statement.

The remaining Visa shares relate to 31,500 Class C (Series 1) common stock.

The Visa shares have been measured at fair value using the $US share price converted to Australian dollars at the applicable exchange rate. Any changes to fair value is reflected in the available for sale asset reserve.

(b) Unlisted shares

Unlisted shares that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, are measured at cost. These are shares in Australian Settlements Limited.

Also included in unlisted shares are shares in HBS Superannuation Nominees Pty Limited. HBS Superannuation Nominees Pty Limited previously acted solely in a fiduciary capacity for the members of the superannuation fund for which it was trustee, and therefore was not controlled by Heritage Bank Limited. The company is no longer a trustee for the superannuation fund and is now a non-operating company.

(c) Other

The other category comprises the Australian Settlements Limited subordinated debt, which is measured at cost as the fair value is unable to be measured reliably.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Board and Management of Heritage are responsible for implementing a risk management process to limit risks to prudent levels. The Finance Committee and Audit & Compliance Committee have been established by the Board to develop and monitor risk management policies within their specific areas.

Heritage's risk management policy and supporting framework are in place to enable the risks faced by Heritage to be identified and analysed, evaluated, and monitored over time. Risk management policies are reviewed regularly to reflect changes from sources both internal and external to Heritage.

The Audit & Compliance Committee is responsible for monitoring compliance with Heritage's risk management policies and procedures, and reviewing the adequacy of the risk management framework. The Audit & Compliance Committee is assisted in this role by Internal Audit. Internal Audit perform reviews of risk management processes and controls, reporting the results to the Audit & Compliance Committee.

Heritage has exposure to the following risks from its use of financial instruments:

Market risk

Liquidity risk

Credit risk

Operational risk.

(a) Market risk

Market risk is the risk that changes in market prices, such as interest rates and exchange rates, will affect Heritage's income or the value of its holdings of financial instruments. The objective of market risk is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of Market Risks

Heritage does not undertake trading activities and all exposure to market risk is in its non-trading portfolio.

Overall authority for market risk is vested in the Board and delegated to the Finance Committee. Treasury is responsible for the development of detailed risk management policies (subject to review by Finance Committee and approval by Board) and for the day-to-day review of their implementation.

Interest Rate Risk

Interest rate risk is the potential for loss of earnings to Heritage due to adverse movements in interest rates.

Heritage utilises two key risk management strategies; a pricing committee facilitates direct (pricing) intervention strategies and the Finance Committee facilitates indirect (hedging) intervention strategies.

Forward Rate Agreements, Interest Rate Swaps, Options (including Interest Rate Caps and Floors), Interest Rate Futures and Options on Interest Rate Futures are all authorised hedging instruments but are subject to approval by the Finance Committee where they have not been utilised within the previous 12 months.

Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands (set with reference to prudential capital base). The Finance Committee is the monitoring body for compliance with these limits and is assisted by the monitoring activities implemented by Treasury in its day-to-day operations.

Notes to the Financial Statements (continued)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(a) Market risk (continued)

Sensitivity of net profit and loss

The following demonstrates the sensitivity to a reasonable possible change in interest rates and the equities market with all other variables held constant.

The sensitivity of the Income Statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 30 June 2012, including the effect of hedging instruments.

Change	Sensitivity of net interest income (NII)	
	2012 $'000	2011 $'000
100 basis points	1,136	857
(100) basis points	(411)	(125)

Sensitivity of equity

The sensitivity of equity is calculated by determining the effect of an assumed change in interest rates on any swaps designated as cash flow hedges and the net interest income. It also includes the effect of a revaluation of the available for sale (AFS) financial investments.

Change	Sensitivity of NII & cash flow hedge reserve		Sensitivity of available for sale asset reserve	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
100 basis points	5,018	3,043		
(100) basis points	(4,293)	(2,311)		
10% increase in AFS investments			267	346
10% decrease in AFS investments			(243)	(315)
10% increase in US dollar rate			267	346
10% decrease in US dollar rate			(243)	(315)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(a) Market risk (continued)

Currency Risk

Other than the Visa shares denominated in US dollars, Heritage is not exposed to any significant currency risk.

One SPV has Euro denominated notes paying floating Eurobor. In order to remove the foreign exchange risk the SPV has transacted a pay Australian dollar, receive Eurobor cross currency swap. The receive Eurobor leg of the swap perfectly matches the Eurobor note cashflows, effectively converting the floating Eurobor debt to floating Australian dollar debt. As such there is no exposure to currency risk.

The Group maintains nine foreign currency accounts (US, GBP, EURO, NZ, HKD, SGD, BAHT, CAD, JPY) which are used as float accounts to meet foreign currency card load obligations. The Income Statement exposure relating to these accounts is limited to any unrealised and realised gains and losses as a result of converting the fee revenue earned on the floats from the overseas denominated currencies to Australian dollars.

Prepayment Risk

Prepayment risk is the risk that Heritage will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected. Heritage manages the risk by monitoring the prepayment rate on the loans and taking the rate into account when adopting appropriate hedging strategies.

(b) Liquidity risk

Liquidity risk is the inability to access sufficient funds, both anticipated and unforseen that may lead to Heritage being unable to meet its cash flow and funding obligations as they arise.

Management of Liquidity Risk

Heritage's approach to managing liquidity is to ensure, as much as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal or stressed conditions, without incurring unacceptable losses or risking damage to Heritage's reputation.

Heritage has a Liquidity Management Policy that is supervised by the Chief Executive Officer and administered by the Chief Financial Officer, the Manager of Accounting Services and the Chief Treasury and Business Strategy Officer. To ensure liquidity requirements are met, Heritage maintains minimum liquidity holdings relative to its balance sheet liabilities including irrevocable commitments but excluding eligible capital. The minimum liquidity holdings comprise high quality liquid assets held within a Liquid Assets Portfolio.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. A daily report covers the daily liquidity position, liquidity forecasts are generated weekly and summary reports are provided to Finance Committee monthly.

Analysis of financial liabilities by remaining contractual maturities

The tables below summarises the maturity profile of the Group's financial liabilities, commitments and contingencies. This is based on contractual undiscounted cash flows and will not agree directly to the amounts recognised in the Statement of Financial Position. The derivatives have been calculated using existing contractual terms and rates prevailing at 30 June 2012. The amount will differ accordingly from the Statement of Financial Position.

Notes to the Financial Statements (continued)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(b) Liquidity risk (continued)

Consolidated	Up to 1 year $'000	1 to 5 years $'000	Over 5 years $'000	Total $'000
2012				
Deposits and borrowings	**5,652,439**	**1,513,659**	**568,493**	**7,734,591**
Accounts payable and other liabilities	**220,507**	**-**	**-**	**220,507**
Subordinated debt	**6,578**	**22,140**	**72,741**	**101,459**
Derivatives	**22,342**	**34,083**	**-**	**56,425**
Credit related commitments	**474,398**	**-**	**-**	**474,398**
Financial guarantees	**4,481**	**-**	**-**	**4,481**
	6,380,745	**1,569,882**	**641,234**	**8,591,861**

Consolidated	Up to 1 year $'000	1 to 5 years $'000	Over 5 years $'000	Total $'000
2011				
Deposits and borrowings	5,046,979	1,037,557	1,781,703	7,866,239
Accounts payable and other liabilities	214,504	-	-	214,504
Subordinated debt	8,721	30,203	114,343	153,267
Derivatives	11,992	15,268	-	27,260
Credit related commitments	410,784	-	-	410,784
Financial guarantees	4,681	-	-	4,681
	5,697,661	1,083,028	1,896,046	8,676,735

Parent	Up to 1 year $'000	1 to 5 years $'000	Over 5 years $'000	Total $'000
2012				
Deposits and borrowings and inter entity loan	**5,648,818**	**1,512,690**	**568,128**	**7,729,636**
Accounts payable and other liabilities	**220,357**	**-**	**-**	**220,357**
Subordinated debt	**6,578**	**22,140**	**72,741**	**101,459**
Derivatives	**22,342**	**34,083**	**-**	**56,425**
Credit related commitments	**474,398**	**-**	**-**	**474,398**
Financial guarantees	**4,481**	**-**	**-**	**4,481**
	6,376,974	**1,568,913**	**640,869**	**8,586,756**

Parent	Up to 1 year $'000	1 to 5 years $'000	Over 5 years $'000	Total $'000
2011				
Deposits and borrowings and inter entity loan	5,041,802	1,036,492	1,779,875	7,858,169
Accounts payable and other liabilities	225,258	-	-	225,258
Subordinated debt	8,721	30,203	114,343	153,267
Derivatives	11,992	15,268	-	27,260
Credit related commitments	410,784	-	-	410,784
Financial guarantees	4,681	-	-	4,681
	5,703,238	1,081,963	1,894,218	8,679,419

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(c) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the entity. The management of credit risk is supervised by the Chief Executive Officer and administered by the Company Secretary for loans and receivables. For cash, liquid investments and derivatives these are administered by the Chief Financial Officer and the Chief Treasury and Business Strategy Officer. Management of credit risk for loans and receivables includes:

- Formulating credit policies including credit assessment, documentary and legal procedures and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to branch managers and loan assessment officers.
- Reviewing and assessing credit risk. The Chief Executive Officer, Company Secretary together with the credit committee assesses credit exposures in excess of designated limits, prior to facilities being committed to customers.

The table below shows the maximum exposure to credit risk:

Gross Maximum Exposure

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
Cash and cash equivalents	**133,081**	40,649	**123,769**	37,919
Receivables due from other financial institutions	**277,809**	398,956	**229,559**	361,556
Other receivables	**48,959**	57,096	**48,593**	56,635
Loans and receivables	**6,637,957**	6,486,295	**6,637,957**	6,486,295
Held to maturity financial assets	**1,079,857**	1,020,973	**1,079,857**	1,020,973
Available for sale financial investments	**4,299**	5,421	**4,299**	5,421
Other investments	**-**	-	**327,335**	285,620
	8,181,962	8,009,390	**8,451,369**	8,254,419
Financial guarantees	**4,481**	4,681	**4,481**	4,681
Credit related commitments	**474,398**	410,784	**474,398**	410,784
	478,879	415,465	**478,879**	415,465
	8,660,841	8,424,855	**8,930,248**	8,669,884

Counterparty Risk

As part of Heritage's investment policy individual counterparties need to have the appropriate investment grading and are monitored in respect to their limits and credit rating. The appropriate credit rating and limit levels ensures Heritage is not exposed to any significant individual counterparty exposure.

Notes to the Financial Statements (continued)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(c) Credit risk (continued)

Credit exposure by credit rating

The following table outlines the credit ratings of the Group's investments with counterparties:

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
AAA to AA-	**780,695**	1,003,232	**732,445**	965,832
A+ to A-	**345,076**	133,238	**345,076**	133,238
BBB+ to BBB-	**176,116**	214,624	**176,116**	214,624
Unrated	**55,779**	68,835	**55,779**	68,835
	1,357,666	1,419,929	**1,309,416**	1,382,529

Credit risk of the loan portfolio

Heritage lending is made up of predominantly residential properties. A credit assessment is completed for each loan which includes information about applicant's cost of living, capacity to repay, previous credit conduct and value of security. The majority of Heritage's loan portfolio is secured with mortgages over relevant properties and as a result manages credit risk by using the loan to value ratio (LVR). The LVR is calculated by dividing the total of the loan by the lower of Heritage approved valuation amount or the purchase price. The average of the Group's LVRs (by value) are as follows:

	CONSOLIDATED		PARENT	
LVR	**2012 %**	2011 %	**2012 %**	2011 %
0-60%	**38**	38	**38**	38
61-80%	**45**	45	**45**	45
81-90%	**14**	14	**14**	14
91-100%	**3**	3	**3**	3
> 100%	**-**	-	**-**	-
	100	100	**100**	100

Security

For mortgage lending the registered mortgage is held as security. Where the loan to valuation ratio is greater than 80% mortgage insurance is required.

Past due but not impaired loans

These relate to loans where the contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Group.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(c) Credit risk (continued)

Past due items by individual facility as at 30 June are:

	Less than 30 days ($'000)	31 to 60 days ($'000)	61 to 90 days ($'000)	More than 90 days ($'000)	Total ($'000)
2012					
Residential owner occupied	**201**	**42**	**72**	**295**	**610**
Residential investor	**83**	**17**	**30**	**121**	**251**
Credit card	**96**	**-**	**48**	**86**	**230**
Other personal	**191**	**-**	**169**	**293**	**653**
	571	**59**	**319**	**795**	**1,744**
2011					
Residential owner occupied	341	28	20	213	602
Residential investor	140	11	8	88	247
Credit card	96	-	41	59	196
Other personal	185	-	192	325	702
	762	39	261	685	1,747

The total security relating to the above past due items greater than 90 days is $12,472,000 (2011 - $9,497,000).

Impaired loans

Impaired loans are loans for which the Group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan.

Allowances for impairment

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolios. The main components of this allowance are a specific loss component that relates to individually significant exposures, including a prescribed provision in accordance with the Australian Prudential Regulation Authority's (APRA) methodology, and a collective provision. The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. A model is maintained to identify the inherent risk of various portfolios. The model is used in determining whether impairment provisions may be required.

Write off policy

The Group writes off a loan when it is determined that the loan is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation or that proceeds from collateral will not be sufficient to pay back the entire exposure.

Notes to the Financial Statements (continued)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(c) Credit risk (continued)

Concentrations of credit risk

The Group minimises concentrations of credit risk by undertaking transactions with a large number of customers within the specified category. However, the majority of customers are concentrated in Queensland.

Concentrations of credit risk on loans arise in the following categories:

	Maximum credit risk exposure* for each concentration			
	CONSOLIDATED			
	Percentage of total loans receivable (%)		$'000	
Geographic	**2012**	2011	**2012**	2011
Queensland residents	**68%**	67%	**4,491,559**	4,331,123
Other	**32%**	33%	**2,139,993**	2,150,283
	100%	100%	**** 6,631,552**	** 6,481,406

	Maximum credit risk exposure* for each concentration			
	PARENT			
	Percentage of total loans receivable (%)		$'000	
Geographic	**2012**	2011	**2012**	2011
Queensland residents	**68%**	67%	**4,491,559**	4,331,123
Other	**32%**	33%	**2,139,993**	2,150,283
	100%	100%	**** 6,631,552**	** 6,481,406

* The maximum credit risk exposure does not take into account the value of any collateral or other security held, in the event other entities/parties fail to perform their obligations under the financial instruments in question.

** The total loans and receivables figure differs from that presented in the Statement of Financial Position in Note 10 by the securitisation establishment costs of $2.354 million (2011 - $0.998 million) and the broker commission of $4.051 million (2011 - $3.891 million), as the securitisation establishment costs and broker commission are reclassifications, as a result of the effective interest rate method and are not applicable for the analysis of the concentration of credit risk.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(d) Fair Values

The net fair value of financial assets and financial liabilities are categorised under a three level hierarchy, reflecting the availability of observable market inputs when estimating the fair value. The three levels are:

Level 1: Valued by reference to quoted prices in active markets for identical assets and liabilities. These quoted prices represent actual and regularly occurring market transactions on an arm's length basis.

Level 2: Valued using inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) including:

(a) quoted prices in active markets for similar assets or liabilities,

(b) quoted prices in markets in which there are few transactions for identical or similar assets or liabilities, and

(c) other inputs that are not quoted prices but are observable for the asset or liability, for example interest rate yield curves.

Level 3: Valued in whole or in part using valuation techniques or models that are based on unobservable inputs that are neither supported by prices from observable current market transactions in the same instrument nor based on available market data.

The following table shows an analysis of financial instruments recorded at fair value by each level of the fair value hierarchy:

			Level 1 $'000	Level 2 $'000	Level 3 $'000	Total Fair Value $'000
Consolidated						
2012	**Assets**					
		Available for sale financial investments	3,821	-	-	3,821
		Derivatives	-	3,180	-	3,180
			3,821	3,180	-	7,001
	Liabilities					
		Subordinated debt	53,018	-	-	53,018
		Derivatives	-	35,810		35,810
			53,018	35,810	-	88,828
2011	**Assets**					
		Available for sale financial investments	4,943	-	-	4,943
		Derivatives	-	1,101	-	1,101
			4,943	1,101	-	6,044
	Liabilities					
		Subordinated debt	51,047	-	-	51,047
		Derivatives	-	43,528	-	43,528
			51,047	43,528	-	94,575

Notes to the Financial Statements (continued)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(d) Fair Values (continued)

		Level 1 $'000	Level 2 $'000	Level 3 $'000	Total Fair Value $'000
Parent					
2012	**Assets**				
	Available for sale financial investments	3,821	-	-	3,821
	Derivatives	-	16,280		16,280
		3,821	16,280	-	20,101
	Liabilities				
	Subordinated debt	53,018	-	-	53,018
	Derivatives	-	6,097	-	6,097
		53,018	6,097	-	59,115
2011	**Assets**				
	Available for sale financial investments	4,943	-	-	4,943
	Derivatives	-	8,587	-	8,587
		4,943	8,587	-	13,530
	Liabilities				
	Subordinated debt	51,047	-	-	51,047
	Derivatives	-	1,136	-	1,136
		51,047	1,136	-	52,183

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(d) Fair Values (continued)

The following table summarises the carrying amounts and fair values (inclusive of accrued interest), of those financial assets and financial liabilities not presented at their fair value on the Group's Statement of Financial Position.

	Carrying amount per Statement of Financial Position		Aggregate Net Fair Value	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
Consolidated				
Financial Assets				
Held to maturity financial assets	1,079,857	1,020,973	1,084,704	1,034,116
Loans and receivables	6,637,957	6,486,295	6,668,750	6,474,244
	7,717,814	7,507,268	7,753,454	7,508,360
Financial Liabilities				
Term debt	902,640	704,373	908,544	714,076
Interest bearing notes	1,716,534	2,059,767	1,793,031	2,155,931
Subordinated debt	10,000	45,000	10,042	45,248
	2,629,174	2,809,140	2,711,617	2,915,255
Parent				
Financial Assets				
Held to maturity financial assets	1,079,857	1,020,973	1,084,704	1,034,116
Loans and receivables	6,637,957	6,486,295	6,668,750	6,474,244
	7,717,814	7,507,268	7,753,454	7,508,360
Financial Liabilities				
Term debt	902,640	704,373	908,544	714,076
Inter entity loan	2,021,730	2,348,296	2,030,922	2,346,896
Subordinated debt	10,000	45,000	10,042	45,248
	2,934,370	3,097,669	2,949,508	3,106,220

Notes to the Financial Statements (continued)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(d) Fair Values (continued)

Financial Assets

Cash and cash equivalents and receivables due from other financial institutions

The carrying amounts approximate fair value because of their short term to maturity or are receivable on demand.

Other receivables, accounts payable and other liabilities

The carrying amounts approximate fair value as they are short term in nature.

Held to maturity financial assets

For financial instruments traded in organised financial markets, fair value is the current quoted market price for an asset or offer price for a liability, adjusted for transaction costs necessary to realise the asset.

Loans and receivables

The fair value of loans are estimated using discounted cash flow analysis based on current incremental lending rates for similar types of lending arrangements.

Available for sale financial investments

The fair value is determined with reference to the actual quoted market price at reporting date.

Financial Liabilities

Deposits and borrowings

The carrying amount approximates fair value because 87% (2011 - 81%) of deposits have a short date to maturity. For longer term deposits, their current interest rates are similar to market rates.

Interest bearing notes

The estimated fair value is determined by a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

Term debt

The estimated fair value is determined by a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

Interest rate, basis and cross currency swaps

The fair value is determined as the present value of the future interest cash flows.

(e) Derivative financial instruments

Derivative financial instruments are measured at fair value and recorded in the Statement of Financial Position as assets and liabilities. Changes in values of derivative financial instruments are recognised in the Income statement unless they qualify as cash flow hedges for accounting purposes, as set out in Note 2 (g).

The Group uses derivative financial instruments to hedge financial risk from movements in interest rates and foreign exchange rates. A description of these financial instruments is given on the following page.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(e) Derivative financial instruments (continued)

Interest rate swaps - cash flow hedges

The Group has adopted a cash flow hedging strategy where it transacts pay fixed / receive floating swaps with approved external counterparties to mitigate against variability in cash flows of a portfolio of floating rate liabilities.

At balance sheet date, the Group has interest rate swap agreements with a notional amount of $350 million (2011 - $160 million), on which it pays 2.923% to 5.555% interest and receives Bank Bill Swap Rate (BBSW). The swaps expire between July 2012 and May 2015.

The Group has adopted a cash flow hedging strategy where it transacts pay floating / receive fixed swaps (some of an amortising nature) with SPVs to counteract against variability in cash flows of a portfolio of floating rate assets.

At balance sheet date, there is a portfolio balance of $584 million pay floating / received fixed interest rate swaps that Heritage has transacted with SPVs.

Interest rate swap - fixed rate bonds

The Group has entered into pay fixed / receive floating swaps to mitigate against changes in the fair value of the fixed rate bonds.

At balance sheet date, there is a portfolio balance of $27.2 million pay fixed / receive floating interest rate swaps.

Interest rate swap - fair value hedge

The Group has adopted a fair value hedging strategy where it transacts pay floating / receive fixed swaps with approved external counterparties to mitigate against changes in the fair value of term subordinated debt due to movement in interest rates.

At balance sheet date, there was a portfolio balance of $50 million pay floating / receive fixed interest rate swaps.

Basis swaps

The Parent is a basis swap provider to a number of SPVs. As a swap provider, the basis swaps are taken up in the Parent's income or expense. At consolidation, these swaps are eliminated from the Statement of Financial Position.
At balance sheet date, the Parent has basis swap agreements with a notional amount of $1,163 million (2011 - $1,417 million). The swaps are provided to the SPVs to hedge the basis between the pool assets and the note holder interest. Hedge accounting is not being applied to the basis swaps.

Cross currency swaps

One of the SPVs entered into a cross currency swap agreement. The Group has adopted the cash flow strategy for the designation of this swap. At balance sheet date, the Group has a cross currency swap agreement with a value of $29.712 million net liability (2011 - $42.392 million net liabilities relating to two SPVs). The swap is used to convert the Euro dollar note holder obligation to Australian dollar obligation.

(f) Operational Risk

Operational risk is risk arising from inadequate or failed internal processes, people and information systems, or from external events (other than credit, market, and liquidity risks). Operational risks arise from Heritage's operational activities.

Heritage's objective is to manage the risks associated with its activities to realise opportunities and minimise the impact of undesired and unexpected events on its business activities.

Management of risks through the implementation of appropriate control strategies is supported by a programme of periodic reviews undertaken by Internal Audit. The results of the reviews are provided to the responsible management of the subject business unit and reported to the Audit & Compliance Committee.

Notes to the Financial Statements (continued)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(g) Capital

Capital adequacy is calculated in accordance with the Prudential Standards issued by Australian Prudential Regulation Authority (APRA). APRA has set minimum regulatory capital requirements that are consistent with the Basel II Framework. During the year, the Group has complied in full with all its externally imposed capital requirements.

The Group's capital management policy is supervised by the Chief Executive Officer and administered by the Chief Financial Officer, the Manager Accounting Services and the Chief Treasury and Business Strategy Officer. Other objectives include making efficient use of capital in the pursuit of strategic objectives. The capital adequacy ratio is monitored on a daily basis.

Regulatory Capital

	2012 $'000	2011 $'000
Tier 1 capital	269,837	242,732
Tier 2 capital	63,078	97,038
Total capital	332,915	339,770
Risk Weighted Assets	2,660,571	2,403,667
Capital Ratio	12.51%	14.14%

Tier 1 capital consists of general reserves and current year earnings. Tier 2 includes other reserves and subordinated debt.

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
16. OTHER INVESTMENTS				
Other investments	-	-	327,335	285,620

Heritage created a special purpose vehicle, HBS Trust 2008-1R for internal securitisation purposes.

17. PROPERTY, PLANT AND EQUIPMENT

		CONSOLIDATED			
		Freehold land $'000	Heritage Plaza building units $'000	Furniture, fittings, plant and equipment $'000	Total $'000
Year ended 30 June 2012					
At 1 July 2011, net of accumulated depreciation and impairment		1,800	8,090	11,139	21,029
Additions		-	130	4,756	4,886
Disposals		-	-	(303)	(303)
Depreciation charge for the year		-	(584)	(4,435)	(5,019)
As at 30 June 2012, net of accumulated depreciation and impairment		1,800	7,636	11,157	20,593
At 30 June 2012					
Cost		1,800	11,590	48,510	61,900
Accumulated depreciation and impairment	(a)	-	(3,954)	(37,353)	(41,307)
Net carrying amount		1,800	7,636	11,157	20,593
Year ended 30 June 2011					
At 1 July 2010, net of accumulated depreciation and impairment		1,800	8,553	11,105	21,458
Additions		-	372	5,182	5,554
Disposals		-	-	(429)	(429)
Depreciation charge for the year		-	(835)	(4,719)	(5,554)
As at 30 June 2011, net of accumulated depreciation and impairment		1,800	8,090	11,139	21,029
At 30 June 2011					
Cost		1,800	11,461	46,536	59,797
Accumulated depreciation and impairment	(a)	-	(3,371)	(35,397)	(38,768)
Net carrying amount		1,800	8,090	11,139	21,029

Notes to the Financial Statements (continued)

17. PROPERTY, PLANT AND EQUIPMENT (continued)

		PARENT			
		Freehold land	Heritage Plaza building units	Furniture, fittings, plant and equipment	Total
		$'000	$'000	$'000	$'000
Year ended 30 June 2012					
At 1 July 2011, net of accumulated depreciation and impairment		1,800	8,090	11,139	21,029
Additions		-	130	4,756	4,886
Disposals		-	-	(303)	(303)
Depreciation charge for the year		-	(584)	(4,435)	(5,019)
As at 30 June 2012, net of accumulated depreciation and impairment		1,800	7,636	11,157	20,593
At 30 June 2012					
Cost		1,800	11,590	48,510	61,900
Accumulated depreciation and impairment	(a)	-	(3,954)	(37,353)	(41,307)
Net carrying amount		1,800	7,636	11,157	20,593
Year ended 30 June 2011					
At 1 July 2010, net of accumulated depreciation and impairment		1,800	8,553	11,105	21,458
Additions		-	372	5,182	5,554
Disposals		-	-	(429)	(429)
Depreciation charge for the year		-	(835)	(4,719)	(5,554)
As at 30 June 2011, net of accumulated depreciation and impairment		1,800	8,090	11,139	21,029
At 30 June 2011					
Cost		1,800	11,461	46,536	59,797
Accumulated depreciation and impairment	(a)	-	(3,371)	(35,397)	(38,768)
Net carrying amount		1,800	8,090	11,139	21,029

(a) Impairment of property, plant and equipment

An impairment loss is recognised for the amount by which the assets carrying value exceeds its recoverable amount. The freehold land and buildings at 400 Ruthven Street Toowoomba is tested for impairment. The major drivers and triggers of impairment were identified and reviewed, and have not given rise to any identified impairment loss. Therefore, no impairment loss or gain has been recognised in the 2011 or 2012 financial statements.

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000

18. OTHER ASSETS

Prepayments	1,407	1,161	1,407	1,161
Make good asset	1,326	1,326	1,326	1,326
Less: Amortisation	(1,224)	(1,146)	(1,224)	(1,146)
	102	180	102	180
	1,509	1,341	1,509	1,341

19. INTANGIBLES

Computer Software

Opening balance, net of accumulated amortisation and impairment	1,408	1,849	1,408	1,849
Additions	435	445	435	445
Disposals	-	-	-	-
Amortisation charge for the year	(794)	(886)	(794)	(886)
Closing balance, net of accumulated amortisation and impairment	1,049	1,408	1,049	1,408

20. DEPOSITS AND BORROWINGS

Customer deposits	4,909,821	4,579,363	4,909,821	4,579,363
Term debt	902,489	704,373	902,489	704,373
Accrued interest on deposits / notes	54,845	56,189	49,891	48,119
Interest bearing notes	1,716,534	2,059,767	-	-
Related parties	1,792	861	1,792	861
	7,585,481	7,400,553	5,863,993	5,332,716

(a) Aggregate deposit and borrowings of related parties

Key management personnel	1,792	861	1,792	861

Notes to the Financial Statements (continued)

	Note	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
20. DEPOSITS AND BORROWINGS (continued)					
(b) Concentration of deposits					
Queensland depositors		**4,313,945**	4,147,689	**4,266,750**	3,853,659
Other		**3,271,536**	3,252,864	**1,597,243**	1,479,057
		7,585,481	7,400,553	**5,863,993**	5,332,716

The Group's deposit portfolio does not include any deposit which represents 10% or more of total liabilities.

21. ACCOUNTS PAYABLE AND OTHER LIABILITIES

	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Trade creditors	**220,507**	214,504	**220,357**	225,258
Inter entity loan (interest bearing)	**-**	-	**2,021,730**	2,348,296
	220,507	214,504	**2,242,087**	2,573,554

22. PROVISIONS

	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Employee benefits	**8,173**	7,315	**8,173**	7,315
Directors' retiring allowance	**542**	647	**542**	647
Make good provision	**1,326**	1,326	**1,326**	1,326
	10,041	9,288	**10,041**	9,288
Make good provision				
Current	**488**	427	**488**	427
Non-current	**838**	899	**838**	899
	1,326	1,326	**1,326**	1,326

23. RETIREMENT BENEFIT OBLIGATIONS

(a) Superannuation plan

The Group contributes on behalf of its employees to the Heritage Bank Limited Superannuation Plan. Employer contributions are based on the advice of the plan's actuary, but as a minimum the Group contributes for all employees in accordance with the *Superannuation Guarantee (Administration) Act 1992.* The plan provides both defined benefits and accumulation style benefits. The object of the plan is to fund the retirement, disability and death benefits of its members.

Defined benefits

The following sets out details in respect of the defined benefit section only.

(b) Statement of Financial Position amounts

The amounts recognised in the Statement of Financial Position are determined as follows:

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
Present value of the defined benefit obligation	**8,356**	6,331	**8,356**	6,331
Fair value of defined benefit plan assets	**5,932**	5,482	**5,932**	5,482
Net liability / (asset)	**2,424**	849	**2,424**	849

(c) Categories of plan assets

The percentage invested in each major category of plan assets at the end of the year:

	CONSOLIDATED		PARENT	
	2012	2011	**2012**	2011
Australian equity	**24%**	27%	**24%**	27%
International equity	**24%**	26%	**24%**	26%
Fixed income	**20%**	15%	**20%**	15%
Cash	**18%**	16%	**18%**	16%
Property	**6%**	9%	**6%**	9%
Alternatives / Other	**8%**	7%	**8%**	7%
	100%	100%	**100%**	100%

Notes to the Financial Statements (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000

23. RETIREMENT BENEFIT OBLIGATIONS (continued)

(d) Reconciliations

Reconciliation of the present value of the defined benefit obligation:

	2012 $'000	2011 $'000	2012 $'000	2011 $'000
Balance at the beginning of the year	6,331	5,757	6,331	5,757
Current service cost	432	409	432	409
Interest cost	266	269	266	269
Contributions by plan participants	17	17	17	17
Actuarial (gain) / loss	1,460	441	1,460	441
Benefits paid	-	(443)	-	(443)
Taxes, premiums and expenses paid	(150)	(119)	(150)	(119)
Balance at the end of the year	8,356	6,331	8,356	6,331

Reconciliation of the fair value of plan assets:

	2012 $'000	2011 $'000	2012 $'000	2011 $'000
Balance at the beginning of the year	5,482	5,228	5,482	5,228
Expected return on plan assets	350	369	350	369
Actuarial gain / (loss)	(342)	(94)	(342)	(94)
Employer contributions	575	524	575	524
Contributions by plan participants	17	17	17	17
Benefits paid	-	(443)	-	(443)
Taxes, premiums and expenses paid	(150)	(119)	(150)	(119)
Balance at the end of the year	5,932	5,482	5,932	5,482

(e) Principal actuarial assumptions

The principal actuarial assumptions adopted for the calculations were:

	CONSOLIDATED		PARENT	
	2012	2011	2012	2011
Discount rate	2.4% pa	4.4% pa	2.4% pa	4.4% pa
Expected rate of return on plan assets	6.2% pa	6.3% pa	6.2% pa	6.3% pa
Expected salary increase rate	5.0% pa	4.5% pa	5.0% pa	4.5% pa

The expected return on assets assumption is determined by weighting the expected long-term return for each asset class by the target allocation of assets to each asset class and allowing for the correlations of the investment returns between asset classes. The returns used for each asset class are net of investment tax and investments fees.

23. RETIREMENT BENEFIT OBLIGATIONS (continued)

(f) Income Statement

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
Service cost	432	409	432	409
Interest cost	266	269	266	269
Expected return on assets	(350)	(369)	(350)	(369)
Superannuation expense / (income)	348	309	348	309
Actual return on plan assets	8	275	8	275

(g) Employer contributions

Eligible employees contribute to the plan at a fixed percentage of their salaries and the Group contributes such amounts as necessary to provide the benefits shown under the plan. Any voluntary contributions that are made on the plan accumulate interest and are paid in addition to any other benefits shown under the plan. In terms of the trust deed the Group is not bound to contribute to the plan.

(h) Historic summary

	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Actuarial (gain) / loss recognised in the year in the Statement of Comprehensive Income	1,802	535	1,802	535
Cumulative actuarial (gain) / loss recognised in the Statement of Comprehensive Income	3,552	1,750	3,552	1,750
Present value of the defined benefit obligation	8,356	6,331	8,356	6,331
Fair value of defined benefit plan assets	5,932	5,482	5,932	5,482
Net liability / (asset)	2,424	849	2,424	849
Experience adjustments arising on plan liabilities - (gain) / loss	379	(18)	379	(18)
Experience adjustments arising on plan assets - (gain) / loss	342	94	342	94

24. SUBORDINATED DEBT

	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Subordinated debt listed with Australian Securities Exchange at fair value through the Income Statement	53,018	51,047	53,018	51,047
Other Subordinated debt at amortised cost	10,000	45,000	10,000	45,000
Accrued interest on listed and other subordinated debt	1,002	1,149	1,002	1,149
	64,020	97,196	64,020	97,196

Notes to the Financial Statements (continued)

24. SUBORDINATED DEBT (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
(a) Aggregate subordinated debt of related parties				
Key management personnel	177	177	177	177
Concentration of subordinated debt				
Queensland debt holders - face value	33,091	31,143	33,091	31,143
Other - face value	26,909	63,857	26,909	63,857
	60,000	95,000	60,000	95,000

Subordinated debt matures between October 2017 and October 2019 (2011 - December 2016 and October 2019) with an effective interest rate of 9.25% (2011 - 7.96%).

25. RESERVES

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
(a) Reserves				
Asset revaluation reserve				
Balance 1 July	5,714	5,714	5,714	5,714
Revaluation of land	-	-	-	-
Revaluation of buildings	-	-	-	-
Balance 30 June	5,714	5,714	5,714	5,714
Cash flow hedge reserve				
Balance 1 July	1,860	(3,105)	4,446	6,183
Transfer to profit	-	-	-	-
Gain / (loss) on cash flow hedging instruments	(7,270)	7,187	1,165	(2,388)
Deferred tax	2,181	(2,222)	(350)	651
Balance 30 June	(3,229)	1,860	5,261	4,446
Available for sale asset reserve				
Balance 1 July	1,506	1,707	1,506	1,707
Net gain on proceeds from Visa sale reclassified to the Income Statement	(2,464)	-	(2,464)	-
Revaluation of shares	2,741	(287)	2,741	(287)
Deferred tax	(83)	86	(83)	86
Balance 30 June	1,700	1,506	1,700	1,506
Total Reserves	4,185	9,080	12,675	11,666

25. RESERVES (continued)

(b) Nature and purpose of reserves

(i) Asset revaluation reserve

The property, plant and equipment revaluation reserve was used to record increments and decrements on the revaluation of non-current assets up until the transition to IFRS. The asset revaluation reserve will not be used under the existing accounting policy on property plant and equipment (refer Note 2 (k)).

(ii) Cash flow hedge reserve

The hedging reserve is used to record gains or losses on a hedging instrument in a cash flow hedge that are recognised directly in equity, as described in Note 2 (g). As the underlying transaction occurs the balance will be transferred back to the Income Statement.

(iii) Available for sale asset reserve

This reserve is used to record increments and decrements on the revaluation of the Visa shares described in Note 14 (a).

Notes to the Financial Statements (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000

26. CASH FLOW STATEMENT RECONCILIATION

(a) Reconciliation of the operating profit after tax to the net cash flows from operations

	CONSOLIDATED 2012 $'000	CONSOLIDATED 2011 $'000	PARENT 2012 $'000	PARENT 2011 $'000
Operating profit after tax	**31,272**	32,056	**31,272**	32,056
Non cash items				
Share of associates' net profits	**164**	1,729	**164**	1,729
Impairment losses on loans	**2,092**	2,040	**2,092**	2,040
Defined benefit fund	**(227)**	(215)	**(227)**	(215)
Depreciation	**5,019**	5,554	**5,019**	5,554
Amortisation - loans and receivables	**900**	668	**900**	668
Amortisation - computer software and make good asset	**872**	994	**872**	994
Amortisation - establishment cost of borrowings	**741**	740	**741**	740
Provision for employee benefits	**858**	425	**858**	425
Changes in assets				
Loss from sale of property, plant and equipment	**70**	142	**70**	142
Realised gain on sale of investments	**(2,464)**	-	**(2,464)**	-
Accrued interest on investments	**1,568**	(1,500)	**1,498**	(1,498)
Intangibles	**(434)**	(442)	**(434)**	(442)
Sundry debtors	**(995)**	(539)	**(1,019)**	(550)
Prepayments	**(405)**	321	**(405)**	321
Expenditure carried forward	**(2,256)**	(952)	**(2,256)**	(952)
Swap asset	**(2,292)**	34	**(2,292)**	34
Deferred tax asset	**(2,373)**	1,133	**(990)**	(292)
Changes in liabilities				
Accrued investors interest	**(1,491)**	8,074	**1,625**	6,984
Current tax liability	**(1,604)**	(926)	**(1,604)**	(926)
Revaluation of term subordinated debt	**1,500**	150	**1,500**	150
Sundry creditors	**11,046**	4,744	**11,249**	3,656
Swap liability	**513**	-	**513**	-
Directors' retiring allowance	**(105)**	(40)	**(105)**	(40)
Deferred tax liability	**2,996**	(3,564)	**1,612**	(2,140)
Net cash flows from operating activities	**44,965**	50,626	**48,189**	48,438

	CONSOLIDATED		PARENT	
	2012	2011	**2012**	2011
	$'000	$'000	**$'000**	$'000

26. CASH FLOW STATEMENT RECONCILIATION (continued)

(b) Reconciliation of cash

Cash balance comprises:				
- Cash (refer Note 7)	**133,081**	40,649	**123,769**	37,919

(c) Cash flows presented on a net basis

Cash flows arising from the following activities are presented on a net basis in the Cash Flow Statement:

(i) Customer deposits to and withdrawals from deposit accounts;

(ii) Borrowings and repayments on loans and receivables; and

(iii) Sale and purchase of investment securities.

(d) Securitisation facilities available

Securitisation warehouse facilities are in place with Waratah for HBS Trust No. 2 and ANZ for HBS Trust No. 4. Terms and conditions of these facilities are set and agreed to from time to time.

At balance date, the following facilities had been negotiated and were available:

CONSOLIDATED	Negotiated Facility		Facility Utilised	
	2012	2011	**2012**	2011
	$'000	$'000	**$'000**	$'000
HBS Trust No. 2 (a)	**700,000**	700,000	**197,686**	518,251
HBS Trust No. 3	**-**	300,000	**-**	267,388
HBS Trust No. 4	**500,000**	500,000	**23,539**	148,862

(a) The amount and terms of the facility for HBS Trust No. 2 are currently being renegotiated.

Notes to the Financial Statements (continued)

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
27. EXPENDITURE COMMITMENTS				
(a) Lease expenditure commitments				
Estimated lease expenditure contracted for at balance date but not provided for:				
Operating leases (non-cancellable)				
Not later than 1 year	**8,037**	7,401	**8,037**	7,401
Later than 1 and not later than 5 years	**23,624**	12,526	**23,624**	12,526
Later than 5 years	**4,285**	408	**4,285**	408
Aggregate lease expenditure contracted for at balance date	**35,946**	20,335	**35,946**	20,335

These commitments represent payments due under non-cancellable operating leases for various premises occupied. The average lease term is five years.

28. CONTINGENT LIABILITIES AND CREDIT COMMITMENTS

In the normal course of business the Group enters into various types of contracts that give rise to contingent or future obligations. These contracts generally relate to the financial needs of customers. The Group uses the same credit policies and assessment criteria in making commitments and conditional obligations for off-balance sheet risks as it does for on-balance sheet loan assets. The Group holds collateral supporting these commitments where it is deemed necessary.

(a) Credit related commitments

Binding commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract.

Approved but undrawn loans and credit limits	**474,398**	410,784	**474,398**	410,784

29. RELATED PARTY DISCLOSURES

(a) Remuneration of key management personnel

Remuneration of the key management personnel of the Group is as follows:

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
BENEFITS				
Short-term				
Salary and fees	3,756	3,524	3,756	3,524
Cash bonus	370	352	370	352
Other	180	151	180	151
Long-term				
Long service leave entitlements	87	100	87	100
Post employment				
Superannuation	570	553	570	553
Retirement benefits	247	235	247	235
Total				
Total remuneration	5,210	4,915	5,210	4,915
Total performance related (%)	7%	7%	7%	7%

(b) Loans to key management personnel

All loans to key management personnel and their related parties are on similar terms and conditions available to members.

The following tables provide details of loans made to key management personnel and their related parties.

	Balance 1 July 2011 $'000	Written off $'000	Interest charged $'000	Interest not charged $'000	Balance 30 June 2012 $'000	Number in group
Key management personnel and their related parties	1,894	-	113	-	2,011	6

Notes to the Financial Statements (continued)

29. RELATED PARTY DISCLOSURES (continued)

(b) Loans to key management personnel (continued)

Individuals and their related parties with loans above $100,000 during the period.

Executive	Balance 1 July 2011	Written off	Interest charged	Interest not charged	Balance 30 June 2012	Highest indebted-ness in period
	$'000	$'000	$'000	$'000	$'000	$'000
Bill Armagnacq	504	-	31	-	447	504
Jane Calder	333	-	16	-	320	333
Stephen Davis	144	-	6	-	121	149
Dunstin Lynch	566	-	41	-	823	835
John Williams	347	-	19	-	300	347

(c) Transactions with key management personnel

All of the deposit accounts, loans and credit cards between the Group and key management personnel are transactions that are at arms length. The interest charged on credit cards held by the Senior Executive Group, balance 30 June 2012 - $58,000 (2011 - $25,000) is at a discount rate offered to all staff members. Balances for the key management personnel include the following:

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000
Financial Assets				
Credit cards	85	58	85	58
Loan accounts	2,011	1,750	2,011	1,750
	2,096	1,808	2,096	1,808
Financial Liabilities				
Savings accounts	1,430	688	1,430	688
Term deposits	211	172	211	172
Heritage Retail Bonds at par value	151	-	151	-
Heritage Notes at par value	177	177	177	177
	1,969	1,037	1,969	1,037

29. RELATED PARTY DISCLOSURES (continued)

(d) Other transactions and balances with key management personnel

Mr Kerry J. Betros is the Managing Director of Betros Bros Holdings Pty Limited. A member of this group of companies, Betros Bros Pty Limited, acts as an investing agent. All transactions with the company were performed in the ordinary course of business and on normal commercial terms and conditions. Commissions and rental paid to Betros Bros Pty Limited during the year were $76,000 (2011 - $76,000).

Mr Brian R. Carter is Managing Director of Bricar Pty Limited. During the year $2,000 (2011 - nil) was paid to Bricar Pty Limited for reimbursement of secretarial costs.

Mr Stephen Davis is Managing Director of David W Swan & Associates Pty Limited. During the year $90,000 was paid to the company in relation to real estate valuations.

(e) Special Purpose Vehicles (SPVs)

The SPVs which form part of the consolidated results include the following trusts:

HBS Trust No. 1	HBS Trust 2004-1
HBS Trust No. 2	HBS Trust 2005-1E
HBS Trust No. 3	HBS Trust 2006-1
HBS Trust No. 4	HBS Trust 2008-1R
HBS Trust 2003-1E	HBS Trust 2011-1

Refer to Note 21 for disclosure of the inter entity loan.

Heritage provides a number of facilities and services to the SPVs. The facilities and services can include the following:

Servicer

The role of servicer requires Heritage to collect monies and administer the securitised loans. During the year fee income of $7,522,000 (2011 - $8,500,000) was received for performing these functions.

Liquidity and redraw facility provider

Heritage provides a facility to fund any redraws made by members in relation to the securitised loans. It also provides a liquidity arrangement ensuring the SPV is able to meet its cash flow obligations. During the year fee income of $85,000 (2011 - $135,000) was received for performing these functions.

Swap provider

Heritage enters into swaps with the SPVs. Interest revenue or expense in respect of these swaps is dependent on prevailing interest rates.

Heritage received $1,668,000 (2011 - $2,134,000) in interest relating to the securitisation deposits during the year. The average balance of the securitisation deposits held was $37,658,000 (2011 - $46,952,000).

Custodian and management fee

Heritage provided custodian and management services to HBS Trust No. 4 and HBS Trust 2011-1 for the full financial year. HBS Custodian Pty Limited retired from its role as custodian and manager of the remaining SPVs effective 31 December 2011. For the remainder of the year Heritage undertook this role. During the year fee income of $298,000 (2011 - $16,000) was received for performing this function.

Notes to the Financial Statements (continued)

29. RELATED PARTY DISCLOSURES (continued)

(f) Other

Details of interest in controlled entities are set out in Note 31. There are no further dealings with these entities.

Details of interest in associated companies are set out in Note 13. During the year, dividends of $748,800 (2011 - $2,746,000) were received from Permanent LMI Pty Limited.

During the financial year fee income for the provision of management and accounting services of $125,000 (2011 - $364,000) was received from HBS Custodian Pty Limited. A dividend of $156,000 was paid to Heritage as a result of the retirement of HBS Custodian Pty Limited.

30. AUDITOR'S REMUNERATION

	CONSOLIDATED		PARENT	
	2012 $'000	2011 $'000	**2012 $'000**	2011 $'000
Amounts received or due and receivable by the auditors for:				
An audit and review of the financial report of the Group	**440**	420	**362**	340
Taxation services	**67**	112	**47**	92
Accounting advice - financing and taxation	**24**	70	**24**	70
Regulatory review	**61**	-	**61**	-
Securitisation services	**94**	73	**24**	-
	686	675	**518**	502
Amounts received or due and receivable by non Ernst & Young audit firms for:				
Other non-audit services in relation to the Group	**-**	-	**-**	-
	-	-	**-**	-
	686	675	**518**	502

31. CONTROLLED ENTITIES

Name of Entity		Book value of investment		% of shares held		Country of incorpor-ation	Contribution to consolidated profit after tax	
		2012 $'000	2011 $'000	2012 %	2011 %		2012 $'000	2011 $'000
Parent Entity								
Heritage Bank Limited		-	-	-	-	Australia	-	-
Special Purpose Vehicles (SPVs)								
The SPVs relate to the securitisation of Heritage's loans and include the following trusts: (Refer to Note 2 (c) for further details).	(a)	327,335	285,620	N/A	N/A	N/A	-	-

HBS Trust No. 1

HBS Trust No. 2

HBS Trust No. 4

HBS Trust 2004-1

HBS Trust 2005-1E

HBS Trust 2006-1

HBS Trust 2008-1R

HBS Trust 2011-1

(a) Refer Note 16 for details.

The clean up option for HBS Trust 2003-1E was exercised on 19 September 2011. On this date, pursuant to Clause 11.1 of the Series Notice, the Trust extinguished all of its right, title and interest in the remaining loans in favour of Heritage.

The clean up option for HBS Trust No. 3 was exercised on 8 December 2011. On this date, pursuant to Clause 10.1 of the Series Notice, the Trust extinguished all of its right, title and interest in the remaining loans in favour of Heritage.

32. SEGMENT INFORMATION

The Group operated predominantly in the finance industry within Australia. The operations comprise the provision of financial products and services to members.

Specific segmentation of loans and deposits are set out in Notes 10 and 20.

33. EVENTS SUBSEQUENT TO REPORTING DATE

There are no significant events since the end of the financial year which will affect the operating results or state of affairs of the Group in subsequent years.

Directors' Declaration

DIRECTORS' DECLARATION

In accordance with a resolution of the directors of Heritage Bank Limited, we state that:

In the opinion of the directors:

(a) the financial statements and notes of Heritage are in accordance with the *Corporations Act 2001*, including:
   (i) giving a true and fair view of Heritage's financial position as at 30 June 2012 and of their performance for the year ended on that date; and
   (ii) complying with Accounting Standards and Corporations Regulations 2001; and

(b) the financial statements also complies with International Financial Reporting Standards as issued by the International Accounting Standards Board; and

(c) there are reasonable grounds to believe that Heritage will be able to pay its debts as and when they become due and payable.
On behalf of the Board

TOOWOOMBA	**KERRY J. BETROS**	**DENNIS P. CAMPBELL**
23 August 2012	Chairman	Deputy Chairman

Auditor's Independence Declaration

111 Eagle Street
Brisbane QLD 4000 Australia
GPO Box 7878 Brisbane QLD 4001

Tel: +61 7 3011 3333
Fax: +61 7 3011 3100
www.ey.com/au

Auditor's Independence Declaration to the Directors of Heritage Bank Limited

In relation to our audit of the financial report of Heritage Bank Limited for the financial year ended 30 June 2012, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

P McLuskie

Paula McLuskie
Partner
23 August 2012

Independent Auditor's Report

ERNST & YOUNG

111 Eagle Street
Brisbane QLD 4000 Australia
GPO Box 7878 Brisbane QLD 4001

Tel: +61 7 3011 3333
Fax: +61 7 3011 3100
www.ey.com/au

Independent auditor's report to the members of Heritage Bank Limited

Report on the financial report

We have audited the accompanying financial report of Heritage Bank Limited (the Bank), which comprises the statements of financial position as at 30 June 2012, the income statement, statement of comprehensive income, the statement of changes in equity and the cash flow statement for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the Bank and the consolidated entity comprising the Bank and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the Bank are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 2, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

Independence

In conducting our audit we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the Bank a written Auditor's Independence Declaration.

Opinion

In our opinion:

a. the financial report of Heritage Bank Limited is in accordance with the *Corporations Act 2001*, including:

   i giving a true and fair view of the Bank's and consolidated entity's financial positions as at 30 June 2012 and of their performance for the year ended on that date; and

   ii complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and

b. the financial report also complies with International Financial Reporting Standards as disclosed in Note 2.

Report on the remuneration report

We have audited the Remuneration Report included in pages 6 to 12 of the directors' report for the year ended 30 June 2012. The directors of the Bank are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Opinion

In our opinion, the Remuneration Report of Heritage Bank Limited for the year ended 30 June 2012, complies with section 300A of the *Corporations Act 2001*.

Ernst & Young

Ernst & Young

P McLuskie

Paula McLuskie
Partner
Brisbane
23 August 2012

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