Financial Report

2015/2016

Heritage Bank


It’s not a

Heritage Bank Limited
ABN 32 087 652 024. AFSL 240984. Australian Credit Licence 240984.

Financial Report for the year ended 30 June 2016

Contents

Auditors
Ernst & Young

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Directors' Report

Your directors submit their report of the consolidated entity (the "Group"), being Heritage Bank Limited ("Heritage") and its controlled entities, for the year ended 30 June 2016.

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 Kerry J. Betros
BBus, FCPA, MAICD
Chairman of Directors

Mr Betros is Managing Director of Betros Bros Holdings Pty Ltd 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 and was awarded the College Medal. He has previously served on various other Boards and organisations and was awarded the Centenary of Federation Medal for distinguished service to the community. He is a Fellow of CPA Australia. Mr Betros has been a Director of Heritage since 1991. He was the inaugural Chairman of Heritage's Finance Committee, Chairman of the Internal Audit Committee and has served on a number of other committees. He was appointed to the role of Deputy Chairman in July 2011 and became Chairman of Directors on 21 June 2012.

Dr Dennis P. Campbell
PhD, MBA, FCHSE, CHE, FAIM, GAICD
Deputy Chairman

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 and has legal and health qualifications. Dr Campbell joined the Heritage Bank Board in 2000 and became Chairman of the Finance Committee on 19 July 2012 and is a member of the Remuneration and Governance Committee. 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 Heritage on 21 June 2012.

Mrs Vivienne A. Quinn
MAHRI, FAICD

Mrs Quinn is the Director of Quinn & Associates Pty Ltd and Quinn Practice Broking Pty Ltd. She has had over 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 Bank Board since 1995, is a member of the Audit and Compliance and Finance (appointed July 2014) Committees and is Chairman of the Superannuation Policy Committee.

Ms Susan M. Campbell
FCPA, MAICD, BCom, GradDip(SIA), MBA, Cert IV Training & Assessment

Ms Campbell was appointed as a Director in 2005 and brings with her a range of finance and risk skills from the banking and financial services sector. She is managing director of ARGYLL, a specialist risk consulting services firm, and is Heritage's first interstate director. Ms Campbell is a member of the Risk Management Committee having been its inaugural chairman and was a member of the Finance Committee. Susan is active with the Risk Management Institute of Australia and the Australian Financial Markets Association and has worked with many organisations in Australia and Asia developing their treasury and risk management skills. Susan is also a director of Benetas Aged Care Services and is on their Finance and Quality committees. Her previous employment has included working with global banks in Melbourne and London, corporate treasuries and as a senior lecturer at RMIT University and LaTrobe University.

Mr Brendan P. Baulch
BCom, LLB, CA, MAICD

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 a

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. He is also a member of the Risk Management Committee.

Mr Stephen Davis
AAPI, MAICD

Mr Davis is a licensed valuer and previously a licensed auctioneer and real estate agent and has since 1989 been the Managing Director of David W. Swan & Associates Pty Ltd. He is also the Managing Director of Australian Strata Title Services Pty Ltd 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 Bank Board on 1 July 2011 and is a member of the Audit & Compliance, Finance (appointed July 2014) and the Superannuation Policy Committees.

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 Bank Board on 18 April 2012 has been a member of the Finance (to July 2014) and Risk Management (Chairman from July 2014) Committees.

Company secretaries

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

Mr Armagnacq has been with Heritage since May 2003. From January 1998 to April 2003 he was company secretary of a number of Ergon Energy Corporation Limited Group companies. From July 1989 to December 1997, Mr Armagnacq was a partner of KPMG Chartered Accountants. He is the Chair of The Glennie School Council and a director of Empire Theatres Pty Ltd.

Miss Shelley Sorrenson
LLB, BJus, MAICD
General Counsel/Assistant Company Secretary

Miss Sorrenson joined Heritage in October 2014. She previously worked as a lawyer for the Australian Securities and Investments Commission and King & Company Solicitors. She holds law and justice degrees from the Queensland University of Technology and currently serves as Secretary and as a Board Member of Brisbane Youth Service Inc.

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		Risk Management		Remuneration and Governance	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Mr Betros	11	11	12	12	7	6	4	3	1	1
Dr Campbell	11	11	12	12	-	-	-	-	1	1
Mrs Quinn	11	11	12	12	7	7	-	-	1	1
Ms Campbell	11	11	-	-	-	-	4	4	-	-
Mr Baulch	11	11	-	-	7	7	4	4	-	-
Mr Davis	11	11	12	12	7	7	-	-	-	-
Mr Thorpe	11	10	-	-	-	-	4	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 Superannuation Policy Committee is not a Board Committee, however Mrs Quinn and Mr Davis were employer representatives during the financial year.

Mr Betros is an ex officio member, not an appointed member of the Audit and Compliance Committee, Risk Management Committee and Finance Committee.

Corporate Governance statement is online

Heritage complies with its Constitution, the *Corporations Act 2001* (Cth), the ASX Listing Rules, and the third edition of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (Third Edition) (ASX Principles), which is reflected in our Corporate Governance Statement.

As an APRA-regulated entity, Heritage also complies with the governance requirements prescribed by APRA under Prudential Standard CPS 510 Governance.

Information about Heritage's Board and senior executives, corporate governance policies and practices and Risk Management approach can be found in our Corporate Governance Statement available at www.heritage.com.au/our-company/directors-management.

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 798 full time equivalent employees as at 30 June 2016 (2015 – 780 employees).

Review and result of operations

The operating profit of the Group for the financial year after income tax was $36.141 million (2015 - $33.605 million). This represents a 7.5% increase compared to the previous year which is a strong result in view of the continuing competitive environment.

The Group reported a minor decrease in total consolidated assets to a total of $8.441 billion (2015 - $8.557 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 2016 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.

Indemnification of auditors

To the extent permitted by law, the Group has agreed to indemnify its auditors, Ernst & Young, as part of the terms of its audit engagement agreement against claims by third parties arising from the audit. No payment has been made to indemnify Ernst & Young during or since the financial year.

Remuneration report (Audited)

This Remuneration Report has been prepared in accordance with section 300A of the *Corporations Act 2001* for the year ended 30 June 2016. 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 applying to 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".

REMUNERATION AND GOVERNANCE

The Remuneration and Governance Committee is appointed and authorised by Heritage's Board to assist the Board in fulfilling its regulatory obligations. Accordingly, the Remuneration and Governance Committee exercises the authority and power delegated to it by the Board.

The Remuneration and Governance 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 Chief Executive Officer (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 Governance Committee affect the financial soundness of Heritage and any other person specified by APRA.

In exercising its responsibilities, the Remuneration and Governance 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 Governance Committee are non-executive directors. Members of the Remuneration and Governance Committee during the period to 30 June 2016 have been Mr Kerry Betros, Dr Dennis Campbell and Mrs Vivienne Quinn.

REMUNERATION FRAMEWORK

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

Executive 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. Senior executive base salary is reviewed annually taking into account the individual executive's position, external market trends and personal performance. Any decisions in respect of remuneration are made on the recommendation of the CEO and approved by the Remuneration and Governance Committee and the Board.

Directors' Report (continued)

Remuneration report (Audited) (continued)

REMUNERATION FRAMEWORK (continued)

Executive remuneration (continued)

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.

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 Governance Committee.

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

Executive employment agreements

Heritage's senior executive employment contracts are fixed term in nature. The CEO is on a three year contract term with six months notice period required and other senior executives are on a three year contract term with three months notice period required. The terms and conditions of such employment contracts are commensurable with the banking and finance industry in which Heritage operates.

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.

Non-executive Director remuneration

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

EXECUTIVE REMUNERATION

Senior executive remuneration comprises fixed based remuneration and short term incentive benefits.

Fixed base

Fixed base remuneration comprises cash salary, superannuation, motor vehicle and leave entitlements.

Short Term Incentive Benefits

Executive remuneration includes an annual incentive component. The incentive is designed to support Heritage's overall remuneration policy by focusing senior executives on achieving yearly personal and departmental performance goals which contribute to sustainable Heritage growth and member value.

The short term incentive is dependent on the individual's performance throughout the year and the duties and responsibilities undertaken. The incentive payments are determined 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.

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

NON-EXECUTIVE DIRECTOR REMUNERATION

The remuneration of Non-executive Directors is based on the following principles and arrangements. There is no direct link between Non-executive Director fees and the financial performance of Heritage or the performance of the directors. Non-executive Directors do not receive incentive payments.

The Non-executive Directors' aggregate fee amount as set by members at the Annual General Meeting on 21 October 2015 was $1,075,000. This amount does not include superannuation, retirement allowances or any other entitlements.

Non-executive Directors receive a fixed annual fee plus superannuation contributions at 9.50% of the base fee, directors' liability and personal accident insurance and related fringe benefits tax. Under Heritage's Constitution, Non-executive 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.

Remuneration report (Audited) (continued)

Loans to Key Management Personnel

Details of loans to key management personnel and their related parties are as follows:

	Balance 1 July 2015 $'000	Written off $'000	Interest charged $'000	Interest not charged $'000	Balance 30 June 2016 $'000	Highest indebtedness in period $'000
Non-executive Director						
Steve Davis	108	-	1	-	-	108
Total	108	-	1	-	-	108
Executives						
Peter Lock	-	-	1	-	487	487
Jane Calder	269	-	1	-	249	269
Paul Francis	299	-	15	-	297	299
Bob Hogarth	316	-	17	-	760	760
Dunstin Lynch	640	-	27	-	596	640
John Williams	190	-	3	-	-	190
Paul Williams	129	-	6	-	134	139
Total	1,843	-	70	-	2,523	2,784

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

Directors' Report (continued)

Remuneration table

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

		SHORT TERM BENEFITS		LONG TERM BENEFITS		TOTAL
		Fees	Non-Cash Benefits	Superannuation Contributions	Retiring Allowance	
Non - Executive Directors		$ ' 000	$ ' 000	$ ' 000	$ ' 000	$ ' 000
Mr K.J. Betros Chairman	**2016**	**268**	**2**	**25**	**67**	**362**
	2015	261	2	25	65	353
Dr D.P. Campbell Deputy Chairman	**2016**	**196**	**2**	**18**	**49**	**265**
	2015	193	2	18	48	261
Mrs V.A. Quinn Director	**2016**	**103**	**2**	**9**	**26**	**140**
	2015	100	2	9	25	136
Professor P. Swannell AM Director retired effective 22 October 2014	**2016**	-	-	-	-	-
	2015	31	2	3	8	44
Ms S.M. Campbell Director	**2016**	**103**	**2**	**9**	**26**	**140**
	2015	100	2	9	25	136
Mr B.P. Baulch Director	**2016**	**113**	**2**	**11**	**28**	**154**
	2015	112	2	11	28	153
Mr S. Davis Director	**2016**	**103**	**2**	**9**	**26**	**140**
	2015	100	2	9	25	136
Mr D.W. Thorpe Director	**2016**	**113**	**2**	**11**	**28**	**154**
	2015	110	2	10	28	150
Total for 2016		**999**	**14**	**92**	**250**	**1,355**
Total for 2015		1,007	16	94	252	1,369

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

		SHORT TERM BENEFITS			LONG TERM BENEFITS		TOTAL
		Salary	Incentive	Non-Cash Benefits	Superannuation Contributions	Other long term benefits	
Executives		$'000	$'000	$'000	$'000	$'000	$'000
Peter Lock Chief Executive Officer Appointed on 23 November 2015	**2016**	**379**	-	**28**	**20**	**1**	**428**
	2015	-	-	-	-	-	-
John Minz Chief Executive Officer Resigned on 19 November 2015	**2016**	**251**	-	**4**	**47**	**5**	**307**
	2015	596	70	15	112	13	806
Bill Armagnacq Company Secretary / Assistant CEO	**2016**	**302**	**30**	**20**	**36**	**7**	**395**
	2015	293	36	20	35	8	392
Jane Calder General Manager, Marketing	**2016**	**259**	**30**	**17**	**36**	**6**	**348**
	2015	252	36	9	35	6	338
Peter Cavanagh General Manager, Emerging Business Streams	**2016**	**275**	**33**	**15**	**36**	**6**	**365**
	2015	261	40	19	35	6	361
Peter Cleary Chief Financial Officer	**2016**	**314**	**35**	-	**57**	**9**	**415**
	2015	302	40	-	56	8	406
Paul Francis General Manager, Retail Services	**2016**	**326**	**37**	**14**	**36**	**6**	**419**
	2015	316	44	13	35	7	415
Bob Hogarth General Manager, People and Culture	**2016**	**246**	**32**	**13**	**47**	**6**	**344**
	2015	227	38	20	45	5	335
Dunstin Lynch General Manager, Technology	**2016**	**229**	**30**	**32**	**36**	**14**	**341**
	2015	207	36	32	34	7	316
John Williams Chief Operating Officer	**2016**	**309**	**37**	**20**	**36**	**20**	**422**
	2015	281	44	20	44	10	399
Paul Williams Chief Strategy & Investment Officer	**2016**	**364**	**40**	-	**31**	**9**	**444**
	2015	351	46	-	30	11	438
Total for 2016		**3,254**	**304**	**163**	**418**	**89**	**4,228**
Total for 2015		3,086	430	148	461	81	4,206

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 46.

Rounding

The amounts contained in this report and in the financial statements have been rounded to the nearest thousand dollars (where rounding is applicable) in accordance with ASIC Corporations Instrument 2016/191.

Signed in accordance with a resolution of the directors:

TOOWOOMBA
25 August 2016

KERRY J. BETROS
Chairman

DENNIS P. CAMPBELL
Deputy Chairman

Statement of Profit or Loss

FOR THE YEAR ENDED 30 JUNE 2016

	Note	CONSOLIDATED		PARENT	
		2016 $'000	2015 $'000	2016 $'000	2015 $'000
Net interest income					
Interest revenue	2.1	356,559	378,017	356,559	378,017
Interest expense	2.1	(207,895)	(238,290)	(207,895)	(238,290)
Net interest income		148,664	139,727	148,664	139,727
Other operating income	2.1	36,615	36,882	36,615	36,882
Total net operating income		185,279	176,609	185,279	176,609
Expenses					
Impairment losses on loans and receivables		(2,415)	(2,546)	(2,415)	(2,546)
Marketing expense		(8,053)	(7,421)	(8,053)	(7,421)
Occupancy expense		(12,476)	(11,900)	(12,476)	(11,900)
Employee benefits expense	2.2	(72,291)	(69,357)	(72,291)	(69,357)
Administrative expense		(25,371)	(23,664)	(25,371)	(23,664)
Depreciation		(5,399)	(5,464)	(5,399)	(5,464)
Amortisation		(1,919)	(1,914)	(1,919)	(1,914)
Communication		(4,864)	(5,007)	(4,864)	(5,007)
Fees and commissions		(1,380)	(1,327)	(1,380)	(1,327)
Total operating expenses		(134,168)	(128,600)	(134,168)	(128,600)
Profit before income tax		51,111	48,009	51,111	48,009
Income tax expense	2.3	(14,970)	(14,404)	(14,970)	(14,404)
Profit for the year		36,141	33,605	36,141	33,605

The accompanying notes form part of these financial statements

Statement of Comprehensive Income

FOR THE YEAR ENDED 30 JUNE 2016

	Note	CONSOLIDATED		PARENT	
		2016 $'000	2015 $'000	2016 $'000	2015 $'000
Profit for the year		36,141	33,605	36,141	33,605
Other comprehensive income					
Items that may be reclassified subsequently to profit or loss					
Gain/(loss) on cash flow hedge taken to members' funds		3,517	(5,590)	3,517	(5,590)
Income tax on other comprehensive income	2.3	(1,055)	1,677	(1,055)	1,677
		2,462	(3,913)	2,462	(3,913)
Items that will not be reclassified subsequently to profit or loss					
Actuarial (loss)/gain on defined benefit plan		(349)	587	(349)	587
Other comprehensive income/(loss), net of tax		2,113	(3,326)	2,113	(3,326)
Total comprehensive income		38,254	30,279	38,254	30,279

The accompanying notes form part of these financial statements

Statement of Financial Position

AS AT 30 JUNE 2016

	Note	CONSOLIDATED		PARENT	
		2016 $'000	2015 $'000	2016 $'000	2015 $'000
Assets					
Cash and cash equivalents	4.1	103,743	196,911	103,743	196,911
Receivables due from other financial institutions	4.2	194,374	243,993	194,374	243,993
Held to maturity financial assets	4.2	1,003,978	1,248,129	1,003,978	1,248,129
Other receivables	4.2	30,514	24,614	30,514	24,614
Loans and receivables	3.1	7,064,232	6,801,035	7,064,232	6,801,035
Available for sale financial investments		478	528	478	528
Derivatives	4.7	297	1,120	297	1,120
Deferred tax assets	2.3	9,318	9,698	9,318	9,698
Property, plant and equipment	6.1	25,758	23,671	25,758	23,671
Other assets		2,350	2,367	2,350	2,367
Intangibles	6.2	5,685	5,207	5,685	5,207
Total Assets		8,440,727	8,557,273	8,440,727	8,557,273
Liabilities					
Deposits	4.3	6,132,792	5,911,479	6,132,792	5,911,479
Other financial liabilities	4.5	350,846	305,210	350,846	305,210
Borrowings	4.4	1,397,144	1,818,101	1,397,144	1,818,101
Derivatives	4.7	11,848	8,339	11,848	8,339
Current tax liabilities		2,122	2,375	2,122	2,375
Other payables	6.3	36,882	41,934	36,882	41,934
Provisions	6.4	16,911	15,885	16,911	15,885
Deferred tax liabilities	2.3	403	463	403	463
Subordinated debt	4.6	49,674	49,636	49,674	49,636
Total Liabilities		7,998,622	8,153,422	7,998,622	8,153,422
Net Assets		442,105	403,851	442,105	403,851
Members' Funds					
Retained profits		442,871	407,079	442,871	407,079
Reserves		(766)	(3,228)	(766)	(3,228)
Total Members' Funds		442,105	403,851	442,105	403,851

The accompanying notes form part of these financial statements

Statement of Changes in Members' Funds

FOR THE YEAR ENDED 30 JUNE 2016

	CONSOLIDATED			
	Retained profits $'000	Asset revaluation reserve $'000	Cash flow hedge reserve $'000	Total members' funds $'000
Balance at 1 July 2015	**407,079**	**2,445**	**(5,673)**	**403,851**
Profit for the year	36,141	-	-	36,141
Other comprehensive income, net of tax				
Actuarial loss on defined benefit plan	(349)	-	-	(349)
Net gain taken to members' funds	-	-	2,462	2,462
Total comprehensive income	**35,792**	**-**	**2,462**	**38,254**
Balance at 30 June 2016	**442,871**	**2,445**	**(3,211)**	**442,105**
Balance at 1 July 2014	372,887	2,445	(1,760)	373,572
Profit for the year	33,605	-	-	33,605
Other comprehensive income, net of tax				
Actuarial gain on defined benefit plan	587	-	-	587
Net loss taken to members' funds	-	-	(3,913)	(3,913)
Total comprehensive income	34,192	-	(3,913)	30,279
Balance at 30 June 2015	407,079	2,445	(5,673)	403,851

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

The accompanying notes form part of these financial statements

Statement of Cash Flows

FOR THE YEAR ENDED 30 JUNE 2016

	Note	CONSOLIDATED		PARENT	
		2016 $'000	2015 $'000	2016 $'000	2015 $'000
Cash flows from operating activities					
Interest received		366,880	389,711	366,880	389,711
Borrowing costs and interest paid		(212,515)	(244,979)	(212,515)	(244,979)
Other non-interest income received		39,032	38,154	39,032	38,154
Payments to suppliers and employees		(129,157)	(137,918)	(129,157)	(137,918)
Income tax paid		(15,993)	(16,917)	(15,993)	(16,917)
Net increase in loans and receivables and other receivables		(257,288)	(219,282)	(257,288)	(219,282)
Net (decrease) / increase in deposits and borrowings		(156,804)	10,819	(156,804)	10,819
Net cash flows used in operating activities	4.1	(365,845)	(180,412)	(365,845)	(180,412)
Cash flows from investing activities					
Net decrease in investment securities and receivables due from other financial institutions		279,919	192,317	279,919	192,317
Proceeds from sale of property, plant and equipment		303	246	303	246
Acquisition of property, plant and equipment		(7,545)	(3,542)	(7,545)	(3,542)
Net cash flows from investing activities		272,677	189,021	272,677	189,021
Cash flows from financing activities					
Issue of subordinated debt		-	50,000	-	50,000
Payments for redemption of subordinated debt		-	(50,000)	-	(50,000)
Net cash flows from financing activities		-	-	-	-
Net (decrease) / increase in cash held		(93,168)	8,609	(93,168)	8,609
Cash - beginning of the year		196,911	188,302	196,911	188,302
Cash and cash equivalents - end of the year	4.1	103,743	196,911	103,743	196,911

The accompanying notes form part of these financial statements

Notes to the Financial Statements

1. Basis of preparation

1.1 Corporate information

The consolidated financial report of Heritage Bank Limited and the Consolidated Structured Entities (CSEs) for the year ended 30 June 2016 was authorised for issue in accordance with a resolution of the directors on 25 August 2016.

Heritage Bank Limited is a for-profit entity. 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 is the provision of financial products and services to members.

1.2 Basis of accounting

(a) Basis of preparation

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 land and buildings which have been measured at fair value.

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

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 Corporations Instrument 2016/191.

(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.

1.3 Significant accounting judgements and estimates

In the process of applying the Group's accounting policies, management has used its judgements and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgements and estimates has been applied to the following areas. Refer to the respective notes for additional details.

	Reference
Provision for impairment of loans and receivables	Note 3.2
Fair value of financial instruments	Note 6.5

Notes to the Financial Statements (continued)

2 Financial performance

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
2.1 Income				
Net interest income				
Interest revenue				
Deposits and investment securities	36,916	47,985	36,916	47,985
Loans and receivables	330,659	340,297	330,659	340,297
Interest rate swaps	62	520	62	520
Add: Loan application fees	1,210	1,608	1,210	1,608
Less: Commission and agent direct costs	(11,788)	(11,550)	(11,788)	(11,550)
Less: Securitisation establishment costs	(500)	(843)	(500)	(843)
	356,559	378,017	356,559	378,017
Interest expense				
Deposits	163,216	186,762	163,216	186,762
Subordinated debt	2,966	845	2,966	845
Securitisation liabilities	33,143	44,822	33,143	44,822
Interest rate swaps	8,570	5,861	8,570	5,861
	207,895	238,290	207,895	238,290
Total net interest income	148,664	139,727	148,664	139,727
Other operating income				
Fees and commissions	34,562	35,777	34,562	35,777
Net loss on derivatives held at fair value	(221)	(30)	(221)	(30)
Loss on fair value hedges	-	(512)	-	(512)
Impairment losses on loans recovered	420	379	420	379
Other	1,854	1,268	1,854	1,268
Total other operating income	36,615	36,882	36,615	36,882

Recognition and measurement

Interest income
Revenue is recognised as interest accrues using the effective interest method. 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.

In line with the effective interest rate method, payments made to mortgage brokers for the introduction of loans to Heritage are expensed over a period to match the cost of acquiring the loan to the income derived from it. The commission is reclassified to interest revenue.

Securitisation establishment costs are amortised over the period of probable future economic benefits. In line with the effective interest rate method, securitisation establishment costs are reclassified to interest revenue.

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.

2 Financial performance (continued)

2.2 Expenses

	CONSOLIDATED 2016 $'000	CONSOLIDATED 2015 $'000	PARENT 2016 $'000	PARENT 2015 $'000
Employee benefits expense				
Salaries, wages and allowances	56,185	53,592	56,185	53,592
Net defined benefit fund expense	425	501	425	501
Contribution to accumulation fund	5,317	5,166	5,317	5,166
Other employee costs	10,364	10,098	10,364	10,098
Total employee benefits expense	72,291	69,357	72,291	69,357

2.3 Income tax

The major components of income tax expense are:

	CONSOLIDATED 2016 $'000	CONSOLIDATED 2015 $'000	PARENT 2016 $'000	PARENT 2015 $'000
Statement of Profit or Loss				
Current income tax expense				
Current income tax charge	16,129	15,063	16,129	15,063
Research and development credit	(321)	-	(321)	-
Adjustment for prior year	(120)	6	(120)	6
Deferred income tax expense				
Deferred income tax relating to temporary differences	(718)	(665)	(718)	(665)
Income tax expense reported in the Statement of Profit or Loss	14,970	14,404	14,970	14,404
Statement of Comprehensive Income				
Cash flow hedges	(1,055)	1,677	(1,055)	1,677
Income tax reported in other comprehensive income	(1,055)	1,677	(1,055)	1,677
Tax reconciliation				
Profit before income tax	51,111	48,009	51,111	48,009
Income tax at the statutory tax rate of 30%	15,333	14,403	15,333	14,403
Adjust for tax effect of:				
Non-deductible expenses	78	(5)	78	(5)
Research and development credit	(321)	-	(321)	-
Adjustment for prior year	(120)	6	(120)	6
Income tax on profit before tax	14,970	14,404	14,970	14,404

Notes to the Financial Statements (continued)

2 Financial performance (continued)

2.3 Income tax (continued)

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
Deferred tax assets comprise temporary differences attributable to:				
Employee benefits	4,524	4,232	4,524	4,232
Provision for impairment	1,903	1,835	1,903	1,835
Cash flow hedges	1,376	2,431	1,376	2,431
Other	1,515	1,200	1,515	1,200
Total deferred tax assets	9,318	9,698	9,318	9,698
Deferred tax liabilities comprise temporary differences attributable to:				
Plant and equipment	408	299	408	299
Other	(5)	164	(5)	164
Total deferred tax liabilities	403	463	403	463
Net deferred tax assets	8,915	9,235	8,915	9,235

Recognition and measurement

Income tax expense comprises current and deferred tax. It is recognised in the Statement of Profit or Loss except to the extent that it relates to items recognised directly in members' funds or in other comprehensive income.

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustments to the tax payable or receivable in respect of previous years.

Deferred tax is recognised in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax assets are recognised for unused tax credits and deductible temporary differences to the extent that is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

3. Loans and receivables

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
3.1 Loans and receivables				
Residential loans	6,756,204	6,498,603	6,756,204	6,498,603
Business loans	121,568	123,420	121,568	123,420
Credit cards	82,014	79,734	82,014	79,734
Personal and other loans	103,732	99,118	103,732	99,118
	7,063,518	6,800,875	7,063,518	6,800,875
Add: Securitisation establishment costs	896	1,153	896	1,153
Add: Commission and agent direct costs	6,163	5,125	6,163	5,125
Gross loans and receivables	7,070,577	6,807,153	7,070,577	6,807,153
Provision for impairment	(6,345)	(6,118)	(6,345)	(6,118)
Net loans and receivables	7,064,232	6,801,035	7,064,232	6,801,035
Maturity analysis				
Not longer than 12 months	1,465,806	1,461,452	1,465,806	1,461,452
Longer than 12 months	5,597,712	5,339,423	5,597,712	5,339,423
	7,063,518	6,800,875	7,063,518	6,800,875

Recognition and measurement

Loans and receivables are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale. Loans and receivables are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised costs using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The losses arising from impairment are recognised in the Statement of Profit or Loss in 'impairment losses on loans and receivables'.

Notes to the Financial Statements (continued)

3. Loans and receivables (continued)

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
3.2 Provision for impairment				
Specific provision				
Opening balance	3,076	2,182	3,076	2,182
Impairment provided for/(reversed)	(1,335)	894	(1,335)	894
Closing balance	1,741	3,076	1,741	3,076
Collective provision				
Opening balance	3,042	3,182	3,042	3,182
Impairment provided for/(reversed)	1,562	(140)	1,562	(140)
Closing balance	4,604	3,042	4,604	3,042
Total provision for impairment	6,345	6,118	6,345	6,118

Recognition and measurement

All loans are subject to management review to assess whether there is any objective evidence that any specific loan or group of loans is impaired.

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. It also includes a prescribed provision in accordance with the Australian Prudential Regulation Authority (APRA)'s methodology.

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.

Use of judgements and estimates

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 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.

4. Liquidity and funding

4.1 Cash and cash equivalents

	CONSOLIDATED 2016 $'000	CONSOLIDATED 2015 $'000	PARENT 2016 $'000	PARENT 2015 $'000
Cash at bank and on hand	103,743	196,911	103,743	196,911

Recognition and measurement

Cash and cash equivalents include cash on hand and deposits held with banks that have an original maturity of three months or less. Cash at bank earns interest at variable rates based on daily bank and short term deposit rates. Interest is recognised in the Statement of Profit or Loss using the effective interest method.

Notes to the Statement of Cash Flows

Reconciliation of profit for the year to net cash flows used in operating activities

	CONSOLIDATED 2016 $'000	CONSOLIDATED 2015 $'000	PARENT 2016 $'000	PARENT 2015 $'000
Operating profit after tax	36,141	33,605	36,141	33,605
Non cash items				
Impairment losses on loans	2,415	2,546	2,415	2,546
Defined benefit fund	(349)	388	(349)	388
Depreciation	5,399	5,464	5,399	5,464
Amortisation	3,593	3,945	3,593	3,945
Provision for employee benefits	786	234	786	234
Changes in assets				
(Gain)/loss from sale of property, plant and equipment	(99)	49	(99)	49
Accrued interest on investments	(696)	909	(696)	909
Loans and receivables and other receivables	(257,288)	(219,282)	(257,288)	(219,282)
Intangibles	(2,261)	(4,687)	(2,261)	(4,687)
Sundry debtors	1,148	(858)	1,148	(858)
Prepayments	(1,387)	(688)	(1,387)	(688)
Expenditure carried forward	(326)	(72)	(326)	(72)
Swap assets	823	(504)	823	(504)
Deferred tax assets	380	(1,789)	380	(1,789)
Changes in liabilities				
Deposits and borrowings	(156,804)	10,819	(156,804)	10,819
Accrued investors interest	(5,449)	(6,182)	(5,449)	(6,182)
Current tax liabilities	(288)	(1,892)	(288)	(1,892)
Revaluation of subordinated debt	-	(985)	-	(985)
Establishment costs - subordinated debt and term debt	(462)	(245)	(462)	(245)
Sundry creditors	2,779	(2,164)	2,779	(2,164)
Swap liabilities	7,026	(235)	7,026	(235)
Directors' retiring allowance	189	44	189	44
Deferred tax liabilities	(1,115)	1,168	(1,115)	1,168
Net cash flow used in operating activities	(365,845)	(180,412)	(365,845)	(180,412)

Notes to the Financial Statements (continued)

4. Liquidity and funding (continued)

4.2 Financial assets

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
Receivables due from other financial institutions				
Deposits with other authorised deposit-taking institutions	90,531	125,866	90,531	125,866
Foreign currency assets	103,843	118,127	103,843	118,127
	194,374	243,993	194,374	243,993
Maturity analysis				
Not longer than 12 months	194,374	243,993	194,374	243,993
Longer than 12 months	-	-	-	-
	194,374	243,993	194,374	243,993
Held to maturity financial assets				
Bank debt securities	924,632	1,020,192	924,632	1,020,192
Government securities	58,215	203,689	58,215	203,689
Asset backed debt securities	12,925	16,746	12,925	16,746
Accrued interest	8,206	7,502	8,206	7,502
	1,003,978	1,248,129	1,003,978	1,248,129
Maturity analysis				
Not longer than 12 months	629,216	899,765	629,216	899,765
Longer than 12 months	374,762	348,364	374,762	348,364
	1,003,978	1,248,129	1,003,978	1,248,129
Other receivables				
Securitisation deposits	28,411	21,263	28,411	21,263
Other	2,103	3,351	2,103	3,351
	30,514	24,614	30,514	24,614
Maturity analysis				
Not longer than 12 months	30,514	24,614	30,514	24,614
Longer than 12 months	-	-	-	-
	30,514	24,614	30,514	24,614

Recognition and measurement

Receivables due from other financial institutions

Receivables due from other financial institutions are recognised and measured at amortised cost and include foreign currency assets.

4. Liquidity and funding (continued)

4.2 Financial assets (continued)

Recognition and measurement (continued)

Foreign currency assets and liabilities

The Group maintains a number of foreign currency accounts which are used as float accounts to meet foreign currency card settlement obligations. The Group repatriates a significant portion of the three main foreign currency floats (US dollars, Euros and British Pounds) to manage counterparty risk. Foreign currency swaps relating to the three currencies are entered into to reduce foreign currency exposure. For the remaining currencies any unrealised gains or losses on the float accounts are exactly offset by a corresponding unrealised loss or gain on the settlement obligation.

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. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate. Gains and losses are recognised in the Statement of Profit or Loss when the financial assets are derecognised or impaired, as well as through the amortisation process.

Impairment for financial assets

For financial assets carried at amortised cost, the Group assesses impairment collectively. 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. Evidence of impairment may include indications that the counterparties ratings are downgraded and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Derecognition of financial assets

Financial assets are derecognised when the contractual rights to receive cash flows from the assets have expired, or where the Group has transferred its contractual rights to receive the cash flows of the financial assets and substantially all the risks and rewards of ownership.

4.3 Deposits

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
Deposits	**6,107,419**	5,880,288	**6,107,419**	5,880,288
Accrued interest	**25,373**	31,191	**25,373**	31,191
	6,132,792	5,911,479	**6,132,792**	5,911,479

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

Recognition and measurement

All deposits and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowings. After initial recognition, interest bearing borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs on settlement.

Notes to the Financial Statements (continued)

4. Liquidity and funding (continued)

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
4.4 Borrowings				
Term debt	428,262	652,780	428,262	652,780
Securitisation liabilities	968,882	1,075,620	968,882	1,075,620
Bank borrowings	-	89,701	-	89,701
	1,397,144	1,818,101	1,397,144	1,818,101

Recognition and measurement

For recognition and measurement details, refer to Note 4.3.

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
4.5 Other financial liabilities				
Foreign currency liabilities	350,846	305,210	350,846	305,210
	350,846	305,210	350,846	305,210

Recognition and measurement

For recognition and measurement details, refer to Note 4.2.

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
4.6 Subordinated debt				
Subordinated debt	49,674	49,636	49,674	49,636
	49,674	49,636	49,674	49,636

Recognition and measurement

Subordinated debt is initially recognised at fair value net of direct issue costs and measured at amortised cost using the effective interest rate method.

4.7 Derivatives

	CONSOLIDATED			
	Assets 2016 $'000	Liabilities 2016 $'000	Assets 2015 $'000	Liabilities 2015 $'000
Derivatives held at fair value				
Foreign currency swaps	297	7,262	1,120	237
Derivatives held as cash flow hedges				
Interest rate swaps	-	4,586	-	8,102
Total derivatives	297	11,848	1,120	8,339

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

4. Liquidity and funding (continued)

4.7 Derivatives (continued)

Recognition and measurement

The Group uses derivative financial instruments such as interest rate, basis, and foreign currency swaps to hedge its risks associated with interest rate and counterparty exposures. 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 the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

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.

The Group's exposure under derivative contracts is closely monitored as part of the overall management of the Group's market risk.

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 members' funds, while the ineffective portion is recognised in the Statement of Other Comprehensive Income.

Amounts taken to members' funds are transferred to the Statement of Profit or Loss when the hedged transaction affects the Statement of Profit or Loss, such as when hedged income or expenses are recognised.

Derivatives held at fair value

Those derivatives that the Group does not apply hedge accounting to are measured at fair value, with fair value changes charged to the Statement of Profit or Loss.

Notes to the Financial Statements (continued)

5 Risk and capital management

5.1 Risk management

Introduction and overview

The Group has identified three significant financial risks associated with the Group's core activities: non-traded market risk, credit risk and liquidity risk.

Risk management framework

The Board and management of Heritage are responsible for implementing a risk management process to limit risk to prudent levels. The Board has established the following committees with responsibilities to develop and monitor compliance and risk management framework within their respective areas: Audit and Compliance Committee, Finance Committee and Risk Management Committee.

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

The Risk Management Committee has oversight for formulating Heritage's risk management policies and reviewing the adequacy of the risk management framework. The Risk Management Committee receives regular reports from management and can request investigations into one-off or special matters in accordance with their charter. The Finance Committee has responsibility for financial risk management oversight.

The Audit and Compliance Committee's role is to assist the Board to fulfil its oversight responsibilities, by providing an objective non-executive review of the effectiveness of Heritage's prudential APRA reporting, statutory reporting, other financial reporting and professional accounting requirements, internal and external audit and compliance with laws and regulations.

(a) Market risk

Heritage utilises two key risk management strategies: a Product and Pricing Committee facilitates direct (pricing) intervention strategies and the Finance Committee has oversight of indirect (hedging) intervention strategies.

Heritage is not exposed to significant currency risk or equity risk. Heritage does not trade in the financial instruments it holds. Heritage is exposed to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates and the effective weighted average interest rate on classes of financial assets and financial liabilities.

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 management in its day-to-day operations.

5 Risk and capital management (continued)

5.1 Risk management (continued)

(a) Market risk (continued)

Consolidated Repricing period at 30 June 2016	Interest rate repricing within 1 year $'000	 1 to 5 years $'000	 over 5 years $'000	Non interest bearing $'000	Total $'000
Assets					
Cash and cash equivalents	76,697	-	-	27,046	103,743
Receivables due from other financial institutions	194,374	-	-	-	194,374
Held to maturity financial assets	995,772	-	-	-	995,772
Securitisation deposits	28,411	-	-	-	28,411
Loans and receivables (gross)	5,689,290	1,374,228	-	-	7,063,518
Derivatives	297	-	-	-	297
Total	6,984,841	1,374,228	-	27,046	8,386,115
Liabilities					
Deposits	6,020,507	86,912	-	-	6,107,419
Borrowings	1,397,144	-	-	-	1,397,144
Other financial liabilities	350,846	-	-	-	350,846
Derivatives	11,848	-	-	-	11,848
Subordinated debt	49,674	-	-	-	49,674
Commitments	481,161	49,832	-	48,545	579,538
Total	8,311,180	136,744	-	48,545	8,496,469

Consolidated Repricing period at 30 June 2015	Interest rate repricing within 1 year $'000	 1 to 5 years $'000	 over 5 years $'000	Non interest bearing $'000	Total $'000
Assets					
Cash and cash equivalents	170,285	-	-	26,626	196,911
Receivables due from other financial institutions	243,993	-	-	-	243,993
Held to maturity financial assets	1,240,627	-	-	-	1,240,627
Securitisation deposits	21,263	-	-	-	21,263
Loans and advances (gross)	5,367,572	1,433,303	-	-	6,800,875
Derivatives	1,120	-	-	-	1,120
Total	7,044,860	1,433,303	-	26,626	8,504,789
Liabilities					
Deposits	5,748,176	132,112	-	-	5,880,288
Borrowings	1,590,601	227,500	-	-	1,818,101
Other financial liabilities	305,210	-	-	-	305,210
Derivatives	8,339	-	-	-	8,339
Subordinated debt	49,636	-	-	-	49,636
Commitments	449,611	23,991	-	42,699	516,301
Total	8,151,573	383,603	-	42,699	8,577,875

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

Notes to the Financial Statements (continued)

5 Risk and capital management (continued)

5.1 Risk management (continued)

(a) Market risk (continued)

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and financial liabilities to interest rate movements. The following is an analysis of the Group's sensitivity to an increase or decrease in market interest rates for one year, assuming no asymmetrical movement in yield curve and a constant financial position.

Change	Sensitivity of net interest income (NII)		Sensitivity of NII & cash flow hedge reserve	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
100 basis points	8,547	6,958	12,540	15,046
(100) basis points	(7,743)	(6,713)	(11,841)	(14,801)

(b) Credit risk

Credit risk is 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 and the Head of Credit for loans and receivables. For cash, liquid investments and derivatives these are administered by the Chief Financial Officer and the Chief Strategy and Investment 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. Under Heritage's credit policies and delegations there are procedures for identified senior officers to assess credit exposures in excess of designated limits, prior to facilities being committed to customers.

Maximum exposure to credit risk

For financial assets recognised in the Statement of Financial Position, the exposure to credit risk equals their carrying amount. For customer commitments, the maximum exposure to credit risk is the full amount of the commitment facilities as at the reporting date (refer Note 6.7). The amount disclosed are the maximum exposure to credit risk, before taking into account any collateral held or other credit enhancements.

Credit quality by class of financial assets

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 ratings. The appropriate credit ratings and limit levels ensure Heritage is not exposed to any significant individual counterparty exposure.

5 Risk and capital management (continued)

5.1 Risk management (continued)

(b) Credit risk (continued)

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

Consolidated 2016

	Neither past due nor impaired				
	AAA to AA-	A+ to A-	BBB+ to BBB-	Unrated	Total
Assets	$'000	$'000	$'000	$'000	$'000
Cash and cash equivalents	76,665	32	-	27,046	103,743
Receivables due from other financial institutions	50,343	65,853	22,701	55,477	194,374
Securitisation deposits	28,411	-	-	-	28,411
Held to maturity financial assets	333,390	414,433	256,155	-	1,003,978
	488,809	480,318	278,856	82,523	1,330,506

Consolidated 2015

	Neither past due nor impaired				
	AAA to AA-	A+ to A-	BBB+ to BBB-	Unrated	Total
Assets	$'000	$'000	$'000	$'000	$'000
Cash and cash equivalents	170,285	-	-	26,626	196,911
Receivables due from other financial institutions	67,962	100,027	4,000	72,004	243,993
Securitisation deposits	21,263	-	-	-	21,263
Held to maturity financial assets	562,054	435,183	250,892	-	1,248,129
	821,564	535,210	254,892	98,630	1,710,296

The following table represents an ageing analysis of loans and receivables past due but not impaired as at 30 June:

Consolidated 2016

	Less than 30 days	30-90 days	More than 90 days	Total
	$'000	$'000	$'000	$'000
Loans and receivables (gross)				
Residential loans	65,658	7,263	3,709	76,630
Business loans	56	-	350	406
Personal loans	1,958	413	-	2,371
Credit cards	3,253	509	-	3,762
	70,925	8,185	4,059	83,169

Notes to the Financial Statements (continued)

5 Risk and capital management (continued)

5.1 Risk management (continued)

(b) Credit risk (continued)

Consolidated 2015

	Less than 30 days $'000	30-90 days $'000	More than 90 days $'000	Total $'000
Loans and receivables (gross)				
Residential loans	67,367	7,533	9,258	84,158
Business loans	283	329	-	612
Personal loans	2,097	427	-	2,524
Credit cards	4,102	502	-	4,604
	73,849	8,791	9,258	91,898

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

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.

For mortgage lending the registered mortgage is held as security. Where the loan to valuation ratio at time of application is greater than 80% mortgage insurance is required. The total security relating to the above past due items greater than 90 days but not impaired is $12,193,000 (2015 - $12,753,000).

Credit risk - loan portfolio

The majority of Heritage's loan portfolio is secured with mortgages over relevant properties and as a result credit risk is managed by using the loan to value ratio (LVR). The following table shows Heritage's LVR on its residential loan and business loan portfolio secured with mortgages.

	CONSOLIDATED	
LVR	**2016**	2015
0-60%	**36%**	34%
61-80%	**46%**	47%
81-90%	**13%**	14%
91-100%	**5%**	5%
> 100%	**0%**	0%
	100%	100%

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

5 Risk and capital management (continued)

5.1 Risk management (continued)

(b) Credit risk (continued)

Credit risk - geographical analysis

Concentration of credit risk exists when a number of counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors and have similar economic characteristics so that their ability to meet contractual obligations is similarly affected by changes in economic, political or other conditions.

The Group monitors concentrations of credit risk by geographical location for loans and receivables. The table below shows the geographical split of gross residential loans of the Group.

	CONSOLIDATED	
Geographical concentration of credit risk for loans and receivables at amortised cost (gross)	2016 $'000	2015 $'000
Queensland	**4,479,961**	4,220,279
Victoria	**936,507**	929,265
New South Wales	**935,487**	972,691
South Australia	**159,945**	167,519
Western Australia	**154,116**	123,796
Australian Capital Territory	**52,316**	49,729
Tasmania	**21,197**	17,513
Northern Territory	**16,675**	17,811
	6,756,204	6,498,603

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

Notes to the Financial Statements (continued)

5 Risk and capital management (continued)

5.1 Risk management (continued)

(c) 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.

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 Financial Controller and the Chief Strategy and Investment 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 by Treasury 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.

The tables below summarises the maturity profile of the Group's financial liabilities, commitments and contingencies. The amounts disclosed are the contractual undiscounted cash flows. The derivatives have been calculated using existing contractual terms and rates prevailing at 30 June 2016.

Consolidated 2016	Carrying amount $'000	Gross nominal outflow $'000	Up to 1 year $'000	1 - 5 years $'000	Over 5 years $'000
Financial liabilities					
Deposits	6,132,792	6,202,011	6,101,765	100,246	-
Borrowings	1,397,144	1,472,952	567,395	814,413	91,144
Other financial liabilities	350,846	350,846	350,846	-	-
Other payables	36,882	36,882	36,882	-	-
Derivatives	11,848	20,400	13,750	6,650	-
Subordinated debt	49,674	61,052	2,810	58,242	-
Total	7,979,186	8,144,143	7,073,448	979,551	91,144
Off balance sheet positions					
Credit related commitments	530,993	530,993	530,993	-	-
Financial guarantees	5,106	5,106	5,106	-	-
	536,099	536,099	536,099	-	-
2015					
Financial liabilities					
Deposits	5,911,479	5,988,241	5,832,662	155,579	-
Borrowings	1,818,101	1,911,849	574,125	1,111,097	226,627
Other financial liabilities	305,210	305,210	305,210	-	-
Other payables	41,934	41,934	41,934	-	-
Derivatives	8,339	34,886	20,092	14,794	-
Subordinated debt	49,636	64,211	2,890	61,321	-
Total	8,134,699	8,346,331	6,776,913	1,342,791	226,627

5 RISK AND CAPITAL MANAGEMENT (continued)

5.1 Risk management (continued)

(c) Liquidity risk (continued)

Consolidated 2015	Carrying amount $'000	Gross nominal outflow $'000	Up to 1 year $'000	1 - 5 years $'000	Over 5 years $'000
Off balance sheet positions					
Credit related commitments	473,602	473,602	473,602	-	-
Financial guarantees	5,168	5,168	5,168	-	-
	478,770	478,770	478,770	-	-

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

5.2 Capital management

Capital adequacy is calculated in accordance with the Prudential Standards issued by APRA. APRA has set minimum regulatory capital requirements under the Basel III 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 Financial Controller and the Chief Strategy and Investment 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

	CONSOLIDATED 2016 $'000	CONSOLIDATED 2015 $'000
Tier 1 Capital	**421,020**	385,871
Tier 2 Capital	**54,253**	52,842
Total capital	**475,273**	438,713
Risk weighted assets	**3,407,844**	3,280,470
Capital ratio	**13.95%**	13.37%

Tier 1 capital consists of general reserves and current year earnings. Tier 2 capital includes a general reserve for credit losses and subordinated debt.

Full details of regulatory capital is provided on the Heritage website at heritage.com.au>About Heritage>Prudential Reporting.

Notes to the Financial Statements (continued)

6 Other notes

6.1 Property, plant and equipment

	CONSOLIDATED			
	Freehold land $'000	Heritage Plaza building $'000	Plant and equipment $'000	Total $'000
At 30 June 2016				
At Cost / Fair Value	2,000	11,530	44,246	57,776
Accumulated depreciation	-	(1,427)	(30,591)	(32,018)
Total property plant and equipment	2,000	10,103	13,655	25,758
Reconciliation of carrying amount				
Year ended 30 June 2016				
Carrying amount at beginning of financial year	2,000	10,490	11,181	23,671
Additions	-	330	7,363	7,693
Disposals	-	-	(207)	(207)
Depreciation charge for the year	-	(717)	(4,682)	(5,399)
Carrying amount at end of financial year	2,000	10,103	13,655	25,758
At 30 June 2015				
At Cost / Fair Value	2,000	11,200	53,356	66,556
Accumulated depreciation	-	(710)	(42,175)	(42,885)
Total property plant and equipment	2,000	10,490	11,181	23,671
Reconciliation of carrying amount				
Year ended 30 June 2015				
Carrying amount at beginning of financial year	2,000	10,800	11,666	24,466
Additions	-	400	4,294	4,694
Disposals	-	-	(25)	(25)
Depreciation charge for the year	-	(710)	(4,754)	(5,464)
Carrying amount at end of financial year	2,000	10,490	11,181	23,671

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

Recognition and measurement

Land and buildings are measured at fair value less accumulated depreciation on buildings. The latest independent valuation was performed in June 2014. Valuations are performed with sufficient frequency to ensure that the fair value does not differ materially from its carrying amount. A revaluation surplus is recorded in other comprehensive income and credited to the asset revaluation reserve. The revalued land and buildings consist of the Heritage Plaza and associated freehold land.

The fair value of land and building was determined by using the capitalisation approach. In determining the valuation a capitalisation rate of 9.5% was applied to the net market rentals. The fair value hierarchy classification of land and buildings is level 2. The valuation in June 2014 was performed by an accredited independent valuer Porter Property Services.

6 Other notes (continued)

6.1 Property, plant and equipment (continued)

If land and buildings were measured using the cost model, the carrying amount would be as follows:

	2016 $'000	2015 $'000
Cost	12,732	12,402
Accumulated depreciation	(3,244)	(3,239)
Net carrying amount	9,488	9,163

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

All property, plant and equipment other than land and buildings are depreciated 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

Maturity analysis
The settlement date of property, plant and equipment is expected to be greater than 12 months.

6.2 Intangibles

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
Computer Software				
At Cost	12,987	10,945	12,987	10,945
Accumulated amortisation	(7,302)	(5,738)	(7,302)	(5,738)
Total intangibles	5,685	5,207	5,685	5,207
Reconciliation of carrying amount				
Carrying amount at beginning of financial year	5,207	2,234	5,207	2,234
Additions	2,261	4,687	2,261	4,687
Amortisation charge for the year	(1,783)	(1,714)	(1,783)	(1,714)
Carrying amount at end of financial year	5,685	5,207	5,685	5,207

Recognition and measurement
Intangible assets are measured on initial recognition at cost and amortised on the straight line basis over its expected useful life of five years. The weighted average remaining useful life as at 30 June 2016 is 3.57 years (2015: 2.93 years).

Maturity analysis
The settlement date of intangibles is expected to be greater than 12 months.

Notes to the Financial Statements (continued)

6 Other notes (continued)

	CONSOLIDATED 2016 $'000	CONSOLIDATED 2015 $'000	PARENT 2016 $'000	PARENT 2015 $'000
6.3 Other payables				
Sundry creditors and other payables	36,882	41,934	36,882	41,934
	36,882	41,934	36,882	41,934

Recognition and measurement

Sundry creditors and other payables

Sundry creditors and other payables are carried at amortised cost which is the fair value of the consideration for goods and services received.

6.4 Provisions

	CONSOLIDATED 2016 $'000	CONSOLIDATED 2015 $'000	PARENT 2016 $'000	PARENT 2015 $'000
Employee benefits	13,749	12,963	13,749	12,963
Directors' retiring allowance	1,185	996	1,185	996
Make good provision	1,977	1,926	1,977	1,926
	16,911	15,885	16,911	15,885
Maturity analysis				
Not longer than 12 months	8,371	7,576	8,371	7,576
Longer than 12 months	8,540	8,309	8,540	8,309
	16,911	15,885	16,911	15,885

Recognition and measurement

Employee benefits

Provision has been made for the liability to pay annual leave and long service 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 annual leave and long service leave is made for all employees from their date of commencement at discounted expected future values.

6 Other notes (continued)

6.5 Fair value of financial instruments

Consolidated	Carrying amount	Fair value			
2016	$'000	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value					
Foreign currency swaps	297	-	297	-	297
	297	-	297	-	297
Financial assets not measured at fair value					
Held to maturity financial assets	1,003,978	-	1,002,337	-	1,002,337
Loans and receivables	7,064,232	-	-	7,079,775	7,079,775
	8,068,210	-	1,002,337	7,079,775	8,082,112
Financial liabilities measured at fair value					
Interest rate swaps	4,586	-	4,586	-	4,586
Foreign currency swaps	7,262	-	7,262	-	7,262
	11,848	-	11,848	-	11,848
Financial liabilities not measured at fair value					
Term debt	428,262	-	432,944	-	432,944
Securitisation liabilities	968,882	-	972,216	-	972,216
Subordinated debt	49,674	-	50,206	-	50,206
	1,446,818	-	1,455,366	-	1,455,366

Notes to the Financial Statements (continued)

6 Other notes (continued)

6.5 Fair value of financial instruments (continued)

Consolidated	Carrying amount	Fair value			
2015	$'000	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value					
Foreign currency swaps	1,120	-	1,120	-	1,120
	1,120	-	1,120	-	1,120
Financial assets not measured at fair value					
Held to maturity financial assets	1,248,129	-	1,248,980	-	1,248,980
Loans and receivables	6,801,035	-	-	6,822,244	6,822,244
	8,049,164	-	1,248,980	6,822,244	8,071,224
Financial liabilities measured at fair value					
Interest rate swaps	8,102	-	8,102	-	8,102
Foreign currency swaps	237	-	237	-	237
	8,339	-	8,339	-	8,339
Financial liabilities not measured at fair value					
Term debt	652,780	-	681,108	-	681,108
Securitisation liabilities	1,075,620	-	1,103,538	-	1,103,538
Subordinated debt	49,636	-	52,112	-	52,112
	1,778,036	-	1,836,758	-	1,836,758

The Parent data has not been disclosed separately as it is consistent with the consolidated position.

The following assets and liabilities have not been included in the table above as their carrying amount is a reasonable approximation of fair value:

- Cash and cash equivalents
- Receivables due from other financial institutions
- Other receivables and other assets
- Other payables
- Deposits
- Bank borrowings

6 Other notes (continued)

6.5 Fair value of financial instruments (continued)

Recognition and measurement

The Group measures fair value using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

Level 1 – the fair value is calculated using quoted prices in active markets.

Level 2 – the fair value is estimated using inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).

Level 3 – the fair value is estimated using inputs for the asset or liability that are not based on observable market data.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The following methods and assumptions are used to determine the net fair values of financial assets and liabilities.

Transfer between levels are deemed to have occurred at the beginning of the reporting period in which instruments are transferred. There were no transfers between levels during the year for the Group or Parent.

Valuation techniques used to determine fair values

Interest rate and foreign currency swaps

The Group enters into swaps with various counterparties who have investment grade credit ratings. The fair value is calculated as the present value of the estimated future interest cash flows based on observable yield curves. Other inputs include the credit quality of counterparties and foreign exchange spot and forward rates.

Held to maturity financial assets

The fair value for the held to maturity financial assets is based on the current quoted market price. For those assets where there is no quoted price the fair value is calculated as the present value of the estimated future interest cash flows based on observable yield curves.

Loans and receivables

The fair value is determined by adjusting the fixed rate loan portfolio for current market rates as at balance date. For variable rate loans, the carrying amount is a reasonable estimate of the net fair value. The net fair value for fixed rate loans was calculated utilising discounted cash flow models based on the maturity of the loans. The discount rates applied were based on the current benchmark rate offered for the average remaining term of the portfolio as at 30 June 2016. Where observable market transactions are not available to estimate the fair value of loans, the fair value is estimated using valuation models such as discounted cash flow techniques. A counterparty default risk has also been assessed in determining the fair value.

Term debt, subordinated debt and securitisation liabilities

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

Use of judgements and estimates

Where the fair values of financial assets and financial liabilities recorded in the Statement of Financial Position cannot be derived from active markets, they are determined using a variety of valuation models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available these assets are valued using valuation techniques based on non-observable data.

Notes to the Financial Statements (continued)

6 Other notes (continued)

6.6 Related parties

	2016 $'000	2015 $'000
(a) Key management personnel (KMP)		
Remuneration of KMP		
Short-term	4,734	4,685
Long-term	89	80
Post employment	760	809
Total remuneration	5,583	5,574

Transactions with KMP

The loan and savings accounts between the Group and key management personnel are transactions that are at arm's length. Balances for the key management personnel include the following:

	2016	2015
Financial assets		
Loan accounts	2,523	1,951
Financial liabilities		
Savings	2,953	2,617

(b) Consolidated Structured Entities (CSEs)

The following CSEs are controlled by Heritage:

HBS Trust No. 1	HBS Trust 2008-1R
HBS Trust No. 2	HBS Trust 2011-1
HBS Trust No. 4	HBS Trust 2014-1

Transfer of financial assets

The following table sets out the financial assets transferred to CSEs that did not qualify for de-recognition under the accounting standards and associated liabilities from conducting the securitisation program.

	2016 $'000	2015 $'000
Transferred financial assets		
Loans and receivables at amortised costs	1,392,217	1,487,211
Associated financial liabilities		
Securitisation liabilities	1,422,777	1,528,414
For those liabilities that have recourse only to transferred assets		
Fair value of transferred assets	1,394,716	1,490,593
Fair value of associated liabilities	1,424,551	1,555,873
Net position	(29,835)	(65,280)

6 Other notes (continued)

6.6 Related parties (continued)

(b) Consolidated Structured Entities (CSEs) (continued)

Collateral

Securitisation deposits held by Heritage as cash collateral for securitisation trusts under the usual terms and conditions had an average balance of $26,632,000 (2015: $22,232,000).

Transactions with controlled entities

The following table provides the total amount of transactions that were entered into by the Parent with the CSEs for the relevant financial year. These transactions were all carried out under normal commercial terms.

	PARENT	
	2016 $'000	2015 $'000
Net management fee	314	328
Servicer fee	5,043	5,332
Net interest income	14,882	14,034

6.7 Commitments and contingencies

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
Operating lease commitment				
Future minimum lease payments under non-cancellable operating leases as at 30 June 2016 are as follows:				
Not later than 1 year	10,072	9,552	10,072	9,552
Later than 1 and not later than 5 years	32,684	29,722	32,684	29,722
Later than 5 years	5,789	3,425	5,789	3,425
Aggregate lease expenditure contracted for at balance date	48,545	42,699	48,545	42,699
Contingent liabilities				
Credit related commitments				
Approved but undrawn loans and credit limits	530,993	473,602	530,993	473,602

Recognition and measurement

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.

Notes to the Financial Statements (continued)

6 Other notes (continued)

6.8 Auditor's remuneration

	CONSOLIDATED		PARENT	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
Amounts received or due and receivable by the auditor for:				
An audit and review of the financial report of the Group	454	493	454	493
Regulatory and assurance services	95	44	95	44
Taxation services	76	55	76	55
Other	25	27	25	27
	650	619	650	619

6.9 Segment information

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

6.10 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.

7. Accounting policies and new accounting standards

7.1 Accounting policies

(a) Basis of consolidation

The Group controls an entity when the Group is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity.

The Group conducts a securitisation program under an arrangement where mortgage loans sold to a separate legal entity (CSE) are converted to debt securities which are purchased by investors. The Group is entitled to any residual income of the CSEs after all payments to investors and costs of the programs have been met. The Group has the power to direct the activities and affect the variable returns of the CSEs. As a result, the CSEs are consolidated by the Group. The Group has responsibility as servicer and manager and provides a number of facilities to the CSEs. The CSEs are made up of six trust vehicles that have been established for the purpose of securitising Heritage's loans (refer Note 6.6 for further details).

The Parent entity financial statements include those of Heritage and the CSEs. As Heritage controls the CSEs, the assets, liabilities, revenues and expenses have not been derecognised. The CSEs underlying assets, liabilities, revenues, expenses and cash flows are reported in the Parent entity financial statements.

(b) 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.

7. Accounting policies and new accounting standards (continued)

7.1 Accounting policies (continued)

(c) 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 Statement of Profit or Loss on a straight line basis over the lease term.

(d) Impairment of non-financial assets

The carrying value of assets 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 exceeds its estimated recoverable amount. The asset is then written down to its recoverable amount.

7.2 New accounting standards

The Group has adopted the following new and amended Australian Accounting Standards and AASB Interpretations as of 1 July 2015:

- AASB 2013 - 9 Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments
- AASB 2014-1 Part A -Annual Improvements 2010–2012 Cycle
- AASB 2014-1 Part A -Annual Improvements 2011–2013 Cycle
- Amendments to Australian Accounting Standards - Part B Defined Benefit Plans: Employee Contributions (Amendments to AASB 119)
- AASB 2015-3 Amendments to Australian Accounting Standards arising from the Withdrawal of AASB 1031 Materiality

The application of these standards and amendments do not materially impact the consolidated financial statements.

Notes to the Financial Statements (continued)

7. Accounting policies and new accounting standards (continued)

7.2 New accounting standards (continued)

Australian Accounting Standards and Interpretations that have recently been issued or amended, but are not yet effective and have not been early adopted by the Group for the annual reporting period ended 30 June 2016 are outlined in the table below.

Reference		Nature of change to accounting policy	Application date of standard	Application date for Group
AASB 9	*Financial Instruments**	AASB 9 will replace AASB 139 Financial Instruments: Recognition and Measurement. Main changes that are relevant include: - option for designation and measurement at fair value through profit and loss at initial recognition - changes in the fair value accounting for financial liabilities - new hedge accounting requirements - a single forward looking 'expected loss' impairment model	1 January 2018	1 July 2018
AASB 15	*Revenue from Contracts with Customers**	AASB 15 specifies how and when revenue is recognised, based on the concept of recognising revenue for performance obligations as they are satisfied. This could affect the timing and amount recognised for asset management fees, and contracts with multiple services. AASB 15 also requires enhanced disclosures.	1 January 2018	1 July 2018
AASB 16	*Leases**	This standard supersedes AASB 117, Interpretation 4, SIC-15 and SIC -27. This standard specifies the accounting treatment for lessee and lessor.	1 January 2019	1 July 2019
AASB 2015-2	*Amendments to AASB 101 ***	The amendments are designed to further encourage companies to apply professional judgment in determining what information to disclose in the financial statements.	1 January 2016	1 July 2016
AASB 2016-1	*Amendments to AASB 112***	The amendments clarify the requirements on recognition of deferred tax assets for unrealised losses on debt instruments measured at fair value.	1 January 2017	1 July 2017

* The Group is currently assessing the impact of the new requirements under the consolidated financial statements.

** The impact of adopting these standards is not expected to be significant.

All other amendments to standards applicable for the 2016 year end do not impact the Group.

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 Bank Limited are in accordance with the Corporations Act 2001, including:

  (i) giving a true and fair view of Heritage Bank Limited's financial position as at 30 June 2016 and of its performance for the year ended on that date; and

  (ii) complying with Australian 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 Bank Limited 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**
25 August 2016	Chairman	Deputy Chairman

Auditor's Independence Declaration

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Auditor's independence declaration to the directors of Heritage Bank Limited

As lead auditor for the audit of Heritage Bank Limited for the financial year ended 30 June 2016, I declare to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

b) no contraventions of any applicable code of professional conduct in relation to the audit.

Ernst & Young

Ernst & Young

P McLuskie

Paula McLuskie
Partner
25 August 2016

Independent Auditor's Report

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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 "company"), which comprises the statement of financial position as at 30 June 2016, the statement of profit or loss, statement of comprehensive income, the statement of changes in members' funds and the statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the company and the consolidated entity comprising the company 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 company 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 1, 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 company a written Auditor's Independence Declaration, a copy of which is included in the directors' report.

Independent Auditor's Report (continued)

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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 company's and consolidated entity's financial positions as at 30 June 2016 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 1.

Report on the remuneration report

We have audited the remuneration report included in the directors' report for the year ended 30 June 2016. The directors of the company 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 2016 complies with section 300A of the *Corporations Act 2001*.

Ernst & Young

Ernst & Young

P McLuskie

Paula McLuskie
Partner
Brisbane
25 August 2016

People first.